



Refining Britain's Economic Diplomacy

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INTRODUCTION

Economic diplomacy is a broad concept and generally refers to the policy choices made by a government in setting foreign economic policy – and how those aims interact with foreign policy as well as affect the wider society. This is a particularly pertinent question for the UK. The EU referendum has thrown up questions around globalisation as well as how to reposition Britain in the world after Brexit.

The need to refine economic diplomacy stems from the UK government's professed intent to leave the European Union and negotiate its own free trade agreements (FTAs) after Brexit. Britain would be setting its own trade policies for the first time since 1973, which was when such powers were delegated to the then EEC. It also means that the aims of British trade and associated foreign investment policies will need to be explicitly set out for the first time in four decades.

Within the European Union, a similarly close examination of economic diplomacy has recently been undertaken as the global financial crisis of a decade ago revealed fissures and tensions within the world economy.¹ A study by the European Parliament as to the EU's strategy for setting economic diplomacy mentions the following focus:

In the absence of a standard definition, it is generally agreed that economic diplomacy can be defined in a number of different ways. The first attempt to define the concept dates back to the beginning of the 21st Century but most of the work has been carried out since 2009. There are at least three strands, each one wider in scope, that are common to all definitions of economic diplomacy: 1) facilitating access to foreign markets for national businesses; 2) attracting foreign direct investment (FDI) to a national territory; and 3) influencing international rules to serve the national interest.²

There is no doubt that ever-growing global linkages alongside heightened protectionist tendencies point to a need for countries to have a strategic economic and commercially-based approach to access foreign markets and also attract investment. But what are, or should be, the principles underpinning the future trade and investment agreements for the UK? Should Britain seek to influence international rules to serve its national interest? And how will trade and investment agreements affect British foreign policy? And how in turn will these policies affect a British society hugely divided over globalisation and Brexit?



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WHAT SHOULD BRITAIN'S ECONOMIC DIPLOMACY CONSIDER?

In each of these areas, there are numerous issues to consider.

First, which principles should govern international trade and investment policies? For instance, will the government pursue free trade agreements in services that could open up new aspects of the National Health Service (NHS)? This is potentially a part of any U.S. trade deal. Will trade agreements require reciprocity? This is an issue for China, the world's second largest economy, which has relatively closed markets compared with Britain.

Which economies should be the priority for trade agreements? After all, there is only so much capacity to undertake trade negotiations, so there must be prioritisation. The best trade negotiators, such as America's USTR (the office of the U.S. Trade Representative), normally attempt to negotiate a small number of FTAs at a time. Along with discussions over the future relationship with the European Union, should the priority be the major economies (e.g., U.S., China) because they offer the biggest markets or smaller Commonwealth countries (e.g., Australia, Canada) which are potentially easier to agree and could

be used as the basis for more complex deals? What combination of FTAs with advanced versus emerging economies would be optimal both practically and strategically to achieve Britain's economic ambitions?

In terms of international investment, there are also a number of issues to consider. Unlike international trade which has the World Trade Organisation (WTO) as the source of trade law, international investment has no equivalent. Companies and nationals of one country can enter into bilateral investment treaties (BIT) to facilitate investing in another country's markets. At present, there is a pressing need to establish principles in this area. For instance, the growth in state-financed or state-controlled firms poses a challenge in terms of potentially distorting a level playing field when such firms invest in foreign markets.

Investment policies also need to be considered in conjunction with trade policy. A large and growing portion of international trade is conducted by multinational corporations which take decisions about locating supply and distribution chains as well as establishing subsidiaries and affiliates abroad, which constitute intra-firm trade. Companies' international investment decisions are a notable dimension of international trade flows. Intra-firm trade, that is, international trade that is conducted within one firm, is estimated to account for a significant portion of global trade.³ So, how to

conduct international investment is important to consider alongside trade agreements in terms of a country's foreign economic policy.

Whether and how to influence these and other international rules is a further dimension to consider. This is a pertinent area for the UK as it is a largely services-based economy and the world's second largest exporter of services after only the United States. International trade in services is highly influenced by regulations, rules, norms, standards and other non-tariff measures. Unlike goods trade, services trade opening under the WTO is not nearly as encompassing. Thus, the EU, U.S., Japan and other advanced economies launched the Trade in Services Agreement (TiSA) talks in 2013 to liberalise global services trade. This initiative has stalled with a change in U.S. administration. It has significant implications for Britain. The UK has the highest services trade to GDP ratio among advanced economies.⁴ So, as a significant services trader, should Britain take up the mantle and aim to set international rules, particularly in services?

What about digital trade? In a breakthrough after 21 years of negotiations, the WTO has launched a round of talks around liberalising digital trade and e-commerce in January.⁵ Like services, digital trade is fast growing and the UK has a flourishing tech sector. Britain is ranked as one of the top 10 digital economies in the world.⁶

The first mover tends to be influential in helping to establish rules and norms, which may serve the UK's national interest. But, should this be a priority for policymakers compared to focusing on negotiating trade deals?

And how would these trade and investment priorities fit with Britain's broader foreign policy aims? Should the promotion of "soft power" be part of economic diplomacy? How would foreign economic policy advance or hinder those aims? For instance, the government has discussed using aid to support Britain's trade aims.⁷ Is it appropriate to align overseas development assistance with trade aims when aid supports the world's poorest countries? Would some countries potentially not receive assistance should they not be part of Britain's strategic priorities? The Prime Minister at the UN mentioned the importance of the Commonwealth whilst the UK holds the Chair-in-Office for two years.⁸ How much priority should these 52 nations have versus other groupings, such as the CPTPP, the Pacific rim FTA, which the government has also professed an interest in joining?⁹ What about trading with nations with dire human rights records? What about arms sales to such countries? In short, how should economic aims be integrated with foreign policy?

Finally, what is the link between what the UK does abroad and the impact this has on British society across the entire country? In the past few years, there has been a backlash against globalisation in general and multilateral bodies (such as the EU)

in particular. Indeed, some insist that the British economy—one of the most open in the world—may have become too open, and to use a phrase increasingly heard in public discourse, has come to serve the interests of the few and not the many. How will the UK balance between retaining all the advantages of remaining open and being 'Global Britain' and at the same time address these distributional issues?

Of course, the backlash against globalisation captures a wide dimension of challenges, including not just trade but also automation. Even if the latter is thought to have a greater impact than the former in terms of domestic distributional impact, trade has been known to create winners and losers since the days of David Ricardo when he wrote the theory of comparative advantage in the 19th century.¹⁰ But, how policymakers should help those who have been left behind remains an unsettled but very important question. Even if part of the remedy is a level playing field for trade and investment, that alone will not preclude the distributional impact from globalisation. Ricardo's model was one of free trade. The theory is that the economy overall gains but certain groups will lose as the economy specialises less in the sectors in which the country does not have a comparative advantage. Thus, the usual remedy is to redistribute income from the tax gains from the overall bigger economy to those left behind by globalisation. It's domestic policy that's deployed. But, domestic policies to help the losers from globalisation have proved to be insufficient. The discontent against globalisation suggests that new

policies are needed to ensure that opening up the world economy does not worsen the distribution of income or wealth in Britain.

It is these effects that have led domestic politics to be described as a constraint on foreign policy. It would be similar for foreign economic policies around international trade. Therefore, fashioning policies that can muster the support of the populace would be essential to ensure that foreign economic aims are properly coordinated with and set in conjunction with domestic economic and social policies. It's all the more important as Britain is a divided society at present.

VALUES AND THE FUTURE

Another aspect to consider within the broad remit of Britain's economic diplomacy is around values, including promoting universal values and a rules-based international system. Democracy, rule of law, justice, equality, and protecting the environment are among the defining values for the UK. Moral leadership should permeate not only foreign policy but also foreign economic policy. So, an examination of economic diplomacy would need to incorporate how best to promote such values alongside the other interests described earlier.

One position for Britain to consider is how to promote shared values and a rules-based system on the multilateral stage. For instance, can the UK be the neutral arbiter working with the economic superpowers (US, China, EU) to craft universal standards around technology? That is very important for digital trade and the current balkanised environment raises the prospect of a fragmented world economy with different technology standards. There are other examples but with digital and services, it is important to agree standards and norms, which the UK might consider playing a leading role to set on the world stage.

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In a previous LSE IDEAS Strategic Report, I wrote about the UK becoming a global trade hub for services.¹¹ Being a leader for setting standards would go a long ways toward persuading countries that do not have FTAs with each other to choose to direct their trade and investment through the UK. That would enhance Britain’s prospects of becoming a trading hub for the fastest growing areas of world trade: services and digital.

CONCLUSION

To refine Britain’s economic diplomacy would require taking into account a plethora of issues, such as those raised in this article. By establishing the principles that would govern the UK’s foreign economic policy, Britain would be in a strong position to strategically position itself in the 21st century world economy. Economically, a number of the emerging trends are highly suited to the strengths of the UK with its focus on services and the digital economy. Politically, though, this is a challenging time in the world. But that offers an opportunity for the UK to take a lead and set a helpful direction for the rest of the world and ensure that trade and investment policies benefit all in society. ■

ENDNOTES

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