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# Brexit and Outlook for U.S.-UK Trade Agreement

## Introduction

The trade aspects of "Brexit," the expected withdrawal of the United Kingdom (UK) from the European Union (EU), are of congressional interest. Uncertainty over Brexit presents commercial challenges for the nearly 43,000 U.S. companies exporting to the UK and for U.S. firms operating in the UK, including some 4,000 majority-owned subsidiaries (2016 data). The EU has agreed to extend the UK's departure date to October 31, 2019, with an earlier departure possible upon approval of the UK-EU withdrawal agreement. Details about the future UK-EU trade relationship remain largely unknown, with uncertainty over if, when, and to what extent the UK will regain control of its national trade policy. These factors directly shape prospects for a proposed bilateral U.S.-UK free trade agreement (FTA), supported by the Trump Administration and some Members of Congress.

On October 16, 2018, the Trump Administration notified Congress under Trade Promotion Authority (TPA) of proposed trade agreement negotiations with the UK post-Brexit. The UK cannot formally negotiate or conclude a new agreement until it exits the EU, which has exclusive competence over trade policy and negotiates trade deals on behalf of all EU member states (**Fig. 1**). In the interim, and absent a U.S.-EU trade agreement, World Trade Organization (WTO) terms govern U.S.-UK trade (like U.S. trade with the rest of the EU), and would apply after Brexit.

**Figure 1. Current UK Trade Status: Fast Facts**

1. **EU member** since 1973.
2. Participates in the **EU single market,** which covers the "four freedoms" of movement of goods, capital, services, and people in the EU (e.g., no tariffs or customs checks). The single market is more developed for goods than services.
3. Member of the **EU customs union,** which imposes common external tariffs on non-EU countries.
4. Part of **over 40 EU trade agreements** with 70-some countries, as well as ongoing EU trade talks.
5. Set up a new **Department of International Trade** in 2016 to rebuild national trade expertise.

## Trade and Economic Context

The UK, at 15% of the EU gross domestic product (GDP) in 2017, is the EU's second largest economy after Germany (21%). As a bloc, the EU is the UK's largest trading partner, while by country, the United States ranks first. Total U.S.-UK two-way trade in merchandise and services ($236 billion) was about one-third of such UK trade with the EU ($788 billion) in 2017 (U.S. and WTO trade data).

Many firms operating in the UK are taking steps to reduce trade disruptions post-Brexit, especially if the UK leaves the EU without a negotiated deal, loses its preferential access to the EU market, and returns to trade on WTO terms. While EU tariffs are low overall, WTO terms for UK-EU trade would be significantly different than the status quo of tariff-free trade. A no-deal Brexit could lead to lengthy customs checks, and some businesses are stockpiling goods to build inventories. UK-EU supply chains, such as for the auto industry, are tightly integrated and component parts are heavily traded. U.S. and other banks are concerned about losing the ability to use their UK bases to access EU markets without establishing legally separate subsidiaries. Some financial institutions, such as Goldman Sachs, J.P. Morgan, Morgan Stanley, and Citigroup, have shifted (or are planning to shift) some jobs and assets from London to other European cities, such as Amsterdam, Dublin, Frankfurt, and Paris.

In 2016, after the Brexit referendum, the British pound fell to a record low, and concerns emerged about widespread harm to the UK economy. Doomsday fears may have abated, but prolonged uncertainty over Brexit appears to be a drag on the UK economy. In 2018, the UK economy saw its lowest annual growth rate (1.4%) since 2012. Most analyses predict that the UK economy faces lower growth in all Brexit scenarios, with a "no-deal Brexit" constraining growth rates the most.

## Post-Brexit UK-EU Trade Relationship

Brexit casts great uncertainty over the future UK-EU trade relationship. A draft agreement on the UK's withdrawal terms was rejected three times by the House of Commons ahead of the original Brexit date of March 29, 2019. EU leaders have endorsed the deal, which also requires approval by the European Parliament. The Brexit extension gives the UK more time to secure domestic approval of the withdrawal agreement, which the EU says is not open for renegotiation.

### Draft UK-EU Brexit Deal

During the withdrawal agreement's transition period through 2020, the UK could negotiate, but not enter into, its own trade agreements. The UK and EU agreed to work toward a UK-EU FTA, with a fully independent UK trade policy arising after the transition period. As a backstop to address the Irish border issue, however, they agreed to allow the UK to stay in the customs union if they failed to reach an alternative arrangement to avoid a hard border (e.g., customs check, physical infrastructure) between Northern Ireland and Ireland—thereby preserving extensive cross-border economic ties and the peace process. (See CRS Report RL33105, *The United Kingdom: Background, Brexit, and Relations with the United States*, by Derek E. Mix.)

Potential scenarios for future UK-EU trade relations have mixed economic and political attractiveness (**Fig. 2**).

### No Customs Union?

A no-deal Brexit, whatever its downsides, would free the UK to negotiate its own FTAs with the United States and other countries; the UK would no longer be a part of the EU customs union and would regain control over its national trade policy at once. Likewise, under the draft Brexit deal, if an alternative arrangement were reached on the Irish border issue, the UK would not be a part of the customs union and would be free to negotiate its own trade deals.

In either scenario, the UK likely would seek to negotiate an FTA with the EU, but likely would not be able to replicate existing single market access. For instance, the EU bilateral FTAs with Canada and Japan eliminate most tariffs but have a number of exceptions, such as in services. Negotiations could be lengthy; EU negotiations with Canada and Japan took, respectively, seven and four years.

Other examples are Norway and Switzerland, non-EU countries that are not in the customs union, but have tariff-free access to the EU (with some exclusions, e.g., agriculture and fisheries for Norway, some services for Switzerland). Norway and Switzerland have no say on EU decisions on rules and regulations and must accept free movement of workers and pay in to the EU budget. Norway's access to the EU market is through its membership in the European Economic Area (EEA). Switzerland (not in the EEA) has more complicated access through over 100 sectoral agreements with the EU.

**Figure 2. Non-EU Country Arrangements with the EU**

| | Canada | Norway | Switz. | Turkey |
|---|---|---|---|---|
| **EU trade agreement?** | FTA | EEA FTA | Many sectoral | Customs union |
| National trade policy? | Yes | Yes | Yes | No in covered areas |
| EU market access? | Trade liberalized | SM* | SM* | Goods only* |
| **Pay in EU budget?** | No | Yes | Yes | No |
| **Say in EU decisions?** | No | No | No | No |
| **Free worker movement?** | No | Yes | Yes | No |

*Selected examples shown. **EEA:** European Economic Area; **SM**=Single Market.*
**Some sectoral exclusions.*

**Source:** CRS, based on various sources.

### Customs Union?

Alternatively, the UK could remain in the customs union or be a part of another customs arrangement, and not regain control over its trade policy. This could occur if a UK-EU deal keeps the UK in the customs union permanently or in an extended transition period.

Turkey is an example of a non-EU country in a customs union relationship with the EU. Like Norway and Switzerland, Turkey has no voice on EU decisions, but unlike them, does not contribute to the EU budget. Turkey-EU trade is tariff-free on covered products (most goods and processed agricultural products). Turkey has adopted the EU common external tariff, and must apply tariff reductions that the EU negotiates with other countries. Preferential access that the EU gains to these other countries, however, does not automatically apply to Turkey, which would need to negotiate its own agreements with these other countries.

If the UK were to participate in the customs union, it potentially could negotiate with other countries on areas outside of the scope of the customs union, for example, services, digital trade, public procurement, intellectual property, and regulatory cooperation. Still, negotiating flexibility may be limited if a goal of being in the customs union is continued alignment with the EU. A customs union also could limit UK trade policy such as in applying trade remedies or developing country preference programs.

## Other UK Trade Considerations

The UK, seeking continuity in its trade ties after Brexit, is

- *Negotiating its own WTO "schedule" of commitments on goods, services, and agriculture.* The EU schedule applies to all EU members. Agricultural negotiations are particularly complex as they involve reallocation of EU and UK quotas. The UK's post-Brexit continued participation in the WTO Government Procurement Agreement (GPA) was approved recently.
- *Working to replicate existing EU deals with non-EU countries.* These EU deals would not apply to the UK post-Brexit. The UK has concluded a fraction of the deals it aims to replicate. The UK continues to engage, for instance, with Canada, Japan, and South Korea, which have bilateral FTAs with the EU.
- *Negotiating sector-specific regulatory agreements.* A focus is on mutual recognition agreements (MRAs) to assure continued acceptance by UK and partner country regulators of certain product testing and inspections by the other. For instance, the United States and UK concluded an MRA on pharmaceuticals, as well as agreements on derivatives and insurance.
- *Taking steps to pursue a range of new trade deals once outside of the EU.* In addition to the United States, potential countries that the UK has identified as of interest for negotiating new trade deals include Australia, China, India, and New Zealand.

## U.S.-UK Trade Agreement Outlook

Should the UK regain independence over its trade policy, prospects for a U.S.-UK FTA are mixed. Some experts view a U.S.-UK FTA as more feasible than a U.S.-EU FTA, given the U.S.-UK "special relationship" and historical similarities in trade approaches. Others caution against the likelihood of a "quick win." Some stakeholders, particularly in the UK, have raised concerns about effects, for instance, on food safety regulations. Key issues also could include financial services, investment, and e-commerce. In addition, to the extent that the UK decides to continue aligning its rules and regulations with the EU, its largest trading partner, sticking points in past U.S.-EU trade negotiations (e.g., agriculture) could resurface in the U.S.-UK context. The United States, meanwhile, may be hard-pressed to negotiate with the UK without clarity on the future UK-EU relationship. How U.S.-EU tensions over tariffs would affect the U.S.-UK negotiations also may affect the outlook.

Congress is expected to continue consultations with the Administration over the scope of proposed negotiations, and engage in oversight during negotiations. Congress would need to approve implementing legislation for a potential final trade agreement to enter into force. See CRS Report R44817, *U.S.-UK Free Trade Agreement: Prospects and Issues for Congress*, by Shayerah Ilias Akhtar.

**Shayerah Ilias Akhtar**, Specialist in International Trade and Finance

**IF11123**

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