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Brexit and Outlook for a U.S.-UK Free Trade Agreement

The United Kingdom (UK) is a major U.S. trade and economic partner, and foreign direct investment (FDI) and affiliated activity are key aspects of bilateral ties. The United States is the UK's largest trading partner by country, while the European Union (EU), as a bloc, is its largest overall partner (see **Figure 1**). Brexit, the UK's withdrawal from the EU, and the conclusion of a new UK-EU trade agreement are significant for a potential U.S.-UK free trade agreement (FTA), initiated by the Trump Administration. If a Biden Administration continues FTA negotiations, Congress may actively monitor and shape them, and could consider implementing legislation for any final agreement.

Figure 1. Share of U.S. and UK Total Trade, 2019

Source: CRS, based on U.S. Bureau of Economic Analysis and UK Office for National Statistics data.

UK-EU Trade Relationship

On January 1, 2021, after a post-Brexit transition period ended, the UK left the EU single market and customs union, shedding its rights and obligations as an EU member state. The UK regained control over its national trade policy, and is free to conclude its own international trade agreements. UK-EU trade and economic ties are now governed on a provisional basis by a new Trade and Cooperation Agreement. The agreement in principle, which the UK and EU reached on December 24, 2020, follows nine months of contentious negotiations. In the end, both sides say that they struck a fair and balanced agreement that respects each side's priorities. The UK has ratified the deal, and the EU is expected to follow in the coming months.

Many firms, facing years of uncertainty after the Brexit referendum, expressed relief that the deal appears to avoid the trade and economic disruption that a "hard Brexit" on World Trade Organization (WTO) terms was expected to cause. Given the high level of integration of UK-EU trade and investment and the role of the UK as a platform for firms to access the rest of the EU market, Brexit caused uncertainty for U.S. firms exporting and operating in the UK. A number of U.S. manufacturing, financial services, and other firms in the UK have been restructuring operations due to Brexit changes. While the agreement is expected to yield a "certainty dividend" to the UK economy, which also has been hard hit by the Coronavirus Disease 2019 (COVID-19) pandemic, most analyses predict that, even with a deal, the UK's economic growth will be lower in the long-term than it would have been if the UK had remained in the EU—though not as low as it would have been without a deal. Some critics say that the deal lacks a clear framework for services, which comprise

around 80% of UK gross domestic product (GDP) and half of UK exports. The limited treatment of some issues does not smooth all trade frictions introduced by Brexit, but may allow the UK more flexibility in negotiations with other countries. The implications of the deal—over 1,200 pages and with exceptions, limitations, and transition periods—will take time to become fully apparent.

The trade commitments go beyond a typical FTA in some respects, given the unique starting point for the UK-EU trade talks. They cover market access and rules for trade in goods, services, agriculture, government procurement, investment, and energy and transportation; trade-related rules on data flows, intellectual property rights (IPR), and other areas; regulatory cooperation; sustainable development standards; and other issues—enforceable through binding dispute settlement and governed by an institutional framework. A separate protocol governs trade between the EU and Northern Ireland, treated as intra-EU.

The trade deal gives the UK and EU tariff-free, quota-free access to each other's markets and secures more nondiscriminatory trade liberalization than if they used WTO-only terms. This avoids the imposition of tariffs that would have been, for instance, 50% or more on beef, poultry, and dairy; up to 25% on processed fish, and up to 10% on autos. Still, the UK-EU trade deal does not fully replicate trading within the far more frictionless EU single market. Brexit introduced new exporting and importing licensing requirements, border checks, and regulatory compliance requirements, raising costs and the potential for bottlenecks at borders. The agreement does not eliminate customs requirements, but aims to simplify them, such as through mutual recognition of "trusted trader" arrangements to self-certify compliance with the other side's regulations and standards.

Although UK regulatory frameworks have been aligned with the EU, Brexit makes the UK a "third country" from the EU perspective, meaning that the EU must make determinations on whether measures of the UK comply with corresponding EU regulatory frameworks; even with positive determinations, the EU could revoke them at any time, disrupting UK trade. The deal does not include mutual recognition of conformity assessments, meaning that UK manufacturers now must have their products tested for compliance with EU frameworks and vice versa. The deal, however, does contain limited, sector-specific arrangements for regulatory cooperation, such as for pharmaceutical manufacturing practices, motor vehicles, organic products, trade in wine, and chemicals. In terms of services, the deal, for instance, lacks automatic mutual recognition of professional qualifications.

The deal leaves a number of issues open-ended. For financial services, which account for 7% of UK GDP and one million jobs, the deal does not address UK financial services firms' access to the EU, which previously was through a "passporting" right that allowed banks to use their UK bases to access EU markets without establishing legally separate subsidiaries; the parties aim to establish a framework for cooperation by March 2021. Agricultural trade also may face barriers or uncertainty, given the limited treatment of sanitary and phytosanitary standards (SPS). Other issues not fully addressed include cross-border data flows, with the EU delaying a final decision on whether the UK provides adequate personal data protection; many U.S. firms rely on such data flows to communicate with UK and EU customers, partners, and subsidiaries.

To try to ensure a "leveling playing field," the agreement includes a "rebalancing mechanism" to allow each side to unilaterally reduce market access if it assesses that the other side's actions result in subsidies that create market distortions. This may allow the UK to diverge from EU rules, while allowing the EU to protect the integrity of the single market. The two sides also committed minimum standards on labor, the environment, and social issues, and to not lower these standards to attract trade and investment.

Global Britain

Since Brexit, the UK has aimed to retain and strengthen its trade linkages globally. It negotiated and submitted to the WTO for certification its own WTO schedules of commitments on goods, services, and agriculture, which were previously under the EU. The UK also now is a full party in its own right to the WTO Agreement on Government Procurement (GPA). U.S. and other exporters will need to manage separate customs regimes and relationships for the UK and EU.

As of January 1, 2021, EU trade agreements no longer apply to the UK. Since the transition period, the UK has engaged in negotiations to replicate existing EU trade deals with non-EU countries (e.g., Switzerland, Iceland, Norway, South Korea, and Turkey), and pursued new deals with countries with which the EU has not concluded trade deals (e.g., Australia, India, and the United States). It also seeks to join the regional Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP or TPP-11). To date, the UK has signed agreements covering one-quarter of total UK trade with around 60 economies.

The UK also negotiated mutual recognition agreements (MRAs), as distinct agreements in some cases and as part of trade agreements in others, to assure continued acceptance by UK and partner country regulators of each other's product testing and inspections in specific sectors (e.g., telecom and marine equipment in U.S.-UK MRAs).

U.S.-UK Trade Agreement Outlook

The UK's departure from the EU opened up the possibility of negotiating a U.S.-UK FTA. While the UK-EU trade deal injects more certainty, how the UK-EU trade deal is implemented and outstanding issues are treated may affect negotiating positions and flexibility in U.S.-UK FTA talks.

On October 16, 2018, the Trump Administration notified Congress, under Trade Promotion Authority (TPA), of its intent to enter into comprehensive FTA negotiations with the UK. The United States and UK conducted five rounds of negotiations in 2020, all virtually. Despite high interest on both sides and reported progress, the negotiations remain pending over outstanding issues.

It is uncertain if a Biden Administration will continue with the trade negotiations or engage, for instance, on specific bilateral trade issues first. If negotiations are continued, it is not clear what priority they will take in relation to other potential U.S. trade negotiations, such as with the EU. To be considered under the current TPA, an agreement must be concluded by July 1, 2021. As the UK continues to conclude other trade agreements, U.S. businesses will lose advantages in UK markets in the absence a U.S.-UK FTA.

If FTA negotiations are renewed, some experts are optimistic about their success in light of the U.S.-UK "special relationship" and historical similarities in trade approaches. The UK was a leading voice on trade liberalization in the EU. However, any U.S.-UK FTA talks could see flashpoints reemerge (see **text box**).

Potential Issues in U.S.-UK FTA Negotiations

Any continued U.S.-UK FTA talks may see debates over:

Agriculture. Some U.S. stakeholders view UK food safety and animal welfare regulations as protectionism. Meanwhile, UK farmers and some in civil society voice concerns about the implications of U.S. demands for greater access to the UK market, and potential changes to UK food safety regulations.

Pharmaceuticals. The United States seeks standards to ensure that government regulatory reimbursement regimes are transparent and nondiscriminatory and provide full market access for U.S. products. Some in UK civil society expressed concern that a U.S.-UK FTA could lead to the UK privatizing services or raising drug prices; UK officials repeatedly have maintained that these issues are not up for negotiation.

Other issues. Financial services, investment, e-commerce, and regulatory issues may be among other points of contention.

Ongoing U.S.-UK trade frictions. The UK digital services tax, the U.S. Section 232 national security-based steel and aluminum tariffs, and various retaliatory measures could add complications. Many U.S. and UK firms see an FTA as a way to enhance market access and align UK regulations more closely with those of the United States. Other stakeholders oppose what they perceive as efforts to weaken UK regulations. Based on the UK-EU trade deal, the UK may weigh to what extent greater alignment with the United States may offset costs from diverging from the EU.

Many Members of Congress support a U.S.-UK FTA. At the same time, some Members of Congress have cautioned that they would oppose a deal if Brexit undermines the Northern Ireland peace process, whereas others support a trade agreement without such conditions.

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