



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

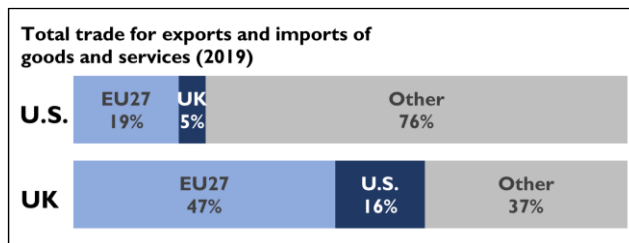
## Introduction

On October 16, 2018, the Trump Administration notified Congress, under Trade Promotion Authority (TPA), of its intent to enter into trade agreement negotiations with the United Kingdom (UK). Brexit—the withdrawal of the UK from the European Union (EU)—occurred on January 31, 2020. During the transition period, set to last until the end of 2020, the UK remains a member of the EU single market and customs union, and subject to EU rules. The UK and EU have launched negotiations on their future trade and economic relationship. Any final UK-EU agreement would directly inform prospects for the potential bilateral U.S.-UK free trade agreement (FTA).

## Post-Brexit UK-EU Trade Relationship

Initial 2019 data shows that the UK was the world’s sixth-largest economy, and the second-largest economy of the EU28, comprising 15% of the bloc’s gross domestic product (GDP); Germany comprised 21% of EU GDP. The EU as a bloc is the UK’s largest trading partner; by country, the United States is its largest (see **Figure 1**). UK-EU trade is tightly integrated through supply chains, trade in services, and foreign affiliate activity.

**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 Agreement** The political declaration attached to the UK-EU withdrawal agreement envisions “an ambitious, broad, deep, and flexible partnership across trade and economic cooperation with a comprehensive and balanced Free Trade Agreement at its core.” Existing EU FTAs vary in their scope of trade liberalization and rules-setting, and it is unclear what the final scope may be of any UK-EU trade agreement.

Draft EU negotiating directives for a trade agreement with the UK include tariff- and quota-free trade on goods and cover a range of sectors, including services trade, digital trade, intellectual property rights (IPR), government procurement, and regulatory cooperation. The EU offer is conditional on commitments to ensure a “level playing field” in relation to state aid, labor and environmental protections and regulations, and taxation agreements.

Progress to date has been limited but the UK is pushing to conclude a deal by autumn, with Prime Minister Johnson telling negotiators in June to “put the tiger in the tank.” EU

officials have warned that a tight time frame may constrain the scope of the talks but that the EU is “ready to find compromises.” One such compromise could allow the UK to diverge from EU rules and regulations, giving it more flexibility in other trade negotiations, in exchange for giving the EU the right to impose higher tariffs on UK goods if the UK deviates from the “level playing field.”

**WTO Terms** If the transition period ends without an UK-EU trade agreement, the UK would no longer have preferential access to the EU market and the two would return to World Trade Organization (WTO) terms of trade at the end of the transition period, which would no longer be tariff-free. EU tariffs are low (5.2% on average in 2018), but WTO trade terms could significantly affect certain industries; for instance, the EU imposes tariffs of 10% on passenger cars and tariffs of up to 6.5% on chemicals. Nontariff barriers such as new customs procedures would add delays and costs to doing business. Most analysts predict that this “no deal” scenario would likely constrain UK economic growth to a greater extent than if the two sides are able to conclude a limited tariff-only trade agreement.

**Nontariff Barriers** UK regulatory frameworks are currently aligned with those of the EU on data protection and data flows, but after the transition period, the EU is to make determinations on UK compliance with the EU regulatory frameworks. To minimize any interruption of cross-border data flows and digital trade, the EU would review the UK’s data regime to determine if it sufficiently protects personal data or if other arrangements are needed. The United States may need to negotiate a separate cross-border data flows agreement with the UK.

For financial services, absent an equivalence decision after the transition period, the UK will not be able to use financial passporting (which allows banks to use their UK bases to access EU markets without establishing legally separate subsidiaries). Even with positive determinations, the EU could revoke equivalence at any time, disrupting UK trade. Continued trade in financial services may require firms in the UK and EU to restructure operations; some financial institutions already have shifted or are planning to shift some jobs and assets from London to EU cities.

**Customs Regime** If, as planned, the UK is no longer part of the EU customs union, it would regain control of its national trade policy. U.S. exporters would need to manage separate customs regimes for the UK and EU starting January 1, 2021. However, the UK stated that it will not implement full customs controls on goods entering from the EU for six months. Rather, the new UK customs regime is to be initiated in three stages, starting January 1, 2021, with full controls in effect by July 1, 2021. The extra time provides UK importers additional time to complete customs declarations and defer tariff payments with border checks

limited to controlled goods and some “high risk” items from the EU. However, for UK exports, the EU stated it will require all customs paperwork. Trade between the EU and Northern Ireland are to be considered intra-EU.

## Global Britain

After the transition period, the UK would regain control over its national trade policy and be free to enter into its own trade agreements with other countries. The UK is acting on multiple fronts to retain and strengthen its trade linkages around the world after the transition period ends. It is negotiating its own WTO schedule of commitments on goods, services, and agriculture. Treatment of agricultural products is especially complex as it requires reallocation of EU and UK tariff-rate quotas. In the interim, the UK continues to apply the EU schedule. The UK’s continued participation in the WTO Agreement on Government Procurement (GPA) was approved in principle; the UK has not submitted its instrument of accession yet.

The UK also is working to replicate existing EU deals with non-EU countries. The EU has more than 40 trade agreements with around 70 countries. During the transition period, EU trade agreements continue to apply to the UK. As of June 2020, the UK had signed continuity deals covering over 8% of total UK trade with close to 50 countries or territories, including Switzerland, Liechtenstein, Chile, Israel, and South Korea.

In addition, the UK is negotiating mutual recognition agreements (MRAs) to assure continued acceptance by UK and partner country regulators of each other’s product testing and inspections in specific sectors. To date, the United States and UK have signed a number of MRAs covering specific sectors such as telecom and marine.

Also, as part of its “Global Britain” strategy, the UK is taking steps to pursue new trade deals. During the transition period, the UK can negotiate, but not implement, trade agreements with other countries and is in discussions with multiple countries with existing EU agreements. Rather than rolling over the EU-Japan FTA, Japan seeks to quickly negotiate new terms with the UK in time for Japan to pass an FTA in autumn. The UK also launched FTA negotiations with Australia and New Zealand, and seeks to join the regional Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

## U.S.-UK Trade Agreement Outlook

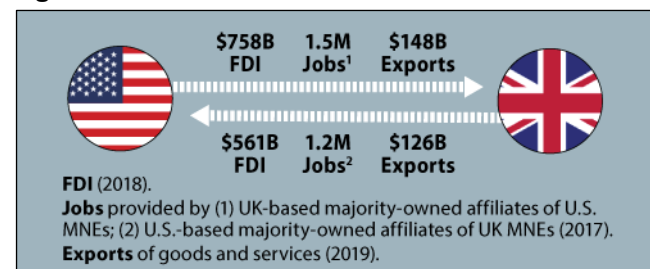
The UK is a major U.S. trade and economic partner, and foreign direct investment (FDI) and affiliate activity are key aspects of bilateral ties (see **Figure 2**). U.S.-UK trade negotiations aim to address tariff and nontariff barriers to trade in goods, services, and agriculture, investment, and government procurement, as well as trade-related rules. The first two rounds of virtual negotiations were conducted in May and June 2020, and further rounds are planned.

U.S. Trade Representative (USTR) Robert Lighthizer has committed to pursuing a comprehensive agreement that would be subject to congressional approval and not a limited, “skinny” deal. He warned, however, that negotiations will take time and likely not be complete in advance of the upcoming presidential election. Agriculture could be the most contentious issue in negotiations. In the USTR’s view, some UK food safety and animal welfare

regulations appear to be “thinly veiled protectionism.” On the other hand, UK farmers and some in civil society have voiced concerns about the implications of U.S. demands for greater access to the UK market, and potential changes to UK food safety regulations. Some observers have suggested creating a dual system in which U.S. agriculture exports not meeting UK standards would be allowed to enter the UK market but would be subject to additional tariffs.

Some Members of Congress and analysts question the sequencing of the talks, to the extent that the United States may face difficulty negotiating with the UK without knowing what the final UK-EU relationship looks like; others counter that the UK-EU trade and economic relationship is becoming clearer. Some experts are optimistic about a U.S.-UK FTA in light of the U.S.-UK “special relationship” and historical similarities in trade approaches. The UK was frequently a leading voice on trade liberalization in the EU.

**Figure 2. U.S.-UK Trade and Direct Investment**



**Source:** CRS, data from U.S. Bureau of Economic Analysis.

**Notes:** Foreign direct investment (FDI) on stock basis.

Many U.S. and UK businesses and other groups see an FTA as an opportunity to enhance market access and align UK regulations more closely with those of the United States than of the EU. Other stakeholders oppose perceived efforts to weaken UK regulations. Other controversial issues could include financial services, investment, e-commerce, and pharmaceuticals. To the extent that the UK remains aligned with the EU, difficulties in past U.S.-EU trade negotiations could resurface in the U.S.-UK context.

Additional complexities for the U.S.-UK trade talks include frictions over tariffs and other policy issues. For instance, the Trump Administration has threatened the UK with tariffs over its plan to apply a new digital services taxes (DST). Other issues, such as the U.S. Section 232 national security-based steel and aluminum tariffs, and potential auto tariffs, could see pushback from the UK side.

Many Members of Congress support a U.S.-UK FTA. However, some Members 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. Congress may continue to hold consultations with the Administration over the scope of the negotiations, and engage in oversight as the negotiations progress. For more information, see CRS Report R45944, *Brexit: Status and Outlook*, coordinated by Derek E. Mix.

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