

Services and Brexit



The **UK** in a
Changing Europe

Foreword

The United Kingdom has left the European Union. Negotiations are underway over a deal to shape the future relationship between the two parties. As things stand, there is no guarantee that such a deal will be agreed. Even if it is, the new relationship will imply significant changes in the way the UK and EU trade with each other.

These impacts will vary significantly by sector and also by region. In this report, Sarah Hall and her collaborators investigate what they might be in the area of services. The UK is, of course, a predominantly services-based economy, so their findings are of huge relevance.

I would like to express my thanks to all those who have been involved in producing this excellent report. First and foremost, Sarah Hall is the lead author and has responded with remarkable patience and good humour to numerous requests for rewriting or clarification. Scott James, Lucia Quaglia and Martin Heneghan made important contributions to the report and I am grateful to them for agreeing to do so. Jill Rutter commented on several iterations of the text. Aron Cheung worked his usual magic with the data to produce the diagrams. Alison Howson ensured that the text reads as clearly as possible, while thanks to John-Paul Salter, remaining typos and errors were picked up. Last but not least, Navjyot Lehl coordinated the entire process with her usual (generally) good tempered efficiency.

I very much hope that you find what follows interesting and informative.

Professor Anand Menon, Director, The UK in a Changing Europe

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Summary

- The UK is predominately a services economy. Services contributed 81% to the economy in 2019, or around 30 million jobs. Internationally, services are a UK success story – they account for a higher proportion of our total exports than in countries like the US and Germany.
- Services are characterised by their breadth and diversity: they include sectors as varied as IT and hairdressing, architecture and the arts, health services, education and financial services.
- The EU's single market is the primary destination for UK services exports, and the UK runs a trade surplus with the EU in services. The services sector also depends heavily on EU migrant workers, whether in financial services, education, the health service or road haulage.
- The EU's single market enables greater cross border services trade than is typical of free trade agreements. When the UK leaves the single market, services will be traded either on the basis of a new free trade agreement between the UK and the EU, or without one.
- The UK is seeking a Comprehensive Free Trade Agreement with the EU that in some areas aims to offer more support for cross-border services trade than is typical in free trade agreements. For example, the UK wants the professional qualifications of lawyers and architects to continue to be recognised by the EU so that these individuals can continue to work in the EU. The UK also wants to include film and television, which the EU has not included in free trade deals to date.
- There is no guarantee that a trade deal will be secured on services given the distance between the negotiating positions of the two sides. While the UK emphasises the need for its regulatory autonomy, the EU insists on conditions to remove the risk it perceives of regulatory competition from the UK.
- Without a trade deal, UK companies would face significant new barriers to doing business in the EU from having too few HGV permits, to losing passporting rights for financial services produced in the UK. UK film and TV producers would find it harder to sell their programming to the EU and performing artists would face additional costs to touring in the EU.
- The difference between the deal being sought by the UK and a no-deal outcome is more limited for services than it is for goods. Access to EU markets for UK services will necessarily be reduced and more precarious with or without a deal. In financial services, for example, access will depend on an equivalence decision that could be withdrawn with only 30 days' notice.
- The UK government's post-Brexit migration proposals may lead to staff shortages in service sectors, such as hospitality and delivery, that rely on workers who will not meet the salary thresholds for the scheme.
- The current Covid-19 crisis is likely to impact the services sector in ways that are not yet clear. Some businesses have managed to operate through the restrictions, others have shut down. Brexit will help shape the post-Covid economy and will have significant regional as well as national impacts.



Introduction

The UK is predominately a service economy. Services make up some 80% of economic activity, and account for an even higher share of employment. Many services cannot be traded – but many can and this is an area where the UK does well. Our services exports help us to pay for the goods we want to import.

Leaving the EU single market will have a profound effect on those tradeable services. Some like tourism will continue much as now, although the UK hospitality sector is very dependent on EU workers. Others like financial services will find themselves having to operate in a very different environment, facing new barriers to selling into the EU market. Indeed, many have already adapted their business models in anticipation of Brexit.

Interestingly, one common characteristic of both the May and Johnson governments is how little attention they have given to the UK's services sector in the Brexit negotiations. This comes despite the UK's central role in facilitating enhanced trade in services within the EU.

The likely impact of the kind of trade deal that the UK is currently seeking to negotiate with the EU and leaving without a deal is more limited for services than it is for goods. This is not unusual. Free trade agreements (FTAs) typically do not address the issues facing cross border trade in services such as the extent to which national regulations are aligned between parties to the same extent as they do for goods.

However, the draft text of the deal sought by the UK [shows](#) that the UK is seeking access to EU markets for services that is greater than is typical in FTAs, including those the EU has already in place. For example, the UK wants to make it easier for UK professionals like architects and lawyers to deliver services to EU markets, and to include the film and television industry in the agreement. Neither of these proposals have been agreed in existing EU FTAs with other countries.

A key question underpinning the UK's negotiation strategy for services is the extent to which the government chooses to privilege regulatory autonomy over EU market access. For sectors that rely heavily on single market access, such as financial services, this would lead to a marked change in export strategy.

The government regards regulatory autonomy as central to its plans to open up new global markets for UK services. Quite what those might look like we do not yet know.

What is clear is that Brexit will change the shape of our economy. Changes to the way in which we trade services will come on top of the adaptations that Brexit will necessitate for manufacturing and for our farming and fishing industries. Just as the distribution of services is uneven across regions, so those changes will play out very differently across the UK.

But they will also affect a sector already reeling from the unprecedented impacts of the Covid-19 enforced economic shutdown. Some service industries have shown themselves to be more crucial than ever in keeping the economy going; some have been able to migrate to virtual working; others have ceased trading completely.

This report looks at the importance of the UK's services economy and how it might change as a result of Brexit.



The UK services sector

The services sector is characterised by its breadth and diversity. It includes retail and delivery services alongside the public sector, business administration, business services such as accounting and consultancy, leisure and cultural activities. In practice, this means that the sector includes firms varying in size from high-street lawyers and accountants to multinational consultancy firms, arts organisations, performing artists, schools and universities, restaurateurs, IT consultants, hairdressers, carers, delivery drivers and many more. Before the 2020 Covid-19 pandemic, services constituted around [81%](#) of the UK economy, or around [30 million](#) jobs.

Although we talk about services and goods as distinct categories, the two cannot be easily separated. Often the purchase of a manufactured good also involves services as an integral component of the purchase. This can include the financing of the purchase of post-production services such as maintenance and insurance.

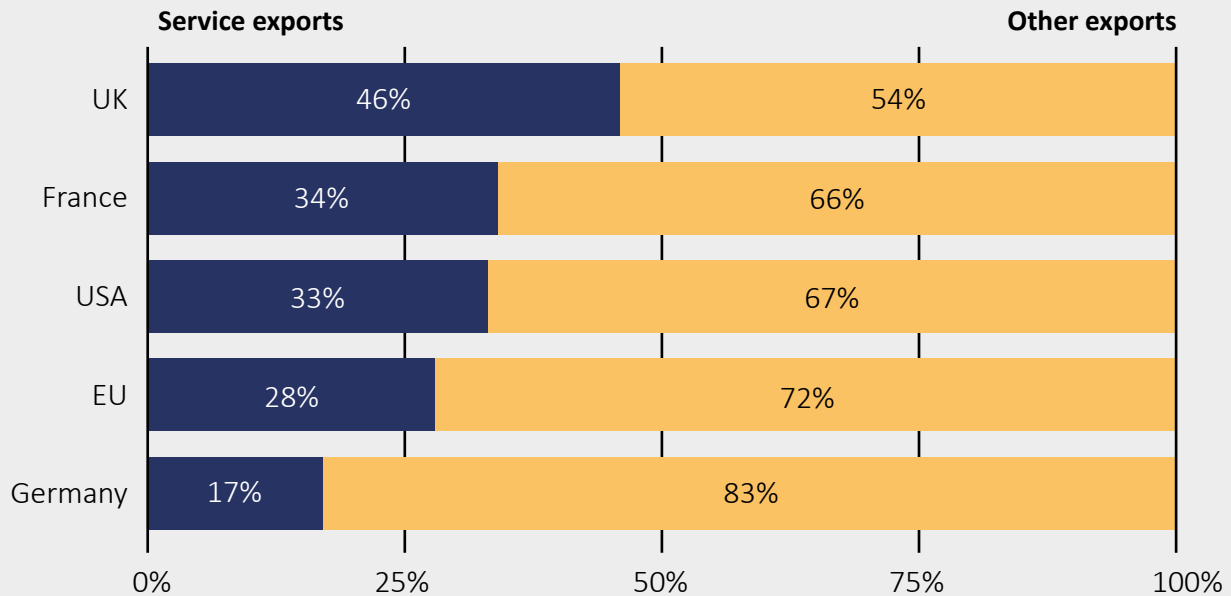
These are known as [embedded or attached services](#) and have been a growth area for the UK in recent years. For example, Rolls Royce is known for its production of aircraft engines. However, the [majority](#) of the company's revenue comes not from the sale of the goods it produces, which in 2017 accounted for 48% of revenue, but in the accompanying services, which accounted for 52%. These services include the long-term maintenance of the engines and other post-production activities. Consequently, services will be affected by what happens to manufacturing which is discussed in our separate report.

While the UK imports more goods than it exports, it ran an overall trade surplus in services [totalling](#) £28 billion in 2018 (the last year for which full year data is available). Other business services such as legal, accounting and consultancy services made up 29% of this export total, followed by financial services, which alone contributed some 22%. Services account for a much higher proportion of UK total exports than they do in many other advanced economies. As Chart 1 shows, in the UK, [46%](#) of exports are in services, compared to 33% of US exports and 17% of German exports.

Chart 1

The UK relies heavily on service exports

Service exports as a percentage of total exports, 2018.



Source: UNCTADstat database.

Behind these headline figures lies an incredibly diverse sector that contributes to the UK economy in different ways. The [most important](#) contributors to the UK services sector are financial and insurance services (8% of UK services) followed by legal services, education and health services (each contributing 7%). Some of these sectors are distributed very unevenly throughout the country and contribute to the economic imbalances we see between regions.

For example, [around](#) 9.4 million people are [employed](#) in financial and related services such as insurance contributing around £128 billion to the UK economy. However, as Chart 2 shows, 48% of this, or £62.3 billion in monetary terms, is [generated](#) by London alone. It is therefore not surprising that London [accounts](#) for 42% of the UK's service exports and the South East is the next largest contributor (17%). The remaining 41% is divided between the other ten regions of the UK. In Northern Ireland, services account for [22% of its exports](#), with sales focused in GB and Ireland from a large number of small firms.

Chart 2

More than half of the UK's service exports are from London and the South East



Breakdown of UK service exports by region, 2017.



Source: Office for National Statistics, International exports of services from subnational areas of the UK: 2017.

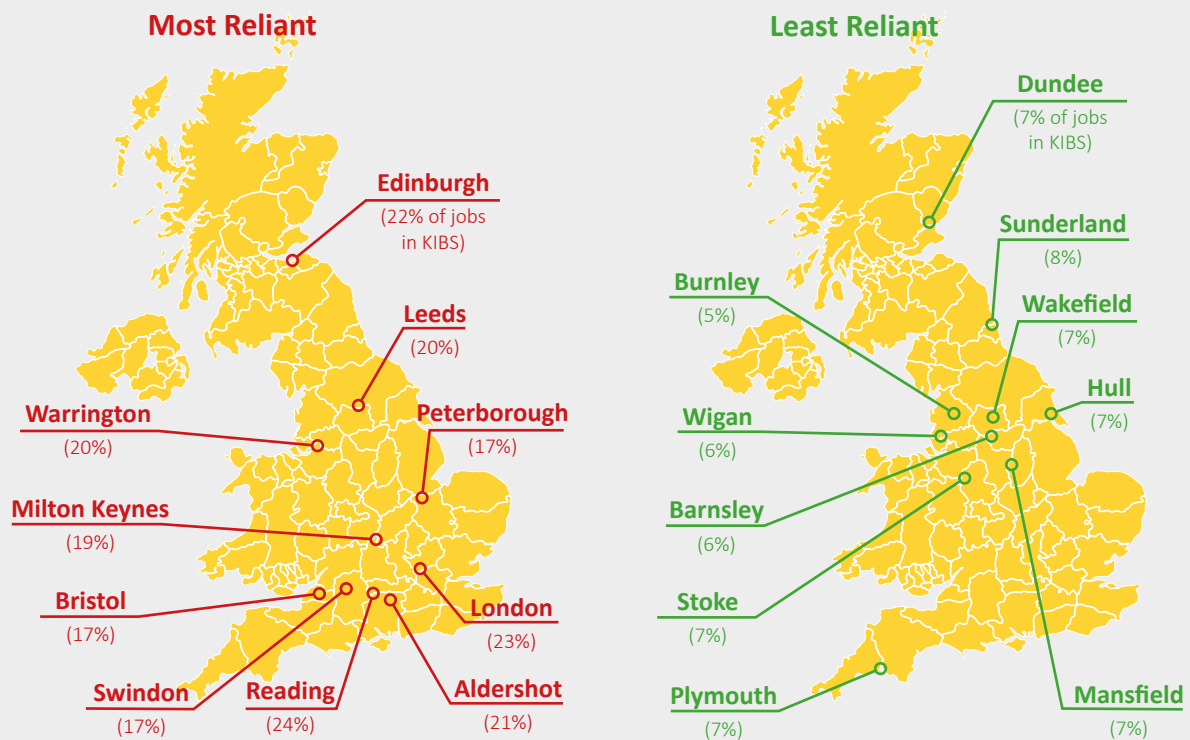
Meanwhile, in regions, towns and cities that have not seen their economies do well in recent years, a large proportion of individuals employed in services work in the public sector. For example, Northern Ireland, Wales and the North East of England all have higher concentrations of civil servants as compared with other regions. These are also the regions where many of the towns and cities with the lowest reliance on tradeable services (such as financial and legal services) are located, as Chart 3 shows.

Chart 3

Town and cities in southern England rely more heavily on business services jobs than those in northern England



Towns and cities that are most or least reliant on knowledge intensive business services (KIBS) jobs, based on KIBS jobs as a percentage of total jobs in 2018.



Source: Centre for Cities, Cities Data Tool. Created in part using datawrapper.

Services trade between the UK and the EU

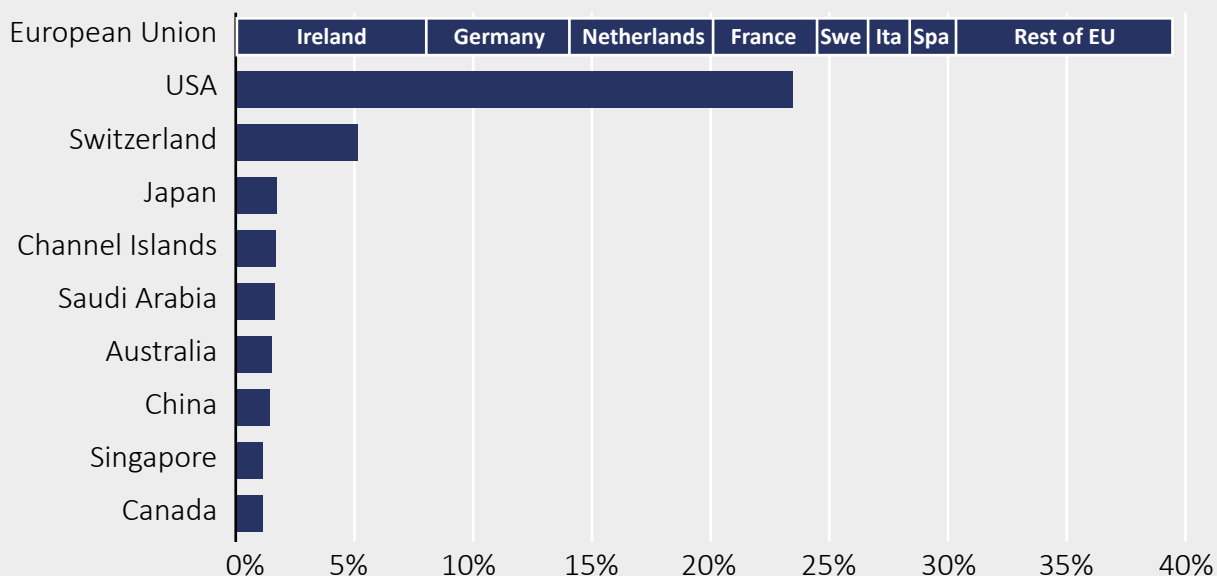
While in the EU, the UK pushed to liberalise trade in services between member states. Although the single market in services is less complete than the single market in goods, the development of the UK services sector has benefited significantly from its single market access. For example, although the US is the largest single destination for UK services exports, trade to the EU as a whole is greater, currently accounting for around [40%](#) of UK services exports. Six of the most important international markets for UK services exports are in the EU: Germany, France, the Netherlands, Ireland, Italy and Spain.

Chart 4

The UK's largest export markets for services are the European Union and the United States



UK's top export markets for services (as a percentage of total service exports), 2018.



Source: International trade in services, UK: 2018.

The dominance of the EU for UK services exports is not surprising. Research [shows](#) that trade flows, even in services, are typically greater between neighbouring countries. However, UK services' reliance on the EU also reflects that the degree of market access is much greater within the single market than is facilitated by free trade agreements with other countries. In some areas, as in the regulation of individuals providing a service, like architecture, the trade in services between EU member states is easier than it is between some US states.

The current liberalisation of services trade within the EU's single market means that economists estimate there will be a significant negative impact on UK services' trade when the UK leaves the single market at the end of transition. For example, [research](#) at the National Institute of Economic and Social Research (NIESR) has suggested that if the transition period ends with a FTA agreement, trade in services with the EU may still [decrease](#) by around 60%. OECD analysis [estimates](#) that even under an FTA, business services would contract by 2% and financial services by 6%.

Research also shows that existing FTAs for services with the EU typically do not lead to significantly greater trade flows than would have been the case with no deal in place at all. For example, government analysis undertaken in 2018 [estimated](#) that the value of services trade from the UK could decline by 8% without a deal and by 5% under a typical FTA. More recent government analysis is not available because the current government is clear that it will not be undertaking this kind of detailed analysis for the comprehensive free trade agreement it is seeking.

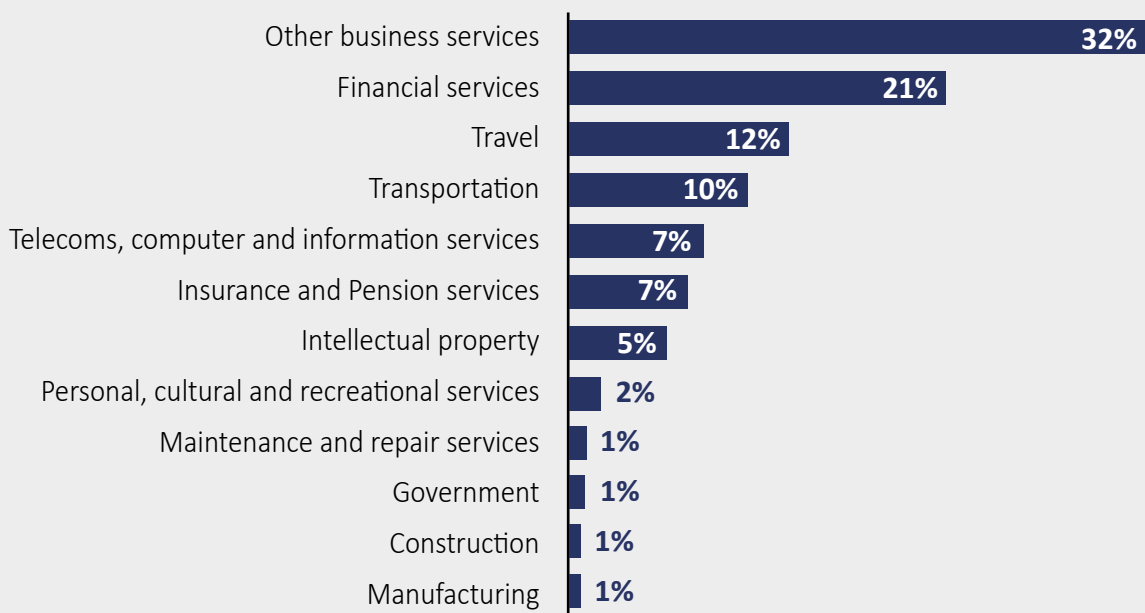
Given the extent to which the single market makes cross border services trade easier, it is not surprising that the sectors that stand to be hardest hit at the end of transition are those that have used the single market to develop their export markets most intensively. As Chart 5 shows, the largest category of services exports by the UK in 2018 (the latest year for which full year data is available) was 'other business services' worth £96 billion, accounting for around a third of all UK service exports. This includes accounting, advertising, architectural, legal, research and any other technical or professional service to business. Financial services were the second largest and accounted for 22% of UK service exports.

Chart 5

The UK's main service exports are business and financial services



Breakdown of UK service exports 2018.



Source: Office for National Statistics, UK Balance of Payments, The Pink Book: 2019

In practical terms, the single market has improved conditions for services by aligning national regulations of member states on who can provide services and what the expected standards of services are. The absence of such regulatory alignments are called non-tariff barriers (NTBs), while tariff barriers are the custom checks and quotas that are the focus of the negotiations for goods and are discussed in our forthcoming report on Manufacturing and Brexit.

The types of NTBs involved depend on the nature of the trade being considered. The World Trade Organization General Agreement on Trade in Services (GATS) identifies four ‘modes’ by which services can be traded across borders, (these are summarised in Table 1).

- **Mode 1:** cross-border supply (e.g., an architect in Manchester working on a project in Berlin);
- **Mode 2:** consumption by a resident from abroad (e.g., Italian trainee nurses studying at UK universities);
- **Mode 3:** commercial presence (e.g., Spanish banks serving UK customers in the UK); and
- **Mode 4:** the presence of natural persons (e.g., a London lawyer working on secondment in Brussels).

There are a number of ways in which the EU’s single market makes services trade easier than under both a typical FTA and under GATS terms by aligning regulations between member states. This means that it is likely inevitable that UK services trade will decline to the EU whether the UK leaves the transition period with or without a deal. The range of possible implications by mode of supply are summarised in Table 1.

Mode 1: Cross-border supply of services

Within the single market it is possible for the same service to be sold cross border, meaning that a law firm can currently sell its services from its UK office to customers based across the EU. This is particularly important in sectors that are heavily regulated, such as financial services. [67%](#) of financial services exports (excluding insurance) are sold from a UK base into the EU. The equivalent figure for services sold to the rest of the world is 28%, which reflects the limited extent to which both GATS and FTAs address cross border services supply.

GATS provisions and typical FTAs do little to approve authorisations and licensing to practice. The UK’s draft agreement is more ambitious and [seeks](#) to enable UK financial firms, for example, to service the EU market from the UK and vice versa, which copies the terms of EU–Canada FTA exactly. Whilst it appears that this would allow business to continue as usual, in practice how financial services providers will be licensed to do this remains uncertain and hence the degree of market access for UK firms is unlikely to remain the same. We discuss this in more detail for the financial services sector, which relies heavily on this mode of supply below.

Given the uncertainty of whether the UK will gain agreement on its aims in this area, and how such agreements could be put into practice, UK services face considerable uncertainty about the future level of EU market access available to them at the end of the transition period. It may, therefore, be more logical in terms of corporate strategy for firms to open a subsidiary office within the EU market they want to export to. There are clearly costs and risks associated with doing this, and some providers will elect not to do so but, in some sectors, such as financial services, firms have already started the process, which we will return to below.

Table 1

Service firms could face significant new restrictions when trading with the EU



Examples of restrictions on overseas provision of services by GATS mode of services supply outside the EU single market.

Mode	Example	Possible changes for UK providers outside of the single market	Example
Mode 1: <i>cross-border supply</i>	<i>Services supplied cross-border without a supplier or purchaser physically moving, e.g.,</i> A UK customer uses a call centre in France	<ul style="list-style-type: none"> • A requirement for foreign service providers to establish a commercial presence • Regulations on consumer protection that unduly restrict trade 	Requiring a UK bank to open a branch in the EU to sell banking services into the single market after Brexit
Mode 2: <i>consumption abroad</i>	<i>Service consumed by a resident in another country, e.g.,</i> A Spanish nurse training in the UK	<ul style="list-style-type: none"> • Travel restrictions to the country where the service supplier is based and the service is offered • Regulations relating to the domestic recognition of overseas degrees and training 	Limiting the recognition in the EU of qualifications earned within the UK
Mode 3: <i>commercial presence</i>	<i>Service is provided by a foreign company opening a branch office, e.g.,</i> An Italian bank opens branches in the UK	<ul style="list-style-type: none"> • Restrictions on the establishment of new service provisions through policies such as minimum capital requirements, limits on the share of foreign capital, prohibition of FDI in particular sectors • Restrictions on the operation of overseas service providers, e.g., through the requirement of permits and licences 	Requiring overseas providers of services to obtain different or additional licences as compared to domestic competition.
Mode 4: <i>movement of natural persons</i>	<i>Service is provided by an individual who travels to the country of purchase, e.g.,</i> A UK lawyer travels to Belgium to provide legal advice	<ul style="list-style-type: none"> • Visa requirements • quotas on the inflow of temporary workers • limitation of the maximum period of stay 	Requiring additional paperwork clearances before a service provider can service an EU based client

Source: UK in a Changing Europe analysis, adapted from Developing Trade Consultants, 'EU Exit and Impacts on Northern Ireland's Service Trade', adapted from [Shepherd et al 2019](#)

Mode 2: Consumption abroad

There is relatively little difference between Mode 2 services delivery within the single market and under a FTA, and consequently we do not discuss this further here. The types of activity included in this mode, such as international student spend and tourism, are not usually considered to be a threat to the competitiveness of domestic economies.

Mode 3: Commercial presence

Within the single market, regulatory changes have been enacted to make it easier for a business to establish an office within any other member state. Again, this is particularly important in heavily regulated service sectors such as financial services where outside the single market, national regulatory differences would preclude this. For example, within the single market, financial services firms can typically set up branches rather than subsidiary offices in other member states. This facilitates trade because branches are less risky and cheaper to establish as they have lower capital requirements than is mandated for subsidiaries. Moreover, these branches can then sell their services within the EU/EEA, which is not typically the case for the European branches of non-EU companies under other FTAs.

Importantly, existing EU FTAs with third countries do more to smooth trade under Mode 3 than under Mode 1. This is [reflected](#) in the UK's draft agreement text. For example, it states that financial service providers from the UK in the EU, and vice versa, should be treated the same as domestic providers on issues such as the make-up of company boards or the number of services they provide cross border.

However, even if the UK's proposals are agreed, a key hurdle will remain for UK businesses at the end of the transition period: what they will be permitted to do in one country may not be the same in another. This is because the draft agreement [published](#) by the UK, in common with other FTAs, allows both the UK and EU member states to make additional stipulations about what types of cross-border services trade can take place and by whom. In practice, they will therefore have to understand and comply with a European patchwork of regulations, which is likely to increase costs. For example, firms working in securities settlement would be able to open branches in Germany but not in Italy.

Mode 4: Temporary movement of natural persons

Without a negotiated agreement between the UK and the EU, Brexit will reshape these flows of people because existing EU free trade agreements and GATS provisions leave significant additional restrictions in place beyond those within the EU's single market.

Theoretically, short projects by service providers in the UK for EU clients will be possible after the end of transition. However, in practice, because member states retain considerable individual control over what forms of mobility they will permit, for whom and in what sector, navigating this landscape of regulations for companies outside of the EU becomes very difficult and costly. As we discuss below, the UK is seeking additional access to the single market in an effort to overcome some of these issues.

In addition to facilitating the export of UK services to the EU through different kinds of business trips, services in the UK have also benefited from attracting EU labour to the UK under these regulations. The Royal Institute of British Architects (RIBA) estimates that one in four architects working in the UK are from the EU. This exposure becomes more acute when we consider the temporary workforce. In highly seasonal sectors such as tourism, around [10%](#) of workers are EU Nationals. Importantly, in public services [around 6%](#) of the NHS workforce are EU27 nationals and are particularly important for the NHS in London, South East England and Northern Ireland.

Figures show that Brexit has already impacted these migration patterns with the number of migrant workers to the UK from the [EU](#) falling to a record low in 2019. The government's proposed post-Brexit migration regime, which it intends to implement once freedom of movement ends, will also affect different services businesses in very different ways.

For some highly paid sectors, the salary threshold proposed by the government of £25,600 for migrants entering the UK – lowered in the case of those holding PhDs – is unlikely to pose a significant barrier to entry, though employers will still have to go through the bureaucracy of applying for visas and there will be significant extra costs to pay that do not apply now to EEA nationals coming to work in the UK. However, the median weekly earnings in caring and leisure services [were](#) £392 per week (£20,384 per annum) and hence workers in these sectors are unlikely to meet the salary threshold required for them to come and work in the UK. These individuals may also be deterred, if any decrease in the value of the pound makes the UK a less lucrative labour market for international workers, who may want to send remittances back home.



Services and UK-EU trade negotiations

Neither Theresa May's government, nor Boris Johnson's has sought to retain UK membership of the single market: May's Chequers' proposals argued for a 'common rulebook' on goods as part of her desire to see frictionless trade and avoid a hard border in the island of Ireland, but did not propose anything similar on services. From the start, Boris Johnson's government has pursued a more distant trading relationship with the EU – at least for Great Britain. His agreement for Northern Ireland leaves it inside the EU single market and the EU's customs area but this only applies to goods and not services.

The emphasis on developing a more distant economic relationship between the UK and the EU, underpinned by regulatory divergence, or at least the possibility in the future for such divergence, was reiterated on 3 February 2020 when Boris Johnson set out the basis of the UK's negotiating position for the 2020 trade talks on goods and services. In it he underlined his commitment to global free trade. He made clear that the UK would not accept any deal that included 'high alignment' with the EU and its regulatory systems in particular. This included the UK not being subject to the European Court of Justice at the end of the transition period. The government is also clear that if the 'broad outline of an agreement' is not sufficiently developed by June 2020 and capable of being finalised by September, then it will need to decide whether the UK's attention should move away from negotiations and focus solely on continuing domestic preparations to exit the transition period in an orderly fashion with no deal. To underscore this approach, the government has been clear that if the UK cannot meet its negotiating aim, then it is prepared to walk away from talks and trade with the EU on World Trade Organization (WTO) terms.

The EU, for its part, has always maintained that the UK cannot enjoy the benefits of the single market without its obligations. President Macron [stated](#) in 2018 that the UK should not retain access to the single market without agreeing to its 'preconditions' including free movement across the EU. He went on to state that "there should be no cherry-picking in the single market because that's a dismantling of the single market".

The UK's negotiating position and the structure of the talks

The UK government [published](#) its approach to negotiations on the future relationship with the EU on 27 February 2020 and a [draft](#) of its proposed FTA on 19 May 2020. The former reiterates the government's position that the future relationship between the UK and the EU should be based around a Comprehensive Free Trade Agreement (CFTA) accompanied by a limited number of supplementary international agreements related to areas such as law enforcement, fisheries and transport once the UK leaves the single market at the end of transition. The EU, on the other hand, favours a single, comprehensive agreement, reflecting its commitment to ensuring that agreements in different areas are linked in any deal.

The UK negotiating team has stated that it is seeking an agreement based on existing EU free trade agreements, particularly the EU-Canada Comprehensive Economic and Trade Agreement (CETA) and the EU-Japan Economic Partnership Agreement (EU-Japan EPA).

In some areas, the draft text published by the UK is identical to CETA. However, in other ways it is asking for greater market access than has been provided by the EU to date. For example, the UK wants to make it easier for UK professionals such as lawyers and architects to work in the EU than is the case for those holding Canadian qualifications. The UK is also seeking greater sectoral coverage than the EU has agreed to date. Importantly, the UK wants to include the audio-visual sector but the EU, in common with its other FTAs, does not.

At the same time as seeking greater market access in some areas than is typical in EU FTAs, the government also wants to preserve its own regulatory autonomy, allowing the possibility of significant divergence in the future. This is in stark contrast to service-sector regulatory alignment that underpins the single market in services. Ruling out a possible extension on 16 April 2020, UK lead negotiator David Frost [said](#) “extending would simply prolong negotiations, create even more uncertainty, leave us [the UK] liable to pay more to the EU in future, and keep us bound by evolving EU laws at a time when we need to control our own affairs”. This suggests the UK would rather walk away than accept any compromise – but a hard line might be expected at this stage in the negotiations. Although the government has emphasised regulatory divergence as a key Brexit policy objective, it is not yet clear whether there are any areas for which the UK would be prepared to accept greater regulatory alignment in return for securing greater access to the single market.

This has sparked concerns on the EU side that the UK could seek to obtain competitive advantage by deregulating compared to the EU – for instance by lowering reporting standards or using tax policy to attract services investment. If a large and geographically close competitor does that, while retaining relatively easy access to the single market, it could make it harder for the EU to compete while maintaining its own rules.



Key issues in the negotiations

The distance between the starting positions of the two sides suggests that they may not manage to agree a trade deal. If they do not come to an arrangement, what degree of regulatory alignment might be agreed?

What is clear is that the services sector needs to plan for its future outside the single market. Whether because of a no deal end to transition or the implementation of FTA, the UK's services trade with the EU will be smaller and very different, even if some of the changes are not immediate.

Below we consider some of the key issues for the UK's services sector, which will be dealt with in the negotiations, and assess the options available.

Financial Services: regulation and access to the EU single market

As part of the EU single market, the City of London has become the leading financial centre within the EU and a strategically important sector in the UK's economy. Financial services contributed [6.9%](#) of the UK's GDP in 2019. Crucially in terms of Brexit, just over a quarter of the sector's activity currently [stems](#) from EU related business.

At the moment, single market access is facilitated through what are known as 'passporting' arrangements between the UK and EU member states. Passporting means that a financial services firm authorised to undertake activity by the regulatory body of one EU member state can apply for a passport to conduct the same business throughout the EU/EEA without the need for further authorisation. Using passporting arrangements, it is estimated that [67%](#) of UK financial services (not including insurance) supplied to the EU are delivered cross border from a UK base.

Although these arrangements have continued during the transition period, once that ends, so too will passporting for UK based financial firms. The UK's draft agreement text follows CETA and [proposes](#) to allow the cross border supply of financial services between the UK and the EU. This might appear to continue the current arrangements, but it is important to note that CETA does not match passporting. CETA only covers limited types of financial services including particular aspects of insurance, such as maritime insurance, certain banking activities and portfolio management.

A most favoured nation (MFN) clause is included in the CETA (and the UK's draft text includes the provision for the UK to include the same), which will limit the degree of bespoke single market access the UK may be able to negotiate. If the EU offered the UK a more favourable deal, then it would have to offer the same arrangement to Canada and other countries with whom it has trade deals with an MFN provision. As the CETA has only been in place since October 2016, some lawyers have [noted](#) that there is still uncertainty as to precisely how it will work and what will be included in relation to financial services.

CETA relies on equivalence decisions in the place of passporting and the same approach is developed in the UK's draft agreement. These legal provisions enable financial firms outside the EU to conduct business within the single market and/or with EU counterparts without being subject to EU regulation in addition to their home country regulation, provided that the EU determines that the legal and regulatory system of the third country is deemed 'equivalent'. However, equivalence does not enable the same breadth of market access across the same number of services as passporting. For example, core banking services such as lending and deposit taking [cannot](#) secure single-market access through equivalence.

Equivalence also provides much less certainty because the EU can revoke its decision to grant equivalence with only 30 days' notice. To try to overcome this, the UK draft agreement text [seeks](#) 'transparency and appropriate consultation in the process of adoption, suspension and withdrawal of equivalence decisions' (p.170) in order to provide UK financial services firms with greater certainty about what type of EU market access they will have. This falls short of the plans [outlined by](#) the previous Chancellor Sajid Javid for a 'comprehensive, permanent equivalence decisions' that would give more certainty to financial firms by agreeing 'appropriate consultation and structured processes for the withdrawal of equivalence findings'.

In the Political Declaration, Brussels and London agreed to complete their respective equivalence assessments by June 2020, an indication of the importance of financial services and financial system stability for the wider economy. Given that the regulatory systems are currently aligned with the UK inside the single market, at the end of February 2020, Chancellor Rishi Sunak [called](#) for rapid progress to be made on granting equivalence rights. However, the EU Commissioner responsible for financial services, Valdis Dombrovskis, denied that it was likely that decisions could be reached by 30 June. There have been other suggestions, for example by Irish Taoiseach Leo Varadkar, that [the EU is keen](#) to hold up an equivalence decision until more progress has been made on other dossiers where the EU wants the UK to flex – not least the contested (though economically trivial) issue of fishing rights.

Beyond the question of equivalence and passporting, there are a number of areas where the UK's draft text goes beyond the market access provided for in CETA in small but important ways. For example, the UK's draft agreement seeks to future proof the definition of what counts as a financial services supplier by including individuals or business who supply or 'wish to' supply financial services. The draft also seeks greater collaboration on things like consumer protection through innovation in financial services. Both of these differences can be read as an attempt to ensure that the fintech sector, in which the UK has developed global leadership, is protected by the proposed UK deal. Finally, the UK draft proposes the establishment of a Financial Services Committee that would meet once a quarter to oversee the implementation of the agreement, signaling the importance the UK attaches to financial services; the equivalent committee under CETA usually meets once a year.

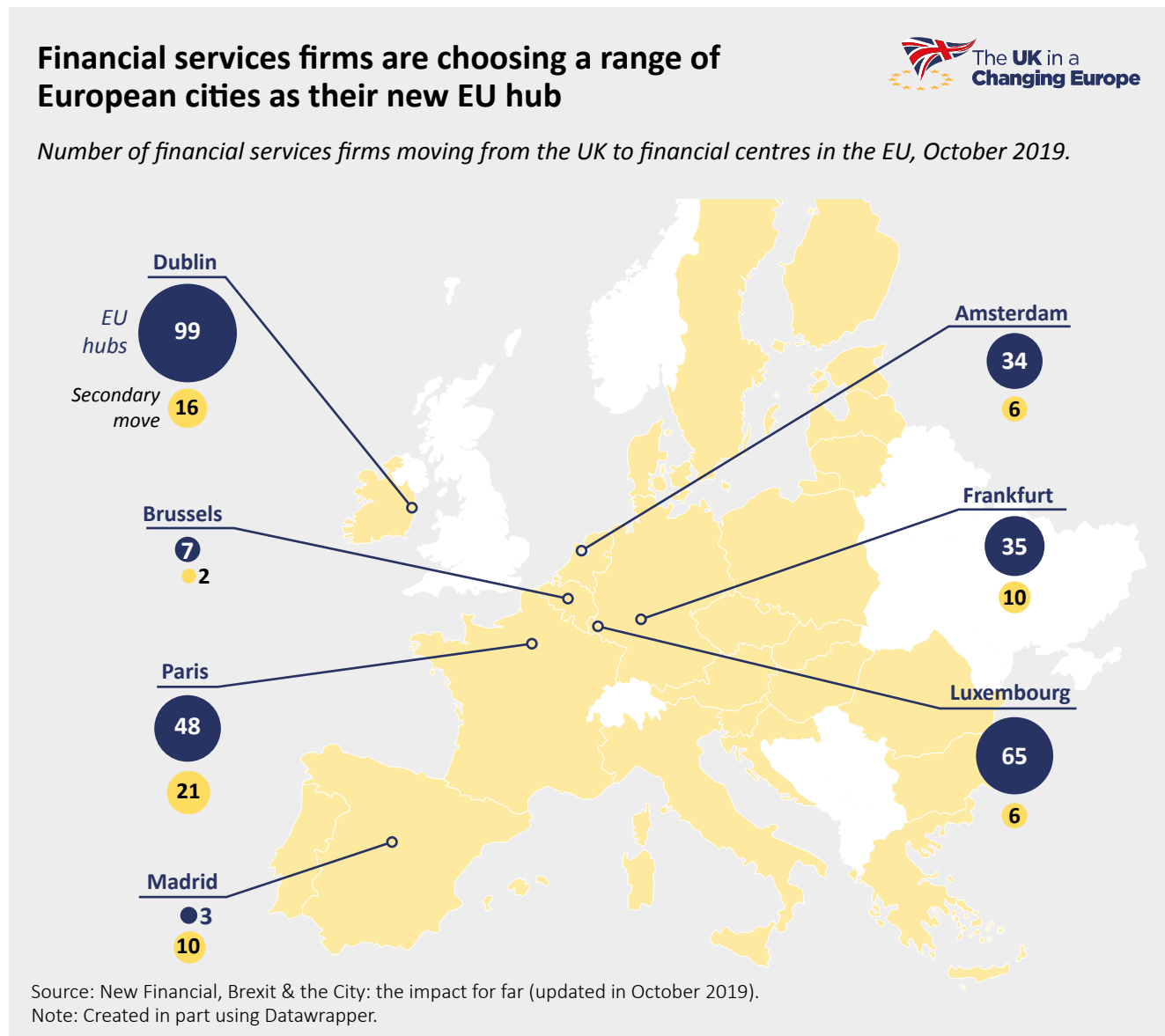
In essence, the UK is seeking a slightly modified version of CETA in financial services. However, crucially it wants to secure this enhanced degree of market access without the level of regulatory alignment that would be typical of the EU. For the UK government, the unique size and importance of financial services in the UK means that it should not become a 'rule taker' from Brussels. As the previous Governor of the Bank of England Mark Carney put it, "It is not desirable at all to align our approaches, to tie our hands and to outsource regulation and effectively supervision of the world's leading complex financial system to another jurisdiction." Similarly, the new Governor, Andrew Bailey, echoed the concerns of industry by warning the EU against allowing politics to trump technical assessments in determining the City's access to EU markets. He also added that there should be a mechanism in place to enable the UK to diverge from EU rules without "a metaphorical punch-up every time".

Of course, some companies have already executed plans to circumvent the loss of passporting and the UK's departure from the single market and set up bases in EU member states from which to conduct their business with EU clients. As Chart 6 shows, this has involved the relocation of some staff and assets to a range of financial centres across Europe, raising the prospect that whilst London's share of EU financial services trade is likely to decline in the medium and longer term, it is not going to be replaced

quickly by a single rival services financial centre. Although the precise numbers involved in relocations are largely kept confidential by firms for fear of divulging their corporate strategy, early indications are that a network of more specialized centres are emerging with banking being concentrated in Frankfurt and asset management in Dublin, for example.

This fragmentation of financial services businesses is reflected in the UK's draft agreement through an explicit request for a degree of regulatory autonomy when it comes to back office functions. These offices undertake essential administrative work on financial transaction but do not meet clients directly. They are not mentioned in CETA and the fact that the UK's draft includes them suggests that the UK is keen to ensure regulatory autonomy across a range of financial activities, even if some move to the EU after transition.

Chart 6



Some in the City, particularly institutional investors and hedge fund managers, see the prospect of reduced European regulatory oversight as a significant opportunity to increase competitiveness through regulatory divergence. Under such a scenario, a range of other mechanisms have also been identified that could be used to support the competitiveness of the City beyond the EU's equivalence regime. For example, bank lobbyists have become increasingly [vocal](#) in calling for tax cuts and lighter regulation to preserve the sector's competitiveness after Brexit. Even the City authorities have recently [called](#) for the government to give regulators a statutory objective to maintain the competitiveness of the City – as was the case with the Financial Services Authority (FSA) before the financial crisis. Indeed, the vision of a low tax, low regulation network of 'Financial Free Zones' around the UK continues to be [promoted](#) by prominent free market advocates and think tanks.

Some international investment banks are concerned about the burden of recent EU directives such as MiFID II (Markets in financial instruments directive) which they – and the regulator the Financial Conduct Authority – consider to be overly complex. This has led to [some](#) in the City to argue that the UK would be better off retaining its ability to choose a different regulatory approach from MiFID II, and therefore should not seek to stay 'equivalent'. Meanwhile, retail banks, whose principal focus is the UK, are far less concerned than global banks about the need to retain access to the EU market.

The Centre for Economic and Business Research (CEBR) [estimated](#) that leaving the single market with no or only modest trading agreements in place beyond WTO terms would lead to export losses of around 15% in financial services. Depending on the extent to which these are replaced by new trade relationships, this could lead to a decline in GDP of 1.4 - 2%. Some of this could be reversed if additional trade deals and relationships are established between the UK and countries outside of the EU and much has been made of the potential for the US in this respect. However, the UK's negotiating mandate with the US remains vague on how this might be facilitated, [stating](#) that it seeks to 'expand opportunities for UK financial services to ease frictions to cross-border trade and investment' as well as developing cooperation on questions of financial regulation. At least in the short term, it is hard to see how this will offset the declining EU exports in financial services at the end of the transition period

Mutual recognition of professional qualifications and labour mobility

An important aspect of the negotiations for services relates to the rules governing who is able to travel between the UK and the EU to provide services. At the moment it is relatively easy to travel to do business in another member state, and UK professional qualifications, such as those needed to practice as a lawyer or an architect, are recognised throughout the EU. This is called the mutual recognition of professional qualifications.

For the business services sector, the largest form of UK-EU services trade, this is a critical issue especially for those that are reliant on regulated professions. A regulated profession requires individuals to be authorised to provide the service in a particular country and meet the regulatory requirements of that country to do so. This includes lawyers, accountants and architects, who are typically allowed to practise and use a professional title once they have undertaken approved education and training. This system of authorisation is typically nationally based so that someone trained and qualified in one country cannot automatically practise in another. The process is usually managed by a trade association or a professional body, which makes implementation of any changes resulting from the trade negotiations harder than if it was a government run process.

Mutual recognition of professional qualifications has been vital in facilitating cross border trade in regulated services. [RIBA](#) has argued that current mutual recognition arrangements within the single market reduce the administrative barriers to the movement of workers within the EU, thereby providing firms with a greater degree of flexibility in terms of how they deliver cross-border services.

The UK negotiating document is ambitious in this area going beyond other FTAs and CETA. The position set out by the UK takes mutual recognition as the default position (i.e., a continuation of the current single market access) and outlines a framework to facilitate this. In contrast, in the CETA a framework is set out for the parties to work towards mutual recognition, where it has been recommended by a Joint Committee on Mutual Recognition established by that agreement.

The EU's position is rather different. In a [notice to stakeholders](#), the EU Commission has stated that:

“The recognition of professional qualifications of United Kingdom nationals in an EU27 member state will be governed by the national policies and rules of that member state, irrespective of whether the qualifications of the United Kingdom national were obtained in the United Kingdom, in another third country or in an EU27 member state.”

The non-recognition of UK qualifications would not just apply to UK citizens – it would also apply to EU citizens who hold a UK qualification and are working in other EU countries. However, EU citizens working in the UK would continue to have their professional qualifications recognised as long as they applied for such recognition before the end of the transition period.

Legal services illustrate how the risks of not securing an agreement in this area might work out in practice. Currently solicitors have the right to be recognised as lawyers by other European bars, they have the protection of legal professional privilege (LPP) when advising clients in the EU and they have the [right](#) to represent clients at the Court of Justice of the European Union The Law Society, 2019. This is reciprocated with the UK's automatic recognition of other European bars, enabling the UK's legal sector to recruit lawyers from across the continent. Moreover, a UK limited liability partnership (LLP) can currently open branches within member states. However, without a new agreement, this would not be the case in all member states. For example, UK LLPs would not [automatically](#) be recognised as a legal form in France, which requires 75% of partners holding 75% of shares to be fully admitted to an EU/EEA/Swiss bar Law Society, 2019.

For some services, such as management consultancy, professional qualifications are less significant, but easy and frequent access to clients within the single market is important. Currently, such travel involves very little in the way of paperwork and fees. However, at the end of the transition period, if no deal is agreed, businesses could be faced with having to navigate the range of visa requirements and associated fees required by member states.

The UK is seeking to address this by including short-term business trips and people moving between their firms' office for short periods of time, known as intra-company transferees within the agreement. This form of business travel is [valued](#) at around 1.6% of UK GDP.

The UK's draft agreement aims for individuals to be able to travel between the EU and the UK, and stay on a temporary basis in order to deliver services. In some areas, the UK is following both the CETA and the EU–Japan EPA, which have gone much further than other FTAs in this area. For example, the draft calls for the requirements for visas to be dropped for short-term business visitors. It also follows the CETA in proposing that entry be granted for the families and dependents of service providers themselves. In

other areas, the UK proposals go further than existing EU trade deals. For example, the UK is offering stays of up to five years for individuals travelling to the UK with their company. The typical length the EU offers in this area is three years. Agreements reached in this area, will assist the range of individuals, from professional musicians, to management consultants and financiers who travel frequently between the UK and EU member states to provide services on a 'fly-in-fly-out' basis, though this will still fall short of the ease of movement they currently enjoy.

Without an agreement there could be significant disruption to this mode of cross-border service supply. In this scenario, individuals planning to travel from the UK to the EU will also need to consider any new paperwork required to take equipment with them at the end of the transition period. As a case in point, the Chief Executive of UK Music [cautioned](#) that the additional challenges associated with travel to the EU in a no-deal scenario could lead to touring artists cancelling performances. This is partly because performers would require a carnet, a kind of passport for goods costing around £300 per year, to avoid paying duty on any items brought into the country for business purposes such as musical instruments.

Data and digital services

The flow of data is vital for the UK and EU economies. In 2017, the European Commission estimated that by 2020 data flows would be valued at €643 billion, which is over 3% of total EU GDP.

Data flows are at the heart of most trade in goods and services. They range from behavioural analysis of customer ordering patterns to assist with marketing, to order-tracking, through to basic processes such as cloud-based email or storage. The UK is a major actor in global data flows and has the largest internet economy as a proportion of GDP within the G20.

The UK is seeking commitments to minimise the barriers to supplying digital services between the UK and the EU, supported by regulatory cooperation. Currently this is achieved through the EU's General Data Protection Regulations (GDPR) introduced in 2018, on transferring data to third countries, which the UK continues to follow during the transition period. However, agreeing this is likely to be difficult because digital data flows, by definition cross borders frequently, often in new forms and are hard to quantify. These challenges are reflected in the fact that CETA does not include cross-border data flows or personal data protection rights associated with GDPR.

Once the UK leaves the EU, in order to continue to be allowed to transfer data into the EU, the UK will require an 'adequacy decision' by which the EU deems the UK's data regulations equivalent to those in the EU. Because the UK Data Protection Act 2018 implemented the GDPR into UK law, some have assumed it will be relatively straightforward for the UK to be judged adequate.

However, the Commission applies rigorous testing of a third country's data protection to assess whether it is of an equivalent level, and previous assessments have taken between 18 months and five years to complete which, if repeated at the end of the transition period, could lead to considerable uncertainty for businesses.

Before this assessment is completed, or in the event of no deal at the end of transition, data transfer for British companies with the EU will become much more complex, costly and technically demanding. For instance, organisations based in the UK which offer goods or services to EU citizens in the EU will need to nominate a representative in each of the EU member states in which they export. This representative needs to act as the Europe facing point of contact for individual customers and local data protection authorities. This is likely to be particularly challenging for small and medium sized companies who will

lack both the financial and human resources to support this sort of additional compliance activity.

Reaching agreement in this area is also made harder by the fact that the digital economy and its data flows are changing rapidly as the sector evolves, as [underlined](#) in the UK's negotiating mandate. This makes it harder to ensure that what is agreed is future proof and will remain applicable as new forms of data and their transfer are developed.

Logistics and haulage services

The logistics sector will be profoundly affected by the deal for trade in goods as it will have to reshape its business to accommodate the reintroduction of border controls.

The dominant mode of transport for UK freight is road with UK hauliers currently accounting for [8%](#) of the EU total haulage activity. It is not surprising, therefore that there is a chapter dedicated to international road transport in the UK's draft agreement.

The UK wants an agreement that allows liberalised transport services to continue with the EU. The EU accepts that it has no say on the rules the UK applies to domestic haulage. The UK is seeking a 'liberalised market' for road transport between the UK and the EU that allows UK and EU operators to provide services in each other's territories without quotas, using the recognition of authorisation for operators in either the UK or the EU. The UK cites its proximity to the EU as a reason for requesting this degree of access because it would allow more efficient haulage route planning that could lead to environmental benefits.

Whilst the EU's trade deals with Canada and Japan do not provide a template in this area, the EU does have a bilateral road transport agreement with Switzerland. This agreement liberalises road and rail transport between the EU and Switzerland by, amongst other things, allowing licences to be mutually recognised between the two parties and harmonizing technical standards in haulage across the Swiss-EU border.

Without a similar agreement in place, a basic issue facing haulage firms in the event of a no-deal outcome is that UK driving licences will no longer be recognised by EU member states and drivers will therefore need to apply for international driving permits to undertake cross-border assignments. These will be required for driving through EU and EEA countries. The European Conference of Ministers of Transport (ECMT) permits are limited in number and the UK's Road Haulage Association (RHA) has warned that the number of available permits currently '[falls woefully short of what is needed](#)'. There are particular concerns about the number of permits that would be needed for the Northern Ireland–Republic of Ireland land border where it is [estimated](#) that around 12,000 haulage vehicles cross the border each day. The question of permits is not addressed in the government's plans for the implementation of the Northern Ireland protocol, set out in May 2020.

The wider UK logistics sector is a services sector that relies in part on EU nationals for its workforce. Currently, [13%](#) percent of the UK's logistics workforce is made up of EU nationals. These workers are particularly important because the number of UK workers employed in logistics has been falling in recent years. As a result, the Freight Transport Association [notes](#) that the UK is facing a driver shortage of 59,000 alongside a driver shortage of 21% across Europe. The sector has therefore been reliant on freedom of movement within the EU to try to address this shortfall. However, the UK's proposed immigration reforms are likely to exacerbate the recruitment issues faced in the sector as hauliers are unlikely to meet the minimum salary threshold being proposed.

Audio-visual sector

The audio-visual sector (including film, TV and TV-related businesses) is one of the services sectors where the EU and the UK appear farthest apart. In common with its other FTAs, the EU is proposing that the sector would be excluded from any deal with the UK. Meanwhile, the UK has [included](#) the sector in its draft agreement.

The UK's aim of including the sector within the negotiations reflects the fact that the UK has the largest audiovisual sector in Europe. Its gross value added in 2014 was [20%](#) larger than Germany's and 50% larger than France's. It is particularly developed in video on demand services (VoD), with 31% of the total EU market by value and 29% of subscribers. The sector employs over [200 000](#) people in the UK and has a £1.3 billion trade surplus with the EU. The UK hosts three of the top ten broadcasters in the EU (Sky, BBC, ITV). In addition to television, the UK is a strong player in the European feature film sector. It ranks number two (after France) for the number of film exports in cinemas and on TV, and number one for the film exports on VoD. EU countries' markets account for a quarter of UK-origin films' worldwide theatrical admissions.

The UK's audiovisual sector has successfully exported into the EU through the use of two main regulations. First, the Audiovisual Media Services Directive (AVMSD) is based on the principle of 'country of origin' and essentially means that a UK broadcasting license issued by Ofcom to a UK channel allows that channel to broadcast throughout the EU without needing to comply with any additional regulations in these export markets. The advantages for providers are that they only need to comply with Ofcom rules in order to provide audiovisual services in any EU member state. The UK draft agreement sets out a process through which Ofcom, as the UK's regulator, could be authorized by the EU 'without undue delay' such that a broadcasting licence issued by Ofcom would continue to be recognised within the EU's single market.

Without an agreement in this area, the UK will become a third country (the EU's usual short-hand for 'non-member state trading partner'), which means Ofcom will no longer be recognised under the AVMSD. As a result, the cost and complexity of exporting to the EU will increase as broadcasters and providers of video on demand services will need to ensure they meet the regulatory requirements to broadcast in their target export market.

The second piece of regulation is the Council of Europe's European Convention on Transfrontier Television (ECTT) which came into force in 1993. This convention guarantees that programming can be shared cross border via terrestrial, satellite and cable services but it does not include on demand – which did not exist in any meaningful way in 1993. As a signatory to the Convention, at the end of the transition period, the UK will still have the right to broadcast to the other 20 member states who have ratified it, but not through on demand services. This is important because the Country of Origin principle has made the UK an attractive location for the headquarters of global broadcasters who use this base to produce on demand content for the EU.

In theory, the ECTT would mean that UK audiovisual services would maintain market access to at least the majority of EU member states at the end of the transition period. This is because the ACMSD also insists on quota provisions to promote content produced in Europe or 'European works'. These provisions envisage that a majority proportion of broadcasting time will be dedicated to European works (excluding the time apportioned to news, sports and advertising). The AVMSD defines European works

as originating in an EU member state or a European state which has signed the ECTT. This means that content produced in the UK will still be classed as a European work when the transition period ends.

However, if the UK seeks to use the ECTT as a fall-back, it is limited in a number of ways. First, it does not include every EU member state. Belgium, Ireland and Denmark did not sign the Convention and Greece, Luxembourg, the Netherlands and Sweden have not ratified it. Second, VoD services are excluded from the scope of the ECTT. Given this is the medium that has the highest potential for growth, this is a major drawback for relying on the ECTT. However, an updated version of the AVMSD needs to be transposed into UK law by September 2020, in common with other EU member states, and this does include some provisions for VoD services. Third, there is no enforcement mechanism in place for the ECTT.

In [written evidence](#) submitted to the Culture, Media and Sport Select Committee, the Independent Film & Television Alliance has outlined the benefits of the EU single market and the consequences of no audio-visual arrangement. The EU is the second most important outlet for audio-visual exports. Over the period 2010 to 2014, UK export earnings in film services and royalties from EU markets was £588 million, which is 38% of total film export earnings.



Covid-19, Brexit and services

To agree all aspects of an FTA was already going to be challenging in a set of talks scheduled to last less than 12 months. By comparison, it took seven years to negotiate the CETA. The EU-UK trade talks also face a further challenge in that trade deals are usually struck by parties seeking closer, not more distant, trading relations. However, these challenges have been significantly increased by the outbreak of Covid-19 in the UK from March 2020 onwards.

It is too early to say how the size and shape of the UK's services sector will change over the longer term in light of the Covid-19 pandemic. But the initial economic impact has been severe: the UK services sector recorded a record contraction in April 2020 according to the IHS Markit/CIPS UK Services [purchasing managers' index](#) (PMI). The PMI for UK services in April 2020 was 12.3, after a fall to 34.5 in March (on the index, 50 means no change in economic activity relative to the previous month, and anything less than 50 signals economic contraction). This is the lowest reported figure in the survey since it began in July 1996 – the previous low of 40.1 was recorded in November 2008 during the financial crisis.

The Bank of England's Decision Maker Panel survey provides an early indication of the possible impact of Covid-19 on UK businesses across all sectors. Its latest results were based on a survey of Chief Financial Officers of small, medium and large UK businesses between 3 April and 17 April and show the significant impact on different parts of the services sector. It reports that on average businesses expect Covid-19 to decrease sales by 80% in the accommodation and food sectors and 37% in financial services. Signs of the longer-term impact of the virus can be seen in the equivalence figures for the effect on investment, which is expected to be 82% lower in the case of accommodation and food businesses and 45% lower in financial services.

The potential for a very significant Covid-19 impact on services during 2020 that coincides with the UK–EU talks on the post-transition trading relationship was reinforced by the Office of Budget Responsibility's (OBR) initial assessment of the possible impact of Covid-19 on the UK economy and public finances released on 14 April 2020. This [estimates](#) a decline in GDP of 35% in Q2 of 2020 followed by a relatively rapid recovery. For reference this is a sharper and deeper decline than during the financial crisis, World War Two, the 1930s recession and the outbreak of Spanish flu in 1918.

The OBR is estimating particular sharp declines in output in 2020 Q2 in accommodation, wholesale, retail and motor trades, education and other services as shown in Chart 7.

Chart 7: Output losses by sector in 2020 Q2

Sector	Per cent	
	Weight in whole economy value added	Effect on output relative to baseline
Agriculture	0.7	0
Mining, energy and water supply	3.4	-20
Manufacturing	10.2	-55
Construction	6.1	-70
Wholesale, retail and motor trades	10.5	-50
Transport and storage	4.2	-35
Accommodation and food services	2.8	-85
Information and communication	6.6	-45
Financial and insurance services	7.2	-5
Real estate	14.0	-20
Professional, scientific and technical activities	7.6	-40
Administrative and support activities	5.1	-40
Public administration and defence	4.9	-20
Education	5.8	-90
Human health and social activities	7.5	50
Other services	3.5	-60
Whole economy	100	-35

Source: OBR Reference Scenario

Beyond the economic impacts of the pandemic, Covid-19 has also impacted on the UK–EU talks scheduled for 2020. Both the EU and UK chief negotiators had to self-isolate because of illness, and talks have moved online. This has led to [calls](#) that it would be sensible to extend the transition by up to two years, as permitted within the Withdrawal Agreement, or implement a period of adjustment at the end of the transition period, if a deal is agreed, to give business the time to plan for the significant changes any deal will bring to the services sector.



Conclusions

As this report makes clear, the UK economy relies heavily on the services sector and the services sector relies heavily on the EU's single market, both for exports and for labour. At the end of the transition period, with or without a deal of the kind being sought by the UK, our services sector is likely to be smaller and differently structured, with implications for wider economic growth. As we discussed, estimates suggest that the value of services exports, for example, could decline by as much as 8% in a no-deal scenario.

This is likely to have a range of different impacts across services, reflecting the diversity of the sector itself. For some businesses, such as financial services, the impact on their EU markets could be such that it makes more sense move parts of their business to European financial centres such as Dublin and Paris. For other sectors that rely on low-waged EU labour, such as food businesses and hotels, the end of the transition period could bring with it labour shortages as EU nationals are unable to travel to the EU to work because they do not meet the salary threshold set out in the government's post-Brexit migration regime.

It will also affect different parts of the UK in distinctive ways. For example, in terms of services, the issues of permits in the haulage industry will be a central concern for Northern Ireland whereas London will be focused on the impacts on financial and related business services.

There is no certainty as to whether a deal will be agreed and when it will be implemented as the Covid-19 pandemic has heightened calls that the transition period should be extended to acknowledge the difficulties of undertaking negotiations during the pandemic.

A key question remains as to what a deal might look like for the services sector. In some ways, the UK's draft agreement mirrors FTAs already agreed with the EU. However, this does not guarantee an agreement, far from it. There are significant differences between the size and scope of UK-EU trade as compared to that with Canada, which will understandably make the EU cautious in replicating the Canadian agreement with such a close and large trading partner as the UK.

In other areas, such as professional services like law and architecture, the UK is asking for more access to the single market than the EU has granted other countries. However, even in these areas, it is important to note that this does not replicate the UK current trading relationship with the EU. This has led some to argue, in parts of the City of London, that there could be advantages in seeking complete regulatory control without any preferential single-market access as would be expected within an FTA.

The government is also focused on using regulatory autonomy to develop other global markets for UK services, particularly the US. The US is already the most important single country for services exports from the UK, making up 21% of the total in 2019. However, the modelling contained within the government's plans of US - UK trade negotiations estimates that a US - UK trade deal would only increase the UK's long-run GDP by significantly less than one percent, which would not go very far to make good the loss to GDP from leaving the single market. This was [estimated](#) by the 2018 government to be between 3.4% and 6.4% if a modest free trade agreement with the EU was secured and between 6.3% and 9% in a no-deal scenario over around 15 years.

The negotiations have been given added urgency because of the ways in which some parts of the services sector are being ravaged by the economic fallout of the Covid-19 pandemic. This health crisis also raises important questions about how international trade will develop in the wake of the virus. For some services activities that rely on in-person delivery, like touring artists and bespoke, high-value services in architecture, the ability to deliver online for a prolonged period of time is limited and the impacts are therefore likely to be long lasting.

Businesses in the services sector are already planning for a future outside the single market, and the government has plans for a different orientation for services beyond the EU's regulatory orbit. Much remains uncertain about the direction these processes will take. Our analysis provides a framework for thinking through what the different issues and implications are likely to be. It shows that it is hard to overestimate the ways in which Brexit, either with or without an FTA is likely to change the UK's services sector in important ways, even if not all of these changes become clear immediately.



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