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Treasury Committee

Oral evidence: The UK's future economic relationship with the European Union, HC 483

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Watch the meeting

Members present: Andrew Tyrie (Chair); Steve Baker; Mark Garnier; Stephen Hammond

Questions 162-246

Witnesses

Hosuk Lee-Makiyama, Director, European Centre for International Political Economy, Dr Richard North, Political Analyst and Shanker Singham, Director of Economic Policy and Prosperity Studies, Legatum Institute.

Examination of Witnesses

Witnesses: Hosuk Lee-Makiyama, Shanker Singham and Dr Richard North.

Q162 **Chair:** Thank you very much for coming to give evidence this afternoon. All three of you are experts in your field, to put it mildly, and you come to the subject from different angles. Can I begin with something that the director-general of the WTO, Roberto Azevêdo, has said? "It is very likely that both the EU and the UK will have to negotiate with all WTO members." He also said that the UK's legal rights at the WTO could find themselves in what he described as a "vacuum". It is important that we get to the bottom of what this means. Many people have taken it for granted that we will go straight into the WTO as soon as we have left the EU—that this will be a seamless transition and we will have a seat at the WTO. It is important to establish that all those things are correct. Can I start with you, Mr Makiyama? All of three of you have vast experience in this field.

Hosuk Lee-Makiyama: Certainly. First of all, thank you for this opportunity to address the Committee. To the Chair's question, the UK is a member of the WTO and also a signatory to almost all of its agreements, whether they are formal or informal. In that respect, the UK already exists in the terms of the WTO; however, its commitments go through the European Union, which means they need to be either replicated or separated from the existing EU commitments. Technically speaking, it is not a major endeavour in terms of drafting. We have certainly had other countries—non-EU countries—joining the EU. In the end, however, the political process has taken several years: the incorporation of Bulgaria and Romania took five years, and that is basically aggregation of existing commitments that Bulgaria and Romania already had with third countries that had to become EU commitments.

Separating entails a few things: first, where there are EU-wide commitments, for example in agriculture on quotas, they need to be separated. We are talking about tonnage of imports, so for example dairy products or beef that the EU has agreed to import from other countries that allow lower tariff rates for imports from other countries. They need to be separated to UK and EU commitments.

Similarly, in the area of services, for example, the UK needs to create its own services schedule in what area of services trade it will allow open trade with the WTO members. In terms of drafting, this is probably an exercise that can be done fairly quickly. In the end, everything in the WTO has to be agreed under what is called single undertaking: all the members of the WTO must agree to the terms. It only takes one country to have one objection against the EU or the UK to disqualify any agreement.

Q163 **Chair:** Does that mean that the EU could, if it wanted to, block a seamless transition of the UK from its current status—which is that it has subordinated its negotiating position to the EU in the WTO—to the position where it is a full and active participant with a seat?

Hosuk Lee-Makiyama: Certainly, the EU could do so.

Q164 **Chair:** The EU could do so.

Hosuk Lee-Makiyama: Yes, but the main concern is not the EU. It is more like a divorce settlement that needs to be agreed and ratified by the rest of the world. In this negotiation, it is more likely that the EU and the UK will be sitting on the same side of the table. Whatever we agree for how these agriculture quotas should be separated must then be agreed by the rest of the world.

Q165 **Chair:** As a percentage, what do you think the chances are of us facing this difficulty in practice as a country and finding our accession, in a sense—our taking of our position, with full rights in the WTO—inhibited or blocked?

Hosuk Lee-Makiyama: It is difficult to talk about a certain percentage point, but I would say that it is likely that it could be agreed with the rest of the world.

Q166 **Chair:** It is likely that it will be agreed with the rest of the world.

Hosuk Lee-Makiyama: Yes.

Q167 **Chair:** It is more likely than not.

Hosuk Lee-Makiyama: Yes.

Q168 **Chair:** I am sorry to interrupt. The scenario that we are discussing, then, is an unlikely risk. If it is likely we will get a deal, this is an unlikely risk.

Hosuk Lee-Makiyama: It is likely because there is a strong commitment to the WTO system still.

Q169 **Chair:** Do you mean it is likely that we will get in quickly, as we want?

Hosuk Lee-Makiyama: Exactly.

Q170 **Chair:** Is it more likely than not or very likely, since you do not like percentages? Are we wasting our time here discussing this? Is this just a remote possibility that we should move on from, and is Mr Azevêdo throwing up a remote concern or is he throwing up something that should give us a good deal of worry here in Parliament?

Hosuk Lee-Makiyama: Let me put it differently. It is likely not only because of the collective self-interest of the WTO membership but also because the necessary concessions that will be required by the EU and the UK to get these divorce terms ratified by the WTO membership will be paid. It is largely in the area of agriculture where the EU has made bilateral commitments in beef, sugar, dairy products, and it is in the end the question about tonnage.

Q171 **Chair:** From another perspective, we might end up taking evidence on that in more detail. We will see. Mr Singham, is there anything you want to add?

Shankar Singham: First of all, the UK was a founding member in the GATT system prior to the WTO, so there is a history there that is sometimes glossed over. I agree with what was just said. The answer to your question is going to depend on precisely what services schedule the UK comes up with and also the ability to provide other schedules where there are benefits the EU is not able to offer. For example, if you look at the EU's tariff schedule, there are certain areas where there are very high tariffs, in trucks, tractors—things that you would not necessarily expect to have high tariffs.

I was involved in the Hungary accession to the European Union, and when Hungary acceded to the European Union, its tariffs were lower than the European Union common external tariff, so Hungary had to pay compensation to other WTO members. There are precedents for this. It does present an opportunity for the UK to provide a better-than-EU services schedule. The UK is relatively open in the services area; services trade is very important to the UK. How other WTO members look at this potential WTO process for the UK is largely going to depend on the kind of offers that the UK is making. For those reasons, I would say that the likelihood of the UK being frozen out in some way or having some WTO member cause difficulty is quite low.

Q172 **Chair:** Okay. Is there anything you want to add, Mr North? Before you get going, I know that you were due to come before another Committee earlier this year that, for reasons I will not go into, at the very last minute told you were not required. You then said: "[The Committee] has no credibility outside its own circle and is just another symptom of the decay of Parliament as a meaningful institution." You then carried on that you wanted to place on record "this cowardly behaviour by a committee of MPs who obviously lack both manners and the courage to address me personally, and skulk behind their staff, getting them to do their dirty work. It is a measure of these loathsome creatures, however, that they don't even have the self-awareness to be ashamed of their own behaviour." I only wanted to put that on the record to say you are very welcome to give evidence to this Committee and we are looking forward to hearing what you have to say. This issue, or whatever it was, for the purposes of this hearing we should set aside completely.

Dr Richard North: Thank you. That is appreciated. May I register my thanks that you are prepared to listen? I hope that it will be worth your while. First of all, the WTO agreement is a treaty. It is an international treaty, and therefore it is subject to the Vienna Convention on the law of treaties. There is nothing the EU or any other party can do to exclude the United Kingdom from full membership of the WTO. That is not on the agenda. Furthermore, within that framework as it stands, the requirement within the European Union is that we agree a common position on WTO matters right across the board and that variously different member states—usually the Presidency—will represent us or represent the common position. Therefore, once we leave we will once again return to the point where we speak for ourselves and are able to vote for ourselves. That is a clear advantage.

There is a distinction and, quite rightly, the point raised about agriculture is a very serious one and one that has not been properly addressed. When it comes to the Doha Round etc. on the negotiation of quotas and also subsidies, and subsidy caps, these are held not by individual member states but by the Commission. Therefore, theoretically, when we leave we will not be able to subsidise our farmers unless we negotiate a settlement with the EU as to an apportionment of the subsidy cap.

Likewise, on quotas, the quota is held by the Commission, and therefore there will be a negotiation. One can imagine a trade-off where some of the member states will be quite anxious to offload as much quota, say beef quota, as they can on the UK as a condition for our exit. We would find ourselves unwillingly forced to take that as a quid pro quo for other concessions. This is an area that is quite possibly going to be time-consuming. If you remember, in the 1970s we spent months discussing minor details on butter quotas, butter subsidies and butter tariffs. This is the sort of detail that the EU excels in. This could have a very serious impact on the progress and the conduct of the negotiations taking an inordinate amount of time.

There is a third element, which is tariffs. We have two experts sitting here. A point that needs to be addressed is what levels of tariffs will the WTO permit us to set, bearing in mind there is very little history now of previous tariffs and, of course, tariffs have changed? When we sit back and we start re-establishing our own independent tariff structure, that seems to me something that is going to have to be negotiated both with the EU but also with the WTO in order to achieve a settlement at the time when we leave.

Q173 **Chair:** It seems that you are not disagreeing with the conclusion there is the possibility that shenanigans take place that prevent the UK from taking up its position when it leaves the EU.

Dr Richard North: Very much—on agriculture.

Q174 **Chair:** It seems the possibility of there being shenanigans that would prevent us from taking our seat is remote or, at least, unlikely—that it is likely that the collective will of the WTO will prevail. Therefore, this theoretical blocking power or opportunity around states will not be taken. It is important that we have that point on the record. What we have been discussing is how we establish a new relationship with the WTO in outline.

There are three other issues: how we create a new relationship with the EU; how we negotiate trade deals with those countries that the EU already has agreements with, of which there are 53; and negotiations and opportunities for trade deals with countries outside of the 53, some of which are very important, such as the US, Brazil, China and India.

We are going to get into more detail in all of these in a moment but, again, moving from left to right, perhaps I could ask you one more question, which is: how would you describe or summarise the approach that would be most beneficial for the UK to take as its negotiating position—the position that it would like to end up with on the spectrum, from just relying on WTO rules at one end to something that has many of the features of membership—"EEA plus"—at the other? Could I start with Mr Makiyama? What do you think is most likely to be in the UK's interests?

Hosuk Lee-Makiyama: If we look at the WTO relationship, as well as the future relationship with Europe and also with third countries, it is very important to bear in mind that they are functions of each other. There is no mutual exclusivity between them necessarily. Also, in terms of negotiation sequencing, I firmly believe that they will overlap in time. The actual delivery of each of these products will be on a separate timeline but, in the end, it is important to bear in mind that you can probably not have a firm WTO commitment without having an idea of what our future relationship with the EU will be, because our WTO commitment will be a product of the Article 50 negotiation with the remaining EU members.

Q175 **Chair:** We are going into those negotiations and we are going into negotiations with the EU. I admit that we are examining a multi-faceted problem. We have no choice but to come to a view about where we want to put each piece and where we want each of these issues to end up. Perhaps you could give me your outline as to what we ought most appropriately to bid for.

Hosuk Lee-Makiyama: Let me start with the question of the future relationship with the EU, because I think that is what the Chair's question is alluding to. Would it be sufficient to have a WTO relationship? Absolutely not. You could say that the WTO commitments are basically the terms that you would have with any third country that you practically have very little integration with.

It is very important to bear in mind that the UK does not necessarily have a trading relationship with Europe; it is basically an integral part of the European market regardless of what the treaties look like. The relationships, the supply chains and the economic exchanges go far deeper than a normal WTO relationship. I do not want to call the WTO commitments superficial but they are more of a life insurance policy or worst-case scenario rather than actual market liberalisation per se. They are subject to great trade diversion from bilateral agreements, and thus you could say that the WTO commitments today function more as a least possible level of decency as to how two trading entities should behave with each other. If 50% of the UK's trade is with Europe, you cannot have those terms imposed upon it.

Q176 **Chair:** That is because, in the unravelling of those single market relationships with this deep integration of supply chains, the UK will suffer a net economic loss.

Hosuk Lee-Makiyama: Yes.

Q177 **Chair:** Do you have any evidence to support that?

Hosuk Lee-Makiyama: There is plenty of economic evidence in terms of what the WTO terms mean in terms of real market access or suppliers' access and what types of trade diversion we have seen in past liberalisation.

Q178 **Chair:** You are now discussing what the WTO benefits are; I am talking about what the current EU benefits are of close access to that single market.

Hosuk Lee-Makiyama: There is certainly empirical evidence of what happens if the tariffs are increased because there are countries that have tried to impose newer tariffs or taxation as a substitute for tariffs and various types of unilateral discriminatory measures that could very closely approximate the type of trade shock that we will be looking at.

Q179 **Chair:** Are you talking about non-tariff barriers in service trade?

Hosuk Lee-Makiyama: It is both. There are several examples of countries imposing trade barriers that could closely replicate what we will face if we return to WTO terms with the EU.

Q180 **Chair:** I understand. You have answered one leg of my three-legged question. What about the other two?

Hosuk Lee-Makiyama: Let me put it this way: if the WTO terms are not on this basis, the question is about the EEA. There have been several questions around the "EEA minus", if that exists. There are several theories around whether that could be the case, and I am sure that we will hear some of them. However, in the end, we have to bear in mind that the EU, particularly today, is a special type of construct. It is a sui generis entity that will negotiate a sui generis exit, which means that there are no precedents.

Q181 **Chair:** Exactly, so what I am asking you to do is not to worry too much about whether we should take the Turkish model with its solution to the rules-of-origin problem or the Norwegian model, which leaves it with a rules-of-origin problem, off the shelf. I am asking you now, conceptually, to construct what you think we should ask for.

Hosuk Lee-Makiyama: Obviously the model that is closest to the current stable relationship would be the most beneficial. I do, however, understand that the political realities in the United Kingdom might be different. The question is: in this two-way negotiation between the EU and the UK, will an "EEA minus" deal be acceptable? My answer is "no". It is not in the interests of the remaining EU members to accept something that deviates from the EEA template. It has signalled so strongly and it is almost in the existential interest of the remainder of the EU to set an example with the terms. Any EEA offer that will be put on the table will be based on the existing template and come at a very high cost: i.e. a major budgetary contribution that far exceeds what Norway is paying in its current share of GDP.

Q182 **Chair:** That might cost us a lot but it is also going to cost them quite a bit, isn't it? We will suffer a GDP shock—that is what you have just said—and that will mean a drop in demand for EU products.

Hosuk Lee-Makiyama: Indeed, it goes both ways.

Q183 **Chair:** You are talking about penalties and the demonstrative effect of penalties; and what you are really saying is that they would be prepared to do something that is not in their best economic interest. We are in the realm here of political economy rather than economics.

Hosuk Lee-Makiyama: Certainly. The EU is a product of intergovernmental political economy. Perhaps it is an interdependence and there is certainly leverage from the perspective of the UK as well as the EU where, for example, the UK has a leverage in terms of procedure and timing, and it remains in charge of the process, while the EU is in charge of setting the price.

Q184 **Chair:** I understand. I am going to move the answers on, if you don't mind, Mr Makiyama, just for the time being. These are not the sunny uplands that I was hoping to hear about this afternoon, so I am hoping for better luck from Mr Singham.

Shankar Singham: Chairman, you have asked a complex question, and the way to look at this question is from the perspective of UK interest and UK industry and so forth. We should make the point at the outset that a disproportionate level of UK exports is in services and the great strength of the UK economy is in services; and it is in services precisely where regulatory barriers and NTBs and so forth play a very big role. Many of those barriers have not been solved within the European Single Market yet.

The UK will be involved in a number of negotiations. They do relate to each other and therefore have to be conducted at the same time. The notion of sequencing does not play a role here. From the perspective of a trade-negotiator, which some of us are or have been, you want to have as many things going on so that trade-offs can be made, because there will be trade-offs made.

As the negotiating process goes forward, commercial interests start to play a bigger role. You are hearing a lot of political statements now from the WTO Director-General and a number of other players, but those statements will become less and less relevant as time goes on. The notion of, for example, the importance of the City of London as a deep capital market will become of more importance—that nothing interferes with that for, for example, the German car industry or major producers all over Europe. These kinds of dynamics will come into play in any negotiation.

That being said, what should we be trying to do? Clearly, for reasons that were alluded to before, untrammelled access to the Single European Market is important for the UK economy; but we need to differentiate between being inside the single market and having access to the single market. From a negotiating standpoint, access to the single market is very important. There will be a price to pay for that, and we can talk about free movement of people and free movement of labour; but prices will be extracted for that kind of access.

Q185 **Chair:** There is something rather curious about immigration criteria being attached to what is essentially a trade relationship. After all, we trade with the United States but they do not tell us what our rules should be on US immigrants. The trade deal should stand or fall by whether it is of benefit to each party. If there are mutual gains—this is the theory of comparative advantage—the deal should go forward. Therefore, there is something a bit odd, if one is no longer part of a community, in attaching more broad-based conditionality. Have I missed something?

Shankar Singham: In a traditional trade goods agreement, for example, movement of people and labour would be irrelevant.

Q186 **Chair:** Or even in a more sophisticated services agreement.

Shankar Singham: The WTO GATS agreement, for example, has mode 4 commitments on the movement of people, but that is really the movement of labour; and countries make commitments specifically in those things. The notion of the movement of people is not alien to a trade agreement but it is the final frontier once you have much deeper integration. Therefore, the more integration you want, the more it is going to become an issue. If you wanted to simply be part of a European free trade area—just tariffs, access and goods—it may not be a major issue.

Q187 **Chair:** What is your preferred package? Mr Makiyama is saying that we are in deep trouble because we have to try to replicate, as far as possible, EU arrangements or else suffer an economic hit. You are saying something slightly different, I think.

Shankar Singham: Yes. You have to look at this in the round and you have to look at what is on offer and what the UK can do. I would look at that across lots of different dimensions, and the first dimension would be our negotiation with the European Union, which should be an access to the single market negotiation. That should be our goal because, for all the reasons that the previous witness mentioned, not having access to the single market would be, in itself in a vacuum, an economic hit. However, there are other things that we can also do, and one of those is to move towards deeper agreements with countries that essentially subscribe to ordinary notions of international trade: competition on the merits as an organising economic principle and property rights protection.

These would be the countries that have been talked about—there is no magic to this—such as Australia, Canada, New Zealand, the US and so forth.

Q188 **Chair:** That rules out the Turkish style arrangement because we cannot go down that road due to the rules-of-origin problem.

Shankar Singham: If you are within the single market, you cannot negotiate these other agreements as a sovereign country; so it does have to be weighed. What is the value and what is the likelihood of being able to negotiate these other agreements?

Chair: We will end up having to agree with having to put the tariffs up.

Shankar Singham: You will be part of the single market so you will have to negotiate as the single market does and be part of the European Union's negotiations with other countries. You would be part of the TTIP negotiation, for example. You can do that and you can look at the other areas of benefit for the UK as a result of this. Depending on the results of the EU negotiation and the WTO negotiation on agriculture and precisely what happens to the Common Agricultural Policy, we might be able to do something more with the Commonwealth countries, particularly on agriculture in terms of potentially even a free trade zone across certain types of Commonwealth countries.

Then you can look at the UK's competitiveness domestically. There is a range of economic regulation that, if the UK is not part of the single market, it would have to implement, such as different anti-dumping regulations, different competition rules, different sanitary and phytosanitary measures and the REACH chemicals regulation, which the UK would no longer necessarily be under. You have to look at all of this and see where the benefits are. It is critical to make sure that we have the negotiating structure and the negotiating machinery that enables you to do all of these things; because, if you simply limit it to a negotiation with Europe and make that the driver of this whole process, there is lots to lose and not very much to gain. Whereas, if this is a much broader opportunity, including, critically, the improvement and competitiveness of the UK economy in terms of a better and more pro-competition regulatory environment, there are very different opportunities that are in play.

Q189 **Chair:** Maybe it would be helpful if you could jot down on one or two pieces of paper the main outline of what this negotiating position might be. I am sorry that these opening exchanges have taken a lot longer than I thought but this is a multi-faceted and very complex subject.

Dr Richard North: Mr Chairman, there are basically three broad heads: the WTO option; an ab initio free trade agreement; and variations on the EEA option—the so-called Norway option is better called an EEA option—and the distinctions there between an "EEA plus" and an "EEA minus". I quite agree with my colleagues that the WTO is a complete non-starter.

It should not ever have been on the agenda. It is a workaround that goes with other agreements.

Q190 **Chair:** Great luminaries such as Nigel Lawson and other experts said we should fall back on WTO rules. That is all for the birds, is it?

Dr Richard North: I could not be more emphatic on this: it is a complete non-starter. It is difficult to use the word "access": you are either in the single market or you are not in the single market. You do not have access to it. You have access to the markets of the member states if you are outside the single market, but you are either in the single market or you are not. If you are not in the single market, not only do you have to have regulatory convergence but a specific and special aspect of the single market is the assumption of conformity. In other words, not only do you conform but it is assumed that you conform, hence the CE mark and all the other systems that go around that.

The moment that you step outside the single market, you have the burden of what is known as "proof of conformity". If you become a third country, that requires, at the border, demonstrating proof of conformity. That is a different system and that means that, if you do not have a recognised system for proving conformity, which you will not have if you rely on a WTO agreement, your produce is automatically detained until such time as you have gone through approved checks—which can take several weeks and cost thousands of pounds per consignment—which means that, the day after we leave the EU, Operation Stack goes into effect in Kent and, by the end of the week, the M1 slow lane is turned into a lorry park.

Q191 **Chair:** Is this the argument against pressing Article 50—our counterparties will know that Operation Stack is then only two years away? They are going to think to themselves, "We will just wait until we are in a much stronger position and the motorway system in the South East of England has seized up"?

Dr Richard North: It is a non-starter.

Q192 **Chair:** Therefore we cannot afford to press the Article 50 button until we have some idea of what the exit route is going to be towards something that is more than just WTO rules.

Dr Richard North: I would tend to agree, but I would modify that.

Q193 **Chair:** I am trying to summarise what you are saying. I am not bringing a view of my own.

Dr Richard North: Basically, the WTO is a non-starter.

Q194 **Chair:** This is the Patrick Minford view as well, as I recall.

Dr Richard North: I am glad we agree on something. The other point that has already come up is the idea that we do not have trade agreements, say, with China, the United States or Australia; but we do. There are 38 trade agreements registered with the United States on the Commission's website, which you can check for yourself. The fact is that they are not trade agreements registered with the WTO on tariffs, but they are nonetheless trade agreements and they do facilitate trade to an enormous extent. There are 65 registered agreements with China, including co-operation agreements and a whole range of multilateral and bilateral agreements related to change.

Now, a crucial part of this to gain access to member state markets is MRAs, but MRAs not on regulatory issues but on conformity assessment. This is an absolutely crucial distinction, which means that we agree on regulatory conformity but then we agree to recognise each other's systems to attest that the produce conforms with the regulation in order to get access at the border. Without those, there is no trade.

Chair: We are in danger of losing the thread, wood for the trees and all that. We will move on from general questions now.

Q195 **Stephen Hammond:** We have touched on some of the issues that I was going to touch on, but we are clear now on the views with regard to the WTO. Can we also be clear, therefore, that all of you are saying that we should not pursue unilateral free trade on the WTO rules?

Dr Richard North: That has got my vote.

Shankar Singham: I do not think any of us would want to leave you with the impression that the WTO accession for the UK is a done deal and would not be challenged. It is a process and one that will start at this time. Whatever position the UK has in the WTO will be dependent on the final round of the negotiations with the EU.

These processes are all going forward. It may well be that the UK's position should be to make significantly better offers within the context of the WTO, both on tariffs and on services. That is part of the negotiating process. The difficulty here and the difficulty of looking at very specific models—the Norway model or whatever model it is—is that we do not know what the ultimate outcome is going to be. There is some uncertainty in that whole process. It depends on how the negotiations go forward.

What you do at the outset of any trade negotiation is maximise the possibility of the best deal that you can get based on the different things that you have in play. Very famously, countries like India always complain that the EU's negotiation adds all kinds of things because they want to armour-plate the CAP. It is a negotiating strategy. We should also be firmly in that role. That is the only thing I would say as a wrinkle to the WTO. Certainly, I would agree that WTO-only would not be a good outcome for the UK.

Q196 **Stephen Hammond:** We have talked about tariffs and tariff barriers. What about some of the non-tariff barriers and what is our ability to negotiate those away so that we can have freer trade?

Dr Richard North: Can I possibly point out one thing here? There is a slight cart before the horse here. The Article 50 negotiations are time-limited to two years with an option, requiring unanimity, that we can extend them onwards. Standing at this side of the negotiations, before we decide what we are going to go for, we have to decide how much time we are going to have.

Q197 **Stephen Hammond:** We have had unanimity from our previous witnesses that it is in the United Kingdom's interests to have as long a period as possible prior to triggering Article 50.

Dr Richard North: But what we are seeing in real politics is an enormous level of distrust within the country that is not going to tolerate a long delay before we see Article 50. On the other hand, you have options within options.

Q198 **Stephen Hammond:** I take your point, but the other realpolitik of that is that, if that allows us to set out, on a year's view before we trigger it, the negotiating stance that we are likely to take, that is clearly going to be a better overall option.

Dr Richard North: There is another option, which is that we go into the negotiations and put on the table a time extension before we even start. That is a novel way of doing it. It was always thought that we would run the negotiations, run out of time and then negotiate for extra time. However, the White Paper points out that that puts us in a very vulnerable position because there is all sorts of leverage; but if we go in with no leverage and say, "We have leverage because you, the community, want us to start the negotiations early and we will do that on the condition that we immediately put on the table an extra three years"—and take time off the table—that will allow us to properly focus.

Q199 **Stephen Hammond:** Does anyone else think that is a realistic prospect?

Dr Richard North: It is possible.

Stephen Hammond: It is possible but, in the world of realpolitik, that is equally unlikely.

Shankar Singham: Generally, in any trade negotiation, you do not want to immediately put all your cards out on the table. As you go further along in the negotiation, there is a lower likelihood that somebody is going to say, "In two years plus *X*"—*X* being the period between now and whenever Article 50 is invoked—"no, we are going to close the door." There is too much at stake. There is too much commercial interest at stake—not commercial interest in the UK but commercial interests in Germany and France and all over the European Union—that will prevent that happening. Every trade negotiation has a time-limited period to stop within and ends up blowing past the time-limited period because it is in everyone's interest for a negotiation to be concluded. This is why the German industry said the day after the referendum it would be foolish to not give the UK at least a free trade agreement, because German industry would suffer as a result. That is what I would say about the timing of this.

You asked a question, Mr Hammond, about non-tariff barriers. If you look at the world, starting with the WTO, the WTO deals very well with tariff barriers and goods market access. It deals much less well with services access. In the WTO, services access is a positive list. Countries put their services up for negotiation. If you look at the services schedules of most countries, including the EU services schedule, they are fairly weak. In many countries' cases, they are non-existent.

The UK's major industry is services. It is very important for us to get this right. This is why in other agreements, such as bilaterals, plurilaterals and so on, services become a much bigger issue. If you look at the NAFTA agreement, for example, services is negotiated in NAFTA on a negative list basis, which means that all services are liberalised unless you put something on the table and say, "We are not liberalising that service." The NAFTA agreement is one of the better trade agreements around the world, even though it is one of the older ones.

The WTO does not deal well with the issue of regulatory barriers or non-tariff barriers. I am using non-tariff barriers not in the technical WTO sense of quotas but in the sense of behind-the-border barriers and regulatory protection. It does not deal well with those issues. Increasingly, other trade agreements have dealt better with those issues. The WTO is only now looking at the agreement in services, which is a plurilateral agreement that countries will accede to. This will take a long time.

The EU, when it has negotiated the 50 agreements, those do relatively better than the WTO on services, but you have to remember that the driving interest of the EU in those negotiations are French and German. There is a disproportionate manufacturing interest in the access there. The UK's interest is services; getting rid of regulatory protection and regulatory barriers and things that affect the services industry are much harder for countries to give than tariff concessions. They are much more likely in an EU negotiation with other countries to give or to get tariff concessions than to get what the UK truly needs. Therefore there is an area where the UK can get better agreements because it has less defensive interests.

Q200 **Stephen Hammond:** You regard the scope of positive regulatory arbitrage for UK services as very limited.

Chair: No, I think you are saying the opposite. Sorry to interrupt.

Q201 **Stephen Hammond:** If I heard you right, you were saying that they would be less likely to offer that than they would be to offer tariffs.

Shankar Singham: Yes. It is much easier to offer a tariff concession.

Q202 **Stephen Hammond:** They are not likely to offer the regulatory concession.

Shankar Singham: They have not.

Q203 **Stephen Hammond:** My question is, then, what are the opportunities or what is the likelihood of being offered that regulatory concession to allow UK financial services to stand apart?

Shankar Singham: It is not necessarily just a financial services question. It is overall regulatory. There are very specific issues in financial services that I am sure we are going to get to. With respect to the non-tariff barriers and the regulatory barriers, you look for like-minded countries that have similar kinds of economies. They do not have to be geographically close to you.

Those countries are the countries that are more likely to give you the kind of free trade agreement plus regulatory pro-competitive agreement. Essentially what the UK should be looking for, and what the services industries do generally look for, is open trade, competition on the merits as an organising principle, and property rights protection. This is why we have suggested this prosperity zone where you would have essentially the countries that self-select in this area. These are the countries that have already started to talk about this, like Australia, New Zealand, Canada etc. You can get more with that grouping of countries on non-tariff barriers that you would get with, say, an India, or a China, or even the EU. You have that approach with respect to those countries.

Then you have another approach with respect to the big BRIC emerging markets, the Indias, the Chinas, the Brazils and so forth, where you do not expect very much in terms of dealing with non-tariff barriers that affect industry. You have the same approach with respect to access through the European Union. You get as much as you can on a reduction of non-tariff barriers there as well, which is what the US is trying to get in the context of TTIP—and not succeeding in getting.

Q204 **Stephen Hammond:** Some of the non-tariff barriers in trade, as opposed to services, effectively just allow one to trade, because there are standard that operate round the world, so the scope for deviation off those, if one wanted to, in any arrangement is limited as well.

Dr Richard North: There is none. There is no scope for deviation. You either have regulatory convergence and conformity or you are not allowed in. It is as simple as that. The question is how we could even negotiate that access.

Hosuk Lee-Makiyama: Just very briefly, on Article 50, anyone who has negotiated anything, especially international treaties, knows there are no such things as artificial deadlines. As long as there is a collective interest to come to a conclusion—and especially if you are dealing directly with the EU member states, France and Germany in particular—the deadline is nearly irrelevant. The fact that we would have a scenario that we would snap back to a WTO non-preferential arrangement of trade between the UK and the EU is a sign of failure in itself, meaning that there was no interest or extremely poorly communicated interest of a commonly beneficial outcome. I would say that very briefly about Article 50.

When it comes to the question about the NTMs, there are a couple of other points I would like to add. It is true that there is a changed burden of proof of evidence in regard to whether you are conforming or not once you are outside the EU. However, not all standards are set by the EU itself. It is very sector-specific. If I start, for example, in the manufacturing sector, in the car industry, it is set by UNECE. It is basically an EU-centric organisation. The United States is not a part of it; Japan is almost fully compliant with the UNECE system. If you look at, for example, electronics, it is set almost entirely by the industry. This is the reason why, for example, the trade with China and Taiwan prospers although there are no free trade agreements between the EU and the United States with China.

There are certain areas where these standards can be problematic, even in manufacturing, for example, in chemicals, or pharmaceuticals, where there is an approval system such that, basically, the higher the risk they pose public health or public interest, the more stringent the control before they are allowed into the market. Where there is a stringent pre-market authority and approval system, you can assume that we are out of it. That is one point.

We also talk about the services aspect. I assume that we will be talking about passporting and equivalence. We need to bear in mind that in Europe this is not a technical objective process; this is a political process, which is done, for example, within financial services product by product. Clearing will be dealt with separately from other types of activity, so banking. It is not even by product; it is per activity in a financial institution. It takes quite a lot of time.

It is not only a burden for a UK business, once they establish themselves to conduct business in the single market. This is also a huge barrier for investment into the UK. If you look at the Japanese and the US banks, they rely on passporting via London in order to access the single market. They will probably choose another entry point in order to access the single market in the future. In the end it may not make a major difference to the major financial institutions here in London, but it will make a huge difference to the future of London as a financial hub.

I would also note that the agreements we have done so far, starting with Korea as the first next-generation agreement that the EU has concluded, are basically tariff-centric. They do not contain much in terms of regulatory convergence. They shave off the worst cases of regulatory barriers but there is no assumption of regulatory compliance and there is no mutual recognition. In fact, it is deeply ingrained in EU trade policy that it does not necessarily believe in mutual recognition, because it has not worked very well in the past. There is always a way around to block a product, if you want to. Even if you take, for example, areas where there is a huge degree of convergence in terms of which companies are there and what kinds of products we are talking about, you have very little recognition, or no recognition whatsoever, in terms of standards and approval procedures. Look, for example, at the pharmaceutical sector, or the medical devices sector, where basically it is the same company that is filing the same application on both sides of the Atlantic.

In that sense, FTAs will not provide the type of access that we would like to see in the future with the EU, both in services and also in key sectors of manufacturing. This means that, if we are no longer looking at an EEA type of scenario, we have to look at an FTA-plus type of scenario. CETA has been mentioned many times as a possible template. It contains basically no regulatory co-operation. The only thing that has ever come close to what we are talking about is probably TTIP, which does not necessarily exist yet, except on paper—and not even on paper, to be honest, in most of the chapters. The advantage of TTIP is that it has already been agreed to among the EU member states. We already have a common position, including the UK, on TTIP, which could serve as a template for a future relationship if an EEA relationship is not place.

Q205 **Mark Garnier:** Mr Makiyama, on TTIP and the Trans-Pacific partnership, we are getting hints from the presidential hopefuls in America that they are less than optimistic or less than enthusiastic about these types of trade deals. Do you get the sense that there is increasing protectionism coming into the world? I am thinking specifically that, since 2009, there have been, among the G20 countries, 1,583 trade-restrictive measures imposed, of which only a quarter have been removed. Are we moving to a more protectionist world?

Dr Richard North: The OECD keeps a register annually. Yes. It is quantifiable. 10 years ago it was in the 100s. Currently it is over 2,000. Quantifiably, trade restrictions are increasing year by year. The OECD keeps the count. So, yes.

Hosuk Lee-Makiyama: To qualify that, we have not seen the type of protectionism that we saw in the 1930s with the Smoot–Hawley Tariff Act. There are some institutional anomalies still in the various governments in the world; there are, of course, some exceptions. They have fared exceptionally poorly, but in the end we have not seen major increases of import duties.

Q206 **Mark Garnier:** If I could summarise those two statements, on the one hand we have seen more instances but each instance is in itself—

Hosuk Lee-Makiyama: They are selective. They usually are about appeasing core national interests. It is a soft mercantilism, designed to maximise export and minimise import. Many of them have, as I have mentioned, links to either strong political interests domestically, or it could also be a question of national security. So, yes, there are more instances of protectionism, indeed, but we are not looking at the rampant massive scale of protectionism that we saw in the 1970s and 1930s.

I would also add another qualifier, which is that, if you look at the macroeconomic fundamentals, the trade-driven growth that we saw in the 1990s or the beginning of the 2000s is not likely to return, especially for a country in the European sphere. It is very much less likely today that you will be exporting yourself out of a crisis and into economic growth. What we have seen is, to a certain extent, also normalisation. We do not see much drawback on or diminishment of trade, but we do see a new plateau when it comes to trade-driven growth.

Shankar Singham: I just wanted to add that it depends what you mean by protectionism. Lamy said, very famously, after the fiscal crisis, we have not seen a return of trade protectionism, and this is a good thing, but what he was referring to was that we had not seen an increase in tariffs. What we did see in that period was a very high increase in regulatory protectionism and behind-the-border barriers.

Q207 **Mark Garnier:** This goes back to Mr North's point.

Shankar Singham: It goes back to the point that he made, yes.

Q208 **Mark Garnier:** Do you genuinely think that is the case?

Shankar Singham: That is definitely the case. I do think there are extreme protectionist pressures that political systems are facing. You just have to look at the US election process. You have to look at Australia, Austria, Hungary, Poland and the huge number of countries where these protectionist political pressures are being faced, which I do agree are very much mercantilist notions and pressures.

I would make one point with respect to TTIP, which is the difficulty of negotiating TTIP, from a US perspective, is that the way Europe regulates is very different from the way the US regulates. There is the EU's precautionary principle, in terms of standard-setting, the role of CEN and CENELEC and the very much government-directed setting of standards, against the US system, which is very much voluntary standard-setting organisations, which are kept out of the European process by CEN and CENELEC. This means that it is very unlikely we will see a US-EU deal on regulatory unless one country or region takes the entire regulatory system of the other, because the approach is so different.

A UK outside of the EU would not necessarily have an EU approach and could negotiate that aspect of a TTIP-style agreement relatively quickly, certainly more quickly than the EU would be able to. Also, were the UK liberated from the CAP and CFP, that might also make things a lot easier. The tariff side of the TTIP could be done in a weekend. That is not a difficult negotiation. I think the fact that the European Council of Ministers and the Commission have already accepted certain principles that are enshrined in the whole TTIP process does help. A UK negotiation for an FTA with Europe would not look that dissimilar from the TTIP-type negotiation. You would want the tariff deal and you would want additionally a regulatory deal. Part of that regulatory deal would include a series of mutual recognition agreements.

Q209 **Mark Garnier:** It is interesting, because you are looking at it as a trans-channel trade investment partnership, I guess—a TCTIP, probably. However, I am also looking at it from the point of view of how we would propose to negotiate with places like India, China or indeed America. One of the things I am picking up from what you are saying is that being part of the EU, so having the big trading bloc to big trading bloc negotiations, is getting increasingly more complicated in a more complicated world, and actually there is a lot to be said for not being part of a big trading bloc in terms of our negotiations with America. We will have a UK version of TTIP, which is much easier to achieve. Is that right?

Dr Richard North: Interestingly, if you go back to the OECD and look at the modern developments in terms of trade agreements, they list 14 mechanisms for reaching trade-related agreements outwith the conventional trade agreement like TTIP, which are the dinosaurs of the world. One of the most exciting initiatives, for instance, is UNECE—the United Nations Economic Commission for Europe—which has set up what is called Working Party 6, which within that has developed a system of international regulation that works on the basis of common regulatory objectives. Any one member state, say on vehicles or on a pharmaceutical product, can offer a particular product or a particular sector where they agree then to set up a common regulatory objective. That is then handed over to ISO, which of course relies on the Vienna agreement and the TBT agreement of 1992, which thereby obliges all the parties to adopt that standard. Then, all of a sudden, you have a mini global trade agreement under the horizon, which has the effect of a mini TTIP progressing through the system and facilitating trade.

We have already seen one very successful example of that, with the global agreement on hazardous signing, which was brokered by the United Nations. That might sound like a very minor detail, but if you have got several million pounds' worth of very expensive chemicals going into a foreign country, and their regulatory system says that the markings must be square labels and yours are diamond labels, all of a sudden it is sitting on the wharf side with demurrage costs and all sorts of things while you relabel it. The very fact that we had this global agreement on this tiny sector was a huge advance, and that is what is happening globally, sector by sector by sector.

This is what UNECE is doing this year, on vehicles, where regulation 0 comes into force with whole vehicle certification. It is only a few countries, but then they inkblot it. They spread it around and spread it around, and it seems to me that that, outside the EU, is going to be the future. You are going to see a lot more of that without trying to go for the big bang dinosaur agreements that fall apart at the last stage. That still leaves us having to deal with what we are going to do with the EU, and we have not addressed that yet.

Q210 **Mark Garnier:** Mr Makiyama, you wanted to come in.

Hosuk Lee-Makiyama: Yes, on the question of TTIP—that it would be easier to do between the UK and the US—I think that is a gross simplification. First of all, it is true indeed that one of the major complications of the EU-US deal has been that both sides have basically copied and pasted their own domestic regulations into the free trade agreements. It has created some quite interesting conflict in, for example, countries like Korea, where they have basically taken on two regulatory standards, and they are not always coherent.

However, if I look at TTIP post-Brexit, I would say yes, indeed, it is true that the UK would have perhaps a more flexible stance on some of the issues, like, for example, geographic indication, which is a major legal complication for the United States. However, it is also the only proponent of financial services, and especially in banking. Since it is a state competency in the United States. It is a sub-central competence. It is one of the key things that the United States cannot negotiate in a free trade agreement.

Q211 **Mark Garnier:** Sorry, banking services?

Hosuk Lee-Makiyama: Yes—financial services.

Q212 **Chair:** This is because there is not a federal system.

Hosuk Lee-Makiyama: It is the federal system, and it is also increasing political sensitivity.

Chair: It is broken down to the states.

Hosuk Lee-Makiyama: If you look at, for example, TPP, it is in a certain respect, including financial services, less ambitious than the United States' previous agreements, because it contains so many exceptions or caveats for measures taken in the financial sector.

Q213 **Mark Garnier:** Effectively the financial sector is excluded from that.

Hosuk Lee-Makiyama: It is excluded from many chapters of the TPP, yes.

Q214 **Mark Garnier:** In a practical sense, that means we cannot, or will not be able to, sell banking services into America. Is that right?

Hosuk Lee-Makiyama: We would have no commitments from the United States on the financial sector. In the TPP there are very few—almost no commitments.

Q215 **Chair:** And you are saying there are no prospects of any.

Hosuk Lee-Makiyama: What I am saying is that, yes, in many regards it has become simpler for the UK, because we have maybe cut loose some of the issues that are primarily of vested interest for Germany, France or Sweden, but in the end we are the key proponent on the most sensitive sector for the United States. I am not sure if the UK is ready to sign an agreement with the United States that has a blanket exception for financial services. I am not sure if that is in the UK's interests.

At the same time, you could argue that for the EU it has become easier, because now the key proponent for financial services in TTIP has left the stage. However, in the end you still have at least 20 more outstanding issues, so if you have one less it makes really no difference.

Q216 **Mark Garnier:** Sorry; I just want to be absolutely clear in my own mind what this means from a British point of view. If you are a British financial services institution, what does it mean in a practical sense if you do not have this within a US-UK TTIP-style arrangement?

Hosuk Lee-Makiyama: The current state is that you basically have to deal with market access on a state-to-state level.

Shankar Singham: This particularly affects the insurance industry, where you have insurance regulators in every state.

Q217 **Mark Garnier:** You would then have to have a subsidiary in every state, compliant with those regulations.

Shankar Singham: Yes, and you would have to get approval in every state and licensed in every state.

Q218 **Mark Garnier:** To be fair, the single market in financial services is still very far from complete.

Shankar Singham: It is a long way away. However, there is a financial services schedule, albeit with lots of exemptions and so forth, in the WTO. There are other precedents where US states have agreed to take on commitments. For example, in the government procurement agreement, about 30 states or so have commitments in government procurement. It is a political issue, and it is the Treasury in the US that will speak to this issue, and it depends again on the management of defensive interests versus offensive interests. There are financial service interest difficulties, but then you have agricultural difficulties as well, with respect to the rest of Europe.

I would not say it is as cut and dried as, "We will never get a financial services agreement with the US." It depends what else we are prepared to put on the table.

Q219 **Mark Garnier:** However, equally, I think there is a case with India. India are worried about automotive products, and are happy doing automotive trade with the UK but not with, for example, Germany. In some cases that can work to our advantage.

Shankar Singham: There will be specific areas throughout like that, and because it is very sector- and country-specific, it ultimately comes down to whether you have a large amount of defensive interests and a reasonable amount of offensive interests, or whether you do not have many defensive interests. If you do not have many defensive interests, a trade negotiation is both easier and quicker. The point I was making is that the UK has fewer defensive interests than many European member states and the European Union as a whole.

Q220 **Mark Garnier:** Just so I am clear, what do you mean by defensive interests?

Shankar Singham: For example, agriculture: for every country that negotiates with the EU, the very first discussion is whether agriculture is going to be part of the negotiation. Under the WTO process, all of these things are illegal–all of these preferential trade agreements. They are allowed under Article 24 at the WTO if they cover substantially all trade. Yet in the EU's agreements with many countries around the world, agriculture is taken off the table right at the beginning.

Q221 **Mark Garnier:** That is a defensive interest, is it?

Shankar Singham: That is a very powerful defensive interest that the EU has, and if they tried to do serious negotiations on agriculture, they would find great difficulty in doing that. If I am India, China or any other country around the world, and the EU comes to me for a trade agreement and says, "We are taking agriculture off the table," my response is going to be, because the trade negotiation is unfortunately a somewhat mercantilist process, "You cannot have the sorts of things you are asking for." The problem for the UK in this dynamic is that the things that the UK needs, because of its service industry strength, are precisely the things that are the most difficult things to get. If the EU goes in with that sort of defensive interest to start with, it puts UK industry at a huge disadvantage.

Q222 **Mark Garnier:** That is on a UK-EU trade negotiation.

Shankar Singham: Yes. In an EU negotiation with third countries.

Q223 **Chair:** Okay, so what is the answer?

Shankar Singham: One of the things you mentioned earlier on, Chairman, was the 53 negotiations the EU has. We are talking about a lot of trade negotiations that we have to launch without a great deal of trade capacity in the country at the moment. It may be better to grandfather in some of these agreements, but we should do this on a case-by-case basis. I am thinking particularly of agreements like the EU-Mexico agreement, where the UK negotiating with a NAFTA process might get a better deal for both sides.

You would look at it on a case-by-case basis, but with some of those 50 agreements, you might say, "As part of this process, we want to renegotiate or take it to the next level for the UK." There is a floor, which is the EU-Mexico floor, and then you go beyond that. NAFTA has done this itself. There is an SPP agreement with NAFTA, which takes the NAFTA floor and tries to do more things in terms of regulatory.

Q224 **Chair:** SPP meaning—

Shankar Singham: The Security and Prosperity Partnership agreement, which is a NAFTA agreement. The first thing you have is the NAFTA agreement. Then the SPP is taking the NAFTA agreement to the next level, dealing with some of the regulatory barriers and non-tariff barriers that were discussed earlier on.

Q225 **Mark Garnier:** Can I just ask one more question with regard to most-favoured-nation rules? As I understand it, you are suggesting we start all those negotiations based on what we have with our existing relationships derived from Europe, but if we have certain countries where they are going to be worried about our services or that have more of an interest in our automotive sector for one reason or another, how does that play in when it comes to MFNs, so having different deals with different countries? Do you still have to find a floor with everything, or can you pick and choose your trade deals depending on who you are dealing with?

Shankar Singham: The MFN issue is precisely why the WTO rule is that these are all illegal, because they have different rules and different tariff arrangements and so forth. The general Article 24 rule in the WTO is that they have to be trade creative and they have to cover substantially all trade. The general principle is that, if you are going WTO-plus—in other words if you are negotiating a trade agreement where the tariff levels are well below the agreed bindings that the countries have in the WTO—nobody is going to object to that. That is a trade-creating agreement. That is a good thing. That is a stepping stone to further trade liberalisation. However, the issue is that there is a very clear set of ways of approaching this with tariffs. It is not as clear with respect to rules. The example that Mr Makiyama cited with respect to Korea and standards is a good example of this. There is no clear floor with rules-based negotiation, because you have to make a value judgment about whose standard-setting is better, from a trade liberalisation perspective.

One thing the UK does need to think about is that we very often talk about these things as if we are talking in zero-sum terms: as if there is the standard of Europe; the standard of the US; we do a deal; and then somehow the economy is the same as it was before but with some benefits, because people are not trying to manufacture to different standards.

There is another issue here, which is the way you negotiate on rules and standards can create wealth, if you can do a negotiation that is pro-competitive and have a pro-competitive standard-setting position. I would say that the US method for standard-setting, with voluntary exchange, is better from a wealth-creating, pro-competitive standpoint. When the UK is looking at negotiating agreements around the world, think about the countries that have that kind of approach and have a different approach to negotiating a trade agreement with China, India or a country that may not have that kind of approach. That is why it is so important to negotiate and be very clear about what we can get from a coalition of the willing, if you like, in terms of the US, Canada, Australia and the sorts of countries that have embraced the three core tenets that lead to wealth-creation, which are open trade, competition and property rights.

Q226 **Chair:** Okay. Mr North, you were trying to jump in a bit earlier.

Dr Richard North: I am just trying to imagine a situation where we are struggling to do a deal on a continued trade agreement with the EU while all this stuff is going on. Basically, if we are looking at the real world, I would have thought we would want to park all the third country agreements, look for the presumption-of-continuity principle as far as we can—in other words, just carry over all the agreements we have got—and focus our efforts on coming to an agreement with the EU.

Q227 **Mark Garnier:** The EU has always got to be the first one we negotiate.

Dr Richard North: It has got to be, has it not?

Q228 **Mark Garnier:** Then everything falls away from that or is built on that.

Dr Richard North: The rest, it seems to me, has got to be parked. I do not think we can cope with all the rest. The real issue is we came into the EU in 1973 and we have had 43 years of integration; we are not going to suddenly find a single solution in one go. We have to treat this as a process. We have got to look at a series of steps, and we are going to be looking at parking as much as we can to say, "We will deal with that a few years later," and, "We will deal with it under different circumstances, different terms." It is treaty, do not forget; this is not voluntary. These two years are a treaty limitation. Unless we resolve the key issue of our relationship with the EU, we are in serious trouble. You cannot overstate that.

Q229 **Mark Garnier:** Mr Makiyama, do you have anything to add to that?

Hosuk Lee-Makiyama: I would agree and disagree with my fellow panellists. First of all, it is really easy to foresee a future where you would have more dynamic standard-setting in the UK, better business regulation, and therefore a much more preferential business environment. I would be very much in favour of that. Also, we need to remember that whatever agreement we have with Europe will also bring constraint. As we have heard, Europe has very much a legalistic and Brussels-centric standard-setting procedure, whether we are talking about technical standards or regulatory standards, which means that if we want to have single market access, we will bind ourselves to the mast, at least to a certain point, in terms of what we can do with third countries.

Unfortunately, the realities are such that in a world where the UK trades 50:50 with the EU and the rest of the world, whatever trade we lose with Europe cannot be recreated with the rest of the world.

Q230 **Mark Garnier:** Why not?

Hosuk Lee-Makiyama: It is just not in the balance. The market access we would obtain from the free trade agreements would not equal the trade loss we would have with Europe. It is just a different scale. All in all, we need to do both.

Also, in terms of sequencing, when we talk about trade and trade strategy, sequencing is basically the main component of a trade strategy. Trade is a little bit like a game of chess. Everyone can learn how to move the pieces, but in which order you move the pieces and which pieces you sacrifice determines whether you are a good chess-player or not, and whether you can plan for all eventualities several steps ahead of the game.

What my co-panellists are saying is basically that an EU and a WTO commitment potentially needs to be created first, and I do agree with some of that reasoning. It would have at least to be crystallised first. We need to be very clear about what the landing zone is. We have to agree on the modality of negotiation with Europe before we can move ahead. Once that is not formally written in stone but understood by both parties, the rest of the negotiation will be basically a technicality—a very difficult technicality, nonetheless.

However, there is also another factor, which is that nobody buys a pig in a poke. Nobody will negotiate with the UK unless it has a WTO commitment, because then you might run into a risk whereby you might be negotiating and giving concessions for something that the UK in the future will give up for free. It is not unprecedented, however, that you have negotiations of a bilateral free-trade agreement with countries that are not WTO members; notably Russia after the fall of the Soviet Union concluded a few agreements. Algeria did one with the European Union, but on the basis that Algeria was trading only with Europe anyway, so WTO membership did not make any sense. The UK is not in that position. In order to negotiate with other parties, basically the relationship with Europe—and hence the WTO—needs to be formalised first.

Then I agree that the grandfathering of the Korea, CETA, Singapore and Peru agreements are relatively easy deals. As I said, they are basically tariff-centric. They do not contain major elements of regulatory co-operation or standard-setting. If you look at the chapters, for example, on intellectual property and the more sensitive and more regulatorily complex parts of the negotiation, they are basically copied and pasted from multilateral deals that we have done in WIPO, or the WTO. From that perspective, it is a legal verification exercise to grandfather these agreements.

It is trickier with the ongoing, and once again I would like to stress that any UK-US deal is not a walk in the park, not only because of the financial services but because we have to bear in mind many of the sectoral interests, offensive as well as defensive, that the UK has or does not even know that it has. The UK has been hiding behind other member states that are more vocal about it. That also includes agriculture. The UK does have an agricultural sector, which still has a certain domestic leverage. We also need to bear in mind that we live in a post-Europe and post-CAP reality; will the farmers of the UK agree to further market access being brought into the UK from third countries when they have just lost their subsidies? It is a question that you need to answer, as fortunately I am not qualified to. It is not only agriculture; there is a range of products, even in manufacturing, where you will run into the problem that the UK finds itself to be more sensitive than it thought.

Japan is quite an exception from this, because the outstanding issues in the EU-Japan negotiations are basically products where Europe is asking for TPP-plus concessions. Europe would like to have more from Japan than what Japan has given to the United States, Australia and New Zealand, because our offensive interest in agriculture towards the Japanese consumer market is different from the ones for the United States. The United States is interested in exporting rice, made in California, to Japan. We do not export rice. Our interests are primarily in dairy, high-quality cheeses and wines, pasta, certain types of meat. It is not an offensive interest of the UK. We could probably sign a deal with Japan tomorrow. However, the question is whether Japan would be interested in doing so, because if you look at the Japanese firms—and this applies to not only Japan but most of the third country economies—they have invested in the UK after 1973 on a specific guarantee that the UK will be a part of the single market. I am not really sure that the rationale exists, although the defensive interests are less.

India, as we have heard before, is a much more complex situation. First of all, one of the most offensive interests of India is mode 4—movement of labour. I cannot see an agreement with India that does not include mode 4. Also, we need to bear in mind that India is currently in a process of its own introspection, after Prime Minister Modi took power, where it is really uncertain and ambivalent about the merits of trade. Several trade agreements, including the one with Europe, have basically come to a halt.

If these were the ongoing agreements, it is also possible that this new situation of uncertainty has created a certain room for political entrepreneurship—policy space, if you like. An FTA with China is certainly one that could work, mainly because the reason there is no free trade agreement between China and the EU is because of domestic sensitivities in Europe about China and the rise of China, and the extent to which China has caught up with the European manufacturing sectors without Europe necessarily advancing its own technological development to the same extent that China has caught up.

Also, it is important that when it comes to third country FTAs, many countries, including China, conclude an agreement with an EFTA country or Switzerland first, before negotiating with Europe. It is logical from a negotiation sequencing point of view. You negotiate with a weaker part, a smaller part, almost like a practice round, because it has a similar industrial structure, and you are more likely to get a better bid out of the smaller country. Let me take an example.

Chair: A few words—do go ahead, but just briefly, because I must bring in another colleague in a moment.

Hosuk Lee-Makiyama: This is the reason why Europe negotiated first with Korea, then with Japan, and will negotiate eventually with China. You go to the guy who will give you the best offer, and then you take the same bid to the bigger guy and say, "I want the same from you." This is the reason why, for example, China has chosen to negotiate with Switzerland first, as a practice round. Hence it is possible to see, in future negotiations with China, and potentially with Australia and New Zealand, that the UK could serve that role. However, it all hinges on the fact that there is a market attractiveness still remaining in the UK, because the UK has still an attractive link to the single market.

Chair: Okay, and that last point was the very first point you made at the beginning of the evidence session.

Q231 **Mr Baker:** Good afternoon. We are running a bit short on time. If I can, I will get through three areas. I want to clear up something about approach, which has come out of the evidence all of you have just given in the last few minutes, and then ask something about platforms, and then go on to TTIP specifically.

This is mostly going to be for Shankar Singham to answer, but I think it is fair to say Richard North was most emphatic that we should deal with the relationship with the European Union first.

Dr Richard North: Yes.

Q232 **Mr Baker:** Yes, and, Mr Makiyama, you seemed to be agreeing, although you later said that we should have a practice run with smaller, weaker countries, so I was trying to reconcile that in my mind. Perhaps I will come back to you in a moment, but specifically, Shankar Singham, I think you made the point that if we were to negotiate exclusively with the EU first, there would only be downside risk and no upsides. I think you said also in your evidence quite clearly and emphatically that there was advantage in running multiple deals at a time, so that you could go through trade-offs and get the best possible deal in all areas. Could I ask you, Shankar specifically, to try to tease out those differences of approach and state clearly why it is that you, uniquely, want to run multiple negotiations at once?

Shankar Singham: Just to be clear, a lot of what we are talking about is how we use the period between now and Article 50 being triggered, in the

UK, in terms of understanding landing zones. I am not suggesting that we immediately embark on actual trade negotiations with a number of players. Mr Makiyama talked about landing zones, and in a negotiation you try to figure out what the other parties' red lines are, what your red lines are, what the potential landing zone for an agreement is, and you game it out ahead of time. What I am suggesting is that we use the time between now and Article 50 to do that, not just for the EU negotiation but for some of these other negotiations as well, so that our trade negotiators have the ability to do necessary trade-offs, at some point. Nothing is going to change until the conclusion of the EU negotiations. That is going to be the pivot point for all the rest of these things to follow.

However, it would be a mistake to simply do that and then say, "Now what are we going to do with a potential agreement with Australia, New Zealand, or grandfathering other free trade agreements, or looking at that, because our leverage has now been dissipated?" Sequencing is the key to a lot of this, but right now the problem we have is how we use the next period to position ourselves in the best possible way, and to that end some attention needs to be paid to the negotiating machinery we have to do all of this. If we are unable to have the kind of negotiation machinery that will support this kind of approach, that will determine what we do.

However, I think we can have negotiating machinery to do all of this. I would not be pessimistic about that, but we would have to use this opportunity of political entrepreneurship, as you said, to look at the economics of this slightly differently and say, "Look, we have a government structure that is set up from the 19th century: 'I make product A in country A, and I sell it in country B, and there are tariff barriers and we need to deal with those.'" This is a world of competing global supply chains.

There is an opportunity here to essentially look both at these external trade arrangements and internal UK competitiveness in the same way, within the same ministry, and we have suggested standing up an office of a special trade representative. In the US, the USTR office is a very successful piece of trade negotiating machinery. It does not require hundreds and thousands of people. The USTR is 200 people. It is very effective. If you were to do that, with the right kind of political appointment process, there would be no shortage of trade negotiators around the world who would be willing to look at this, partly because every other major trade negotiation—not the MRAs and so forth—is stalled. DOHA has stalled. TTIP is not going anywhere. TPP, based on the US election, probably will not go anywhere. There are many negotiations where nothing is really happening, and there is an opportunity here to do something that could lead to a wealth-creating outcome.

Mr Baker: Thank you.

Dr Richard North: Do not forget, if I may, if you are going to go down the EEA route, your negotiations with the EEA are separate from your Article 50 negotiations. The EEA is a separate treaty and a separate entity, so you are going to have a set of negotiations with the Article 218 designated negotiator through Article 50, and do not forget that the EEA agreement does not include agriculture or fisheries. If you are going to want to load temporarily fisheries and agriculture into the EEA, you are going to be negotiating separately with the EEA Council.

Q233 **Mr Baker:** I am sorry to interrupt you, but we are all terribly short of time, and I want to come back to that point in a moment. Before I do, could I ask you, Mr Makiyama, do you want to deal with that point I raised earlier of the tension between wanting to go for smaller countries first as practice, versus the EU?

Hosuk Lee-Makiyama: I can provide a very simple and short answer to that, Mr Baker. You are the smaller and weaker party, and you have nothing to sell unless you have defined your relationship with Europe first. However, after that there is a common practice to negotiate with countries that have long experience, very often on long geographic differences as well, that will not lead to a massive trade surge. You would very often negotiate with New Zealand, Chile and Korea first.

Mr Baker: I am going to resist the temptation to rehearse the line about us being the fifth largest economy in the world.

Shankar Singham: That is the qualification I was going to make.

Q234 **Mr Baker:** I want to come on to this point about platforms, because I think it was the US Special Trade Representative, Michael Froman, who said that he wants platforms to join. We have heard of at least two platforms from you this afternoon. Possibly there is a third to come out. So, Richard North, I think the platform you are proposing is that we join the EEA, with a Liechtenstein-style arrangement on freedom of movement, and then move on to adopt and further the model of the UNECE in order to have a more global platform. Have I correctly understood and characterised what you are saying?

Dr Richard North: More or less, yes. Let us concentrate on getting out. Do not forget, this is not just trade. You have defence, you have got security, you have got justice and home affairs, you have got aviation, and you have got space policy. There are all these other issues you have to look at. These are going to take an enormous amount of time, effort and political capital, and there will be trade-offs with trade and other aspects. We have got to settle those, and if we try to take on too much, in my view, we are going to get into trouble. Let's settle Europe. I said earlier I would quote from this book looking at how we got into the EC in the first place, and the tactic taken was to swallow it whole, swallow it now. In other words, buy in with minimum argument, minimum negotiation, settle a deal. Once you have the deal settled, you use it as a process and then move on to the next stage and the next stage. Now, Mr

Hammond—the other Mr Hammond—was saying yesterday in the *Guardian* that it would take six years. I see the process taking 20 years, and if you think in terms of Clapham Junction trains, we are taking two trains down similar tracks and only gradually diverging over a period of time. We settle this and move on; settle this and move on, and so on.

Q235 **Mr Baker:** Shankar Singham, I think you have set out a platform of a prosperity zone of countries with likeminded attitudes to trade and business. Have I understood that correctly?

Shankar Singham: That is defined by the ease of doing the deal, basically. I would agree with what Richard just said. The UK is not a country with a lot of defensive interests and where negotiations are fraught with massive difficulty because you have to manage these various defensive interests. I am not suggesting we have no defensive interests, but one of the advantages we have is that we are a relatively open market to start with, and a market with a lot of offensive interests in services and comparatively few defensive interests in agriculture and manufacturing compared with other places. We have them, but they are not as great as they are in other places. There would be the contemplation of other agreements until the Article 50 process is concluded and preliminary negotiations and so forth. However, I am not sure that the knowledge in the minds of our negotiators in Europe that we are contemplating these other arrangements and deals is such a great imposition over and above what we are going to have to do anyway.

The thing that is going to take the time and the difficulty here is the negotiation with the EU. That is going to dominate the discussion. These other things, I do not think, are going to be necessarily as complex. However, we need to do something on them, and we need to envisage and envision them, before we conclude with the EU.

The other thing that I wanted to also make a point on is the UK competitiveness aspect of this, which is the UK changing its laws and allowing that gap we have with European regulation if we are no longer part of the EU to allow us to have better rules in things like anti-dumping and competition and other things. The way to handle that is simply to say that you can harmonise directives and regulations into UK law that are already, as we sit here today, part of UK law. It will be part of UK law at the end of the Article 50 process. Maybe you could harmonise them with certain exceptions for well thought-out areas of economic regulation where you already know how to put a better pro-competitive regulation in place, and then take that away. We would be diverging slowly and gradually, based on new legislation and decisions of the Supreme Court. That, I think, is a viable pathway forward.

Q236 **Mr Baker:** Mr Makiyama, what is your platform for how we should go forward? What would you envisage?

Hosuk Lee-Makiyama: The default platform is the EEA. I am not sure if it is available to the UK and, if it is, it will come at a very high cost. It will probably come at a financial contribution that is very close to the current UK contribution to the EU membership.

The alternative to that would be something I call FTA-plus-plus, which goes beyond CETA, which contains regulatory incorporation on a sectoral basis. It probably means some form of mechanism to consult each other before you have a new legislative act or new standard, and forming, potentially, a regulatory council in order to incorporate the various types of sectoral regulation. This will come at a price as well. This will probably be modelled on EU offers and suggestions in TTIP.

The third platform is probably, as the other speakers have also mentioned, unilateral liberalisation. There is some beauty to that. You will be turning your back to Europe, basically saying, "We will win this negotiation by not negotiating with you. We will give away everything for free." By that you are defining the UK, and as perhaps a new relationship with Europe, which is close to Singapore or Hong Kong to mainland China. And as we know, mainland China is a very closed market entity, and these satellite economies have created a viable economic model by providing a bridgehead. However, this is probably not something that can be easily replicated, and it will come at a high societal cost. We are talking about major reforms of corporate taxation, administrative burden, labour and social liabilities for firms. I am not really sure whether the UK is ready to redefine its social contract with its citizens.

Q237 **Mr Baker:** Coming on to TTIP, Shankar Singham, I think you have got specific experience. Do you think there is any prospect of TTIP surviving the presidential election and the US Congress?

Shankar Singham: Even without the presidential election—even if we had a pro-TTIP President in the US—negotiators may come to a deal and declare victory, but it might be a very superficial kind of arrangement, and as I have said before a tariff negotiation between the EU and the US is not that difficult to do; it is the regulatory piece, specifically. That is very regulatory-lite kind of agreement, which does not really deal with the issues and is not responsive to the reason for having the agreement launched in the first place. That could happen, but it is not really a success, although negotiators would declare victory.

Now, if you add to that what is happening in the US presidential process, it is going to be very difficult for certainly TPP to get through, unless they can get it through in the lame duck period. I do not think they can conclude anything on TTIP before the presidential election, and it will be very difficult to get TTIP through, regardless of who the winner is.

Q238 **Mr Baker:** One particular difficulty in the UK over TTIP is the investor-state dispute mechanism, which has attracted criticism from the left and the free market right. Is the TTIP dispute mechanism one that is uniquely different from other trade deals, or is it something that would have to be adapted in any trade deal?

Shankar Singham: Not especially. If you look at the bilateral investment treaties that countries have had for years, for decades, they all contain investor-state dispute settlement mechanisms. The NAFTA agreement contains a version of investor-state dispute mechanism for countervailing duties and so forth. There are lots of precedents of investor-state dispute settlement of the kind that is being discussed in TTIP that have existed for many years. Ironically, Germany had more bilateral investment treaties than any country in the world.

There is a misunderstanding of what investor-state dispute settlement means and what it entails. Right now, on bilateral investment treaties, countries can go to the World Bank for arbitration. The ability of an investor to hold a country to account without having to go to its government, and have its government negotiate on its behalf when there is an expropriation of its assets in a country, particularly with countries that do not have particularly strong legal systems, is extremely important from an investor-protection standpoint.

Now, there is a difference. When you are talking about TTIP, you are talking about the whole European Union investor-state dispute settlement. If you are a US investor, and you are concerned about getting justice because the EU or a member state has done something that has expropriated your assets or conducted an action that is tantamount to expropriation or a regulatory taking, and you are in Bulgaria or Romania, that is very different from being in the UK. In the UK you can rely on what is one of the best court systems in the world. The investor need for an investor-state dispute mechanism in an agreement solely with the UK is very different from what you might need EU-wide.

Q239 **Mr Baker:** Thank you very much. You have answered my final question already, which was that the UK is categorically different from some other EU member states. Thank you.

Q240 **Chair:** Is there anything any of you particularly want to add before we wind up? We have been going just under a couple of hours.

Dr Richard North: Very quickly, if I may, we have not talked about trade facilitation. The WTO estimation on savings to the UK alone is about £60 billion a year. The way trade facilitation works is to look at the mechanics of trade, for instance the one-screen system, where an exporter anywhere in the world can enter information on a computer screen, the one screen, and that can carry through the whole system. It is movements like that, outside the framework of these dinosaur deals, that have the potential to save more money—as I say, £60 billion for the UK alone. It is £1.3 trillion a year. That is where we need to be looking, I feel, rather than looking at these dinosaur deals. The standard is Singapore in terms of trade facilitation, and the baseline saving is based on meeting Singaporean standards on trade facilitation.

Q241 **Chair:** Thank you, we have got that. Have you anything you want to add on to that? Mr Singham?

Shankar Singham: I will just add one thing on financial services passporting, which we did not really discuss, in terms of what we need to do in respect of the negotiation with the European Union. MiFID II becoming the regulation on the day of the referendum, ironically, means that when we conclude the Article 50 process not only will the financial systems be equivalent; they will be identical. The issue then becomes whether the regulatory mechanism is different in some way. Is the UK's financial services regulator less competent and less able to do these things? That is a political decision, but it would be a very difficult political argument to make in the teeth of a potential negotiation that, if not successfully concluded, could cost European industry a huge amount. The City of London obviously has a very big stake in all of this, but I would say that the need for the depth of the capital market to remain in London is at least felt by European industry just as much as it is felt by anybody else. That does give the City of London a measure of protection that I would hope this Committee would bear in mind.

Chair: That is very helpful.

Q242 **Mr Rees-Mogg:** I agree with you on that. Am I correct in understanding that MiFID II, when it comes in, allows passporting to regulatory regimes that have equivalence, and if our regulatory regime is identical, it would be very hard to argue that it was not equivalent?

Shankar Singham: Yes, the equivalence decision is a political decision. We have to understand that, and it is more than just the legal system. However, if you have an identical legal system, and I do not think anyone would query the strength of the UK's financial services regulatory system, it means the argument will not pass the laugh test. If they try to make that argument, not only will it not pass the laugh test but industries that will be damaged—and I am not talking about UK industry, but German industry, French industry, etc.—will rise up. That is why in this negotiation it is the Council of Ministers that will become more important.

Q243 **Chair:** Before I bring you in, am I not right, though, in saying whether or not German industry rises up—let's set that point to one side for a moment—the weakness of the equivalence is of course we, as the UK, had a huge hand in writing that, and we probably wrote it as suited us, but once we have left we become a rule-taker, and that 2018 protection may be eroded or removed or anything could happen to it over time?

Shankar Singham: Over time, yes.

Q244 **Chair:** It is only a temporary form of protection, and it is not something on which the City can rely long term?

Shankar Singham: No, the City will have to think about where its future belongs in this process, and if you look at fund managers, where we may lose some fund management capability, where are the pools of savings for fund mangers? They are in Asia. They are really in Asia. That means you have to create a competitive financial services offering to attract the pools of capital and savings that exist.

Q245 **Chair:** The MiFID II equivalence provision benefits have been overstated, I think.

Shankar Singham: As a huge barrier in this process, yes, I think so.

Q246 **Chair:** Mr Makiyama, you wanted to say something.

Hosuk Lee-Makiyama: Maybe I should add on the equivalence question that, yes, it will not pass the laugh test, but there are many things in Brussels that do not. Having lived there for a good decade or more, I do not laugh very often.

Unfortunately, on the process in the UK separation, we have heard before about the sequencing and Article 50 versus negotiating a new relationship with Europe as being something that takes place linearly over time, one after the other. I do not necessarily think that is true, because you cannot define the separation unless you have an idea about landing zone, modalities, call it whatever you like—what the new relationship is going to be. Equivalence is one of the main questions that is going to be dealt with concurrently in both processes of leaving and re-joining.

Also, it is not only a question about financial services, because Brussels over the last decade has created several of these types of pre-approval licence-to-operate systems, many of them in the services sector. One other aspect is privacy. It is not a given that the UK will be given the adequacy decision, which is roughly the same thing as the equivalence decision, but it affects the entire services sector, because it regulates whether you are allowed to record a European citizen as your client. If you cannot, you cannot conduct any business with the single market, and as you may have noticed in the news recently, this has become a major problem for US services providers operating in the EU, because of the revocation of the safe harbour agreement that allowed US services and manufacturing businesses to take a record of their clients in Europe.

It is easy to stare yourself blind at the equivalence decision, but there are many other aspects. General data protection regulation and the adequacy decision for UK privacy regulation is going to be one of the key points.

Chair: It is now two hours since we started, and thank you all very much for coming. I am going to finish.

Mr Rees-Mogg: Can I make my declaration of interest? Investment management came in response to a question.

Chair: That is an exception, but I really am going to bring the hearing to an end, because I promised to do so by quarter past. Thank you very much, all, for coming. You have come on a very unusual day. It is not every day we lose one Prime Minister and get another one, and also have a debate on one of the most important and controversial issues in British politics for the last 20 years or so, perhaps even since Suez—the Chilcot Inquiry debate. Thank you very much for coming to see us. We have just touched the surface of a huge subject, and no doubt we will be hearing a lot more about this from you and from others in the future. Quite early on I did ask for something, Mr Singham. If you could jot that down, I would be very grateful for it.

Thank you very much indeed.