



HOUSE OF LORDS

# Select Committee on the European Union

## International Agreements Sub-Committee

### Oral evidence: UK-Japan trade negotiations

Monday 14 September 2020

3 pm

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Members present: Lord Goldsmith (The Chair); Lord Foster of Bath; Lord Gold; Lord Kerr of Kinlochard; Lord Lansley; Lord Watts.

Evidence Session No. 1

Heard in Public

Questions 1 - 16

### Witnesses

[I](#): Mike Hawes, CEO, The Society of Motor Manufacturers and Traders; James Ramsbotham, CEO, North East England Chamber of Commerce; Dr Anna Jerzewska, International Trade Policy Consultant.

## Examination of witnesses

Mike Hawes, James Ramsbotham and Anna Jerzewska.

**Q1    The Chair:** Good afternoon. This is a meeting of the EU International Agreements Committee of the House of Lords, and we are taking evidence this afternoon as part of our UK-Japan trade inquiry. I welcome our guests and invite them to identify themselves before we turn to the first question.

**James Ramsbotham:** I am chief executive of the North East England Chamber of Commerce.

**Mike Hawes:** I am chief exec of the Society of Motor Manufacturers and Traders.

**Dr Anna Jerzewska:** I am the director of the Trade & Borders consultancy.

**Q2    The Chair:** Thank you all for joining us. You will be aware that the session is being broadcast. A transcript will be taken and you will have the opportunity to review it before it is finalised. You will note that members of the Committee may declare relevant interests before asking questions, but those will be brief. In this Committee, different members will ask you questions as we proceed through the session.

I will start by asking you the obvious first question. We are told that an agreement in principle has now been reached between the UK and Japan; it was announced on Friday. We are obviously awaiting full details of that deal, including for example how its state aid provisions compare to those in other deals which the UK might agree.

Could the first two witnesses give a brief overview of UK-Japan trade in your sector or area, and then all three of you answer this question? As the UK and Japan now prepare to sign the agreement, how do you evaluate what the UK has achieved in the negotiations, and how do you assess the way in which the agreement was originally presented by the Government prior to negotiations and where we seem to have got to now? Perhaps we can start with Mr Ramsbotham on the first question.

**James Ramsbotham:** I think everyone will be aware that the two major organisations in this region are Nissan and Hitachi, both significant Japanese companies with major operations here in the north-east of England. They both have operations that rely very heavily on imports of parts from Japan, but they were also set up with the express determination to be by ports on the east coast of Britain, facing across the North Sea to Europe.

Therefore, their relationship is based very much in the UK but with access to the EU market. So everything in relation to their operations here in the north-east relies not only on trade between the UK and Japan—the purpose of this session—but very much on our dealings and relationship with Europe, on which their businesses rely so heavily.

Our export trade to Japan is only 2% of our regional economy, whereas our exports to Europe are 60% of that economy. The real importance of this deal is therefore very much about ensuring that the right rules of origin are obtained so that we maintain the ability to preserve the outstanding businesses that we have right now. I could go into significantly more detail about each one, but I suspect that as an introduction that is probably enough for now.

**The Chair:** That is helpful. You have yet to see the details of the rules of origin.

**James Ramsbotham:** Absolutely, and that will be part of subsequent operations. Of course, they are also totally reliant on the rules of origin deal with Europe, because complete triangulation is needed for it to work.

**The Chair:** Yes, understood. Mr Hawes, perhaps you could give us your first overview.

**Mike Hawes:** Obviously the relationship between the UK and Japan in automotive terms is hugely important and goes back some 30 or 40 years. Japan represents about 6.2% of the UK new-car market—in other words, the imports that we have—and we exported about £1 billion worth of vehicles into the Japanese market last year.

In numerical terms, they are quite different, because most of the UK exports tended to be premium, high-value, luxury automobiles, whereas those coming in were much more of a mix; there was certainly more volume. The relationship between the two in terms of finished vehicles and, importantly, in parts and components is critical. Japan is probably our fourth biggest export market, the number one by far obviously being the EU, and while there is an imbalance in the relationship in terms of parts and components—obviously we import more parts and accessories than we export—it is still fundamental to the operation of the UK automotive market, because the Japanese footprint of automotive manufacturing in the UK is significant.

So the relationship is critical. Clearly we wanted to see that trading relationship continue as much as in the past, and a free trade agreement between the UK and Japan is fundamental to that, so we welcomed the announcement of the agreement in principle on Friday. Obviously we have not seen the details and the critical issues of rules of origin and cumulation, but certainly the discussions, correspondence, communication that we have had with officials have demonstrated that they fully understood that, and we are confident that the agreement, as and when we get to see the key parts, will largely reflect that ambition. As Mr Ramsbotham said, that is one of the three legs that we need, which are UK-Japan but also UK-Europe, accepting that the EU and Japan already have that third leg.

**The Chair:** It is understood that you need to see what happens on the EU side, but what do you then take from what you think the UK has achieved so far? Has it got a good deal, or do you not yet know?

**Mike Hawes:** We think it is probably a good deal, so, first, we have a good deal. Secondly, it is indicating that it is avoiding WTO tariffs. That was the critical thing: that we avoid the application of tariffs, provided that the rules of origin, as we are led to believe, are suitably acceptable that we can qualify for that. That is where cumulation comes in.

In terms of what we gain, obviously there is the much quoted figure of this adding 0.7% of GDP. As far as other parts of the agreement may offer huge advantages to other sectors, for the automotive sector it is about maintaining what we already have, and we still obviously need the UK-EU agreement for that. If you like, our ambitions were to keep what we currently have as much as possible in order to continue to operate, so I will not say that it gives the sector a boost, but it is hugely welcome, because if we did not have it there would be significant damage.

**The Chair:** I will call Lord Foster in a moment, but first I want to bring in Ms Jerzewska, because I asked you if you could respond at least to the latter part of my question.

**Dr Anna Jerzewska:** It is an interesting deal, just because it is a bit of a hybrid deal. It is not necessarily a simple rollover—as we have heard, we are waiting for details—but the UK has managed to achieve some additional provisions that exceed what was agreed between the UK and the EU. So it is not a simple copy and paste and not a simple rollover or continuity deal. At the same time, it is a not a new deal. When the negotiations were launched, it was sold in a way as the UK's first post-Brexit trade deal. Obviously it is not that, because it is based on the EU agreement.

On the question of whether it is a good deal and how much the UK was able to achieve additional provisions, again we will definitely be able to judge that once we get the text. I do not think that the differences are that great.

One of the things mentioned in the press release issued on Friday was that the UK will be able to export 99% of tariff lines to Japan tariff-free. For the EU-Japan agreement, the number was very similar; I believe it was about 99% of tariff lines and about 100% of exports for the EU, and about 97% of tariff lines and 99% of imports for Japan.

The differences when you look from that perspective are quite small. There will be some important differences in specific tariff lines and for specific products, but overall that deal will be quite similar. As we have already mentioned, on the state aid situation we will see whether the parts that were copied are actually useful for the UK and what the consequences of that will be. But, again, we will be able to judge that when we have the full text, in October most likely.

Q3 **Lord Kerr of Kinlochard:** Perhaps I should ask Anna this, following on from what she has just been saying. It is alleged in the press that 80% of the benefit of this liberalisation will accrue to the Japanese side. I certainly do not think it is a zero-sum game, and I do not think that

things have to be exactly 50:50, but do you think it is true that 80% accrues to the Japanese side, and how do you see the benefits of this for the United Kingdom?

**Dr Anna Jerzewska:** I have not seen that figure, so it is difficult for me to comment on what that figure was based on. I do not necessarily feel that that is the case. Again, as you very correctly pointed out, when it comes to the benefit for Japan and the benefit for the UK, if you import parts from Japan which you then use in production in the UK and then export to Japan, where does that benefit fall? It is not necessarily one or the other; it is not mutually exclusive.

There are benefits for the UK. Again, the way the press release is written it is quite difficult to understand what an additional benefit is versus what has already been agreed between Japan and the EU, and what some of these things are. On rules of origin, for example, it was new and more liberal. That does not tell us very much, and it was the same when the press release referred to the quota for beef, I believe.

Again, it is not specific enough for us to understand what the provisions will be, but I understand that a number of industries were quite pleased with what they understand the provisions will be, and there is definitely good news. The exact scope will be known once we see the text, but I would not think that it is a good deal only for Japan; I am pretty sure that there is tangible benefit for the UK as well.

The key benefit is minimising the impact of a potential no deal. We are trying to maintain as many of the supply chains as possible, and that will definitely be a key benefit for the UK. Just having a deal and not falling over a cliff edge is definitely a benefit.

**Q4 Lord Foster of Bath:** Mike Hawes, you talked earlier about the importance of continuity and about the rules of origin, cumulation and so on. We have just heard that the one area we do not know about is state aid or subsidy. In fact, less than an hour ago in the House of Lords, Lord Grimstone told the House that the subsidy chapters in the Japan trade agreement were going to be a rollover of the existing subsidy chapters in the EU-Japan agreement.

So there is continuity there. I wonder whether you are pleased by that, and if so why, given that the Government themselves told us that the benefit of Brexit was being able to change the way we did state aid in this country, and presumably it is in Japan's interest, not necessarily the UK's interest, to have that rollover, because it means that it does not have to go back and renegotiate with the rest of the EU.

**Mike Hawes:** You are obviously ahead of me in the information. I was not aware of that. A lot is said about state aid at the moment and has been said in recent weeks. As a sector, we would rather operate on the basis that we have competitive conditions: competitive investment, competitive operations and a competitive market.

Often state aid can be used where there is a disadvantage, and we would rather have a framework in place that allows us to be competitive. That has been the case for the last 10, 15 years. Certainly coming out of the global recession we were very competitive, and just about every investor attracted further investment.

However, there are obviously provisions for state aid in the EU and the single market, and companies here are familiar with the opportunities and constraints. UK companies have benefitted in the past. It is not an overly generous allowance, certainly for large companies, but it is the framework we operate in, and if this agreement aligns with that with the EU, hopefully that will make it easier for the other negotiation to proceed, because that is the one we desperately need as well.

**The Chair:** I will go back, if I may, to John Kerr. There is a question in between that we may come back to.

- Q5 **Lord Kerr of Kinlochard:** On state aid, if it is indeed a rollover, how do you think that will play into the negotiation with the EU if, as we are told, Lord Frost is seeking a less restrictive regime than we would have agreed with Japan on subsidies?

**Mike Hawes:** I am not sure who that question is addressed to, but I will go first, if I may. There will be an interesting dynamic between the two, undoubtedly. As I said, the application of state aid going forward is uncertain for the UK. Our key issue is trying to make sure that we get that deal.

State aid was not our prime objective. If you had asked us what our objectives were for both these trade deals—with the EU and with Japan—state aid was not one of the top three. It was avoiding tariffs through rules of origin, cumulation and non-tariff barriers. State aid was not high up the list of priorities. It may be for other sectors, but not for ours. That said, we do not want there to be an anti-competitive issue whereby an alternative location is a lot more competitive because they can access a lot more state-aid funding, which can be the case in emerging markets.

- Q6 **Lord Watts:** Good afternoon. The SMMT has stated that the UK should prioritise maintaining key elements of the existing automotive annexe, or upgrading it if possible. I know it is difficult to say because you have not seen the details of the deal, but can you talk to us about the importance of that—this question is probably for Mike, first—and what you feel is likely to be the outcome of the negotiations that are taking place?

**Mike Hawes:** We certainly hope that, to all intents and purposes, there is a replication of the EU-Japan automotive annexe. That is because, yes, we want to avoid the imposition of tariffs, but we also want to avoid the imposition of non-tariff barriers, and a lot of that centres on regulation.

As someone who has worked in the automotive industry, including for a Japanese manufacturer in the past, discussions between the EU and Japan on a trade agreement had been going on for many decades, generally focused on non-tariff barriers rather than tariff barriers, and a

lot of that was about regulation. The automotive annexe in the EU-Japan agreement sought to minimise those non-tariff barriers, or in a sense to remove them, and a lot was set out in the annexe about continued regulatory convergence in the future and enhanced collaboration and co-operation, following the UNECE and implemented in UNECE regulation.

On the question of what we believe this agreement will do, while it is not the mutual recognition of regulation, which is the ultimate goal, if you will, it should, if all goes to plan as we are led to believe, avoid the need for additional testing and additional certification, because when producing an automotive car and putting it on a market you have to go through various tests. Where those tests are totally aligned you expect one test in one country to be equivalent to the test in the other and recognised in the other. If not, you have to test again.

Testing a vehicle is a hugely expensive exercise, especially when you think about safety testing; you are taking a pre-production vehicle that is worth £500,000 or something and smashing it up. Especially for small manufacturers that is not something that you want to do very often, because the volumes that you are selling are low.

**Lord Watts:** What upgrade were you looking for in the negotiations? Were you looking just at the status quo, or were you looking to improve the present system that you have been working under?

**Mike Hawes:** As a minimum, we want the status quo. If there are opportunities for further collaboration between the two countries, of course we would accept that. Where we have ended up I do not know, but if it largely replicates the existing annexe, that would be hugely welcome.

**The Chair:** Lord Gold, some of the issues that you wanted to raise may have been covered, but please raise them if not.

Q7 **Lord Gold:** Thank you very much, Chair. Indeed, the main thrust of my question was about the importance of achieving an EU-UK deal, but you have already told us what we probably knew, which is that it is absolutely essential. So let me be a little pessimistic for a minute. What if there is no deal? What if we are back to World Trade Organization stuff? Where does that leave your industry and other industries in this country?

**James Ramsbotham:** I think that we in the north-east feel very, very pessimistic about that potential outcome. Here we sit with seven ports all facing east across the North Sea. All the government assessments have always said that it would be the north-east that would experience the biggest threat to GDP from a no-deal outcome. Talking about a no-deal outcome, we have to have a deal at some point; it is just a question of when.

Certainly the Nissan chief executive and COO have made it very clear that they would be looking at closing down operations. Thirty thousand people in the north-east are directly employed in the automotive sector, and probably that many again are employed indirectly. Hitachi, which

moved here very much putting in place a potential investment to export trains to the EU, has so far completely failed to win a deal with any European country, because by the time it had started operations the Brexit referendum had taken place, so it must be under threat, too.

Those are just two examples; we see so much. Our trade with Japan is so much part of those automotive supply chains, and in the automotive sector—Mr Hawes will know this much better than I do—automotive companies try to keep all the costs of logistics down to less than 8%. It is not, therefore, just the tariff problems of the WTO; it is all the bureaucracy and all the huge delays in just-in-time management and everything else.

Many of the businesses that were doing a lot of work with Japan across the pharmaceutical sector and others are quite low-margin businesses, so you do not need to increase costs very much to do significant damage to their long-term investment potential in this region.

**Dr Anna Jerzewska:** I completely agree with what James has said about the impact of no deal. I would just point out a couple of key details in the impact of no deal on the UK-Japan agreement. Something which the UK hoped for and which James and Mike have mentioned was the EU potentially being willing to compete the third leg of this cumulation triangle and to ensure that, at least in some key industries and potentially in the auto industry, parts could be used as if they originated between all three parties.

Whether we have a deal with the EU or not, that particular aspect is very unlikely to change. It is very unlikely that the EU would ever agree to this type of cumulation with the UK and Japan, or indeed with the UK and any other partner. That was one element that was perhaps overstated initially. Obviously it was the hope of the industry, but the chances of that actually happening are quite low, so even if we end up with a deal with the EU, incredible though that idea seems right now, we will probably not get the full cumulation that we hoped for, and industries such as the auto industry will be severely impacted. Supply chains will be impacted anyway, obviously much more so than if we do not have a deal in general, but even with a deal they will still be impacted.

Q8 **Lord Gold:** I want to move on to the rules of origin, and simply ask this. We know a little about the rules of origin, and some of you have mentioned it this afternoon. Again, taking the negative view for a minute, if we are thrown back to WTO, how does this then apply, or does it not? I do not know.

**Mike Hawes:** Certainly for the automotive sector, if there is no deal—I like to think I am an optimist, but I am being severely challenged—the application of WTO tariffs to our sector would threaten the very viability of many companies in it. Mr Ramsbotham talked about the wafer-thin margins that are there. Certainly in manufacturing they are there.

As a general rule of thumb, manufacturing operates somewhere between a 2% and 4% return on investment. The application of tariffs to finished vehicles would be 10% and, to parts and components, 2.5% to 4.5%. The impact of that if the additional cost was passed on to the consumer—in other words, it flowed straight through—would be the price of an average car in the UK going up by about £1,800. It would be a bit more going the other way. It would very much affect the competitiveness of the UK export, because you could not pass that cost on to a European consumer.

As it happens, we put out a press release this morning, with ourselves, our equivalent European association and other member state automotive associations all saying the same thing, which is basically that we need both parties to agree a deal. The cost of not achieving a deal could be as much as £110 billion. That is split. It would cost the European side slightly more, not a huge amount more, than it would cost the UK industry, but of course we are one country; they are 27.

Certainly in all the conversations I have with all our members. it is one of those issues that you do not always get in a particular sector whereby just about everyone is unified on the same position: we need a deal, we need to avoid tariffs. Obviously we wanted, and we still need to maintain, as frictionless trade as possible, because we operate on the basis of just-in-time, just-in-sequence delivery, and we are leaving the single market and the customs union, which poses some challenges when you have over 1,000 trucks a day coming in with parts and going straight to factories. This is a critical issue that we need to make sure we have got.

I have said it before, as have others: we are in damage limitation mode at the moment.

**The Chair:** But you are doubting the viability of a continued motor business in the UK.

**Mike Hawes:** For certain companies. We need motor vehicles for mobility and we will always have a market. However, their viability is threatened in terms of the competitiveness of the exports, especially for companies that export primarily to Europe or for which Europe is one of their biggest markets, because manufacturing is such a wafer-thin business. We have been very competitive over the last 10 years or so, attracting investment. We are very productive; we are one of the most productive places in Europe to make cars. But that competitiveness could be undermined on 31 December.

**The Chair:** Thank you for that very sobering analysis.

Q9 **Lord Lansley:** I should first declare an interest: I am co-chair of the UK-Japan 21st Century Group, and as chance would have it I had an opportunity on Friday and Saturday to take part in an online conference with some of my Japanese friends and colleagues.

I have two or three questions, but I will ask just one now. The way they would have expressed it was that there was something they were looking

for in this deal and they did not get it. They understood why they did not get it, but they none the less regarded it as important. It was that they have allowed the tariff-free entry of UK cars to Japan for 40 years or more, and they wanted to accelerate the point at which they would be able export cars from Japan to the United Kingdom tariff-free rather than wait until 2026 under the terms of the EU agreement.

In the light of that, when you look at the deal as we understand it, how do you assess the benefit of this particular deal and how it might have mitigated the risks that you saw? Perhaps this is a question for Mr Hawes first.

**Mike Hawes:** Obviously this comes with the caveat that we have not actually seen the detail. The fact that we have a deal, first and foremost, is to be applauded. Secondly, that deal seems to replicate much of the EU-Japan deal, which again we were looking for. We wanted to see the parallel tapering of the tariffs that Europe currently has; it just makes sense to do that. Probably the third aspect, leaving aside the future relationship with Europe, is that it was important to get this deal and to have the automotive annexe that I mentioned earlier—touch wood, that is in there, because that addresses some of the regulatory barriers, the non-tariff barriers, that we would seek to avoid.

In any trade agreement, both parties will always want to have had more, but it is obviously in the spirit of compromise in negotiation that we arrive where we are at. However, the basis is also for future discussions; it does not have to be an endpoint. We want to make sure that we have a framework in place that allows UK manufacturing to be competitive. It was important for this Government to do what they could to ensure that we could maintain that competitiveness, that there was no imbalance such that it was in Japan's favour, which might make Japanese manufacturing locations much more attractive for products that end up in the European and UK markets.

**James Ramsbotham:** You mentioned, Lord Lansley, that the committee you look after is looking forward to the 21st century. One of the key things at the moment is electric vehicles. Often when we talk about the automotive sector we talk about it much as we know it now, but of course the EV sector is growing, and growing fast. Here in the north-east, Nissan makes the Leaf, which is one of the biggest-selling all-electric vehicles across Europe. However, because of the way Japan has invested so heavily in electric vehicles, we rely very heavily on the parts that are coming in.

Certainly the annexe to the agreement needs to be really flexible and look forward to future developments. Therefore, for your committee, Lord Lansley, it is very much about how the automotive sector, and indeed all our businesses dealing with Japan, will develop in the future. The electric vehicle market particularly makes the point as to how we need to look to how it develops in the future.

**Lord Lansley:** As I understand it, again we do not have the detail, but

how important and valuable do you think some of the changes in tariffs and tariff-rate quotas on automotive, rail and electronic parts will be to companies in your region?

**James Ramsbotham:** I think they will be crucial. It is very important to make sure that people understand that it is not just the tariffs but all the agreements that go with it, because these sectors rely so heavily on really efficient supply chains, and those supply chains are global. It is not just about cost; it is about resilience. The tsunami in Japan, for example, really focused attention on how much of the supply chain needs to be local to the plant. But for certain things we rely on pieces moving backwards and forwards, assembly, re-assembly, and everything else. So it is not just the tariffs but all the arrangements for all the documentation that goes with this, and it is absolutely crucial to make that work.

Again, this goes back to triangulation, because Japan sees so much of the UK as a launch pad into Europe, so a lot of our exports and imports are actually bits and pieces that are part of a wider global market, and you need to understand the whole; you cannot just look at the individual component parts.

**Dr Anna Jerzewska:** First, apologies for the light here. It is a very sunny day here in Geneva, so apologies for that.

**The Chair:** Why are you apologising? That sounds very nice.

**Dr Anna Jerzewska:** So, yes, tariffs on Japanese cars have not been removed immediately as Japan initially hoped. However, as far as we understand it, at least from the press release, cars and other types of vehicle, and particularly vehicle parts such as rail carriages, might just have been liberalised more quickly than under the EU agreement. As far as I understand it, rail carriages and parts of rail carriages are Japan's second largest export to the UK, which for manufacturers of that particular type of vehicle will be good news. So while Japan did not necessarily get all it was hoping for, it definitely got some reductions on cars.

**Lord Lansley:** I thought that was indeed behind some of the points that you were making, Mr Ramsbotham. It is really rather important that in Hitachi's case we have a European manufacturing centre. But it brings us back to the point which I think Dr Jerzewska—

**Dr Anna Jerzewska:** Please just call me Anna.

**Lord Lansley:** —was making. I just want to play that back to you and to Mr Hawes. You talked earlier about completing the triangular cumulation. We are examining the UK-Japan deal, in which the rules of origin are, as I understand it, what you were hoping to see. But at the moment neither we nor particularly the Japanese can provide for the Japanese parts to be treated as UK-origin for the purposes of tariff-free access to the EU, even if we go into a Canada-style deal. I think that was what Anna was implying: that a Canada-style deal probably does not imply cumulation on

rules of origin in the way Mr Hawes was originally hoping for. Is that correct?

**Dr Anna Jerzewska:** Yes. It is not necessarily to do with the type of deal, whether it is a Canada deal—. It depends what is meant by that. It is whether or not this provision on cumulation is included in the text. Obviously we do not know whether it is included in the UK-Japan agreement, but we have reasons to believe that it might be.

Even if that is the case and we have this extremely liberal provision under the UK-Japan agreement, that leaves us in a bit of a strange situation whereby UK manufacturers can purchase parts from the EU, from EU suppliers, use them as originating, and export them to Japan under tariff preferences. That is very good for EU suppliers and exporters, but EU manufacturers cannot do the same with UK parts, which means that that is not great for UK producers for parts and components.

So with these kinds of origin provisions there are always two sides, but you are absolutely right that it is very unlikely that the EU will reciprocate and that this will be a full triangle. That is very unlikely to happen. Whatever the style of the deal between the UK and the EU, it is just not something that the EU is likely to say yes to. Of course, there are also challenges such as the WTO compatibility of that provision that will need to be resolved at one stage or another.

**The Chair:** Lord Watts also wants to ask about key elements of the automotive industry.

Q10 **Lord Watts:** Can I just go back to the point James made about the regional impact? It seems to me that the heavy investment that we have seen over the last few years makes the north-east susceptible to having a massive problem if no deal is done with the EU, and I would be interested to know James's view if he wants to say any more about that. The Government are claiming that we have a good deal with Japan, and obviously we all hope that that is the case.

How would any such deal be underlined if we do not have a deal with the EU? It seems to me that we might have some small benefits from a trade deal with Japan, but they will be well overtaken by the effects of a no deal with the EU.

**James Ramsbotham:** Indeed. Certainly officials in Nissan and Hitachi have made it very clear that they welcome this deal with Japan, but it would be totally outweighed by the lack of a deal with the EU. As we mentioned before, with the low margins in that business it just would not be sensible. Of course, so many of these Japanese businesses also have operations on the continent, and they have already seen some movement of business.

That is particularly sad for a number of reasons. If I look back to 2009 at the start of the credit crunch, when the automotive sector had a significant hit and had to downsize very fast, Nissan had the experience of being able to do so very quickly and effectively here but with real

problems in Barcelona, where it was trying to do the same. Indeed, at one stage the senior Nissan manager was barricaded into the offices by rioters and needed 150 riot police to get him back out to the airport. When he got back to Tokyo, he said, "Right, if there's any recovery we're investing in Britain and not Spain".

Only 10 years later, they are having a very different discussion because of the threat. They desperately wanted to see Britain as the place to invest but are looking at very different decisions right now.

**Lord Watts:** Thinking about the Government's own figures on the benefits of the trade deal that we have, the figure that you have given the Committee today of, I think, £106 billion puts into context the benefits and disadvantages of not having a deal with Japan or the EU. I would like to give you another opportunity to contrast the importance of two deals, one with Japan and one with the EU.

**James Ramsbotham:** The figure I gave in my introduction was that 2% of our exports go to Japan and 60% to Europe. I think that makes it very clear. Then I look at the other side of it, which is the amount of very significant investment and the number of people who are employed here in the north-east by Japanese investments.

Many Japanese businesses of every size have invested here over the last 30-plus years. They are huge employers and they contribute massively to the UK economy, let alone to the north-east economy, so they are all very welcoming of a much, much closer trading relationship between Japan and the UK. However, in preparation for this, every single one we spoke to particularly wanted to make the point that decisions that are being made in Tokyo are being based on our relationship with the EU, which is the market they based themselves here for in order to take advantage of it.

**The Chair:** Lord Lansley, you mentioned that you had more than one question. Have you exhausted them? I doubt it very much indeed.

Q11 **Lord Lansley:** I just wanted to follow up on the point about standards. I am not aware of what it is in the deal that will precisely try to encourage regulatory cohesion between us and the Japanese on vehicles, but I wondered what you, and Mr Hawes in particular, are hoping to see appear in the deal from this point of view and how that interacts with the EU. Are the Japanese looking for us to continue alignment with EU standards, or are we looking to something that is more international in character?

**Mike Hawes:** On standards, you would be surprised. You can fly to any airport in the world or hire a car, and it is essentially a safe car. You think it is made to the same standards, but they are not all the same. Standards are always a bone of contention in trade negotiations. We generally build new cars to European standards, because that is our biggest export market; 80% of what we produce is exported and more than half goes to the rest of Europe.

The two major regulatory standards globally are those of the US and Europe. Japan is somewhere in between, but there is a global organisation called the UNECE, which sets global standards that get implemented locally, and so forth. So there is an international level and then there are two major regulatory hubs.

What any manufacturer wants is to reduce complexity, so the more you can produce to one standard, the more efficient you will be. The EU-Japan EPA, as we said before, has an automotive annexe that talks about some of these standards and attempts to make sure that, while it is not mutual recognition, as many of the European and Japanese standards as possible will align. That followed most of the international standards but recognised to a certain extent some of each other's.

If we can take the majority of that and see it into the UK-Japan agreement, we will prevent any spread of further discrepancy of regulation, which we will be trying to avoid.

**Lord Lansley:** So as far as you are concerned, we as a Committee should be looking for that text to be carried forward when we see the legal text.

**Mike Hawes:** Absolutely.

**Lord Lansley:** If I might just leap ahead for a second, equally if we get to the point of a UK-US deal, we should be thinking very carefully at what, if anything, that says about vehicle standards between us and the US market.

**Mike Hawes:** Absolutely. Obviously we have had discussions with our counterparts in Europe, and I have met with commerce departments and US trade representatives, and our discussions generally go very well—we both want free and fair trade, and so forth—until we get to the point of regulation.

The US approach to regulation is fundamentally different from the European approach. In Europe, we have something called type approval, whereby you produce a car, you submit it for testing by a national authorised authority, and you are then permitted to sell it anywhere in Europe. The American approach is self-certification, and regulators intervene if they think there is some deviation.

Also, how regulation is arrived at and developed in the US system is quite different from the way it is arrived at and developed in the UK and in Europe, so they will always clash, even though the outcome is pretty similar. As I say, hire a car at JFK and it will essentially be the same car, although subject to a few minor differences. Famously, wing mirrors in America say, "Objects may be closer than they appear". You can see that in any Hollywood film, such as when a dinosaur is attacking you. Things like that can be different, but fundamentally they are the same.

**Q12 The Chair:** Mr Hawes, you have been very helpful in all your answers. I just want to give you the opportunity to explain something to us, because

we understand—this has been mentioned several times—the importance of the rules of origin and of cumulation. If I may ask slightly prosaically, what do you need to see in both the UK-Japan agreement and the UK-EU agreement in order for things to work in the way you want? Can you help us with that?

**Mike Hawes:** Essentially, we need to see the recognition of content and the thresholds that are needed to meet those levels of content in order to define a vehicle as a UK vehicle. Generally, they are around 50%. The important thing is the cumulation; because we are part of a European industry, we need to see that recognition and be able to cumulate parts and components from Europe.

While the UK is a major car-producing country with a good supply chain, we are part of a European industry and a European supply chain, so a lot of our parts and components, as we said before, come into the UK, are processed, and might go back again. Some go into UK vehicles. We are totally integrated, and it is very hard to identify the exact level of content. You can change that level of content only when it comes to a model change, which can be every four to seven years. So we need to see recognition of the complexity and nature of the UK industry being part of Europe.

**James Ramsbotham:** The other important thing for your Lordships to consider when discussing this in the House or whatever is the need to make sure that a sensible period of transition is agreed, because if rules of origin change and therefore content applied changes, it takes time for supply chains to adapt, and if there is real change it will be crucial to sectors like the automotive sector to have a sufficient period in which to change their supply chains so that British businesses are not damaged in that period.

**The Chair:** Can you quantify “sufficient time”, just so we know what you mean by it?

**James Ramsbotham:** Twelve months would be probably be an absolute minimum for adapting those sorts of supply chains.

**The Chair:** That is what I wanted to understand: whether it would be weeks, months or years.

**Dr Anna Jerzewska:** I completely agree with what has just been said, particularly on the need for a transition period, implementation period or whatever you would like to call it. That is definitely important.

When we talk about cumulation and the provisions under the UK-Japan agreement, it is important to understand the magnitude of the UK’s ask. What the UK perhaps managed to achieve under this agreement, and what we know it was able to achieve under some of the other rollover or continuity agreements, was a specific type of cumulation. It is not just simple cumulation. It does not exist in any other FTA.

No FTA in the world applies the type of cumulation across the board which the UK is asking its trade partners to apply. It is a completely unprecedented provision and something that, as I mentioned earlier, might pose a challenge with the WTO. Cumulation exists in most agreements in one way or another. But it is not just a problem of cumulation, it is what kind of cumulation the UK is asking for, and it is important to recognise that the UK is asking for a lot here. It is asking for something that has never been done before. In a way, cumulation came from the auto sector, and it has been used for the purposes of the auto sector in general.

**The Chair:** Can you just explain what you mean by that, because people will read this evidence as well as listen to it and watch it?

**Dr Anna Jerzewska:** There are different types of cumulation. I will not describe every one of the standard cumulation types, because that would take too long.

In principle, when you have an agreement with more than two parties, for cumulation to be applied there are two main conditions that need to be fulfilled. One is that all parties are joined by a trade agreement. The other is that all these trade agreements have identical rules of origin. That is where the problem is, because if the UK wants to have this type of cumulation with different trade partners, it cannot have identical rules of origin with all those partners.

What the UK is asking Japan to do, and what it asked other trade partners to do before, is to apply a very new, very flexible and liberal type of cumulation called extended cumulation, which removes those two conditions. It basically means that two parties agree to treat imports from another party—in this case, the EU—as if it originated without those two conditions, whether or not we have an agreement with the EU and whether or not the rules of origin are identical.

Again, that has been used in a number of agreements so far, including with the EU. The EU has also used it in its agreements but in a very specific and limited way—pun not intended here; apologies.

**The Chair:** I am glad that in Geneva you understand the significance of those two words.

**Dr Anna Jerzewska:** It is very hard not to at this point. But that was definitely not intended; I just heard myself say it.

What I was trying to say is that it has been used for particular tariff lines—for example, for auto parts or for a specific product—but never across the board in the way the UK is intending. It is important to understand just how much we are asking, because we are very unlikely to get it from the EU. It is a very big ask, so even if we manage to get it with Japan, that is already a significant success. That is still worth counting.

**The Chair:** Thank you very much. Do either of the other two witnesses

want to comment on that? If not, we will move on.

**Mike Hawes:** Very quickly—Anna has set that out very eloquently. This is ambitious. This is unprecedented. Then again, unlike most trade agreements, rather than trying to coalesce, this is the removal of one country from an existing trade agreement, so we hope that people see the merits of that approach.

Q13 **The Chair:** There is one question I would like to ask that is slightly different and focuses on Covid-19. Obviously it has been a challenging time for most, perhaps all, industries. How have the industries been impacted by it, and how have they been affected while watching the negotiations that are taking place between the UK and Japan in particular?

**Mike Hawes:** I will talk about the automotive sector, if I may, and I am sure that James can talk more widely. UK automotive manufacturing was trying to work up some degree of buffers and latitudes of plan for this year because it knew that it would be difficult because of Brexit. That flexibility disappeared with Covid, so for many months now we have still been in the restart phase. We are not in recovery yet.

So for companies and businesses, especially supply-chain and small businesses, the opportunity to have the bandwidth to engage not just in these discussions but in other ongoing trade discussions has been compromised. To a certain extent, I am sure negotiators will say that their opportunity for negotiation has been compromised, because government resources too have been spread across the Covid reaction.

It has been very challenging. That is why it is still very important that the sooner we get sight in this case of the actual terms of this trade agreement, the better, so that we can try to make sure that there are no unintended consequences in the way it has been drafted.

**The Chair:** Right. That is important to understand.

**James Ramsbotham:** A whole number of other impacts of the Covid crisis have added to pressures for business. Clearly, even the likes of Nissan had to close down operations for a couple of months, and car and other sales are still at a very low level, although I am told that second-hand car sales are doing extremely well at the moment, as many people are moving from public transport to driving because of the issues on public transport. So there are other sides to that.

The real issue for so many businesses is the amount of time and effort they have had to put in in order to make their operations Covid-secure. Here in the north-east, a larger proportion of our business community is manufacturing, so there has been a lot of effort there, and I pay huge respect to businesses, particularly on the scale of a Nissan or a Hitachi, and the work they have had to do to get themselves up and running.

There will be other impacts on the trade agreement. First, there is a real focus on the resilience of supply chains, as opposed to focusing rather

more on the cost side. One of the obvious impacts in this country, of course, has been on NHS supply chains and the need to focus on having more of the supply closer to the point of consumption. That is important. That will impact on trade agreements, particularly as far afield as Japan.

The other impact in the near future will be cash flow. So many businesses have had to expend a huge amount in dealing with the issues of the pandemic and have therefore had to take on extra borrowings already. That will impact more in relation to the EU deal, but there will be knock-on impacts elsewhere in that, in order to prepare particularly for a no-deal outcome but for any outcome that is not close to the current deal, the amount of stockpiling and everything else that has to happen absorbs a huge amount of cash, and many businesses are now at the absolute limit of the cash that they can get access to. That will have massive impacts on the way so much goes on.

**Dr Anna Jerzewska:** Another thing that will be quite important for businesses, at least the businesses that I speak to, is how quickly we will get information on the UK side on how we can certify origin. When you export under a free trade agreement, you also need a certificate that demonstrates that your goods are eligible, that they originated and meet the rules of origin.

Under the EU-Japan agreement, there are two ways to do that. As a trader, you can self-certify, but you need to do it through an EU system called REX, and we do not yet know what the UK replacement will look like. That is one problem. Or you can do it in a completely new way that comes from the US; it is a US style of certification that is certification by an importer. That is very new to UK companies, so how quickly we get the guidance on that will determine whether companies can actually use that agreement, even if it is enforced on 1 January.

- Q14 **The Chair:** Can I just broaden this out a little? James Ramsbotham may want to answer this first. Some people have argued that our UK trade policy should reflect the levelling-up agenda for the region and devolved Administrations which the Government have been talking about. Do you think that trade policy could generally help the regions? What would help to ensure that the regions maintain the investments and businesses that they currently have?

**James Ramsbotham:** That is a huge subject that you have opened up there.

**The Chair:** It is such an important subject.

**James Ramsbotham:** It is absolutely crucial. In many ways, it relies on a real understanding of what different regions' strengths are and where that connectivity is. You start to get into the whole industrial strategy piece and what resources we have available in each region, where we are situated, what our access points are, et cetera.

Certainly we believe very strongly at the moment, as you would expect from the north-east, that we entered this pandemic situation in many

ways in a weaker place than others and we need extra effort to get out. We are a region that exports much more percentage-wise of everything that we make and do than any other part of the UK. A lot of that—the number of cars that we are exporting, et cetera—is down to Japanese investments, so we rely very heavily on a policy that focuses on building exports, because that is what so many of our businesses do so well. Therefore, it is almost at the moment about making sure that we avoid the negative, because if we get the trade policy wrong we will add further damage to regions like the north-east, which exports so much, and it is crucial to our long-term economy.

**Mike Hawes:** I agree with what James said. We should also remember when we talk about different trade agreements, their impact and how they change fundamentally that there is plenty of precedence for adjustment support. There is an EU globalisation adjustment, the Americans have a trade adjustment assistance programme, and there are examples in other countries of where Governments will intervene to try to mitigate any negative impact of trade adjustments.

I go back to one of my original points: we would rather be competitive. That is the best way, and having an industrial strategy that allows us to be competitive is first and foremost. However, where you need to intervene, those sorts of adjustment mechanisms, which are not now seen to be in breach of state aid—we are going back to that issue again—might benefit in that regard. As Anna said, there is global precedence for such examples.

**The Chair:** Before turning to other provisions that one might hope to see in the detail of the text, what specific provisions in the UK-Japan free trade agreement would you hope to see that could be beneficial in increasing, or at the very least maintaining, the current level of Japanese investment in the UK? Who would like to answer that first? I will go to the north-east, I think.

**James Ramsbotham:** Thank you. We clearly want everything to be done to protect the really great businesses that we have at the moment, so we absolutely look to the agreement to protect the automotive sector, the rail sector, the pharmaceutical sectors. Those are the ones that really matter to us. But what is important in those, as I think I said earlier, is making absolutely sure that those play into whatever future innovation and development there might be. We are very good at putting deals in place that cope with today's situation, but they have to have the flexibility to cope with changes, certainly in the automotive sector with all the work on electric vehicles.

It seems to me that in the UK press on the UK-Japan deal there has been a lot of focus on foods. It is extremely important to all of us, but it is not as important certainly to the north-east as it is to some of the bigger manufacturing sectors that are so crucial.

The other bit that we have not touched on at all and that has really been brought to the fore over the last six months is the focus on the digital

world. There is quite a bit in this deal to do with how we treat data between our two countries, and that will be incredibly important as well.

**Mike Hawes:** I will make two quick points. When companies are looking to make international investments, yes, the trade situation is one of a number of measures they look at. They are obviously looking in our case at the UK being competitive and at the availability and skill levels of the workforce.

There is a range of issues. Those are the hard issues. There is also the softer issue. This is very important in terms of Japan, and I am sure Lord Lansley would know that better than I. The Japanese invested here in the 1980s and 1990s for the long term. They do not think that in 2020 we have got to the long term yet. Their timescale is much longer, and they look very favourably on the UK. Yes, it is a springboard to Europe, but it is a fellow island trading nation, and Japan has a lot of respect for its engineering excellence and so forth.

So when you are looking to attract inward investment, you need the right conditions but you also need trust that you will value that investment for the long term and that things will not change; you will continue to support that business, not necessarily in state aid, and to continue to make sure that the environment is correct. That softer side is often overlooked just on the hard facts, but it is an important part.

**Q15 Lord Foster of Bath:** A lot of the conversation so far has focused on tariffs, rules of origin, cumulation, how we certify origin, the need to complete triangulation in terms of cumulation, and we have mentioned state aid and subsidy, and the very important issue, which James raised very recently, of data, data adequacy and all those issues.

I was particularly taken by Mike's comments about the need to look for unintended consequences, so when the deal is actually published and we can look at it, where would each of our witnesses recommend that we look? What particular chapters should we look at very carefully, not least to see if there are unintended consequences? Perhaps you can add to that your thoughts about your understanding of the areas where we need to introduce new legislation in the UK to deal with some of the issues that have been raised in this UK-Japan trade deal?

**Dr Anna Jerzewska:** It is a complex question. The first point to make is that, yes, there are potential unintended consequences when it comes to state aid, as we have seen over the last couple of days. That just demonstrates something that a lot of people, including me, have mentioned over the last four years: these agreements are already bespoke—they are negotiated between the two or more parties, depending on the size of the agreement, that are involved. Rolling over an agreement, copying and pasting the majority of an agreement, is not always a safe bet, because you can end up, like with state aid, having done something that you did not necessarily want to do.

In terms of the EU-Japan agreement, this will differ very much for different industries. In general, anything to do with non-tariff barriers will

be crucial, because that is where we know there are difficulties between the EU and Japan and between the UK and Japan, and where there is potential for unintended consequences. That is where, I think, Chapters 6 and 7 of the current agreement will be used. Sanitary measures and technical barriers to trade will definitely be important.

To be honest, older chapters might have something that negatively impacts different industries, so it will be a question of each industry or representatives of each industry going through the chapters that are relevant to them and seeing what has been added. Again, it is quite difficult to pinpoint and to pick one or two chapters that are definitely at risk.

**Mike Hawes:** I would probably agree with that. The first thing we will look at will be the tariff schedule and the rules of origin protocol, and then we will see whether there is the automotive annexe that we discussed. We would also look at whether there are other provisions in there such as digital trade, which James mentioned, movement of people, things like that, because we do believe that there will be more generous allowances for movement of people than currently exist on a business basis.

On your question about the potential for UK legislative change, I do not think we will be looking for any change in relation to this, as long as when we are making automotive vehicles and parts and components we continue to follow international standards. That is what we need to do, and it would be questionable to wish to deviate from those international standards. So that is fairly unlikely.

**James Ramsbotham:** The thing I would probably emphasise a bit more is people. Mike mentioned some of the softer issues, but it is all to do with the transfer of skills and the movement of people. The Japanese have done incredibly well in the past six months, because by nature they are not a culture that works well from home. They are very much a presenteeism culture and they like to meet people face to face, and we have to make sure that we allow free movement in a guise that absolutely facilitates our ability to trade and invest with each other. That is where I see the potential danger of unintended consequences if we do not make sure that we get it right.

**The Chair:** That is an important point to emphasise, and we understand that. All three of you have been enormously helpful, and I want to thank you very much indeed. You have given a great deal of your time and given very useful answers, which helps us a great deal.

I will ask members of the Committee whether they have any other questions that they want to raise. Other things are taking place in Parliament as well—I noted that a moment ago—so one or two of our members have not been able to ask the question they wanted to.

Q16 **Lord Lansley:** I just wanted to follow up on, I think, Mr Hawes' point about this not being the endpoint. From our point of view, if we are

looking at this deal and reporting it to the House, are there any particular instances where there might be mechanisms and opportunities for the deal to be taken further in the months and years ahead, not least in relation to using it as a basis for our accession to the CPTPP in due course?

I would also like to ask Mr Ramsbotham this question. One of the Government's hopes, indeed expectations, is that this will promote greater SME access to the Japanese market. From the point of view of your region, which has so much of a relationship with Japan, what support will your SME members be looking for to enable them to exploit the deal? Are there particular sector areas where you think that might well happen?

**Mike Hawes:** I think you might have answered your own question. The CPTPP is a huge opportunity to make massive markets accessible, and agreeing it with Japan is a crucial first step. We do want to see the terms of the agreement. We have talked before about whether there might in the future be further enhancements in relation to people, digital and so forth. We are in an industry that is increasingly digitising in how we make vehicles and in the operation of mobility and so forth. Those are crucial elements.

It is difficult to give any specifics until we see the terms and can see where future opportunities might lie, but, especially as our relationship with Europe gets settled, saying, "Okay, we want to develop in the future, maybe in our sector and in other sectors as well", should be explored.

**James Ramsbotham:** Indeed, and I would hope that a deal like this could be much publicised in order to attract more SMEs to look at it. It needs a lot more publicity and a lot more focus from the DIT. For many smaller and medium-sized businesses, Japan is often seen as quite a highly regulated and quite disciplined market and therefore not as easy to break into as, let us say, Korea, which is not very far away. That is not to say that Korea is undisciplined; it just seems to be more relaxed in its way of doing business, whereas Japan is seen as quite a challenge to get into.

So probably nationally we need to put more effort into promoting it and making sure that in the DIT and the embassy we have more support and are promoting its opportunities and looking to trade missions and trade fairs. Right now in the virtual world there are all sorts of ways of opening up those opportunities, and I would love to think that a trade deal like this would be a launch pad for a lot of that.

**The Chair:** Are there any final questions from anybody if our witnesses are willing to put up with it?

**The Earl of Sandwich:** Chair, I am so sorry to have come in late, and I am sure you have covered all the questions I was going to ask.

**The Chair:** I tried to.

**The Earl of Sandwich:** Can you just confirm that the levelling-up agenda has been dealt with, because I was rather looking forward to the answers?

**The Chair:** The question has been asked and an answer given to it, which you will see when you read the transcript. Was there a specific aspect of it that you would like to ask about? We did ask the question, particularly of our witness from the north-east.

**The Earl of Sandwich:** I just feel that we have heard too little from the regions generally in the course of evidence, so I am anxious that the NEECC perhaps provides some evidence that we really are getting some levelling up.

**The Chair:** I think we may have prevailed as much we can today, but let us look at that.

Can I, on behalf of every member of the Committee, thank our three witnesses—Mike Hawes, James Ramsbotham and Anna Jerzewska—very much indeed for their very expert help on this. As I said, you will see the transcript so that you can confirm it as you wish when you get it. Thank you very much indeed for coming.

**Mike Hawes:** Thank you for the opportunity.

**James Ramsbotham:** Thank you.

**Dr Anna Jerzewska:** Thank you.