

International Trade Committee, House of Commons

The UK-Japan Comprehensive Economic Partnership Agreement (CEPA) inquiry

Evidence by Dr. Minako MORITA-JAEGER

Fellow, UK Trade Policy Observatory (UKTPO), University of Sussex

UK Trade Policy Observatory

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1. Overview of the UK-Japan CEPA

1.1 The UK-Japan CEPA appears to be politically significant especially for the UK. Initially, the UK's top priority post-Brexit was immediately striking an FTA with the US. But its prospects were uncertain due to the US presidential election and British public concerns on safety standards of US agricultural products and on NHS. By concluding the Free Trade Agreement (FTA) with Japan, the UK could demonstrate its capacity to strike a trade deal as an 'independent trading nation'.

1.2 By contrast to its political significance, its economic value looks limited. At least, the Agreement allows Japan and the UK to achieve 'continuity' that is a smooth transition from the EU-Japan Economic Partnership Agreement (EPA) to the Japan-UK FTA on 1st January 2021. Amid increasing risk of no-deal on the EU-UK future relations, avoiding business disruption between Japan and the UK was paramount for both British and Japanese business.

1.3 To understand the economic value of the Agreement on top of 'continuity', it is important to understand to what extent the UK-Japan CEPA goes beyond the EU-Japan EPA in terms of market access and rule-making. On seeing the text of the deal, we observe that the progress made in terms of UK's trading conditions with Japan relative to the conditions under the EU-Japan EPA is limited to some areas of rule-making.

- Neither market access for UK goods nor services exports to Japan were meaningfully improved under the UK-Japan CEPA. Japan's tariff elimination schedule and services commitments are almost identical to those in the EU-Japan EPA except for some very minor details.
- As for Japanese goods imports to the UK, tariffs on some car and rail manufacturing products and inputs are immediately eliminated in order to support Japanese investors in the UK. Other than that, the UK retains EU's tariff schedule in the EU-Japan EPA.¹
- Third, the UK deal offers better terms to Japan than its commitment in the EU-Japan EPA with regards to 'entry and temporary stay of natural persons'. The UK's schedule has improved in some areas, such as the category of intercorporate transferees, allowing spouses and family members' the right to stay in the UK, and allowing 'investors' to stay for up to one

¹ See more detailed evaluation about market access in goods trade in Ayele, Y. (2020). UK-Japan FTA: Tariff gain or no change? UKTPO blog (<https://blogs.sussex.ac.uk/uktpo/2020/10/29/uk-japan-fta-tariff-gain-or-no-change/>)

year. In spite of these improvements, the commitments are not entirely reciprocal as Japan has already committed better terms than the UK's schedule in the EU-Japan EPA and it retains these commitments in the UK-Japan CEPA.

- As for the other chapters, 15 chapters out of the 24 chapters include some changes of provisions. The degree of changes made differs across chapters. Some are minor changes for clarification purposes and others are more substantive changes. The more substantial improvements appear to be with regard to e-commerce, the regulatory framework on financial services, intellectual property and rules of origin. These improvements are expected to provide a legal certainty and predictability to business activities and facilitate trade. Also, regulatory cooperation between the two countries would be enhanced in these areas.

1.4 The above indicates that the economic value of the Agreement on top of 'continuity' seems to be rather limited. According to the DIT's estimates on the macroeconomic impacts for the UK in the latest report,² the possible long-term economic gains from the Japan-UK FTA, account for £1.5 billion in the case of the UK (0.07% increase in UK's GDP) and equally £1.5 billion (0.04 % increase in Japan's GDP) in the case of Japan.³ These figures represent the economic gains relative to WTO terms. Given that the UK is enjoying the EU-Japan EPA since 2019, these estimates do not represent the net benefit of the CEPA relative to the EU-Japan EPA. Also these estimates were based on the assumption that substantial tariff liberalisation and deep non-tariff measures reductions would be achieved. Given that the added-value segments relative to the EU-Japan EPA look limited with regard to the latter, the de facto gains are likely to be smaller than the DIT's estimate of 0.07% increase in UK's GDP for long term.

2. Evaluation of Chapter 8 (services, investment liberalisation and electronic commerce)

We evaluate the UK-Japan CEPA by focusing on the areas of services trade, investment and electronic commerce in comparison with the EU-Japan EPA. Given that trade negotiations can be categorised into market access negotiations and rule-making negotiations (negotiations for making provisions), we analyse the results by categorising into (i) improvements/changes in market access for cross-border services and investment (Schedules for Chapter 8: Annex 8-B) and (ii) improvements/changes in the rule-making issues (provisions in Chapter 8).

Trade in services and investment

Market access

2.1 Japan's schedule of cross-border services and investment liberalisation for the UK-Japan CEPA is almost identical to the one for the EU-Japan EPA except for the two cases below.

- (i) The reservation for existing measures on distribution services (wholesale trade services for agricultural, animal and poultry farm and aquatic products) that affect market access of investment liberalisation and cross-border services trade in the EU-Japan EPA⁴ was removed.

² Department for International Trade (2020). Final Impact Assessment of the Agreement between the United Kingdom of Great Britain and Northern Ireland and Japan for a Comprehensive Economic Partnership, p42.

³ The assessment used in the final impact assessment is drawn from the estimate produced prior to the Japan-UK FTA negotiations. See Department for International Trade (2020). UK-Japan Free Trade Agreement: The UK's Strategic Approach, May 2020, p47.

⁴ Annex 8-I, Japan's reservations, '7. Distribution Services', in the EU-Japan EPA.

(ii) The reservation for future measures on transport services that affect market access, national treatment and some other obligations of investment liberalisation and cross-border services trade⁵ in the EU-Japan EPA was removed.

2.2 This means that relative to the EU-Japan EPA, the UK did not achieve meaningful better access to the Japanese market in terms of liberalisation obligations (e.g. market access, national treatment, most-favoured-nation treatment, prohibition of nationality requirement for senior management and boards of directors, and prohibition of performance requirements) except for the two areas mentioned above.

2.3 As for the UK's schedule of commitments, the UK made three improvements in its schedule of 'Business visitors for establishment purposes, intra-corporate transferees, investors and short-term business visitors'.⁶ In the EU-Japan EPA, the UK did not commit to allow 'investors' to stay in the UK. In the UK-Japan CEPA, it committed up to a one year stay in this category (Japan already committed to an up to five years stay in Japan in the EU-Japan EPA). Also, the UK reciprocally allowed the entry and temporary stay of 'partner and dependent children' who accompany an intra-corporate transferee (Japan made the commitment in the EU-Japan EPA). Furthermore, The UK matched Japan's commitment of VISA procedure within 90 days. These improvements would facilitate Japanese investment activities in the UK. However, the UK has not yet taken commitments in respect of 'short-term business visitors' while Japan has already allowed up to 90 days stay in the EU-Japan EPA. This means that in the area of entry and temporary stay of natural persons, the UK's commitments have not entirely improved to a reciprocal basis in the UK-Japan CEPA.

2.4 It should be recalled that little was expected in terms of market liberalisation for the UK-Japan CEPA negotiations mainly for three reasons. First, the EU-Japan EPA, which is called a 'new generation agreement', is a relatively new FTA (entered into force in February 2019) and has already achieved a high degree of liberalisation commitments (both for trade in goods and for trade in services). Second, there was no strong incentive for Japan to provide a better market access to the UK than to the EU since the size of UK market is one sixth of the EU market. Third, Most Favoured Nation (MFN) provisions in the EU-Japan EPA were a legal stumbling block for Japan to accord a better deal to the UK.⁷ The result demonstrated difficulties that the UK would face when it renegotiates market access with a trade partner who has already made deals with the EU.

3 Rules-making (provisions) relating to services

3.1 In general, the regulations that are covered within the schedule of commitments, including measures inhibiting market access, national treatment, most-favoured-nation treatment, prohibition of nationality requirement for senior management and boards of directors, and prohibition of performance requirements, cannot represent all types of de-facto barriers. In fact, regulatory barriers, such as regulatory divergence, transparency of qualification requirements and procedures, measures which restrict competition, and domestic regulations that are more burdensome than necessary, do matter for business.⁸ Chapter 8 provides general provisions relating to market access negotiations and regulatory barriers outside the scope of market access obligations. Since market access commitments in the UK-Japan CEPA are almost similar to that of the EU-Japan EPA, the value-added segment of rule-making (provisions) is crucial to assess the UK-Japan CEPA's impact.

⁵ Annex 8-II, Japan's reservation for future measure, '18. Transport'. in the EU-Japan EPA.

⁶ Annex III, Schedule of the United Kingdom.

⁷ Morita-Jaeger, M. (2020). The Japan-UK Free Trade Agreement – Continuity or no continuity? How can it be still "ambitious"?, UKTPO Briefing Paper 46, July 2020.

⁸ Morita-Jaeger, M. and Winters, L. A. (2018). The UK's future services trade deals with non-EU countries: A reality check, UKTPO Briefing Paper 24.

Trade in services (Section A and C)

3.2 The EU excludes audio visual services from its Free Trade Agreements and the WTO commitments to protect European cultural diversity.⁹ In the UK-Japan CEPA, audio visual services are still retained as outside the scope of the Agreement. However, the provisions on information exchange of regulatory issues, cooperation in the sector, and possible inclusion of the sector into Chapter 8 are newly stipulated. It would be worthy to clarify how the UK government will position itself on the possible inclusion of audio visual services in the UK-Japan CEPA in the future and how the Government would treat the sector in its future FTA negotiations with other countries.

Investment (Section A and B)

3.3 The EU-Japan EPA covers only the provisions on investment liberalisation (Chapter 8: Section B). Although the UK-Japan CEPA was an opportunity to introduce a comprehensive investment chapter that encompasses trade protection and a dispute resolution mechanism, the Agreement did not touch the chapter of investment liberalisation in the EU-Japan EPA. The UK-Japan CEPA included only the provision for a review on the investment protection and ISDS issues and a possible inclusion of these functions in the Agreement in the future.¹⁰

3.3.1 A lack of comprehensive investment chapter is observed as a major shortfall of the UK-Japan CEPA for the following reasons. First, in terms of the economy, Japan is the largest investor abroad in the world (14% of the world total in 2018).¹¹ And the UK is the second largest FDI destination for Japan accounting for \$171.9 billion of FDI stock. Retaining Japanese investment amid the double economic uncertainty from Covid-19 and Brexit would be critical for the UK economy. Second, further investment liberalisation is no longer a contentious issue for the Japan-UK investment relationship since investment policy environments in both Japan and the UK are already quite liberal,¹² Third, the EU 27 and Japan agreed to negotiate a bilateral investment treaty (BIT) but have not yet reached the agreement. The UK could have taken a lead in this respect. Fourth, Japanese business is interested in investment protection in the UK as there is no BIT between Japan and the UK while the UK has 92 BITs in force.¹³

3.3.2 It can be interpreted that the UK's concessions on tariffs and changes made in rules of origin are the result of the UK and Japan shared interest in supporting existing Japanese automotive and rail investments in the UK. As for tariffs, the UK accepted the immediate reductions of tariffs on specific automotive and rail manufacturing inputs.¹⁴ In the area of rules of origin, the agreement allows for extended cumulation for EU inputs in Japanese products and a lowered threshold of automotive components from 55% (under the EU-Japan EPA) to 50%. However, trilateral diagonal cumulation with the EU is unresolved as this would require agreement also with the EU. It is highly unlikely that the EU would provide such a concession that could give the UK a competitive edge. The important

⁹ Article 167 of the Treaty on the Functioning of the European Union.

¹⁰ Section A: General provisions, Article 8.

¹¹ UNCTAD World Investment Report 2020.

¹² According to the OECD FDI regulatory restrictiveness index (the most restrictive is 1 and open is 0), Japan' restrictiveness accounts for 0.052 and that of the UK accounts for 0.04 while the OECD average accounts for 0.065 in 2018.

¹³ See Morita-Jaeger, M. (2019). P4. And Morita-Jaeger, M. (2020). Japan-UK Free Trade Agreement –What is missing?, UKTPO Blog, 22 October 2020.

¹⁴ For example. electronic control panels, the tariff of which is scheduled to be eliminated in six years under the EU-Japan EPA.

point is that these arrangements cover only certain targeted sectors and activities and are far from comprehensive.

3.3.3 As for the temporary movement of natural persons, the UK's improvement of its commitments with regard to the entry and temporary stay of 'partner and dependent children' who accompany an intra-corporate transferee and 'investors' entry and a temporary stay up to one year (Japan has already committed up to five years in the EU-Japan EPA) would facilitate Japanese investment activities (Japan has already committed this in the EU-Japan EPA). However, the UK's commitments in the area of temporary movement of natural persons has not yet reached a reciprocal basis. For example, the UK does not take commitments in respect of 'short-term business visitors' while Japan has already committed up to 90 days stay in the EU-Japan EPA. Japan has accorded better terms than the UK in this area in the EU-Japan EPA and it maintains its commitments in the UK-Japan CEPA.

3.3.4 In short, the UK government could have done more to facilitate investment activities between the UK and Japan. Regarding its future FTA negotiations, it is recommended that the UK government designs a pro-active Post-Brexit FDI strategy on the role that FTAs might play in achieving investment related policy objectives.

3.4 Regulatory framework (Section E): Section E, Subsection 1: Domestic regulation in the UK-Japan CEPA improved transparency regarding to qualification and licensing conditions and procedures. For example, 'Condition for qualification and licensing' and 'licensing and qualification procedures' became more specified and detailed by the introduction of new provisions.¹⁵ These would improve legal certainty for business.

3.4.1 Like the EU-Japan EPA, a regulatory framework for four sectors (postal and courier services; telecommunications services; financial services; and international maritime transport services) are provided in the UK-Japan CEPA. Nothing was changed with regard to postal and courier services, telecommunications services and international maritime transport services.

3.4.2 Only the provisions of financial services (sub-section 5) was substantially improved. For example, a new definition on "financial service computing facility" was introduced. Also, a detailed explanation about authorisation of "new financial services" was added. Furthermore, provisions of transfers of information and processing of information were improved. These provisions stipulate the rights of a financial supplier regarding information transfers and locating financial service computing facilities in detail. The provisions of data transparency regulation were also enhanced in comparison to the EU-Japan EPA. These provisions would facilitate financial services activities, especially cross-border services (i.e. internet) and cooperation between the financial regulatory authorities in the UK and Japan.

3.5 E-commerce (Section F): The e-commerce section is a highlight of the UK-Japan CEPA. While there are only 12 provisions stipulating e-commerce in the EU-Japan EPA, four new provisions were newly introduced and some provisions were substantially improved in the UK-Japan CEPA. For example, the provisions on definitions became more detailed by adding the new terms, including "algorithm", "cipher" or "cryptographic algorithm"; "ciphertext"; "commercial information and communication technology product"; "computing facilities"; "covered person" and "cryptography". Also, the provision of source code was greatly improved by reflecting technology progress. Furthermore, the provisions on certification; net neutrality; removing ban on data localisation; and free movement of data go beyond the EU-Japan EPA.

¹⁵ Article 8.30 and 8.31.

3.5.1 The substantial improvements of the e-commerce section are expected to facilitate cross-border trade and innovation. It is observed that the UK's National Data Strategy (September 2020),¹⁶ which aims to promote innovation, flow of information across borders and enable regulatory cooperation with international partners Post-Brexit, allowed e such a shift - from the EU style digital policy that values more public sensitivity on data towards the Asia-pacific style market-oriented approach – to be made.

3.5.2 In comparison with the CPTPP, it is observed that the e-commerce provisions in the UK-Japan CEPA, such as provisions relating to protections for software, algorithms, and encryption technology, go beyond the CPTPP e-commerce chapter. It is found that some provisions in the US-Japan Digital Trade Agreement, which provides similar high-standard e-commerce provisions in the USMCA, are incorporated into the UK-Japan CEPA. In this regard, the e-commerce section in the UK-Japan CEPA can be seen as a strong foundation towards UK's future negotiations on digital trade agreements with its trade partners.

3.5.3 On the other hand, we have to note that UK civil society has a strong concern about free data flow in relation to privacy and personal data protection in international trade agreements.¹⁷ Striking a good balance between economic objective and public policy concerns is crucial to develop digital trade rules after the UK's departure from the EU. For the UK's future FTA negotiations, the UK government should carefully listen to non-business stakeholders' concerns for the sake of inclusiveness.

¹⁶ <https://www.gov.uk/government/publications/uk-national-data-strategy/national-data-strategy>

¹⁷ For example, see the opinion of Trade Justice Movement: <https://www.tjm.org.uk/trade-issues/digital-trade-e-commerce>, and the opinion of Open Rights Group: <https://www.openrightsgroup.org/blog/japan-trade-deal-punches-usa-sized-hole-in-privacy/>