

**Written evidence submitted by Dr. Minako MORITA-JAEGER, Fellow, UK Trade Policy Observatory (FRE0063)**

Question: The UK Government initially stated that it would seek a “best in class” FTA with the EU. Do you believe this is still the case? At the same time, the UK Government has also stated that it is simply seeking a deal similar to those that the EU struck with Canada, Japan or South Korea. Does this represent a “best in class” agreement? If so, why so? If not, why not?

After the December 2019 election, the current UK Government further downgraded its ambition for the future EU-UK trade relation. From the political rhetoric point of view, it seems that the current UK Government no longer seeks a “best in class” Free Trade Agreement (FTA) with the EU due to the EU’s insistence on ensuring level playing field. Rather there is a strong political force driving the EU-UK FTA that is similar to the EU-Canada FTA (CETA), the EU-Japan EPA or EU-Korea. But looking at UK’s draft text published on 19<sup>th</sup> May, the UK is actually demanding more than these FTAs.<sup>1</sup>

The phrase “best in class” FTA sounds very political and vague. It could mean something more than CETA, the EU-Japan EPA and the EU-Korea FTA in terms of the scope and the depth of economic cooperation. These are the FTAs that fall into the category of the EU’s “new generation FTAs” that the EU has concluded since 2010. These FTAs encompass not only a high degree of market access and rules on non-tariff barriers (e.g. Technical Barriers on Trade (TBT), Sanitary and Phyto-Sanitary measures (SPS), intellectual property) but also a broad range of trade issues (e.g. investment and e-commerce) as well as trade-related issues (e.g. sustainable development, labour, and environment).<sup>2</sup> So far, these FTAs are the most comprehensive FTAs that the EU has negotiated with non-EU countries although the three FTAs are different in detail reflecting the bilateral relation between the EU and its trade partners.

Even though the scope and the depth of preferential economic cooperation in the UK’s draft goes beyond the three “new generation FTAs” in some areas, such as rules of origin and trade in services, the level of economic integration is far below the EU Custom Union and Single Market. They are simply “Free Trade” Agreements which allow preferential treatments, and are not an agreement which enables “Free Movement” between the two markets. For example, one cannot expect a high-degree of services trade liberalisation in FTAs, given that existing FTAs do not go very far from the WTO General Agreement on Trade in Services. In general, services trade - where the UK has competitive edge - is the area where states want to retain policy flexibility.<sup>3</sup> And most trade barriers fall into a different regime of domestic regulation.

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<sup>1</sup> See the UKTPO study on the issue, Holmes, P, Mangtorn Garrett, M, and Winters, A. (2020). UK-EU Free Trade Agreement: Please, sir, I want some more, UK Trade Policy Observatory Policy Briefing Paper 43, July 2020.

<sup>2</sup> European Commission (2018). *COMMISSION STAFF WORKING DOCUMENT Individual reports and info sheets on implementation of EU Free Trade Agreements*, SWD(2018) 454 final October 2019, [https://trade.ec.europa.eu/doclib/docs/2018/october/tradoc\\_157473.PDF](https://trade.ec.europa.eu/doclib/docs/2018/october/tradoc_157473.PDF).

<sup>3</sup> Morita-Jaeger, M. and Winters, A. (2018). The UK’s future services trade deals with non-EU countries: A

Question: The EU has repeatedly emphasised that the FTAs it has reached with Canada, Japan or South Korea are unrealistic models for any trade deal struck with the UK. Why is that? Do you believe the EU's concerns about geographical proximity and economic interdependence are merited? If so, why so? If not, why not?

The EU has stated that its FTAs with Canada, Japan and Korea are unrealistic models for the future trade deal with the UK. This is because the EU-UK future trade deal is a decoupling exercise. The EU-UK future trade negotiation is the process of disentangling all economic and social legal systems that were integrated since the UK entered the EEC in 1973.

The EU's "new generation FTAs" with Canada, Japan and Korea were not decoupling exercises. In the first place, the three countries are completely independent from the EU with a complete regulatory autonomy based on a different social and regulatory culture. They used to trade with the EU on WTO terms prior to their FTA with the EU. In other words, their relationships started from WTO terms and was developed towards a certain degree of economic integration. Free trade agreements can achieve much less than the degree of integration a custom union and a single market can achieve.

Notably, a decoupling exercise, especially in the areas of established regulatory alignment, is not as simple as a building-up exercise starting from WTO terms. A decoupling exercise requires lots of legal clarification and drastic institutional rearrangements through the process. These exercises would not fit into the new generation FTA model. The EU has made this point.

Secondly, geographical proximity and economic interdependence matters for the EU since the UK used to be a member of the Customs Union and the Single Market. Additionally, the UK is the fifth largest economy in the world and was the second largest economy in the EU-28, so negative impacts on competition would not be negligible for the EU-27 if the UK takes a different policy direction and regulatory standards. Due to geographical proximity and the existing level of integration of UK and EU27, small differences in competitiveness might have large effects on trade flows.

From the political perspective, it is always the case that strong veto-players emerge when a change in status-quo takes place. For each EU member, the condition of fair competition is crucial when they accept a fundamental change in relationship. This is the logic behind whether it can be justified or not.

Question: Looking at recent FTA negotiations between the EU and Canada on CETA and between the EU and Japan on their EPA, what lessons do you think the UK could have learned/should have learned/is learning/may yet still learn about negotiating an FTA as a third country with the EU?

It was not easy for Japan to negotiate its EPA with the EU. Among the bilateral EPAs that Japan has concluded so far, the EU might be the toughest negotiating partner (except for the latest US-Japan trade deal). There are three lessons which the UK could learn from the experiences of Japan when it negotiated its FTA with the EU.

The first concerns the EU's bargaining power. In general, the size of market is a major factor which constitutes a country's bargaining power in international trade negotiations. Especially when it comes to a bilateral FTA negotiation, a country, which has a larger market, can directly exercise its negotiating power on its negotiating partner. In the case of the EU-Japan EPA negotiations, the EU exercised its bargaining power since the EU market was larger than the Japanese market. In addition, Japan's lower tariffs on manufactured products (2.5%, simple average MFN applied) in comparison with EU's tariffs on manufactured products (4.2%, simple average MFN applied)<sup>4</sup> limited Japan's bargaining power. From the beginning, Japan had very limited bargaining power.

Second, the UK has to understand the EU's growing power of exporting its legal norms and regulatory standards through regulatory convergence with its trade partners in FTAs.<sup>5</sup> As the EU centred reduction of non-tariff barriers in its negotiating objective for the EU-Japan EPA, regulatory cooperation became the core negotiating issue. In the Agreement, the strong influence of the EU's legal order can be seen. The EU-Japan data adequacy agreement (entered into force in January 2019), which was a side-product of the EU-Japan EPA, is a good example of this. In order to achieve the free flow of data between the two markets, Japan strongly requested the EU to include provisions on the free flow of data in the EPA, but the idea was rejected by the EU. The EU insisted to separate the data protection issue from the EPA because it did not want its data protection policy based on GDPR was connected to FTA services trade negotiations. In the end, the EU and Japan agreed to use the legal framework of mutual adequacy while retaining the two different legal orders.<sup>6</sup> From the negotiations, we can see that the EU acted as a data convergence actor based on the GDPR.<sup>7</sup> In order to get the adequacy approval from the EU, Japan enacted the supplementary rule of protecting personal data from the EU. The rule applied the higher standards than Japanese law (Personal Information Protection Act, entered into force in April 2005) provides.

The third point is that the EU hardly changes its negotiating positions or makes a compromise to a negotiating partner when it negotiates an FTA. The UK Government should have a good institutional memory when the UK was a member of the EU. Normally, international trade negotiations take place on two levels, the international level and the domestic level. International political economy scholars call it the "two-level game". The EU's case is a "three-level game" that involves the negotiations at international, regional (between the EU members), and domestic levels.<sup>8</sup> All FTA negotiating partners of the EU

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<sup>4</sup> Source: the WTO.

<sup>5</sup> See Bradford, A. (2012). The Brussels Effect, 107 Nw. U. L. Rev. 1.

<sup>6</sup> There is no stand-alone chapter of e-commerce in the EU-Japan EPA. The e-commerce provisions are provided in Chapter 8 (trade in services, investment liberalisation, and electronic commerce), Section F: Electronic commerce (Article 8.70-8.81). The negotiation for the bilateral adequacy agreement took place to follow Article 8.81: Free flow of data.

<sup>7</sup> See Fahey, E. and Mancini, I. (2020). The EU as an Intentional or accidental convergence actor? Learning from the EU-Japan data adequacy negotiations. [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3606087](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3606087)

(more or less) experience the EU's persistence on its policy agenda. In the case of Japan, despite the fact that Japan wanted to include investment protection and dispute resolution in the EU-Japan EPA, Japan had to give up including these in the Agreement, in the face of strong resistance from the EU.

The UK can draw lessons from Japan's experience as explained above. However, it should be noted that there is a fundamental difference between Japan and the UK vis-à-vis the EU. The purpose of the EU-Japan EPA negotiations was creating a preferential trade arrangement starting from WTO terms, while that of the current EU-UK negotiations is disintegrating economies from the most sophisticated EU Customs Union and Single Market in order to avoid falling into a trade relationship that is based on WTO-terms. A trade negotiation of this kind is unprecedented in trade history. From this point of view, it is not difficult to imagine that the EU would take an even tougher approach to protect its own interests.

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<sup>8</sup> The case of the EU-Korea FTA is examined in Ki-Sik, H. and Hyun-Jung, K. (2014). Three-level game theory and the strategy of EU-Korea FTA negotiation, *The Journal of East Asian Affairs*, 1 April 2014, Vol.28(1), pp.85-130.

Question: Looking at FTA negotiations the UK is holding with the United States and Japan, what impact might these have on the UK potentially reaching an FTA with the EU?

The UK-US FTA negotiation and the Japan-UK trade negotiation comprise completely different features and political landscapes. Thus, the potential impact of these two negotiations on the EU-UK FTA would be quite different.

The current trade relation between the UK and the US is on WTO terms. There is no FTA between the EU and the US since the Transatlantic Trade and Investment Partnership (TTIP) negotiations ended without conclusion in 2016. Thus, the UK-US FTA negotiation should start from zero. Looking at the political prospect, concluding an FTA before the US presidential election this autumn is not realistic. Furthermore, there are strong concerns inside the UK on concluding an FTA with the US, such as UK consumers' strong concerns on US's food standards and impact on the NHS. Therefore, one can observe that the UK's expectation of concluding an FTA with the US by the end of this year is rapidly fading. It is highly likely that conclusion of the UK-US FTA will not happen prior to the EU-UK FTA. The EU knows this very well.

On the other hand, among UK political fora, the Japan-UK FTA is seen as the friendliest negotiation. The expectation to finalise negotiations by the end of July and to start a new relation based on the Japan-UK FTA from 1<sup>st</sup> January 2021 is mounting, whether the EU-UK FTA takes place or not. It is true that trade between the UK and Japan is based on the EU-Japan EPA till the end of the transition period. And the Japan-UK FTA would be made based on the EU-Japan EPA. There is much common ground between Japan and the UK, and no major conflicts of interests exist. But if the UK and Japanese governments want to achieve a truly "ambitious, high standard, and mutually beneficial" FTA as noted in the Japan-UK Foreign Minister's Strategic Dialogue 2020, (8<sup>th</sup> February 2020), the timeframe is too short. Since both governments prioritise "continuity" to avoid trade on WTO terms, it is likely the Japan-UK FTA would end up a "de-facto" EU-Japan EPA with limited improvements (e.g. e-commerce and digital economy).

What does it mean for the EU-UK FTA? Of course the UK can use the Japan-UK FTA as a pressure to the EU to conclude the EU-UK FTA in time. But it would not have much impact since the UK is a part of the EU-Japan EPA. And its future preferential relation with Japan under the Japan-UK FTA would be more or less the same as the EU-Japan EPA.

Lastly, it is worth mentioning that the successful conclusion of the EU-UK FTA matters more for Japanese companies doing business in Europe than the Japan-UK FTA. This is well recognised among the Japanese negotiators. In fact, the Japanese ambassador to the UK, Mr Yasumasa Nagamine, stressed the importance of the EU-UK FTA for Japanese business.<sup>9</sup> In this context, the possible economic impacts of the EU-UK FTA on Japanese business would be much stronger than impacts of the Japan-UK FTA.

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<sup>9</sup> From the speech at the World Economic Series 'virtual breakfast' webinars, which took place at 8.30am on Wednesday 1st July 2020.

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