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**UK RELEASES
STRATEGIC
APPROACH FOR
SECURING A FREE
TRADE AGREEMENT
WITH JAPAN**



— THOUGHT LEADERSHIP

JUNE 2020



UK RELEASES STRATEGIC APPROACH FOR SECURING A FREE TRADE AGREEMENT WITH JAPAN

The UK Department for International Trade (DIT) has unveiled its negotiating objectives for securing a free trade agreement with Japan. The DIT highlights textiles, agriculture, services and data exchange as key areas of focus. If secured, a UK-Japan FTA will avoid a potentially damaging post-Brexit 'cliff edge' when the benefits of the recently-concluded EU-Japan Economic Partnership Agreement (JEEPA) fall away after 31 December 2020.

The UK is negotiating with third countries to roll over the benefits of existing EU free trade agreements

The UK benefits from around 40 preferential trade agreements as a result of its membership of the EU. This includes JEEPA, which entered into force in February 2019.

As at 21 May 2020, the UK had signed agreements with 20 countries and trading blocs that will 'roll over' existing EU preferential trade agreements on 1 January 2021. Engagement with another 21 countries and trading blocs is ongoing – including with Japan.

Under JEEPA, Japan scrapped customs duties on 97% of goods imported from the EU, improving bilateral market access in important sectors such as automobiles and agriculture.

Without an agreement on a trade deal with Japan before the end of the Brexit transition period, UK exporters will revert to trading with Japan on WTO rules, as they did prior to February 2019. This would result in additional costs for UK and Japanese traders, and potentially disrupt supply chains. Trade between the UK and Japan will no longer benefit from the tariff liberalisation available under JEEPA, and the UK's recently-released 'most favoured nation' (MFN) tariffs will apply to imports from Japan (the UK Global Tariff).

What are the UK's and Japan's objectives?

The UK wants to achieve an effective and smooth transition from the current trading arrangements under JEEPA to a new agreement between the UK and Japan by the end of the Brexit transition period.

The UK Government hopes that negotiations with Japan will signal to the world that the UK has a dynamic trade agenda post-Brexit. Pronouncements from the UK Government point to an ambitious Japan-UK FTA which it hopes will set new standards in services and digital trade amongst developed economies.

The UK's Negotiating Objectives

- Agree an ambitious and comprehensive Free Trade Agreement (FTA) with Japan that builds on JEEPA, and secures additional benefits for UK businesses.
- Increase UK GDP and provide new opportunities for UK businesses, including SMEs and investors, and facilitate greater choice and lower prices for UK producers and consumers.
- Increase the resilience of UK supply chains and the security of UK economy by diversifying trade.
- Ensure high standards and protections for UK consumers and workers and build on the UK's existing international obligations.



The government's ambition is to secure free trade agreements (FTAs) with countries covering 80% of UK trade within the next three years, to become a truly Global Britain.



— DEPARTMENT FOR INTERNATIONAL TRADE

The UK's trade profile is not the same as that of the EU as a whole. Both the UK and Japanese governments are reportedly looking to conclude a deal that goes beyond JEEPA in certain areas. This will affect both countries' negotiating priorities, and result in a different negotiating dynamic to that of the JEEPA negotiations.

For example, the agricultural sector is extremely sensitive for Japan, and was a key interest for the EU. This resulted in JEEPA's tariff reductions for products such as pork, beef and dairy being hard fought, potentially at the expense of other sectors which are UK priorities. While the UK has some interests in agriculture, these tend to relate to a more specialised and narrower range of products. A UK-Japan FTA may result in a significantly different deal on agriculture than that which was struck in JEEPA.

Unlike the UK, the Japanese government has not published objectives in advance of negotiations. However, when the UK announced it would leave the EU, Japan made specific requests of the UK that may inform Japan's objectives in negotiating any FTA. These include:

- Setting UK import tariffs at a level as low as possible;
- Maintenance of an immigration system in the UK that allows the acceptance of highly skilled professionals in banking and other sectors;
- Avoidance of barriers to foreign investment;
- Implementation of measures to promote further Japanese investment in the UK including the easing of UK regulations; and
- Maintenance of current levels of information protection and the free transfer of data in case the UK establishes its own legislation distinct from that of the EU.

Tokyo's first instinct may be to secure continuity and protection of its existing interests in the best form possible. Japanese business has significant presence in the UK, not least in the automotive sector – a political sensitivity which was a flashpoint requiring prime ministerial intervention shortly after the

UK's decision in 2016 to leave the EU. It is hoped that a bilateral agreement between Japan and the UK will facilitate the continued flow of UK inward investment and secure existing Japanese interests in the UK economy.

Japan has previously raised concerns about the impact of Brexit on the cumulation requirements for rules of origin—both with respect to the future EU-UK relationship, and with respect to existing FTAs between the EU and third countries. In this respect, the complex global supply chains utilised in the production of many manufactured goods – particularly cars – may be disrupted if the UK is not able to agree facilitative rules of origin with the EU and other export destinations.

A number of issues affecting Japanese investments in the UK remain subject to the outcome of negotiations between the UK, EU, and third countries. With UK-EU negotiations still at an early stage, this may place limits on what a UK-Japan FTA can achieve with respect to maintaining the UK's pre-Brexit economic relationship with Japan.

The UK / Japan trading relationship

Japan is an important trading partner for the UK, being the UK's 4th largest non-EU export market and 11th overall. In turn, the UK is Japan's 13th largest export market. UK-Japan trade accounts for around 2% of each country's exports.

The UK has a trade deficit in trade of goods with Japan, exporting £7.0 billion of goods to and importing £9.9 billion of goods from Japan in 2018. For services, the position is reversed: the UK exported £7.3 billion services to and imported £5.3 billion services from Japan in 2018.

DIT highlights how differences in the two countries' economic specialisations create opportunities for complementarity. A DIT analysis of the two countries 'revealed comparative advantage' (a measure used for calculating the relative advantage or disadvantage of a certain country in certain classes of goods or services) is set out in Box 1.

At a glance

Japan has declined to roll over the existing EU-Japan Economic Partnership Agreement (JEEPA), preferring to conclude a new FTA with the UK.

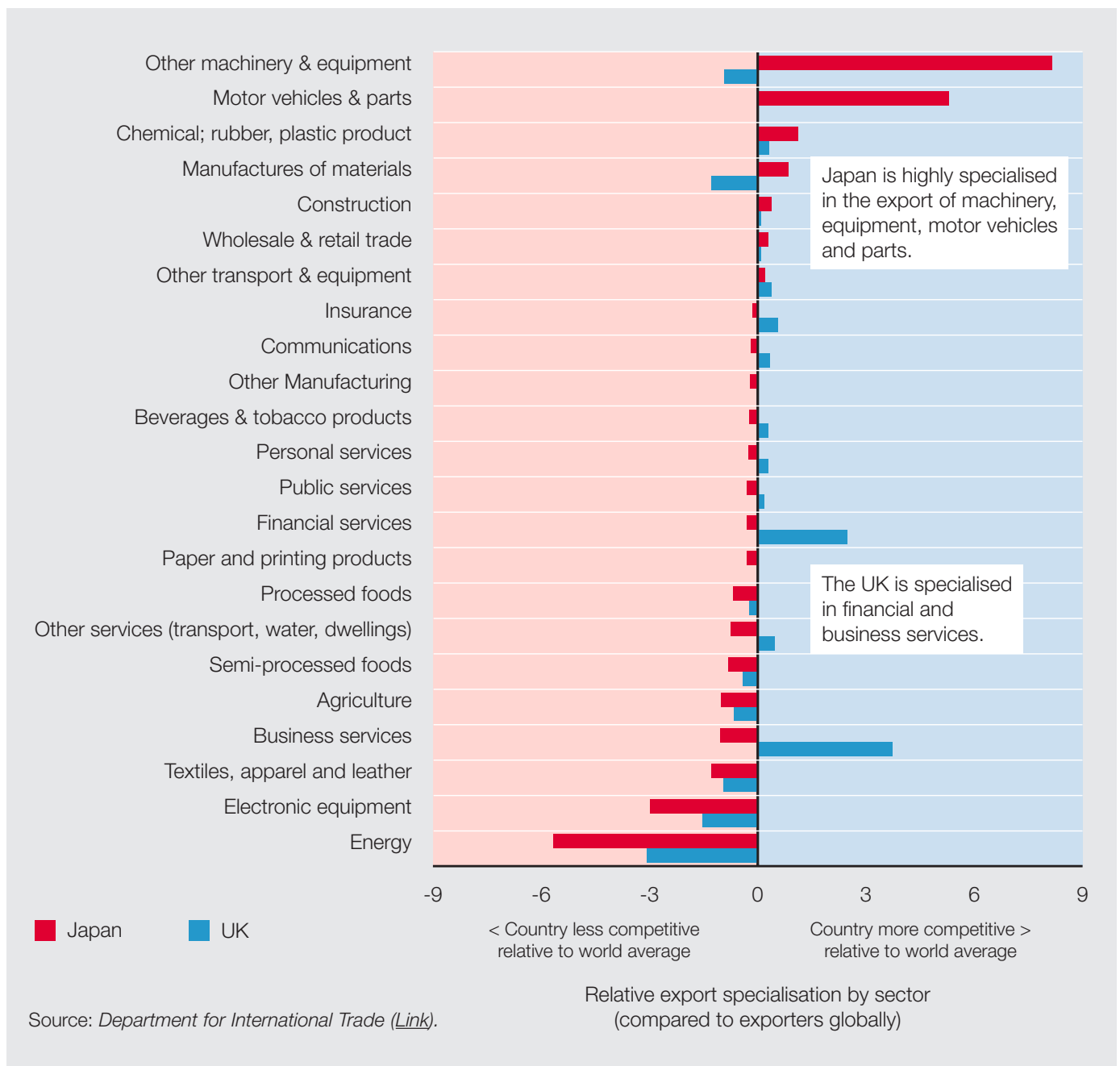
There will be a different negotiating dynamic to that between the EU and Japan during JEEPA negotiations, in particular, in the digital, automotive, financial services, agriculture and food and drink sectors.

Time is tight. Talks began in May, leaving only seven months to conclude a deal before the UK's Brexit transition period concludes.

Absent an agreement with Japan, as of 1 January 2021, the "UK Global Tariff" regime will apply to imports from Japan.

Box 1: The UK and Japan specialise in different goods and services

	Most significant Japanese imports from UK	Most significant UK imports from Japan
Goods	<ol style="list-style-type: none"> 1. Turbojets, machinery and engines. 2. Vehicles and parts. 3. Pharmaceutical products. 	<ol style="list-style-type: none"> 1. Nuclear reactors, boilers. 2. Vehicles and parts 3. Pearls, precious metals, and base metals.
Services	<ol style="list-style-type: none"> 1. Financial 2. Other Business Services 3. Transportation 	<ol style="list-style-type: none"> 1. Financial 2. Intellectual Property 3. Other Business Services



A stepping stone to UK accession to the CPTPP?

Beside the ambition for a FTA with Japan lies a broader UK objective: accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The CPTPP States' economies account for 13.3% of global GDP, with Japan representing over 28% of total CPTPP trade.

"Negotiations with Japan are an important step in CPTPP accession, a key UK priority, which will help us diversify our trade and grow the economy" – Liz Truss, Secretary of State for International Trade

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

The CPTPP was concluded in Tokyo on 23 January 2018 by the 'TPP-11': Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam, using a relatively short-form agreement that incorporates by reference the terms of the 'Trans-Pacific Partnership' that was agreed in 2016; before the withdrawal of the United States' in January 2020. CPTPP is a "next generation" trade agreement containing broad liberalisation commitments, tariff cuts on approximately 90% of trade, and innovative provisions on digital trade and e-commerce, services, investment, environmental protection and labour standards.

A tight schedule

While JEEPA may provide a precedent for Japan and the UK to work from, concluding any FTA will be time-consuming.

The UK's objectives were published a little over six months before the end of the Brexit transition period. The parties' ambitions may be curbed by practical considerations, which are compounded by the coronavirus pandemic. Negotiations must take place remotely, and any deal must still be subject to 'legal scrubbing' and ratification by the Japanese legislature prior to entry into force. Japan may also seek more detail on the future UK-EU relationship before it can conclude a deal with the UK.

Sectors in focus

Digital Trade

The UK's negotiating objectives promise *"cutting edge provisions on digital that maximise opportunities for digital trade across all sectors of the economy"*, which will *"promote a world leading ecosystem for digital trade that supports businesses of all sizes across the UK."*

The UK has identified that, while Japan is relatively more open to foreign trade in digitally traded services than other OECD States, Japan still operates material restrictions on communication infrastructures and connectivity. This includes restrictions on cross-border data flows and electronic transactions. For example, Japan recently enacted a law that will require companies operating e-commerce websites and apps to submit annual reports on their business practices to the Japanese government.

A key UK priority will be to include a dedicated digital trade chapter in this FTA.

The countries have much in common. Both the UK and Japan have implemented advanced data protection frameworks, with large parts of their economies standing to benefit from secure and predictable data sharing arrangements. Such frameworks will provide the infrastructure for growth in data-dependent services such as e-commerce. Recently-concluded FTAs with dedicated digital provisions provide for alignment of cyber-security standards, and the establishment of structures to facilitate regulatory cooperation in data protection, consumer rights, and online harms.

In a global context, Japan and the UK share an interest in liberalisation of digital trade through FTAs. In multilateral negotiations, Japan and the UK have both favoured a global approach focussed on common standards and protecting individual freedoms. Japan and the EU recently issued a joint statement committing each to further rule-making on e-commerce at the WTO *"with a view to facilitating safe and secure cross-border data flows through enhancing data security and privacy"*. Other WTO members, such as China, have taken a

Focus on ISDS

Direct enforcement of investment protections by private investors is a focus of Japanese negotiators. Nearly all of Japan's investment treaties contain investor-State dispute settlement (ISDS) provisions enabling investors to enforce certain obligations through international arbitration. However, a notable exception to this position is JEEPA, which does not contain ISDS, due to the political obstacles encountered by the EU in relation to including ISDS in its FTAs.

Japan will likely push for the inclusion of ISDS provisions in negotiations with the UK. An investment chapter should include standard obligations regarding national treatment and disciplines on performance requirements. Broader investment protections contained in these chapters typically include disciplines on nationalisation and expropriation as well as granting investors rights to fair and equitable treatment (FET) and full protection and security (FPS).

The UK has not yet articulated a formal position on its approach to ISDS in FTA negotiations. The UK may need to accept ISDS if it is to proceed with accession to the CPTPP, and this may make the UK more open to accepting ISDS protections in an FTA with Japan.

more restrictive sovereigntist approach to digital regulation.

The automotive industry

Japanese media reports state that Japan's approach to bilateral trade in the automotive sector will be to seek an immediate and complete abolition of auto tariffs. This would go further than JEEPA, under which 10% EU tariffs on passenger cars are set to be abolished incrementally over a seven-year period (standing currently at 8.8%).

The recently-published UK Global Tariff retains EU MFN tariffs on automotive goods: a 10% tariff on passenger cars. This rate would apply should a UK-Japan agreement not be concluded by the end of the Brexit transition period.

Japan will hope to protect its companies' significant investments in the UK. Nissan, Toyota and Honda account for about half of car production in the UK, reportedly representing over 800,000 jobs. The UK will be concerned, in the absence of a successor agreement to JEEPA, that the EU could become a more attractive base for Japanese manufactures. It remains to be seen whether the FTA can address deep-rooted Japanese concerns about automotive manufacturers' ability to rely on migrant labour from the EU, as well as the costs of energy, waste treatment and other utilities potentially affected by Brexit.

Agriculture, Food and Drink

Japan's agricultural sector has historically been heavily protected from import competition, with a combination of high tariffs, tariff rate quotas and non-tariff barriers applied to a range of products, including rice, beef, pork and dairy. Japan softened aspects of this system in recent years, driven by concessions made in major trade deals such as CPTPP and JEEPA. However Japan continues to maintain very high MFN tariffs and other barriers: in 2018, nearly 22% of Japan agricultural tariff lines were subject to a tariff of greater than 15%, and the average tariff on dairy products was 95.1%.

Under JEEPA, the EU secured tariff reductions for a number of agricultural products (including a phased reduction in tariffs on products including beef, pork, whisky, and cheeses, including Cheddar and Stilton). The UK's key agricultural export interests with Japan are likely to be narrower in scope than those of the EU as a whole, and the overall balance of agricultural tariff reductions could be significantly different in a Japan-UK FTA. Will this new balance favour Japan or the UK? The Initiative for Free Trade calculates that the UK accrued only 50-60% of the export gains generated for the EU as a whole, due largely to the absence of export increases for the UK in meats, dairy and motor vehicles.

Two major staples of the Scottish economy, whisky and salmon, are important exports to the Japanese market. Scotland reportedly exports around GBP150 million of whisky to Japan on an annual basis, while in the 12 months to October 2019, Japan imported over 1,000 tonnes of Atlantic salmon, an annual increase of over 71.8%. Beef, fruit and condiments (including wasabi and soy sauce) are other areas where the right tariff regime could foster increased trade flows.

Financial Services

The UK negotiating objectives for the UK-Japan FTA state that the UK aims to "expand opportunities for UK financial services to ease frictions to cross-border trade and investment, complementing co-operation on financial regulatory issues", and secure best-in-class rules "for all services sectors, as well as sector specific rules to ensure transparency and support our world-leading services industries, including key UK export sectors such as financial services, professional and business services".

However, it remains to be seen what degree of integration and market access can be achieved in the financial services sector – a sector in which it has historically been difficult to achieve liberalisation through free trade agreements.

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