UK trade agreements with third countries: Implications for the EU

SUMMARY

The United Kingdom (UK) left the European Union (EU) on 1 February 2020 and will regain competence for its own international trade policy as soon as the transition period concludes at the end of 2020. Freedom to determine its own trade relationships was a major reason for the UK’s withdrawal from the EU: its new international trade policy is based on the goal of establishing ‘global Britain’, a country asserting that it is strongly committed to trade openness with international leadership.

To this end, the UK has concluded as many continuity agreements as possible, in order to roll over existing EU free trade agreements (FTAs), such as that with South Korea. It has also renegotiated, rather than simply roll over, the provisions of EU FTAs, with partners who so demanded, including Japan. Beyond those countries with EU FTAs to which the UK has been party, it has expanded the range of its FTA negotiations to Australia, New Zealand and the United States (US), three of its major trading partners. When it comes to geographic scope, the UK has set the Pacific as a high priority, its objective being to access the newly established Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). In addition, the UK aims to use its advantage in digital trade and services to become a ‘world digital trade powerhouse’, and has stressed that FTA provisions should promote digital trade and foster regulatory cooperation in the field.

The EU represents 50 % of the UK’s total trade, and the UK economy is integrated with and reliant on the EU. Therefore, although the UK is facing obstacles in signing trade agreements, its new strategy has a number of implications for the EU. The UK is committed to remaining an open country with respect to international trade and its focus on digital trade and services, which depend less on geography, is seen as a way to diversify away from the EU.

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Background

Since it left the European Union (EU) on 1 February 2020, the United Kingdom (UK) has been engaged in negotiations on free trade agreements (FTA) with trading partners including the EU. The UK remains part of the European single market and EU law is still applicable (with some exceptions) until the end of the transition period on 31 December 2020. In practice, the EU FTAs still apply to the UK, but it is allowed to conduct its own international trade policy, with any trade agreement that the UK signs only entering into force once the transition period ends.¹

Former Prime Minister Theresa May, who was appointed on 13 July 2016 shortly after the Brexit referendum, established the Department for International Trade (DIT). With the rank of Secretary of State, the head of the DIT was first Liam Fox² until 24 July 2019, when he was replaced by Liz Truss, appointed by new Prime Minister Boris Johnson.³ The DIT aims to remove barriers to trade and investment, and is responsible for helping businesses succeed within the trade policy framework for the UK, building the ‘global appetite’ for British goods and services. The DIT clearly states ‘championing free trade’ in its objectives, in line with the UK’s ambitious ‘Global Britain’ strategy.

Overview of UK trade deal continuity and negotiations

Already before it left the EU on 1 February 2020, the UK had secured continuity agreements with the EU’s FTA partners, rolling over the existing EU FTAs, in the event that the UK were to have withdrawn from the EU without an agreement. On top of the continuity agreements under discussion, the UK is negotiating new trade agreements with Australia, the EU, New Zealand, and the United States (US). Japan and the UK signed the Comprehensive Economic Partnership Agreement (CEPA) on 23 October 2020. At the time of writing, as of the latest update on the DIT website dated 15 December 2020, the UK had 29 agreements signed or in place with 57 countries,⁴ either with a single country or a bloc of countries, and was in discussion with 14 other countries, three of which had already announced that there would be no continuity (Algeria, Bosnia-Herzegovina, and Serbia).

Figure 1 – State of play of UK trade agreements (as of 15 December 2020).

The UK’s total trade (the sum of exports and imports) is relatively concentrated since only 10 trading countries account for 83.5 % of trade. The EU represents nearly 50 % of UK trade, while the US is the second trading partner (12.3 %). Of its ten largest trading partners, the UK has signed continuity
agreements with Switzerland and Canada and a new FTA with Japan. It is negotiating new FTAs with the US and Turkey. A continuity agreement with Iceland and Norway was signed on 8 December.

Comparison with the European Union

The EU seeks two main types of agreement that give rise to bilateral tariff agreements. Customs unions remove customs duties in bilateral trade, and establish a joint customs tariff for foreign importers. Association agreements, stabilisation agreements, (deep and comprehensive) free trade agreements and economic partnerships remove or reduce customs tariffs in bilateral trade. The EU currently has trade agreements fully or provisionally in force involving 74 countries, signed agreements awaiting ratification involving 24 countries, and trade agreements under negotiation with Australia, China (investment agreement), Indonesia, New Zealand, and the Philippines.

Negotiations with the US were launched in 2013 and ended without conclusion in 2016. In 2019, a new Council decision authorised the Commission to open negotiations for an agreement on the elimination of tariffs for industrial goods. In November 2020, the European Parliament adopted a resolution eliminating tariffs on specific products.

Figure 2 – EU trade agreements

![EU trade agreements map]

Data source: DG Trade.

Table 1 – UK FTAs with the 10 largest partners (2019 trade figures).

<table>
<thead>
<tr>
<th>Country</th>
<th>UK total trade</th>
<th>UK trade agreement</th>
<th>EU trade agreement</th>
</tr>
</thead>
<tbody>
<tr>
<td>EU</td>
<td>49.8 %</td>
<td>Under negotiation</td>
<td></td>
</tr>
<tr>
<td>US</td>
<td>12.3 %</td>
<td>Under negotiation</td>
<td>Under negotiation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(industrial goods)</td>
</tr>
<tr>
<td>China</td>
<td>8.2 %</td>
<td>No negotiations</td>
<td>Under negotiation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(investment only)</td>
</tr>
<tr>
<td>Norway</td>
<td>2.3 %</td>
<td>Agreement signed</td>
<td>Economic Area Agreement</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2.3 %</td>
<td>Agreement in place</td>
<td>FTA in force</td>
</tr>
</tbody>
</table>
Significant trade agreements

Japan

On 23 October 2020, Japan and the UK signed a new FTA, of which texts are publicly available. Albeit built extensively on the existing EU-Japan Agreement for a Comprehensive Economic Partnership (ACEP), the deal constitutes the first FTA negotiated and concluded by the UK. Japan had previously dismissed rolling over the existing EU-Japan Economic Partnership Agreement (EPA), arguing that a better deal could be reached with the UK. The negotiations were launched on 9 June 2020, and the agreed FTA seems to have achieved the objectives previously set out by the parties. In particular, it includes more 'advanced' digital and data provisions without data localisation constraints, improves market access for financial services with 'dialogues' to reduce regulatory friction, and increases the number of geographical indications up to 70 for the UK. It also reduces tariffs on intermediate parts for cars and railway manufacturing, which was Japan's main objective. The deal also provides for tariff reductions for food exports, including pork, beef, and salmon. Moreover, the deal provides for the adoption of more 'liberal' rules of origin that allow for cross-country value-added cumulation for conferring preferential origin, which is strongly supported by the UK. Nevertheless, the deal replicates the restrictions on State aid that were present in the EU-Japan EPA, which contrasts with the UK's claim that it intends to retain sovereignty in this field in the trade negotiations with the EU.

A thorough analysis of tariffs shows that the Japan-UK CEPA mirrors the EU-Japan EPA insofar as tariffs on UK exports are concerned, although the former provides for fewer tariff rate quotas than the latter. Similarly, the UK’s tariff reduction schedule for Japanese exports to the UK is identical to the EU’s tariff reduction schedule under the EU-Japan EPA, apart from 24 tariff product headings that will benefit from zero tariffs immediately, unlike the EU-Japan EPA which requires a few years. These 24 headings accounted for about 12% of Japanese exports to the UK in 2019.

Although some experts consider the economic importance and improvements of the FTA with respect to the EU-Japan EPA to be relatively slight, continuity was essential for Japan and the UK, which have a strong investment relationship. Indeed, the UK has become a significant link in the production chain between the EU and Japan, especially in the automotive sector. The share of Japan’s total investment in the former EU-28 was highly concentrated in the UK (39.4%). As for the UK, Japanese firms’ investments represent 6.3% of
UK stocks of inward foreign direct investment, making Japan the third largest investor in the UK, behind the EU (43.7%) and the US (22.8%). Japanese firms are estimated to employ approximately 130,000 UK workers (0.5% of the UK’s total employment).

Canada

In July 2019, Canada turned down the UK’s request to sign a continuity agreement, because according to observers, it was waiting to see how the post-Brexit EU-UK relationship turned out. In addition, the UK’s temporary import tariff schedule, published in March 2019, was already satisfactory to Canada; indeed, zero tariffs are to be applied on metals and minerals, which represent two-thirds of Canada’s exports to the UK. The zero-tariff scheme applied to major Canadian exports to the UK evidently gives Canada stronger bargaining power in FTA negotiations. Therefore, the talks were announced to be in a deadlock until 7 September 2020, when Secretary of State Liz Truss announced on Twitter that negotiations with Canada had resumed, with a view to having a deal in place by the time the transition ended. Observers believe that food, especially cheese, could be an obstacle in the negotiations. Nevertheless, on 12 November 2020, Canadian Prime Minister Justin Trudeau predicted that a deal with the UK rolling over the Canada-EU Comprehensive Economic and Trade Agreement (CETA) would be easy, adding that the issue was the UK’s shortage of negotiating capacity (the ‘bandwidth’) for getting the last details done on time. The signature of a continuity agreement was eventually announced on 21 November 2020.

Significant negotiations

Australia and New Zealand

On 17 June, the UK launched bilateral FTA discussions simultaneously with Australia and New Zealand, which rank 14th and 32nd among UK trading partners respectively, and together account for 1.18% of total UK trade. Even though the two countries are less significant in terms of trade than Japan and the US, they are considered to be ‘key like-minded partners’ for the UK. Australia emphasises the two countries ‘have a shared commitment to the rule of law and to an open and rules-based international trading system’. The UK has set technology, innovation and R&D among its overall priorities for the negotiations with Australia. The UK sees an opportunity to design an ambitious framework focusing on the ‘role of trade policy in facilitating innovation’, and the parties have agreed on the FTA being ambitious in the services and digital trade areas. New Zealand’s objective is to reach a comprehensive and commercially meaningful agreement that reflects New Zealand’s Trade for All agenda on sustainable development and inclusive trade (for Māori, women and small and medium-sized enterprises in particular). In addition, the agreement should preserve the right of governments to regulate in the public interest, including for the environment, education, health and well-being of New Zealanders, and it precludes investor-state dispute settlement provisions.

United States

The UK and the US launched negotiations for an FTA on 5 March 2020. In its negotiating objectives published earlier in February 2019, the US stated that it aimed to access the UK food market by eliminating ‘practices that unfairly decrease U.S. market access opportunities or distort agricultural markets to the detriment of the US, including non-tariff barriers that discriminate against U.S. agricultural goods’. It also insisted on alignment with World Trade Organization (WTO) rules and scientific evidence. The US Chamber of Commerce lists comprehensive trade agreements with the UK, and also the EU, as one of its trade priorities. In a statement at a hearing in the UK House of Lords EU International Agreements sub-committee on 16 July 2020, Marjolie Chorlins, Senior Vice President for European Affairs at the US Chamber of Commerce, said that the US gives priority to
including chapter provisions regarding digital trade in a future UK-US comprehensive trade agreement.9

However, some experts believe that the US objectives are particularly demanding for the UK, giving little in return. They also believe that the change in food standards would add trade barriers between the EU and the UK. In its approach to the negotiations the UK made clear that the deal should maintain high standards on food safety, implicitly rejecting major changes in food regulation, and expressed reservations regarding liberalising tariffs in agriculture. Parties recently admitted that a deal was unlikely by the end of the transition period owing to the US elections and the coronavirus pandemic. Furthermore, the Internal Market Bill that the UK’s government tabled in Parliament in September, part of which would breach the Northern Ireland Protocol in the Withdrawal Agreement, was viewed as a threat to the Good Friday (Belfast) Agreement (GFA). The GFA was signed in 1999 by Ireland and the UK and is widely seen as key to preserving peace in Northern Ireland. US President-elect Joe Biden had previously declared that an FTA with the UK would be impossible if the prime minister allows the Northern Ireland peace process ‘to become a casualty of Brexit’. Following his election, Biden reiterated his support for the GFA in a phone call to Boris Johnson and warned him not to jeopardise the GFA in the context of the EU-UK negotiations. Following intensive discussions between the parties, the UK announced, following a meeting of the EU-UK Joint Committee on 8 December, that it would withdraw the clauses. On 17 December, the UK and the US announced that a mini-deal could be sealed before the new US administration takes office.

The Trans-Pacific Partnership

The UK has made accession to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) an ‘important part’ of its strategy. The CPTPP is a free trade agreement signed by 11 countries of the Pacific, including Australia, Canada, Japan, Mexico and New Zealand, but not China and the US, with a trading area representing 13.5% of world GDP.10 The objective is to place the UK at the centre of a ‘modern, progressive network of free trade agreements with dynamic economies’, turning the UK into a ‘global hub for businesses and investors wanting to trade with the rest of the world’.

Even though the UK has not submitted any formal application to the CPTPP, it has been engaged in bilateral discussions with all 11 member countries since 2018. The trade deals with Japan, and Canada, and the negotiations for bilateral FTAs with Australia and New Zealand are designed to constitute significant steps towards CPTPP accession. Japan, which represents nearly half of CPTPP GDP is in favour of the UK’s accession, which would foster the attractiveness of the bloc to other potential partners. Some experts suspect that the UK’s involvement in the bloc would be peripheral to regional political and economic dynamics. Other observers argue that the bid is merely symbolic since the UK’s industrial chain is not closely linked to the Asia-Pacific region.

Implications for the EU

The UK has been successful at setting up negotiating teams within a short timeframe, and they have been able to sign a relatively large number of continuity trade agreements and launch major FTA

Box 2 – Global tech powerhouse

The UK has become an international hub for technologies and the UK intends to make digital trade the core component of its trade strategy, turning the country into a ‘global tech powerhouse’. Liz Truss compares the strategy to that of attracting automobile industries in the 1980s. Concrete measures are set out in the future trade tech strategy launched by the UK government in June 2020. This includes the creation of a budget package of £8 million (€8.7 million), to help UK SMEs access the Asian market, and an ‘academy’ to provide SMEs with high-potential in international markets with expertise. In addition, facilities will be set up to help 25 technology exporting champions to scale up internationally. Trade agreements are viewed as a major supporting device for this objective as they will address digital trade barriers specifically and in greater depth.
negotiations simultaneously, even though the output is broadly built on the legacy of EU trade agreements through continuity agreements. Nevertheless, the concrete action taken by the UK has revealed or confirmed its priorities. First, the number of agreements it is seeking shows that the UK is indeed aiming to become a champion of free trade. As expressed by Secretary of State Liz Truss in February 2020, the UK’s objective is to ‘secure free trade agreements with countries covering 80% of UK trade within the next three years’ – which leaves no alternative but to secure a deal with the EU. Second, by placing the Pacific area among its highest trade priorities, the UK is also proving to be seeking to 'diversify [its] trading links and supply chains', as mentioned in the CPTPP position statement, thus reducing its dependence on the EU. This has implications for the EU. In a note for the European Centre for International Political Economy, Henrik Isakson shows that the more UK tariffs with third countries decrease, e.g. with the US, the worse the impact for EU companies, with the effect depending on the price sensitivity of products.

Furthermore, the large number of continuity agreements and the fast-track Japan-UK CEPA shows that the UK aims to preserve the current state of the production chains it is already part of. Given the high degree of UK dependence on the EU in this respect, the EU-UK deal is likely to be essential in reaching this objective. In addition, it is no surprise that the UK emphasised the inclusion of ‘diagonal’ cumulative rules of origin in its proposed EU-UK FTA texts, a rule that has been included in the Japan-UK CEPA, and allows for cumulation of production across FTA partners to confer preferential trade treatment.\(^\text{11}\)

Finally, State aid is one major obstacle in the EU-UK negotiations and observers suggest that the Japan-UK CEPA has shown that the UK may be willing to make concessions here. In fact, the Japan-UK agreement explicitly prohibits indefinite state guarantees on debts of struggling companies or bailouts without a clear restructuring plan in place. These provisions are more stringent than those offered by the UK in the EU-UK talks, yet remain far less than those demanded by the EU. For instance, the EU texts note that the ‘Court of Justice of the European Union (CJEU) has jurisdiction under the Treaties in respect of acts of the Commission in the area of State aid’ (Article LPFS.2.6), and provides that the CJEU has jurisdiction to give binding rulings on questions of interpretation of EU Law. The UK draft text reaffirms the rights and obligations of parties under the WTO agreements, referring implicitly to the dispute settlement provided by the agreement on subsidies and countervailing measures.
FURTHER REFERENCES


ENDNOTES

1 Within the EU, the ‘common commercial policy’ is an EU exclusive competence.

2 On 8 July 2020, Liam Fox was nominated by the UK to run for the post of Director General of the World Trade Organisation to succeed Roberto Azevêdo who will step down on 31 August 2020. While he was among the five candidates who were selected in the first round in September, his candidacy failed to make the last round in October.

3 On 10 September 2019, Elizabeth Truss was also appointed Minister of Women and Equalities.

4 This number includes the agreement in principle with Kenya.

5 On 10 July 2020, Turkey and the UK declared that they were close to reaching a trade deal, but that it would enter into force only if the EU and the UK secured a trade deal as well, as Turkey is part of the EU customs union.

6 In their joint statement concluding the EU-India summit on 15 July, the parties ‘reaffirmed their commitment to work towards balanced, ambitious and mutually-beneficial trade and investment agreements, opening markets and creating a level playing field on both sides’, showing interest in resuming trade talks.

7 Tariff rate quotas are provisions setting quantity limits on goods benefiting from low tariffs.

8 Note that Crawford Falconer, formerly New Zealand’s Deputy Secretary in the Ministry of Foreign Affairs and Trade, is now Second Permanent Secretary and Chief Trade Negotiation Adviser in the UK’s DIT.

9 In the same statement, Marjolie Chorlins noted that the continuity in trade and investment relations between the EU and the UK was essential to US companies, which had invested nearly $800 billion in the UK as a ‘springboard’ to the EU.

10 The CPTPP is a free trade agreement signed by 11 countries of the Pacific, namely Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. The CPTPP will form a trading area representing 500 million consumers and 13.5 % of world GDP. It has entered into force in seven countries so far, namely Australia, Canada, Japan, Mexico, New Zealand, Singapore, and Vietnam.

11 ‘Diagonal cumulative rules of origin’ would allow preferential origin production to accumulate across countries with which the EU and the UK have signed FTAs in the calculation of the share of the preferential origin of a good. The EU has excluded diagonal cumulation from its EU-UK FTA texts.

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