



EUROPEAN COMMISSION

Brussels, 18.7.2012
SWD(2012) 210 final

COMMISSION STAFF WORKING DOCUMENT

**EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT ON EU-
JAPAN TRADE RELATIONS**

Accompanying the document

Recommendation for a Council Decision

**authorising the opening of negotiations on a Free Trade Agreement between the
European Union and Japan**

{COM(2012) 390 final}
{SWD(2012) 209 final}

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1. PROBLEM DEFINITION

What precisely is the problem?

Trade between the EU and Japan, major global economic players, has been in decline for a number of years. Over the period 2006/2010, EU exports to Japan fell by 0.6% per annum, compared with a rise in global EU exports of 3.8%. Over the same period Japanese exports to the EU fell by 3.2% per annum, while global exports from Japan rose by 3.1%.

This underperformance in the bilateral trade and investment relationship between two such major developed economies leads to losses in competitiveness, productivity and welfare, both bilaterally and in the global economic context; reduced choice and higher prices for consumers; weak support for employment and depressed wages.

Economic studies and public consultation indicate that the bilateral EU/Japan trade and investment relationship is not fulfilling its potential. The main reasons are a combination of tariffs and non-tariff measures [NTMs], the latter being the major concern for EU exporters to and investors in Japan.

Who is most affected?

The EU and Japanese economies are negatively affected, as is EU and Japanese business, employees and consumers, the worst affected EU sectors being those likely to benefit from the removal of NTMs: e.g. agro-food, automotive, pharmaceutical and medical devices sectors.

Why is public intervention necessary?

Without negotiated responses to the problems depressing trade and investment, the situation is likely to worsen. In recognition of this situation, at the 28 May 2011 Japan-EU summit the summit leaders' agreed to start the process for parallel negotiations for:

- a deep and comprehensive Free Trade Agreement (FTA)/Economic Partnership Agreement (EPA), addressing all issues of shared interest to both sides including tariffs, non-tariff measures, services, investment, Intellectual Property Rights, competition and public procurement; and

- a binding agreement, covering political, global and other sectoral cooperation in a comprehensive manner, and underpinned by their shared commitment to fundamental values and principles.'

The summit leaders also decided to start a scoping exercise as soon as possible to define the scope and level of ambition of both negotiations.

The problem drivers

A number of factors depress or limit trade and investment potential between EU and Japan, some of which could be addressed by trade policy or domestic reforms, including trade negotiations, while others (such as geographical distance, communication problems, and consumer preferences) are less likely to be improved by such measures.

Negotiations have potential to change tariffs, non-tariff measures and also discriminatory or burdensome features of the regulatory environment, affecting trade in goods and services, investment and public procurement.

Both the EU and Japan have low tariffs on goods.. However, Japan's tariffs remain high in the agricultural and processed food sectors and for beverages, in all of which sectors the EU is a major global exporter. Average Japanese tariffs applied to other important EU exports are generally low.

EU tariffs on the main Japanese exports are higher. Japanese exports to the EU largely fall in a small number of manufacturing sectors, e.g. motor vehicles, electronics and machinery. Thus Japan's offensive interests focus on tariff elimination, particularly since the entry into force of the EU-Korea FTA, given the competition between Japan and Korea in similar export sectors.

Public consultation and studies stress that non-tariff measures are major barriers to EU exports to Japan. Parts of the Japanese market, e.g. some agricultural products and some transport equipment and aeronautical products, are almost totally closed to EU exports. Seven business sectors that cover the bulk of EU exports to Japan are those most affected by existing NTMs: chemicals (including pharmaceuticals), automotive, medical devices, processed foods, transport equipment, telecommunication and financial services. The lack of transparency in public procurement, and problems relating to IPR, have also been identified as important non-tariff barriers that make the Japanese market effectively inaccessible for EU companies.

2. ANALYSIS OF SUBSIDIARITY

Trade policy and the negotiation of international trade agreements are areas of exclusive EU competence: Article 207 of the Treaty on the Functioning of the European Union (TFEU). The principle of subsidiarity does not apply in this case. The proposal also fulfils the test of proportionality: even the most far reaching options do not extend beyond fulfilment of the stated policy objectives.

3. OBJECTIVES

The overall objective of EU policy as regards economic and trade relations is to

- enhance and further develop bilateral trade,

- abolish existing restrictions on trade and foreign investment, and
- lower customs and other barriers. .

The general objectives of European trade policy therefore include:

- smart, sustainable and inclusive growth through the expansion of trade;
- the creation of job and labour opportunities and welfare gains;
- lower consumer prices and other consumer benefits;
- improved competitiveness in global markets.

In respect of future EU-Japan economic and trade relations, the EU's specific policy objectives are:

- increasing the volume of bilateral trade in goods and services by reducing barriers;
- increasing investment flows between the EU and Japan by reducing barriers;
- achieving balanced access to the government procurement markets of both parties.

The specific objectives under each of these four topics are further translated into more detailed operational objectives in the main report.

4. POLICY OPTIONS

With a view to attaining these objectives various different policy scenarios have been examined. These include

(a) continuing the current framework in the 2001 Action Plan, with bilateral economic dialogues and business cooperation programmes, such as the Regulatory Reform Dialogue, and the High Level Trade Dialogue and other sectoral bilateral dialogues (e.g.: Industrial Policy Dialogue, Financial Services Dialogue, IP Bilateral Dialogue), with possible improvement of their functioning and effectiveness.

(b) a comprehensive EU-Japan free trade agreement (FTA) with elimination of tariffs, liberalization of trade in services and liberalization and facilitation of investment flows in both services and non-services sectors, together with the reduction of costs of NTMs. Under this option, the analysis looks at four different possible scenarios proposing different degrees of trade liberalization: two conservative and two ambitious scenarios, with a symmetric and an asymmetric scenario in each case.

The conservative and ambitious scenarios concerning cost reductions relating to NTMs are intended to provide a range of possible results. The 20% reduction provides a minimum substantially below the results in fact achieved in the negotiation of the EU/Korea FTA, while the 50% cost reductions assesses the potential of a very ambitious outcome concerning NTMs¹. Results within this range are consistently positive, varying only in the degree of overall gain.

The symmetric and asymmetric scenarios provide a more complete view of the ambitions and objectives of both parties. The symmetric scenarios provide a view of complete parity. The

¹ Given that there are a number of legitimate reasons for national regulations, it is unrealistic to assume that all NTMs can be eliminated, or even that any regulatory divergence can be aligned. A 50% cost reduction can therefore be considered as ambitious.

asymmetric scenarios recognize that while the reduction of the burden caused by NTMs is one main EU's main priority, Japan's main priority is EU tariffs in key sectors for Japan. A degree of asymmetry may well be required to achieve an acceptable balance of the eventual negotiated outcome. In the asymmetric scenarios examined, one third of the amount of reduction in the cost of NTMs on goods that would take place on the Japanese side is assumed to take place on the EU side.

The ambitious scenarios envisage an agreement in line with the new generation of trade agreements that the EU is currently negotiating with trade partners such as Canada. Recent EU trade agreements tend to go beyond Japanese FTAs in both scope and level of ambition. A comprehensive EU-Japan FTA would need to cover a high number of market access issues of interest to both parties, including tariffs, non-tariff measures affecting trade in goods (including TBT and SPS aspects) and trade in services, further market access for services, investment and public procurement and cover investment protection, competition and intellectual property rights.

A comprehensive EU-Japan FTA was indicated as the option of choice of the EU and Japan by their decision at the 28 May 2011 summit to begin the process towards FTA negotiations, provided that the right conditions for this could be created.

Both the EU and Japan are likely to conclude a number of FTAs with third countries in the coming years. The agreements that the EU is currently negotiating with other trade partners (Canada, India, Mercosur and ASEAN countries) or has recently finalised (e.g. the EU-Korea FTA) have been taken into account.

The different scenarios are analyzed under the assumption that the Doha Development Agenda in the World Trade Organization will be successfully concluded. However for comparison purposes available data on bilateral trade liberalization without the impact of a future DDA deal have also been included and considered.

5. ASSESSMENT OF IMPACTS

Option (a), continuing similar arrangements to those presently in force, given the extremely limited results achieved to date over many years, is not likely to produce any substantial growth of bilateral trade and investment volumes. Thus, no significant GDP gains could be expected in either the EU or Japan.

Option (b), a comprehensive FTA, shows substantial gains in GDP for the EU by 2020: 0.75% in the case of the conservative, symmetric scenario, or 0.34% for the conservative, asymmetric scenario; and 1.9% in the ambitious, symmetric scenario, or 0.8% for the ambitious, asymmetric scenario². For Japan the GDP increase is estimated at 0.27% for both conservative scenarios and at 0.7% for both ambitious scenarios.

Under both conservative and ambitious scenarios, EU global exports are projected to increase in the same sectors with large increases in the processed food, electrical machinery and business services sectors. Under the ambitious scenarios, EU global imports would rise substantially in the processed foods, air transport, and finance and business services sectors

² NB. In the asymmetric scenario, the amount of reduction in the cost of NTMs on goods on the EU side is foreseen as one-third of the reduction on the Japanese side.

and fall in the electrical machinery sector. The motor vehicle industry would see a rise in both the EU's global exports [6.73%/asymmetric] and imports [2.6%/asymmetric].

For Japan, global exports would increase notably for electrical machinery, motor vehicles, other machinery, other transport equipment and other manufactures sectors. Japan would experience a substantial rise in global imports in the processed foods, chemicals, transport equipment, motor vehicles, metals, and business services sectors.

EU SMEs can be expected to gain from an EU/Japan FTA since regulatory compliance costs are more burdensome for them and because SMEs are prominent in sectors likely to benefit such as processed foods.

For the environment, negative impacts on waste, biodiversity and natural resources, are likely to be mitigated to some extent by increased trade in environmentally sustainable goods and services. In respect of global emissions any increase following an FTA is expected to be close to zero [1.5 million tonnes of CO₂].

Increased trade between the EU and Japan would lead to an increased demand for labour, and raise the welfare of both parties: the greater liberalisation, the greater the welfare gains. Employment in the EU is projected to increase considerably e.g in the electrical machinery sector, with limited losses in the motor vehicle sector [between -0.40% for a conservative, asymmetric FTA and -0.10% for an ambitious, asymmetric FTA]

As two highly developed democracies, an EU/Japan FTA is not expected to have direct impact on human rights.

The EU and Japan and third countries will benefit from simplification effects resulting from a reduction of NTMs in both countries, reducing administrative costs when trading with the EU or Japan.

6. COMPARISON OF OPTIONS

Option (a), continuing with the status quo, does not achieve the operational objectives set out above. Continuing bilateral economic cooperation programs such as the Regulatory Reform Dialogue, with further cooperation in areas where agreements have already been signed, is not expected to produce much in terms of results. Its effectiveness in achieving the operational objectives can be considered to be zero or even potentially negative.

Option (b), with its various scenarios, calls for full-scale FTA negotiations, with different degrees of trade liberalization, and reductions in the costs of trade, all of which result in considerable benefits in both the EU and Japan. Benefits include increases in GDP, increases in exports, overall increases in employment, increases in wages for both semi-skilled and skilled employees, together with increases in competitiveness and an improved standing for both the EU and Japan in respect of other global competitors.

A comparison of the main results for the various options of an FTA is set out in the form of a table in Annex.1

7. MONITORING AND EVALUATION

A table summarising the main indicators proposed for monitoring progress towards achievement of the stated general, specific and operational objectives is set out in Annex 2.

ANNEX 1

Criterion	Policy Options				
	A	B1	B2	B3	B4
Faster and more sustainable economic growth	0	+	+	+	+
Improving labour opportunities and consumer and welfare gains	0	+	+	++	++
Improving Europe's competitiveness in global markets	0	+	+	++	+++
Increasing the volume of bilateral trade in goods by reducing barriers	0	+	+	++	+++
Increasing the volume of bilateral trade in services by reducing barriers	0	+	+	++	+++
Increasing investment flows between the EU and Japan by reducing barriers	0	+	+	++	++
Achieving access to the Japanese government procurement market comparable to that offered by the EU	0	+	+	++	++
(Overall) Effectiveness	0/-	+	+	++	+++
Efficiency (Time and resources spent in relation to estimated effectiveness)	0/-	+	+	++	++
Coherence with overarching EU policy objectives (for example, outlined in the EU 2020 strategy)	0	+	+	++	++
Ability to profit from synergy effects (for example, exchange of expertise)	0	+	+	++	++
Gains from simplification effects (for example through a reduction of NTMs)	0	+	+	++	++

ANNEX 2

General objectives	Indicators
Economic growth	- percent change in GDP - absolute change in national income
Creation of job opportunities and welfare gains	- percent change in more and less skilled employment - percent change in more and less skilled wages
Improving relative competitiveness of the EU	placement of EU member states in rankings measuring global competitiveness, such as the "Global Competitiveness Report" of the World Economic Forum
Specific objectives	
Increase of bilateral trade in goods	- relative and absolute/percent change in value of bilateral exports and imports of goods by sector
Increase of bilateral trade in services	- relative and absolute/percent change in value of bilateral exports and imports of services by sector
Increase of bilateral investment	- relative and absolute/percent change of bilateral investment flows
Increase of market access, especially for the EU, in the government procurement sector	Increase of number of tenders secured by EU companies
Operational objectives	
Elimination of tariffs on industrial goods and agricultural products	Japanese tariff schedules
Reduce NTMs concerning trade in goods	- convergence of standards/technical regulations - specific annexes - change in regulations/laws - increase of transparency/availability of information - business surveys
Reduce NTMs and increase market access in trade in services	- convergence of standards /technical regulations - change in regulations/laws - list of commitments and specific annexes - increase of transparency/availability of information - business surveys
Reduce NTMs concerning foreign direct investment	- convergence of standards/technical regulations - list of commitments and specific annexes - change in regulations/laws - increase of transparency/availability of information - business surveys
Reduce NTMs and increase market access of the Japanese government procurement market	- convergence of standards/technical regulations - change in regulations/laws - increase of transparency/availability of information - list of commitments and specific annex business surveys