

Towards a Free Trade Agreement with Japan?

Policy Brief for the European Parliament

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Abstract

The European Commission has asked for a negotiation mandate for an EU-Japan FTA and presented the favourable **Commission's Impact Assessment Report** (CIAR, 2012) in July 2012. Here, this proposal and the CIAR are analysed and critically discussed.¹

Concerning the **rationale** for a FTA, Japan does fit moderately into the new EU FTA strategy. Japan is a very large and highly developed market, there seems to be the opportunity for a deep and comprehensive FTA and the modest current trade relation appears to promise significant potential for improvement. However, the low growth and the closed nature of the Japanese economy as well as the high relevance of de facto barriers (non-policy related) raise the basic question, how large the export and investment gains for the EU could realistically be.

Japanese **Non-Tariff Measures (NTMs)** are central to the debate, because the EU will reduce its tariffs, once and for all, in a clearly measurable and enforceable way – in exchange for a potentially significant improvement in Japan's regulatory framework which, however, is much more difficult to monitor and enforce in the long term. Even though the Japanese governments' attitude towards regulatory changes seems to have improved significantly over time, there is a general demand for Japanese prior action on effective NTM reductions *before* FTA negotiations are started – and also some dissatisfaction about the progress already achieved in this respect. Some doubts remain whether reform ownership is sufficiently strong in Japan. The Commission's strategic approach to deal with this problem – NTM-Roadmap, threat to end negotiations after one year, EU tariff reduction conditioned on Japanese NTM reduction – seems fairly sensible, but still lacks some important underpinning.

The **CIAR expects significant gains** in output and employment. It is the most optimistic, but also the most up-to-date study – with a more comprehensive data set than other analyses. However, due to optimistic assumptions and the black box character of trade models, results have to be **interpreted with some caution**. Moreover, there is the general question of whether standard trade models are adequate to cope with the peculiarity that due to the high relevance of non-policy barriers, Japan's economy is more closed than similar economies.

¹ While the IW Köln is clearly regarding trade and openness as drivers of growth, welfare and competitiveness, the aim of this study is not too replicate the rather optimistic standpoint of the CIAR. Due to the focus on critical aspects and the requirement for brevity, the general gist of this study might appear more sceptical than intended.

1.0 General Overview and Context

The European Commission had asked for a negotiation mandate for an EU-Japan FTA and presented the favourable **Commission's Impact Assessment Report (CIAR, 2012)** in July 2012. Here, this proposal and the CIAR are analysed and critically discussed.²

This introductory chapter will give a general overview. The two following chapters will focus on the role of NTMs (non-tariff measures) in Japan and on available evidence about potential outcomes of an EU-Japan FTA.

1.1 Trade and investment background

In the following introduction an overview is provided of the trade and investment relations between the EU and Japan are described as well as the trade and investment regime – with a focus on EU exports to and investment in Japan.

Trade and investment relations

Trade and investment relations with Japan and their development are **relatively modest** when the size and degree of economic development of both trading partners are taken into account. On a global scale, the EU-27 as a region is the largest economy and Japan the third largest individual country behind the US and China. Nevertheless, Japan ranked only seventh among the EU's main partners in goods trade in 2011 – behind much smaller (but geographically closer) countries like Switzerland, Norway and Turkey. EU exports of goods and services to Japan only account for 3.3% of total external EU trade (figure 1), and FDI stocks in Japan (€ 129 bn. in 2010) only for 2.3% of total outward FDI stocks of the EU. What is more, while trade in goods and services between the EU and Japan has more or less stagnated since 2004 (figure 2), **Japan's share in EU's external trade** has continuously and significantly **declined** over this period (figure 1). Concerning balances, from the EU perspective there are traditional deficits in the trade in goods and services and FDI stocks, both of which have however declined somewhat recently (figure 2 for trade).

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Both in terms of trade and investment **Japan is a fairly closed economy** compared to similar countries. Generally, larger countries have relatively smaller trade and import shares in GDP than smaller countries. Even taking this into account, however, Japan's import share of less than 15% of GDP appears very small compared to the other G6 countries (figure 3). Particularly, it is much lower than in Germany (42%), whose nominal GDP in current US dollars amounts to about around 60% of Japan's GDP in 2011, and even smaller than in the USA (16%), whose nominal GDP in current US dollars amounts to more than 2.5 times that of Japan. Even more striking is the very small share of inward FDI stock in GDP in Japan (3.9%) in comparison to the other G6 countries (figure 4).

The possible **reasons for this lack of international openness** and for the disappointing recent trade developments are various and can only be partly discussed here. Apart from trade, investment and regulatory barriers, which will be regarded later, two other sets of aspects are relevant.

- Firstly, there are some **specific features of the Japanese economy and society**, which have to be taken as a given in the short term and which an FTA cannot effectively tackle: these are cultural differences in attitudes and values, strong consumer preference for domestic products, traditional close domestic customer-supplier ties, a certain scepticism about foreign suppliers and foreign direct investment as well as language and communication problems and geographical distance.³
- Secondly, and related to the **success of China and other emerging market countries**, divergence in economic growth plays an important role for the declining share of trade between the EU and Japan. The impressive growth of many emerging market countries and subsequently larger opportunities for increasing international trade and off-shoring have in recent years led to a shift of trade shares away from most industrialised countries such as Japan and the USA. On top of this is Japan's dismal growth performance. The average growth rate of real GDP was 1.1% in the 1990s and only 0.7% in the last decade, both much below the growth rates of other large industrialised and advanced economies (figure 5). This contributed importantly to the very disappointing growth of imports of goods and services into Japan, particularly in the last decade (figure 6).

³ The large geographical distance between the EU and Japan should not be overrated. The geographical distance to China is about the same, but China's share in EU external trade – at more than 13% in 2011 – is more than three times higher than Japan's.

Trade, investment and regulatory environment

An important question refers to the relative importance of trade and investment barriers in explaining the low Japanese openness and the at best modest status and development of the trade and investment relations between the EU and Japan. A cursory look at tariffs, non-tariff measures (NTMs) and other regulatory trade and investment obstacles shall shed some light on this question.

Generally, **tariffs** play only a limited role in Japan and the EU. According to the European Commission, simple average applied MFN tariffs rates for goods were at 3.8% in Japan and the EU, and trade weighted MFN average applied tariffs at 1.7% in Japan for EU exports and 3.4% in the EU for Japanese exports.⁴ But there are some important exceptions (table 1, 2):

- Tariffs on **industrial goods** are relatively low (simple average MFN applied rate of 2.5% in Japan and 4.0% in the EU in 2010 according to WTO/ITC data). However, in Japan this does not apply to textiles, clothing, leather and footwear etc., where maximum tariff peaks even reach up to 476%. In these sectors the EU also has somewhat higher applied tariffs, but its tariff peaks only reach up to 22%.
- However, while Japan has low or no tariffs on machinery, electronics and transport equipment, the **EU protects automotive and electronics products** with tariff peaks of up to 22% in transport equipment according to WTO/ITC data. This is highly relevant for Japan, as Japanese exports are concentrated with a share of about two thirds in machinery and transport equipment in 2011 with important subsectors being transport equipment (24%) as well as office and telecommunication equipment (16%). What is more, Japan has strong offensive interests in these sectors because Korea (as one of Japan's main competitors) will benefit from tariff elimination with the EU-Korea FTA, which puts Japanese companies at a significant disadvantage.
- Trade in **agricultural products and processed food** is hampered by relatively high tariff barriers of both partners, but even more so in Japan (simple average applied MFN rate of 17.3% in Japan and 12.8% in the EU in 2010 according to WTO/ITC data). In Japan prohibitive tariff peaks of up to 640% prevent any significant trade in the relevant tariff lines. Thus, the EU has offensive interests here.

⁴ According to the WTO/ITC/UNCTAD Tariff Profiles 2011, simple average applied MFN tariff rates for all goods were as high as 5.1% in the EU and 4.4% in Japan in 2010. Trade weighted tariffs in the Japanese exports to the EU are higher than for EU exports to Japan because there is considerable more trade in tariff lines with relatively high tariffs for Japanese than for EU exports.

Non-tariff measures (NTMs)⁵ and regulatory environment hamper trade in goods and services, investment and public procurement in Japan and the EU. As chapter 2 focuses explicitly on the high relevance of NTMs for EU exporters in Japan, this aspect is dealt with only cursory here. Generally, the Japanese regulatory environment suffers from a lack of international harmonisation and appears relatively complex, burdensome, and often opaque. A large number of NTMs, identified by several reports and the EU's public consultation, hamper EU exports in different fields (see chapter 2).

Not only **EU goods exporters** but also **EU service providers** are affected by Japanese NTMs. According to the EU's public consultation, Japanese regulations (and their interpretation by national authorities of different government levels) as well as **competition rules** often lead to significant discriminatory restrictions, e.g. with regard to the recognition of professional qualifications and barriers/delays concerning the temporary movement of employees. Several important sectors, e.g. many financial services, are effectively closed to EU firms. In close relation to this, **foreign direct investment** is also generally hampered or even prevented by restrictive regulations (e.g. triangular merger rules), cross shareholdings in Japanese keiretsu (enterprise groups), and cultural attitudes inimical to foreign ownership. The OECD's FDI restrictiveness index ranks Japan significantly worse than nearly all other industrialised countries (except Iceland and New Zealand) and particularly worse than most EU countries (figure 7).

Moreover, the Japanese **public procurement** market is restricted by a variety of non tariff barriers, like access limitations in certain sectors, lack of transparency, different rules on the national/regional/local government level, and implicit discrimination of (particularly new) foreign suppliers.⁶ Several sectors also complain about problems concerning **IPR protection**.

⁵ Copenhagen Economics (2009, p.15) defines non-tariff measures as "all non-price and non-quantity restrictions on trade in goods and services. This includes border measures (customs procedures etc.) as well as behind-the border measures flowing from domestic laws, regulations and practices". Not all NTMs are considered "actionable", i.e. can be tackled by an FTA. The aim of tackling NTMs is to reduce the related trade costs for businesses. However, in the following the expression 'reduction of NTMs' is used for reasons of readability.

⁶ However, the business survey by Copenhagen Economics (2009) points to only relatively limited restrictiveness of the Japanese public procurement market (1.5 on a scale from 0 to 5, with 5 being most restrictive).

In order to assess the relevance of NTMs for the low degree of openness in trade and investment in Japan, it is useful to very briefly compare available estimates for the **overall effects of NTMs** in Japan, the EU and the US. As a result, the statements by Copenhagen Economics (2009, 31) that “there are generally higher costs of NTMs in Japan than in the EU“ and that „Japan is the least open partner in terms of NTMs in the Quad“ have to be qualified. Table 3 shows that NTMs can be measured in a variety of different ways with rather diverging results.⁷ Bearing in mind this caveat, only a few measures in table 3 find that Japanese NTMs are most restrictive (i.e. Bradford/Lawrence, 2004⁸, CIAR, 2012). And also in the CIAR, estimated trade costs of NTMs are only slightly higher than in the EU.

Thus, as tariffs in Japan are low and NTMs are apparently not significantly higher than in the EU and US, it is still a **conundrum** and an open question **why Japan is relatively closed** to trade and investment. More research is obviously needed to quantify the relevance of cultural and structural factors which can hardly be changed by a FTA or in the short and medium term.

1.2 The FTA strategy of the EU

Since 2006 the EU – in the framework of the **Global Europe Strategy** – has embarked on a new FTA strategy, after former Trade Commissioner Lamy had declared a moratorium on bilateral FTAs before the start of the Doha negotiations in 2001. The reversal of this position and the new FTA initiative was not only due to the demise of the multilateral negotiations at the WTO in Geneva, but also to rising political pressures from EU companies to get better access to fast growing and still relatively trade-restricted emerging markets. Moreover, other important trading partners of the EU (like the US, Japan, China) had also started to actively conclude FTAs with attractive markets which threatened to put the EU at a competitive disadvantage.

⁷ Thus, studies trying to quantify NTMs should be interpreted with great caution. For example, Kee et al. (2006), in calculating their measure of overall trade restrictiveness find somewhat counter-intuitively that tariff protection is higher in Japan (5.8 % trade cost increase) than in the EU (3.0 %).

⁸ The price gap identified by the study Bradford/Lawrence is a result not only of trade barriers, but also of potentially strong consumer preferences for domestic products.

As a follow up to the Global Europe strategy, the "**Trade, Growth & World Affairs**" **Communication** of the EU Commission (COM, 2010) reconfirmed the shift to a new generation of deep and comprehensive FTAs which should focus especially on attractive trading partners and should go significantly beyond liberalisations in the context of the WTO or of former FTAs. This approach is – in direct relation to the Europe 2020 strategy – intended to boost trade, welfare and competitiveness of the EU.

Many new ambitious **FTA negotiations** have been started or concluded already. South Korea was a first success in this respect, because in the course of the EU-Korea FTA technical barriers to trade will be dismantled and markets for services and public procurement opened to a considerable degree. Relatively comprehensive FTAs with some smaller Latin American countries like Colombia and Peru, and Central American countries followed. However, FTA negotiations with India have proved more difficult and lengthy, and there is some reason to believe that negotiations with important ASEAN countries (like Malaysia and Vietnam) could face the same fate.

There are also FTA negotiations with countries in Eastern Europe – Armenia, Georgia, Moldova, Ukraine; the negotiations with the Ukraine are currently hampered by political strains, which also partly applies to the envisaged comprehensive FTAs with many Southern Mediterranean countries.

In the past, less comprehensive FTA were also concluded with important emerging markets like Chile, Mexico and South Africa. However, FTA negotiations with Mercosur (comprising Brazil and Argentina) are still proving to be very difficult after their resumption.

In the past the EU had abstained from negotiating **FTAs with other industrialised countries** – as part of a ‘gentlemen’s agreement’ in the multilateral context in order not to disadvantage less developed countries due to trade distorting effects. This **restraint** has recently been **loosened** with the FTA negotiations with Canada since May 2009. On top of this, and mostly due to the near failure of the Doha negotiations, FTA negotiations with the USA and Japan are currently being discussed.

1.3 Rationale behind a possible FTA and steps already made

Rationale

The rationale for an EU-Japan FTA is based on the existing framework of EU trade policy, as argued, e.g. in the COM Impact Assessment Report (CIAR, 2012).⁹ In general **trade** is rightly seen as a **driver of growth**, welfare, competition, productivity, competitiveness, investment, lower prices and greater consumer choice. These positive effects would indeed be welcomed in the general context of the Europe 2020 strategy and particularly in this current time of crisis in the Eurozone.

The rather **positive picture** painted by the Commission can, however, be **qualified** to a certain extent as follows:

- From a purely economic point of view unilateral trade liberalisation would be the best option. However, also **political economy aspects** have to be taken into account.¹⁰ Bilateral FTA negotiations are essentially about achieving a balance between concessions on both sides. Thus, the offensive and defensive interests of the EU need to be a central feature of the analysis and the resulting recommendations at the end of this study.
- Economic **benefits** from trade liberalisation are the main objective of the EU-Japan FTA. However, they will materialise only in the **medium to long term**. In the meantime, production factors are reallocated as a result of structural change to more productive uses. During this adjustment phase towards a higher welfare level, **unemployment** could increase **temporarily**, which would aggravate the already serious unemployment situations in several EU countries due to the **current crisis**.
- The generally positive impact of a potential EU-Japan FTA on consumer choice, prices, competition, competitiveness, etc. might in this particular case be limited by the fact that Japanese competitors such as Korea and other Asian countries offer relatively similar and often even cheaper products than Japan, particularly for example motor vehicles or consumer electronics.

⁹ Enlarging briefly on the rationale for an EU-Japan FTA in this chapter also implicitly covers the aspect of potential political and economic consequences of not having an EU-Japan FTA/EPA (required by the TOR for this policy paper).

¹⁰ As the IW Köln is a policy-oriented think tank, political economy aspects are particularly focused on.

- Bilateral **FTAs** which lower tariffs and liberalise NTMs on a preferential basis can generally lead to **trade distortions and trade diversion** to the possible detriment of the liberalising country. This is due to the fact that potentially more efficient suppliers in third countries are discriminated against by the remaining tariffs so that their goods and services are priced out the market even though they might be less costly.
- Bilateral FTAs increase trading transaction costs particularly for SMEs and contribute on a global scale to an ever more complex web of overlapping bilateral agreements (the so-called **spaghetti bowl**).

The **decisive question** in view of the results of chapter 1.1 is **how large the trade benefits** of a potential EU-Japan FTA can be. Japan does fit moderately into the new FTA strategy of the EU. On the one hand, Japan is a very large market and is also open to relatively far reaching negotiations. On the other hand, there is a lack of economic (and import) growth which differentiates Japan greatly from fast growing (but smaller countries in terms of GDP and imports) countries like India or Vietnam, who also have higher trade barriers than Japan.

Looking into the future, the **growth outlook for Japan** appears uncertain, as the chronic problems particularly in the banking sector are still not completely solved and as the massive public debt burden of over 220% of GDP will most likely also act as a drag on the economy in the years to come. Accordingly, the IMF forecasts Japanese economic growth will reach only on average 1.3% per year between 2013 and 2017.

Moreover, the closed nature of the Japanese economy remains a conundrum with Japan appearing as a particular case in comparison to other large industrialised countries (see chapter 1.1). Thus, the question arises **how reliable standard economic CGE models** can be in view of this peculiarity and the high relevance of deeply embedded cultural and structural factors that impede imports and FDI inflows.

Nevertheless, the available economic studies (for an evaluation see chapter 3) and the liberalisation potential identified by the EU Commission's public consultation point to moderate **trade and welfare benefits of an ambitious EU-Japan FTA**. To achieve this aim it is of paramount importance from the EU perspective that Japan significantly reduces its NTMs and improves its regulatory environment (see chapter 2). EU exports in goods and services, in-

vestment opportunities in Japan as well as the EU's access to the Japanese public procurement market would profit from these liberalisations. Moreover, high Japanese tariffs on agricultural products and processed foods also belong to the **offensive interests of the EU**.

There is another important **strategic case** regarding the EU's tactics to negotiate a potential EU-Japan FTA (see chapter 3.2 for more details). Japan's offensive interests (while also targeting NTMs in the EU) focus particularly on the EU's still relatively high tariffs for transport equipment and electronics. So, in a nutshell, the EU-Japan FTA will be about Japan targeting EU tariffs and the EU focusing on Japanese NTMs. This framework poses considerable **challenges for the EU's negotiation strategy**, because tariffs in the EU will be eliminated once and for all, while the reduction of NTMs is harder to implement and control – and it can potentially be reversed in the future by seeking recourse to regulations which are (or are only portrayed to be) necessary to secure such values as public health, national security, or environmental quality.

Steps already made

On July 18, 2012 the EU Commission officially proposed to open negotiations for an EU-Japan FTA and presented an in-depth **Impact Assessment** (cited here as COM Impact Assessment Report (CIAR, 2012)).

The way towards this official request was long and for a long time not very fruitful. After conducting relatively **loose consultative bilateral trade relations for years** (with a relatively vague Joint Declaration in 1991 and informal dialogues in several areas) and after establishing a Regulatory Reform Dialogue in 1995, Japan and the EU adopted a ten year Action Plan in 2001 increasing the number of dialogues on trade issues. Several bilateral agreements were concluded¹¹, but the results of all these approaches were very limited.

Towards the end of this plan, and especially after the conclusion of the EU-Korea FTA the **pressure from Japan** increased considerably **to start FTA/EPA negotiations** – and the EU became generally more open towards such a step in the context of its new trade strategy. In

¹¹ These are: Mutual Recognition Agreement in 2002, Agreement on Cooperation and on Anti-competitive Activities in 2003, Agreement on Co-operation and Mutual Administrative Assistance in Customs Matters in 2008, and Science and Technology Agreement in 2009.

reaction to this, during the Japan-EU summit in April 2010 a **Joint High Level Group** (JHLG) was set up to identify “options for strengthening all the aspects of the Japan-EU relationship. This JHLG produced a report for the Japan-EU Summit in May 2011 where the process for the negotiation of a deep and comprehensive FTA/EPA was started. To this end, a Scoping Exercise for a potential FTA was initiated up which (according to the CIAR) is still ongoing.

1.4 The envisaged contents of the EU-Japan FTA/EPA

The following chapter draws on publicly available information¹² and expert interviews about the preliminary results of the **Scoping Exercise**. According to the **key principles** of the Scoping Exercise, an EU-Japan FTA should secure the **highest level of liberalization**, it should be deep and comprehensive and cover all aspects of trade and investment of interest to both sides. General principles such as **transparency** of regulatory processes and **regulatory co-operation** (including stakeholder consultations) are stressed, particularly in view of potential new trade barriers.

Concerning **trade in goods**, full trade liberalization is aimed at, including items excluded from existing FTAs/EPAs. Tariffs on most lines should be eliminated upon entry into force of the agreement; also there is the aim to eliminate export duties (or measures of equivalent effects). **Customs and trade facilitation** is also stressed with a view to ensuring the application of international rules of the WTO or the World Customs Organisation. Full liberalization of **current payments and capital movements** is also aimed at.

Reductions of **NTMs and TBTs** (Technical Barriers to Trade) should aim at improving the application of the WTO’s TBT Agreement and could be guided by an indicative list of methods to address NTMs with a priority given to key sectors. In parallel with the Scoping Exercise a Roadmap has been developed including 30 specific NTMs and relatively concrete steps and timelines for their reduction or elimination (see chapter 2 for more details). Important facets of tackling NTMs include the application of international standards, streamlined testing

¹² Public information relating to the Scoping Exercise are available under http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149531.pdf and <http://www.esf.be/new/wp-content/uploads/2012/07/EU-Japan-FTA-Extracts-of-Scoping-Exercise.pdf>.

and certification requirements, and a consultation mechanism to address specific NTMs. The integration of the Mutual Recognition Agreement into the potential FTA is also to be considered. On Sanitary and Phytosanitary measures (**SPS**), negative trade effects should be minimized and more certainty introduced, e.g. by relying more on science-based practices.

Liberalisations of **trade in services** should principally include all sectors (without prior exclusion) and target the broadest possible elimination of all discriminatory measures in the sectors covered. In the closely related area of **electronic commerce** a high level of commitments has been agreed upon. Moreover, regarding the liberalization of **investment** (in services and non-service) exceptions should also be kept to a strict minimum, with the use of negative listing for both services trade and investment where appropriate.

The opening of **government procurement** markets is intended to go beyond the relevant WTO agreement (GPA) and introduce more precise and effective disciplines, particularly in relation with tendering procedures, technical specifications, remedy procedures, with all government levels covered. **Intellectual Property Rights** (IPR) (such as copy rights, trademarks, geographical indications (GI), designs, patents) should be effectively enforced by means of complementing the WTO's TRIPS Agreement (Trade Related Aspects of Intellectual Property Rights).

With regard to **competition policy**, restrictions like concerted practices, abuses of dominant positions, private monopolization, and unfair trade practices should be covered and competition should be increased with no exceptions by adhering to general principles such as non-discrimination and procedural fairness. There should be binding disciplines for the most harmful types of **subsidies** for goods and service providers. Here, and also with regard to **state monopolies**, the precise scope of commitments is to be decided in the course of negotiations.

A **dispute settlement** mechanism should be based on the WTO's DSU (Dispute Settlement Understanding), provide consultation, arbitration (supplemented by an alternative mediation mechanism), provide for clear compliance rules and apply to most of the FTA provisions. An **investor-to-state dispute settlement** system is also foreseen. The precise scope of dispute settlement should be determined in the course of negotiations.

Sustainable development should be promoted, e.g. by implementing internationally recognized labour standards and multilateral environment agreements, by considering commitments on environmental goods, and by promoting responsible business conduct.

All in all, and in lieu of a brief **evaluation**, all relevant issues are covered by the Scoping Exercise. While a high and comprehensive level of commitments is generally foreseen, many aspects inevitably still remain vague.

1.5 Positions of the European Parliament and stakeholders

The main source of information about the positions of stakeholders concerning a potential EU-Japan FTA is the **Public Consultation** conducted by the EU Commission (published in spring 2011) which includes participants from government and business representatives from the EU and Japan. Many contributions are publicly accessible and a summary is added as Annex 7 to the COM Impact Assessment Report (CIAR). Thus, a brief overview of the main result is provided here. The largest part of the Consultation deals with the assessment of various trade barriers. This information has been helpful in the chapters 1.1 and 2 of this study. In the following, the opinion of stakeholders about the expected effects and about the approach to tackle the existing trade barriers is focused on.

The **majority of respondents expect positive effects** from closer economic integration between the EU and Japan – in terms of market access to the Japanese market (exports and investment) and also in terms of employment. Most participants also **favour** tackling the remaining trade barriers by means of an encompassing **FTA** (also called Economic Integration Agreement – EIA). Among the main supporters from the EU business side are the chemical and pharmaceutical sector, the agricultural and processed food sector, information technology, consumer electronics, telecommunications and textiles.

However, there is also **dissent and hesitation** in some important EU industries. Above all, the automotive sector does not expect any export increases and fears declines in [output and] employment. The latter is also true for the railway sector. Some EU business organisations

favour an enhanced high level regulatory dialogue between the EU and Japan instead of a FTA and point to the importance of the multilateral negotiations in the Doha Round.

There is a broad **consensus** on the European side on the appropriate strategy to adopt. As scepticism is widespread about the willingness of Japan to ensure a level playing field, European respondents favour a demand that **Japan demonstrates its good intentions** by effectively reducing relevant NTMs *before* FTA negotiations are started.

The evaluation of the Public Consultation suggests that some **caution** is needed when interpreting the largely positive and optimistic results, mainly because the survey **sample is not representative**:

- There is no weighting of responses according to the size of the organizations submitting views.
- There is probably a so-called selection bias, because it is likely that mainly those respondents/organisations participated which expect a significant effect for their clientele.
- According to the summary of the Public Consultation in Annex 7 of the CIAR, 80% of respondents called for an EIA (FTA). However, this measure does not provide a clear view of the opinion of EU respondents, as one third of the respondents can be associated with Japanese interests. Focusing only on EU respondents, nearly 30% of respondents did *not* support an EIA (FTA).

However, since the publication of the Public Consultation the case for an EU-Japan FTA has further evolved and it is now to be decided whether the EU Commission should obtain a negotiation mandate. There is no comprehensive information on how stakeholders view the current state of play, but several **large business organisations** have published their **current points of view** in recent months. The European Services Forum and EuroCommerce voice strong support for a FTA. BUSINESSEUROPE accepts that work on a potential FTA has advanced, but expresses disappointment about the lack of progress in removing identified NTMs in Japan. All three organisations call for a high level ambition in the mandate, particularly concerning the reduction of NTMs (in a wide sense). ACEA, however, continues to be sceptical about the benefits of an EU-Japan FTA, regards the preparatory process (Scoping Exercise, see chapter 1.4) as insufficient and considers it premature to launch FTA negotiations.

EU governments have divergent views – with France, Italy, and Spain being sceptical about an EU-Japan FTA and countries from northern Europe, e.g. the United Kingdom and Denmark, being strongly in favour.

With regard to EU institutions, the Council representing Member States is still undecided. The Commission was initially sceptical, but over time has become more and more open to an EU-Japan FTA. The **European Parliament** is principally in favour of a FTA. But the EP requires that Japan must make significant commitments on removing NTB's (including in public procurement) *before* negotiations could be started. The parliament is also dissatisfied with the progress achieved up to now in the course of the Scoping Exercise. To assuage fears of significant declines of production and employment in sensitive sectors, the EP suggests that effective safeguard measures to be included in an FTA.

2.0 Non-tariff barriers in Japan and other behind the border obstacles

2.1 General overview of regulatory barriers in Japan and possible approaches

Generally, Japan has a highly complex regulatory environment, lacking transparency and leading to significant bureaucracy costs and delays for foreign businesses. A brief overview of the role of NTMs as trade barriers in trade in goods and services as well as in government procurement was given in chapter 1.1. In this chapter, a **summary of individual Japanese NTMs** is provided as well as an overview of the main information sources.

Copenhagen Economics (2009) has presented the **most comprehensive and systematic study** on NTMs in Japan to date – establishing a long list of detailed NTMs and seven sectoral case studies. Concerning detailed Japanese NTMs, Annex 3 of this study provides a **list of 194 NTMs** in many different sectors that draw on a number of sources.¹³ Furthermore, the NTMs have been **categorized** by sector, by type (e.g. TBT, SPS) and by the prospects of an FTA remedying them. The main results are highlighted in the following:

- Of the 194 NTMs, 99 apply to manufacturing and 62 to services.

¹³ European Business Council in Japan, EU Commission: EU Proposals for Regulatory Reform in Japan, US Department of State, WTO Trade Policy Review Japan.

- Of the 99 NTMs in manufacturing, 65 are TBTs.
- Of the four most important manufacturing sectors (identified by NTM numbers) 59 out of 82 NTMs can be remedied only or in combination (much more common) with a FTA.
- Of 66 service NTMs 52 can be remedied only or in combination (much more common) with an FTA.

Concerning the seriousness of NTMs in Japan, Copenhagen Economics (2009) did **case studies for seven sectors** (Annexes 6 to 12) – their selection was based on trade volumes and sectors in which NTM reductions could be expected to result in significant increases in trade: chemicals (including pharmaceuticals), automotive, medical devices, processed foods, transport equipment, telecommunication and financial services. Annexes list the most important Japanese NTMs in the respective sectors, assess current trade, quantify the NTMs' impact on trade and offer potential solutions. **Additional sectors** are covered by the complementary study (by Copenhagen Economics) of the **CIAR** (retail and wholesale trade, maritime transport, postal/courier services and business services sectors), but the results are not published in the CIAR.

Some further selected data on NTMs in Japan is available from the **EU Trade and Investment Barrier Reports 2011**. Several NTMs – of obviously particular relevance for EU businesses – were chosen concerning:

- government procurement:
 - o restrictions to access contracts awarded by railway and urban transport operators;
 - o excessive thresholds for public contracts for construction works;
 - o lack of exhaustive coverage of local contracting authorities.
- medical devices: insufficient recognition of international standards and lengthy approval procedures
- insurance: preferential treatment of Japan Post by the Japanese regulator¹⁴

¹⁴ The 2012 EU Trade and Investment Barrier Report identifies only some limited improvements in Japan, with regard to government procurement of railways (more transparency and less discrimination in applying the operational safety clause) and in medical services (e.g. concerning conformity assessments).

A list of selected sectors is provided in **table 4** which gives an **overview of available information sources**. Further important sources are included, namely the EU Public Consultation and the European Business Council Studies (EBC, 2008, 2011).

2.2 Strategic considerations for EU trade policy

With regard to **NTMs in Japan** and looking at the basic European strategic interests, an uneven bargain could be in the offing for the EU (as mentioned in chapter 1.3) by giving Japan, once and for all, clearly measurable and enforceable tariff reductions in exchange for a potentially significant improvement in Japan's regulatory framework, but which is more **difficult to monitor and enforce**. What is more, Japan will keep the backdoor open to create new future NTMs which could be justified by their potential aim not to endanger e.g. national security, health or important environmental objectives.

To **evaluate this strategic challenge more systematically**, three questions can be asked:

1. Is Japan prepared to take on a serious commitment to reduce NTMs and improve its regulatory framework significantly?
2. If yes, is the Japanese government able to effectively enforce this commitment in view of domestic resistance from some ministries, the bureaucracy and important interest groups?
3. If so, will the implementation of the commitments lead to significantly higher EU exports or are other informal barriers in Japan, like cultural differences and preferences for domestic products, a more binding factor than CGE models suggest?

The answers to these questions are not straightforward:

- First, the **Japanese governments' attitude** towards regulatory changes and co-operation seems to have **improved** significantly over time. And the EU's leverage due to the EU-Korea FTA appears to be strong. However, it is to some degree an open question whether the EU can be sure, that the apparently strong current resolve in Japan will continue. This is a fundamental question about ownership of reforms: Is the Japanese government (and other governments to follow) really convinced that the Japanese economy will benefit from broad-based regulatory reforms?

- Second, currently the Japanese government appears to take serious attempts to reduce NTMs and to push these reforms through the relevant institutions. The **eventual success** of these obviously well-intended efforts is **still to be seen**.
- Third, **CGE models are an imperfect tool** for modeling the real world and their reliability is uncertain (see chapter 3). This is all the more true in case of Japan, where trade openness is much more limited than the level of formal trade barriers would suggest.

The **strategic policy approach of the European Commission** attempts to address these problems and appears broadly acceptable – with some qualifications:

- A (non-exclusive) **Roadmap with a list of 30 Japanese NTMs** has been identified in the Scoping Exercise, as far as public available information and expert interviews suggest.¹⁵ Some have to be reduced either before or upon the conclusion of the negotiations. Moreover, Japan has agreed to reduce a small number of specific NTMs in 2012 or by March 2013. In exchange, Japan expects that formal FTA negotiations will start soon. Evaluating the Roadmap, it is a clearly positive sign that Japan is prepared to deliver some NTM liberalization before being granted actual (mainly tariff) concessions from the EU. However, more broad-based progress would have been desirable before starting the negotiations, as the items to be delivered by March 2013 are only of limited importance. The liberalization to be achieved during the negotiations is seen by some experts to be sometimes fairly vaguely specified. It remains an open question whether Japan's currently cooperative stance will be continued.¹⁶ Once negotiations are opened (which has been the main Japanese aim for years), it is automatic that the conclusion of an ambitious FTA would entail wide ranging EU tariff elimination.

¹⁵ See http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149531.pdf. An additional specific but less detailed Roadmap on Railways and Urban Transport to improve reciprocal market access was also set up.

¹⁶ During the EP Workshop some doubts were raised in this respect by ACEA. Reference was made to a decision of the Japanese Cabinet of July 10, 2012 that adopted a Policy on Regulatory and Institutional Reform based on recommendations put forward by the Government Revitalisation Unit (GRU). This cabinet decision is interpreted by ACEA as watering down the original GRU recommendations and also certain elements of the Conclusions of the Scoping Exercise with respect to the elimination of NTBs in the automobile sector. According to further information obtained by the author from ACEA, the watering down refers to several specific items, among them a documented backtracking of Japan on the harmonization of Japanese automobile standards with international standards (UNECE regulations).

Therefore, the Commission proposes a Review Clause with the provision that the **negotiations shall be evaluated after one year and shall end**, if progress in reducing NTMs in Japan is considered too slow. At first sight, this appears to be a promising approach. However, the effectiveness and credibility of this instrument is uncertain (see Recommendations at the end of this study). First, it is questionable that this is a credible threat, because ending negotiations would be a major diplomatic affront and would probably severely disturb foreign policy relations between the EU and Japan. Second, the room for Commission discretion in such a decision is likely to be large. Third, the time frame of one year is rather short. Japan could slow down its efforts afterwards. This does not appear very likely as the EU continues to have leverage in relation to Japan's desire to redress its competitive disadvantages resulting from the EU-Korea FTA. Thus, the EU could drag out the negotiations if progress on NTMs in Japan slows.

As an additional lever, the Commission states that EU **tariff reductions** in important sectors shall proceed only **in parallel** with and conditioned upon progress in **NTM reductions**. This approach appears promising as a means of eliminating existing Japanese NTMs in the medium term, but has to be made sufficiently robust to be successful (see Recommendations at the end of this study). The approach suggested in the Scoping Exercise, that tariffs on most lines are to be eliminated upon entry into force of the agreement, looks inappropriate in this context.

However, the problem remains that **Japan can introduce new NTMs after EU tariffs have been eliminated**. If new NTMs are created for "justified" reasons (e.g. public health or security) there will be hardly any means to oppose this. As mediation or arbitration processes might not be sufficiently reliable, the possibility to temporarily re-introduce EU tariffs could be considered.

Overall, the Commission's approach seems fairly sensible, but still lacks some important underpinning. Continuous and more extensive transparency on NTM reductions (or on detailed plans for this aim) is clearly needed to establish trust in the EU trading community that Japan's commitment to deregulation of its economy is credible, unmistakable and sustainable. Particularly the European Parliament should be regularly informed by the Commission about progress on NTM reductions in Japan.

3.0 Potential outcomes of the FTA

The calculation of potential outcomes of FTAs often relies on Computable General Equilibrium (CGE) models. The (trade policy related) CGE approach usually models the main global economies/regions and the important channels through which trade liberalisation affects welfare, outputs, exports, employment and wages in the economies concluding an FTA. A **CGE model is a highly complex tool** – essentially a system of interdependent equations describing markets, macroeconomic variables, and private actors' behaviour. It includes detailed information about trading links, trade barriers, intermediate linkages between sectors and countries, taxes, etc. This complexity leads to the impression that a CGE model **basically appears like a black box**.

The following chapter first focuses on the CGE-based results of the COM Impact Assessment Report (CIAR, 2012) and explains intuitively the main effects underlying these results. Then it sheds some light on its plausibility by comparing it to former studies and by critically discussing its main assumptions.

3.1 COM Impact Assessment Report

The CIAR's quantitative results are based on a study by Copenhagen Economics from 2011 – called the complementary study. As the CIAR is available to the EP, the assumptions and results are only briefly sketched here, before some intuitive and qualitative insights are provided about the main channels influencing the results.

Assumptions

All scenarios include full tariff liberalisation (see table 5). In order to illustrate the range of possible results, the CIAR differentiates between **four different scenarios**: a conservative scenario (20% NTM cost reduction in Japan) and an ambitious scenario (50% NTM cost reduction in Japan) with each scenario being combined with the assumption of an asymmetric and symmetric liberalisation between the EU and Japan. In the asymmetric (symmetric) case the EU reduces NTM related trade costs *in goods trade* by only 1/3 of (to the same degree than) the NTM reduction in Japan. In the following the **focus will be largely on the asymmetric scenarios** because – as the CIAR (2012, p. 31) points out – a symmetric outcome of the EU-Japan FTA is unlikely, as Japan is interested mainly in tariff reductions in Europe and

the EU mainly in NTM reductions in Japan. Therefore, the EU will very probably not concede NTM liberalisations to the same degree as Japan.

Importantly, the CIAR assumes that **2/3 of NTM reductions** in the EU and Japan are implemented on an **MFN basis**, so that all other countries exporting to the EU and Japan would benefit from these regulatory changes. Thus, global imports of the EU and Japan would increase significantly. This spillover effect is highly critical, as 90% of overall results derive from this (CIAR, 2012, p. 35).

Results of the COM Impact Assessment Report

The results of the CIAR are generally positive for the economies of the EU and Japan. **Overall**, outputs, exports and wages of both countries should increase – the extent of changes depending on the scenarios (see table 6 for main results). In the long run (about 2020) GDP of the EU is expected to increase in the asymmetric conservative (ambitious) scenario by 0.34% (0.79%) and bilateral exports of the EU to Japan by 23% (33%). This corresponds to a rise in national income in the EU of € 42 bn (€ 100 bn).

The **impact on sectors** is differentiated (see table 7):

- Concerning output and employment effects (of the asymmetric *conservative* scenario), electrical machinery should benefit most, followed by processed foods, water transport and construction.
- Output and employment are expected to decline most in air transport, motor vehicles and chemicals.

This ranking is roughly similar in the (asymmetric) *ambitious* scenario – however, with the negative impact less pronounced for motor vehicles and more pronounced for metal products.

The CIAR qualifies the **fears of potential job losses** due to the EU-Japan FTA (particularly in the automotive sector) expressed in the public consultation by taking up an argument from the Japanese side (CIAR, 2012, p. 49-50). According to this the high level of **Japanese FDI and employment in the EU** (again particularly in the automotive sector) is said to be threatened by the EU-Korea FTA. An EU-Japan FTA would “reduce the risk of diminished Japanese FDI in Europe” (p. 50). This conclusion is not straightforward, however and depends on the character and motivation of Japanese FDI in the EU. **If the main motive was tariff jump-**

ing (i.e. to produce behind the EU tariff barriers), an EU-Japan FTA could lead to a reduction of FDI in Europe. **Exports from Japan could then substitute for EU production.**¹⁷

Therefore, it would be important to find out whether Japanese FDI in the EU has the character of tariff-jumping or of seeking a market. In the latter case, closeness to customers is important and an EU-Japan FTA would more likely foster Japanese FDI in final production as well as Japanese exports of parts and components.

Intuition: the main drivers of results

Several main channels of influence can be discerned, with the impact intensity being different for various sectors. Some diverging impacts are not easily resolved due to the black box character of the CGE model and a lack of detailed explanation in the CIAR.

Table 8a (row 3) shows that the EU sectors most affected (in terms of output declines) by **tariff reductions alone** are motor vehicles (-0.52%) and electrical machinery (-0.3%). As tariffs in both sectors are still relatively high in the EU a tariff cut would increase the competition from Japanese suppliers. For motor vehicles the negative output effect increases to -1.08%, if the assumption is abandoned that the Doha Round will be concluded and implemented by 2020.¹⁸ The effects of Japanese tariff cuts alone are of high significance only in the agricultural sector and for processed foods, where Japan still has high tariffs. EU exports of processed foods are expected to increase by an impressive 170% (276%) if the Doha Round is (is not) implemented.

Increases of EU manufactured goods exports (where Japanese tariffs are generally low) are mainly driven by the **reduction of NTMs in Japan**. Exports of chemicals, other transport equipment, other manufactures, and metal products are forecast to profit most (tables 8a and 8b). As depicted in the tables, the Japanese NTMs are relatively high in these sectors so that,

¹⁷ This could become all the more relevant, as the Japanese domestic automotive market will probably shrink in the next decade, so that there is an incentive to secure domestic Japanese production and employment by increasing exports to the EU, potentially at the expense of FDI related employment in the EU.

¹⁸ This effect is, however, mitigated by the impact of NTM liberalisations in Japan so that – in the case of no Doha implementation – the total output effect on motor vehicles of an EU-Japan FTA would be -0.9% (-0.6%) in the asymmetric conservative (ambitious) scenario (COM, 2012, p. 44). It is somewhat surprising – and again an indication of the black box character of the CGE models – that the tariff effect on electrical machinery is independent of whether the Doha Round is concluded or not.

for example, EU chemical exports to Japan are expected to increase by 22% (52%) in the asymmetric conservative (ambitious) scenario.¹⁹ The generally positive export effects do not, however, regularly feed through to positive output effects – a fact which is mostly pronounced in chemicals, but is also relevant for metal products and some other sectors.

This is due to the fact that the **NTM reductions in the EU on an MFN-basis and the associated spillovers** can lead to negative output effects which can outweigh the positive output effects from exports. A sector with high NTMs in the EU is considered to be less competitive than other sectors so that a decrease in NTM protection tends to increase global imports of this sector by a relatively large degree.²⁰ Competing global imports substitute for domestic production to some extent, hence the potentially negative output effect of an NTM reduction on an MFN-basis in the EU.

Nevertheless, as with tariff cuts, there is **also a positive output effect of NTM reductions on an MFN-basis**, because more imports tend to lower prices and increase consumer choice and because domestic production is reallocated to more productive uses. For most EU sectors there are, overall, positive effects from the NTM reduction on a MFN-basis and from the resulting spillovers.²¹ However, for chemicals, metal products and processed foods, there is an overall negative effect. Again, the detailed reasons for these differentiated effects can only be rationalised to some extent due to the black box character of the CGE model.

How reliable are the results of the CIAR? There is no definite answer to this question, even though the CGE model of Copenhagen Economics is highly elaborated and state-of-the-art. Some useful information can, however, be gathered by comparing the different available studies and by critically evaluating the assumptions.

¹⁹ It is also striking (and lacks explanation) that communication exports are forecast to increase by only 2.1% even in the ambitious asymmetric example even though the trade costs of NTMs in Japan are estimated to be as high as 25%. High NTMs and relatively low export growth also coincide in finance and to a smaller extent in water transport.

²⁰ A stark exception to this is electrical machinery where a moderate level of NTM costs in the EU coincides with a decline (instead of increase) in global imports. Apart from a substantive increase of EU exports to Japan, this is probably the main reason for the outstanding increase in output and employment of electrical machinery. The reason for the decrease of global imports is not obvious due to the black box character of the CGE model.

²¹ This can be seen when comparing the asymmetric and the symmetric scenarios which only differ by the degree of NTM reductions in the EU.

3.2 Comparison to other studies

By now, there are **four officially available thorough and systematic studies** about the potential economic impact of an EU-Japan FTA. Apart from the CIAR, there are studies by Copenhagen Economics (2009), Ecorys (2009) and the Swedish National Board of Trade (SNBT, 2009). **Table 9 to table 11 portray the main results** of these studies and table 12 shows the main differences in model setup, assumptions and results between all studies including the CIAR.

It is striking that there is **no agreement on overall results**, even on a qualitative level.

- Ecorys and SNBT see (very small) negative impacts on GDP (and on employment and wages, where available). On the other hand, the two studies by Copenhagen Economics (including the CIAR) point to substantial positive overall effects.²²
- Except the CIAR, all other studies expect greater overall benefits for Japan in comparison to the EU.
- The CIAR (except in the asymmetric conservative scenario) forecasts a small positive output effect for motor vehicles.²³ The other studies are more sceptical and expect a significant output decline: Copenhagen Economics (2009): -3.1%, Ecorys (2009): -8.3%, SNBT (2009): -5.3%.

However, there are also **some important common results** of all studies:

- The relevance of NTMs in Japan is much higher than the relevance of tariffs.
- Motor vehicles is a sector where the relative gains and losses are rather unevenly distributed between Japan and the EU, with Japan benefiting strongly and the EU suffering output declines in most studies or only small output increases in the more optimistic scenarios of the CIAR.

²² An important reason for the negative results of SNBT and Ecorys appears to lie in the high relevance of economies of scale and the resulting benefits of lower average costs with higher production. In their CGE models, important sectors with large economies of scale, such as motor vehicles, shrink considerably due to the EU-Japan FTA. This diminishes scale and results in higher costs and lower consumer benefits.

²³ However, when the Doha Round is not concluded until 2020 the output effects will also be negative in the ambitious asymmetric scenario (-0.6%) in the CIAR. Moreover, the employment effects on lower and higher skilled employees are slightly negative in all scenarios.

3.3 Discussion of main assumptions

As shown in **table 12** the studies differ considerably in their assumptions. Over time, and looking at the chronological order of the existing CGE studies (from right to left in table 12), assumptions have become more optimistic. The decisive question is, whether this increased optimism is adequate and realistic.

The **COM Impact Assessment Report (CIAR)** is the most optimistic, but also the most **up-to-date study**. To name just a few aspects (CIAR, 2012, p. 6-7, Annex 1): It uses newer data on trade and trade barriers and a more comprehensive set of Japanese NTMs than the other studies (covering more sectors than Copenhagen Economics (2009)). However, the presentations of results in the CIAR and the choice of assumptions require a more detailed analysis.

Concerning the presentation of the case for an EU-Japan FTA by the CIAR, an unbiased reader will notice the **generally positive tone** and also the sometimes relatively large focus on the results from the more optimistic scenarios. It is striking that the Commission portrays the symmetric scenarios as unrealistic (CIAR, 2012, p. 31), but nevertheless time and again mentions results from these scenarios in the report prominently.

With regard to the main assumptions, the results of the CGE model tend to be underestimated for some reasons and possibly overestimated for others. However, due to the black box character of the highly complex CGE model, the exact extent of the over- and underestimations as well as their relative relevance cannot be discerned here.

Underestimations could occur mainly due to the assumption that the **Doha Round** is concluded by 2020 (which appears questionable from today's perspective)²⁴ and due to the fact that the CGE model does not capture the impact of **productivity increases** of possible innovations induced by the EU-Japan FTA.

Potential **overestimations** might be relevant for the main assumptions concerning the liberalisation of tariffs and NTMs. The assumption of **complete tariff elimination** – including tariffs

²⁴ Copenhagen Economics (2009) assumes no implementation of the Doha Round but points out that this assumption does not influence overall results significantly.

also on the most sensitive agricultural goods – appears somewhat optimistic. Both Japan and the EU significantly protect their agricultural markets and are generally faced with strong interest groups opposing complete tariff cuts. The assumption of complete tariff liberalisation is relevant for the export increases calculated by the CIAR, because about 60% of the total bilateral EU export increase to Japan is accounted for by processed foods and agricultural goods in the asymmetric conservative scenario (about 45% in the ambitious scenario). If the exports of these goods remained constant²⁵, overall exports would only increase by around 9% (19%) instead of 23% (33%) in the asymmetric conservative (ambitious) scenario.²⁶

The assumptions that **NTMs in Japan are reduced by 20% (50%)** in the conservative (ambitious) scenarios should cover the range of possible outcomes, as intended by the Commission. The CIAR considers the reduction of 20% as conservative and broadly in line with former FTAs of Japan and of the EU (apart from the EU-Korea FTA), which were less ambitious and far reaching than foreseen by the new EU FTA strategy. However, even a reduction of NTM related total trade costs by 20 % implies a reduction of “actionable” NTM related trade costs (those that can be tackled by an FTA) by about 1/3 and assumes that NTMs in all sectors are reduced by this percentage. It is difficult to gauge how realistic this assumption is. On the one hand, it is sometimes stated that an FTA between two highly developed countries can be expected to achieve even more than the EU-Korea FTA, whose NTM reduction is unfortunately not quantified. On the other hand, it is questionable how effective and enduring the Japanese government will eventually be in reducing NTMs and in pressuring the domestic Japanese administration to co-operate (see chapter 2). Moreover, the 50% NTM reduction would broadly amount to a decrease in actionable NTM costs by 5/6. This appears rather ambitious as conceded also by the CIAR. The EU surely has a considerable degree of leverage over Japan due to the existence of the EU-Korea FTA and Japan’s competitive disadvantages. But it appears questionable whether this leverage could lead to a reduction of 5/6 of actionable NTM related costs in Japan.

The CIAR assumes that **65% of NTM reductions are taken on an MFN-basis** so that other importing countries would also benefit from this liberalisation in the course of so-called

²⁵ This unrealistic assumption is just taken for illustrative purposes.

²⁶ In other words, these export increases are relevant for exports of manufactured goods and services.

“spillovers”.²⁷ As this assumption accounts for 90% of overall economic effects (see chapter 3.1), it is highly sensitive. But again, it is very difficult to gauge how realistic it is. In Japan, it would probably require a very broad-based regulatory liberalisation strategy focused on fostering competition in the domestic markets without much regard to third trade partners. However, even though Japan recently seems to have become more inclined to domestic regulatory reform, it appears hardly imaginable that it would take such a wide ranging approach, particularly in the ambitious case of a 50% NTM reduction.

The same applies to the EU, especially in the **EU service sector** where it is assumed that the EU reduces NTMs to the same degree as Japan, i.e. by 20% (50%) in the conservative (ambitious) case. This assumption appears optimistic per se, but even more so, when 65% of NTM reductions are to be taken on an MFN-basis. This **would require a far reaching regulatory reform** process in the EU’s services sector, which does not appear very realistic in the course of the EU-Japan FTA.

What is more, from a **political economy point of view**, liberalisation on an MFN-basis in FTA negotiations do not appear very likely: The demandeur of NTM reductions is interested in obtaining *preferential* liberalisations (to gain competitiveness vis-à-vis third countries). And for the liberalising country it is rational to keep negotiation chips in one’s pocket for future FTAs with other countries and not give them away for free on an MFN-basis. Thus, the assumption of 65% of NTM reductions on an MFN-basis appears highly optimistic. This is probably why it was not used by Copenhagen Economics (2009).

All in all, the fairly positive results of the CIAR concerning potential outcomes of an EU-Japan FTA have to be interpreted with some caution, particularly as the calculation of exact figures for export and output increases suggests an accuracy that is not justified. Common qualitative results should be reliable. The reliability of CIAR results that diverge from

²⁷ The study by Copenhagen Economics (2009) does not assume NTM liberalisations on an MFN-basis but only vaguely hints at this possibility (p. 9). When comparing the results of this study with the CIAR, due to the black box character of the CGE models it is difficult to reconcile the following diverging results: Without NTM reductions on an MFN-basis and the resulting spillovers, the result of the CIAR study are reduced to around 1/10 of the depicted results, which would be much below the results of the study by Copenhagen Economics (2009). While there are certain differences in assumptions (see table 12), the result of the CIAR thus seem to qualify the also relatively positive results of Copenhagen Economics (2009).

the results of the other CGE models depends to a large degree on the question how realistic the assumptions of the CIAR are. Clearly, more transparency is needed regarding the functioning of the CGE model to illuminate the black box.

4.0 Conclusions and Recommendations

Conclusion

The European Commission has asked for a negotiating mandate for an EU-Japan FTA and presented the favourable Commission's Impact Assessment Report (CIAR, 2012) in July 2012. Here, this proposal and the CIAR are analysed and critically discussed.²⁸

Japan does fit moderately well with the new EU FTA strategy. Japan is a very large and highly developed market. The opportunity of a deep and comprehensive FTA and the modest scale of current trade relations appear to promise significant potential for improvement. Nevertheless, the low growth and the relatively closed nature of the Japanese economy as well as the significance of de facto (non-policy related) trade barriers raise the basic question, how large the export and investment gains for the EU could realistically be.

Japanese non-tariff measures (NTMs) stand in centre of the debate, because the EU will reduce its tariff, once and for all, in a clearly measurable and enforceable way – in exchange for a potentially significant improvement in Japan's regulatory framework which, however, is much more difficult to monitor and enforce in the long term. Even though the Japanese government's attitude towards regulatory changes seems to have improved significantly over time, there remains a broad demand that Japan acts to effectively reduce NTMs *before* FTA negotiations are started – and also some dissatisfaction about the progress already achieved in this respect. Doubts remain about whether the commitment to reform is sufficiently strong in Japan. The Commission's strategic approach to deal with this problem – NTM-Roadmap, threat to end negotiations after one year, EU tariff reduction conditioned on Japanese NTM reduction – seems fairly sensible, but still lacks some important underpinning.

²⁸ While the IW Köln is clearly regarding trade and openness as drivers of growth, welfare and competitiveness, the aim of this study is not too replicate the rather optimistic standpoint of the CIAR. Due to the focus on critical aspects and the requirement for brevity, the general gist of this study might appear more sceptical than intended.

The CIAR expects significant overall gains in output and employment. It is the most optimistic, but also the most up-to-date study – with a more comprehensive data set than former analyses. However, due to optimistic assumptions and the black box character of trade models, the results have to be interpreted with some caution. Moreover, the general question has to be raised whether standard trade models are adequate to cope with the peculiarity that due to the high relevance of non-policy barriers Japan's economy is more closed than similar countries.

Recommendations

Concerning the conundrum of the disproportionately closed nature of the Japanese economy

- more research would be useful to get a better insight into the role of non-policy barriers and the chances of their attenuation in the medium term,
- the applicability of standard CGE trade models to the peculiarity of Japan should be further investigated.

Regarding NTM reduction in Japan, several steps should be made before potentially launching negotiations:

- In the formulation of the potential negotiating mandate the reduction plans for the NTMs in the Roadmap of the Scoping Exercise should be made more concrete and furnished as far as possible with clearer deadlines. This concerns NTMs in goods, services, and government procurement. The mandate should also be clear and detailed in other offensive interests of the EU.
- More prior actions of Japan before launching negotiations would mitigate the scepticism and strengthen the trust among the EU business community that the Japanese government is determined and able to make widespread regulatory reform. Thus, the decision about the potential mandate for negotiations should only be taken, when progress in NTM reductions is considered satisfactory.
- More and continuous transparency is needed on progress in Japanese NTM reductions. Particularly the European Parliament should be regularly informed by the Commission about progress on NTM reductions in Japan.

The incentives for Japan to continue with the NTM reductions after the start of negotiations should be enhanced by several (alternative or cumulative) means:

- The Review Clause (the declaration to end negotiations after one year) has to be sufficiently robust. To this aim and in order to limit the discretion of the Commission, Member States should also be involved in the eventual decision.
 - o Additional similar thresholds could be introduced, e.g. yearly progress reviews, if there is a significant concern that Japan could slow down its efforts despite the EU's leverage due to the EU-Korea FTA.
 - o To make the Review Clause more credible, the decision could be changed from a negative to positive one, i.e. a break of negotiations could be foreseen, and negotiations would only continue, if progress was sufficient.
- The parallelism of EU Tariff elimination and Japanese NTM reductions also has to be sufficiently robust, clearly defined, and institutionally ensured. As far as significant Japanese NTM reductions will be foreseen *after* the implementation of the potential FTA, the EU has to exclude sufficient tariff lines of interest to Japan – mainly in the automotive and electronics sector – from instant tariff elimination (as suggested by the Scoping Exercise for most tariff lines upon entry into force of the FTA).
- A strong and resilient mechanism is needed to prevent the introduction of new NTMs in Japan which lack justification or which are unnecessarily trade distorting.

Concerning the reliability of CGE trade models, more transparency is needed about the internal mechanism and about the sensitivity of important assumptions. Several what-if-questions could be at the start of such an exercise. How would results change, if

- NTM reductions would not take place on an MFN-basis?
- EU NTMs in the service sector would also be reduced by only 1/3 of NTM reductions in Japan?
- sensitive tariff lines in agricultural goods and processed foods were exempted from tariff elimination?

More research would be useful to determine the character of Japanese FDI in the EU (tariff hopping or market seeking) and to get a better idea whether an EU-Japan FTA would secure or reduce Japanese FDI and employment in the EU.

A safeguard clause could tackle the problem of rapid import increases and resulting employment losses that could temporarily aggravate the deplorable unemployment levels in the EU countries suffering from the current crisis.

Executive Summary

The European Commission has asked for a negotiation mandate for an EU-Japan FTA and presented the favourable **Commission's Impact Assessment Report (CIAR, 2012)** in July 2012. Here, this proposal and the CIAR are analysed and critically discussed.²⁹

Trade and investment relations between the EU and Japan and their development are relatively modest. Japan's share in EU external trade is surprisingly small and has continuously and significantly declined in recent years. Moreover, Japan is a fairly closed economy compared to similar countries, both in terms of trade and investment. It has been highlighted that this is a conundrum, because Japanese policy related trade barriers are relatively moderate: tariffs are lower and non-tariff measures (NTMs) appear to be not significantly higher than in similar countries. Cultural values, consumer preferences for domestic products, traditional supplier ties, etc. seem to be of relatively high importance and account for the relatively closed nature of Japan's economy. Such non-policy related. These non-policy barriers can hardly be tackled by an FTA.

An evaluation of the **rationale** for an EU-Japan FTA has to be differentiated:

- In general, trade and investment are correctly regarded – particularly in the current times of crisis – as drivers of growth and competitiveness (aims of the Europe 2020 strategy). However, these benefits will materialise only in the medium and long term. During a phase of adjustment and reallocation, unemployment could increase temporarily.
- Japan does fit moderately into the new EU FTA strategy. On the one hand, Japan is a very large and highly developed market and there seems to be the opportunity for a deep and comprehensive FTA and the promise of a significant potential increase in trade given the modest nature of current trade. On the other hand, both the closed nature of the Japanese economy and the apparently high relevance of non-policy trade barriers raise questions about how large the export and investment gains for the EU could be.
- While Japan is a very large economy, it has recently been growing only very slowly and will continue to do so according to available IMF forecasts.

²⁹ While the IW Köln is clearly regarding trade and openness as drivers of growth, welfare and competitiveness, the aim of this study is not too replicate the rather optimistic standpoint of the CIAR. Due to the focus on critical aspects and the requirement for brevity, the general gist of this study might appear more skeptical than intended.

In order to agree on the ambition and range of a potential FTA, the EU and Japan have conducted a **Scoping Exercise**. This aims at a high level of commitments, principally covering all relevant issues and has produced a Roadmap for the reduction of 30 specific NTMs in Japan in the near and medium term. However, many fairly necessary elements appear relatively vague. Several important stakeholders, e.g. BUSINESSEUROPE and ACEA, are dissatisfied with the Scoping Exercise, but the **position of relevant stakeholders** towards a potential EU-Japan FTA is not clear cut. A majority of European voices, such as the European Services Forum and EuroCommerce, are strongly in favour and expect positive effects from closer bilateral economic integration. However, there is dissent from the automotive sector, which does not expect any increase in exports and fears reductions in output and employment (the latter is also true for railways). There is however, a significant consensus favouring the demand that Japan should reduce relevant NTMs *before* FTA negotiations start.

NTMs are in fact the crucial issue for the EU in a potential EU-Japan FTA. Several studies – above all by Copenhagen Economics (2009) and the European Business Council in Japan (EBC, 2008, 2011) – provide detailed information about many specific NTMs, and the former has ventured a useful systematization. More important are the strategic considerations for EU trade policy. The EU will reduce its tariff, once and for all, in a clearly measurable and enforceable way – in exchange for a potentially significant improvement in Japan’s regulatory framework in the longer term that is much more difficult to monitor and enforce. On the one hand, the Japanese government’s attitude towards regulatory changes has recently changed and the EU’s leverage due to the EU-Korea FTA (and the Japanese intention to redress the related competitive disadvantages) appears to be strong. On the other hand, it remains an open question whether ownership of the reform agenda is sufficiently strong in Japan.

The **Commission’s strategic approach** to deal with this problem seems rather sensible, but still requires some important strengthening. While the Roadmap for concrete NTM reductions is surely valuable, the items to be delivered by March 2013 are only of limited relevance and the liberalization to be achieved afterwards is sometimes formulated vaguely. The Commission’s intention to end negotiations after one year, if progress is deemed insufficient seems sensible. But the credibility of this threat is somewhat questionable, as ending negotiations would entail a major diplomatic affront. A more promising step is to condition EU tariff reductions on concrete progress in Japanese NTM reductions. But once EU tariffs are eliminated, there will still be scope for Japan to introduce new NTMs.

Concerning **potential outcomes** of an EU-Japan FTA, the CIAR presents a range of results. These are depicted for the two - more realistic - asymmetric scenarios (EU reduces NTMs in goods trade only by 1/3 compared to Japan): a conservative and an ambitious (asymmetric) scenario, which both include full tariff liberalisation, but a 20% / 50% (respectively) reduction of all NTMs in Japan and of service NTMs in the EU. In the conservative (ambitious) case, the GDP of the EU is expected to increase by 0.34% (0.79%) and bilateral exports of the EU to Japan by 23% (33%) The impact on sectors is expected to vary with electrical machinery and processed food benefiting most. Chemicals and to a lesser degree motor vehicles belong to the sectors with most pronounced losses in output and employment.

The CIAR qualifies fears of job losses particularly in the automotive sector by claiming that the high level of **Japanese FDI in the EU** could be threatened by the EU-Korea FTA. Yet, this conclusion depends on the character of Japanese FDI in the EU. If the main motive was tariff jumping (i.e. to produce behind the EU tariff barriers), an EU-Japan FTA could lead to a reduction of FDI in Europe as exports from Japan substitute for production in the EU.

The **comparison of available studies** (all based on CGE trade models) shows there is not much on which they all agree, such as large impact differences on motor vehicles between the EU and Japan. On the contrary, large differences in results are discerned, with earlier studies showing very slight *losses* of overall GDP and larger losses in output and employment for the automotive sector, while the more recent studies by Copenhagen Economics (including the CIAR) point to significant overall gains. The evaluation of these results is complicated, because the trade models used to calculate potential effects are very complex and thus basically appear like a black box. Moreover, the studies differ considerably in their **assumptions**. The CIAR is the most optimistic, but also the most up-to-date study – with a more comprehensive data set than other analyses. The most sensitive assumption of the CIAR (that 65% of NTM reductions are made on an MFN-basis in Japan and the EU) accounts for 90% of the overall results, but appears rather optimistic for a number of reasons. All in all, the positive results of the **CIAR** have to be **interpreted with some caution**. Moreover, the question arises whether standard trade models can cope with the relatively closed nature of the Japanese market due to the high incidence of de facto (non-policy related) barriers compared to similar countries.

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Figures

Figure 1

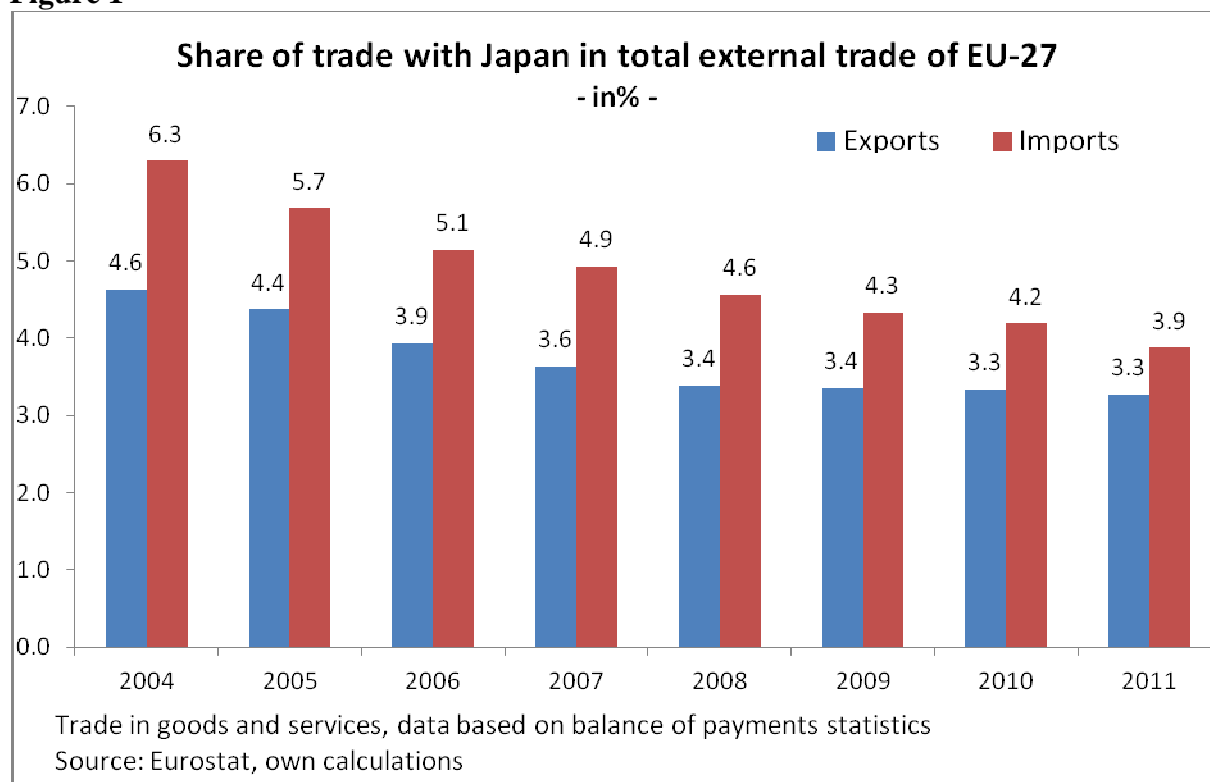


Figure 2

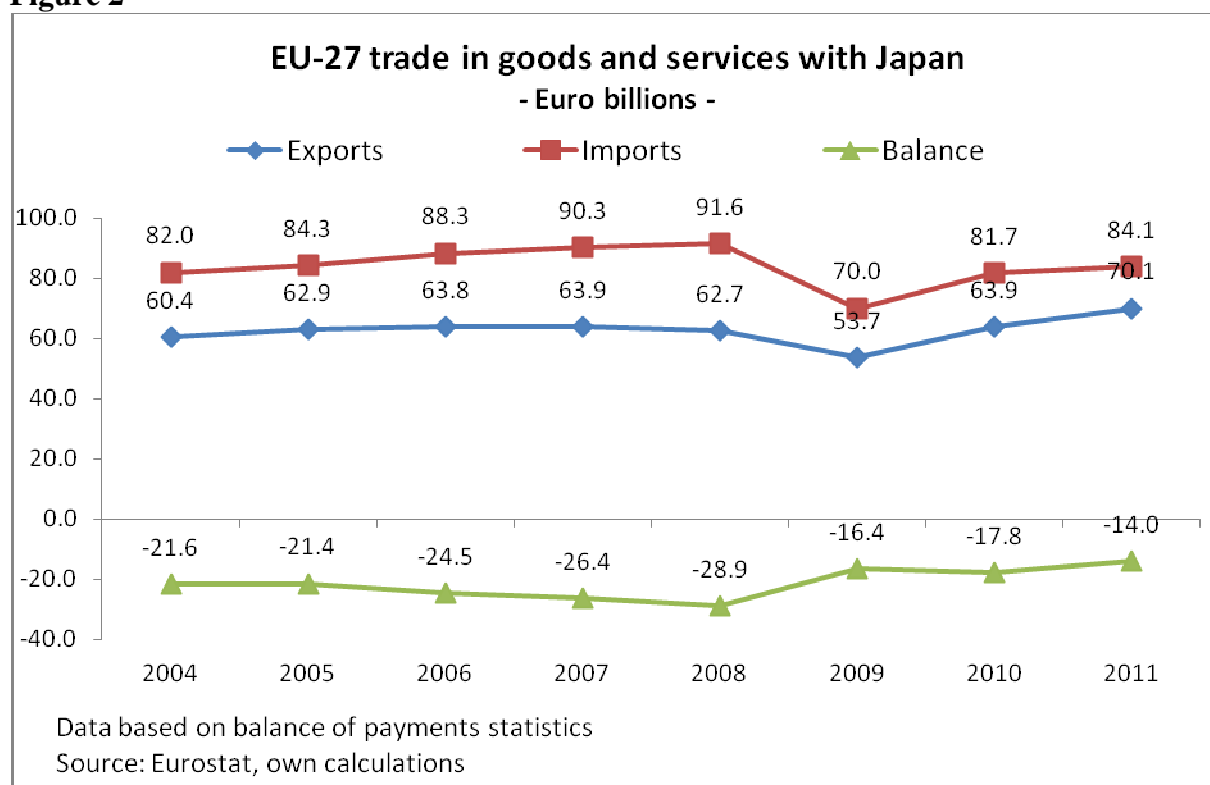


Figure 3

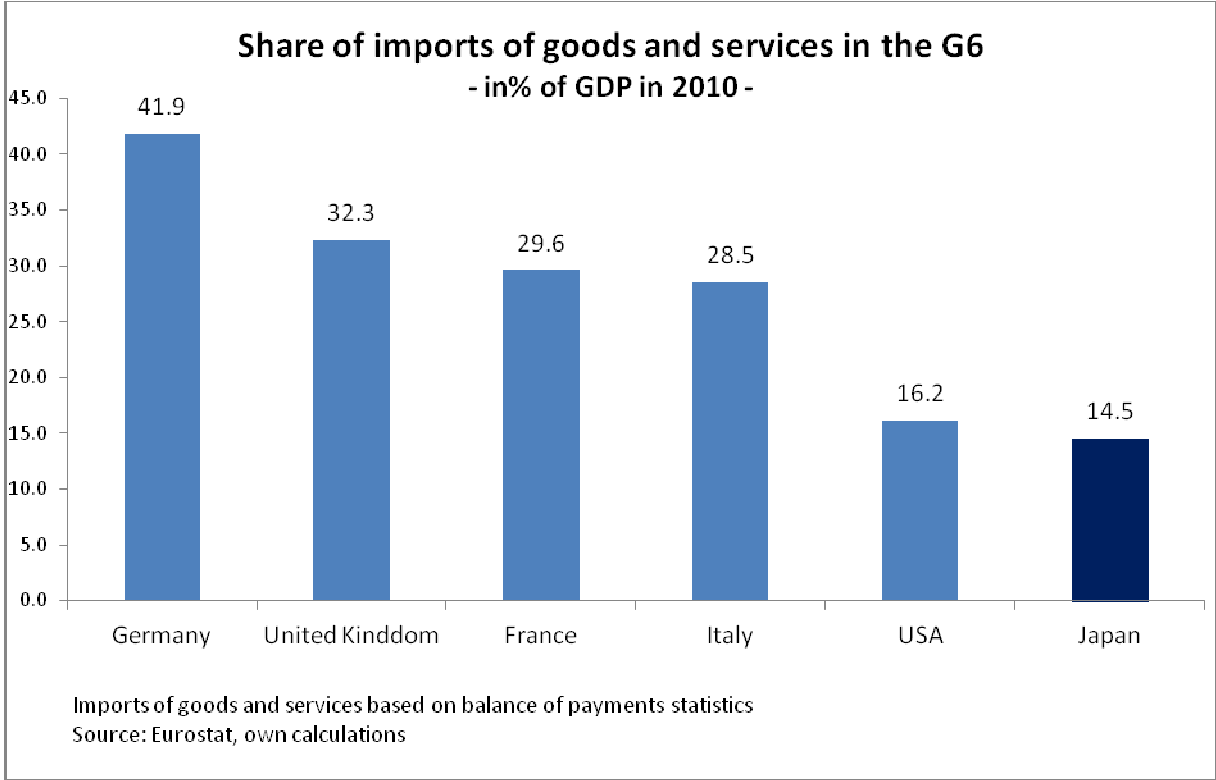


Figure 4

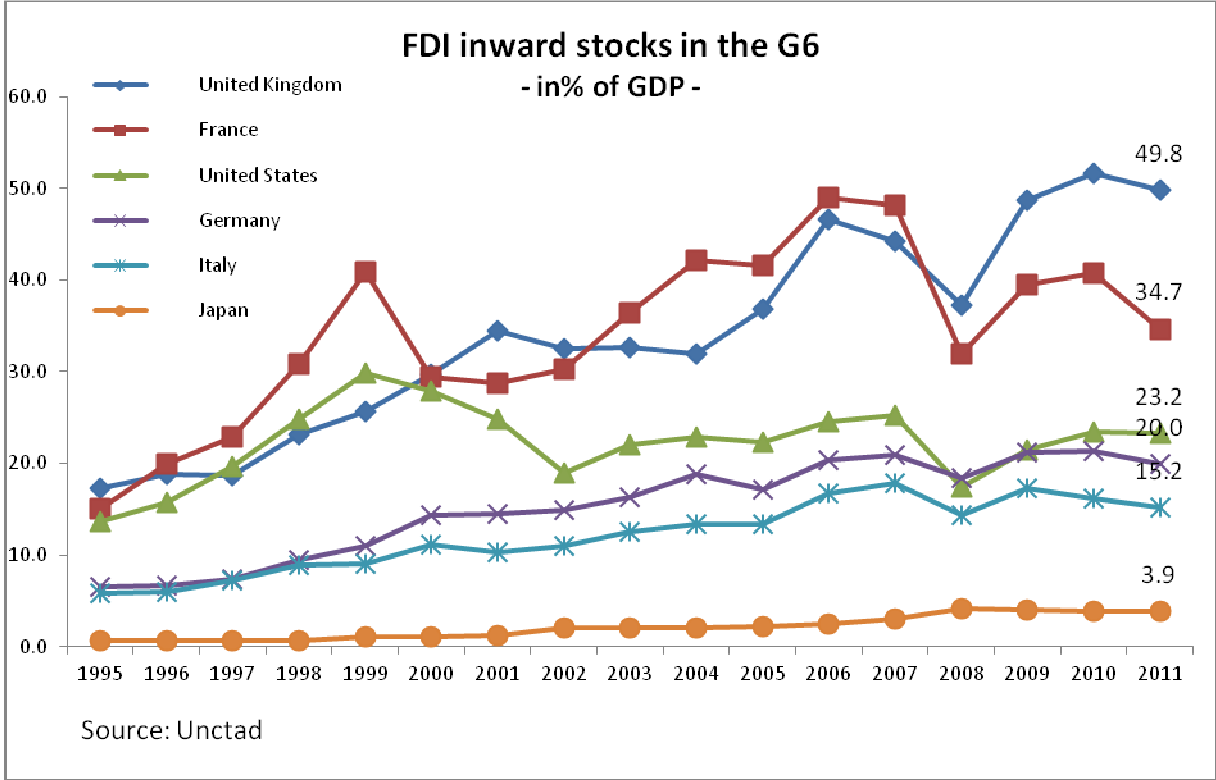


Figure 5

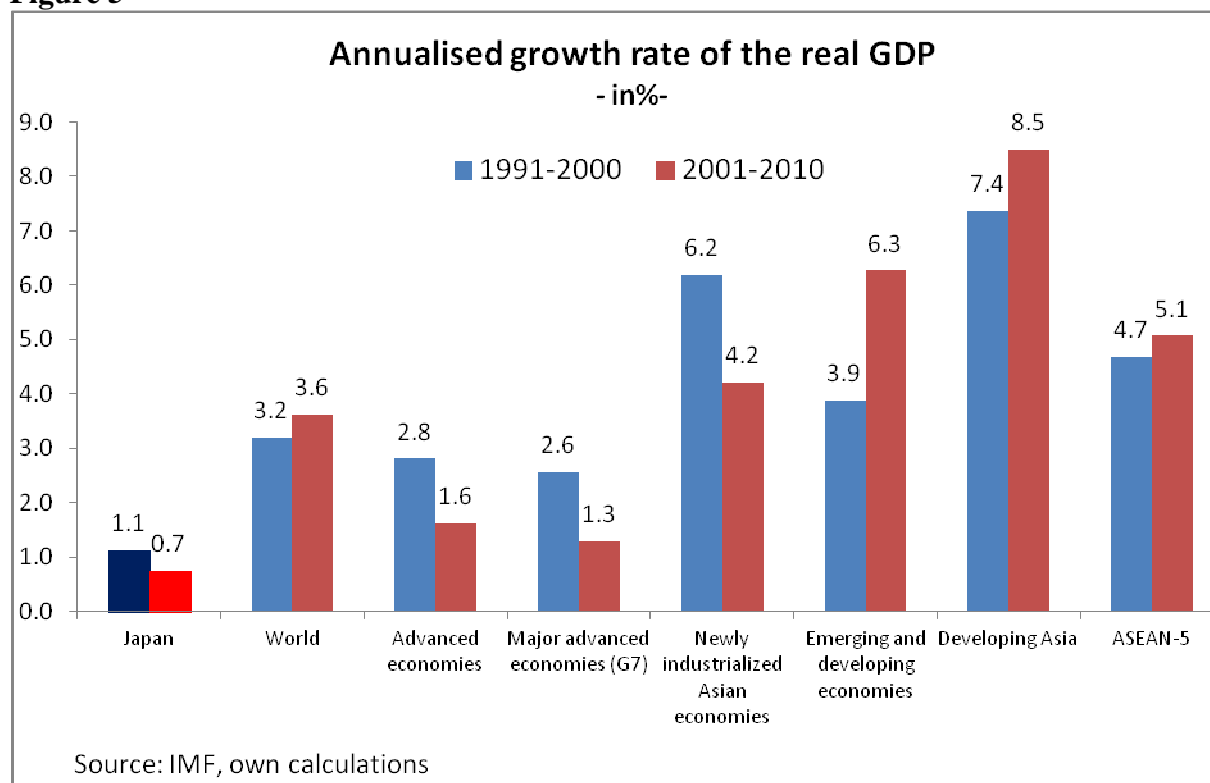


Figure 6

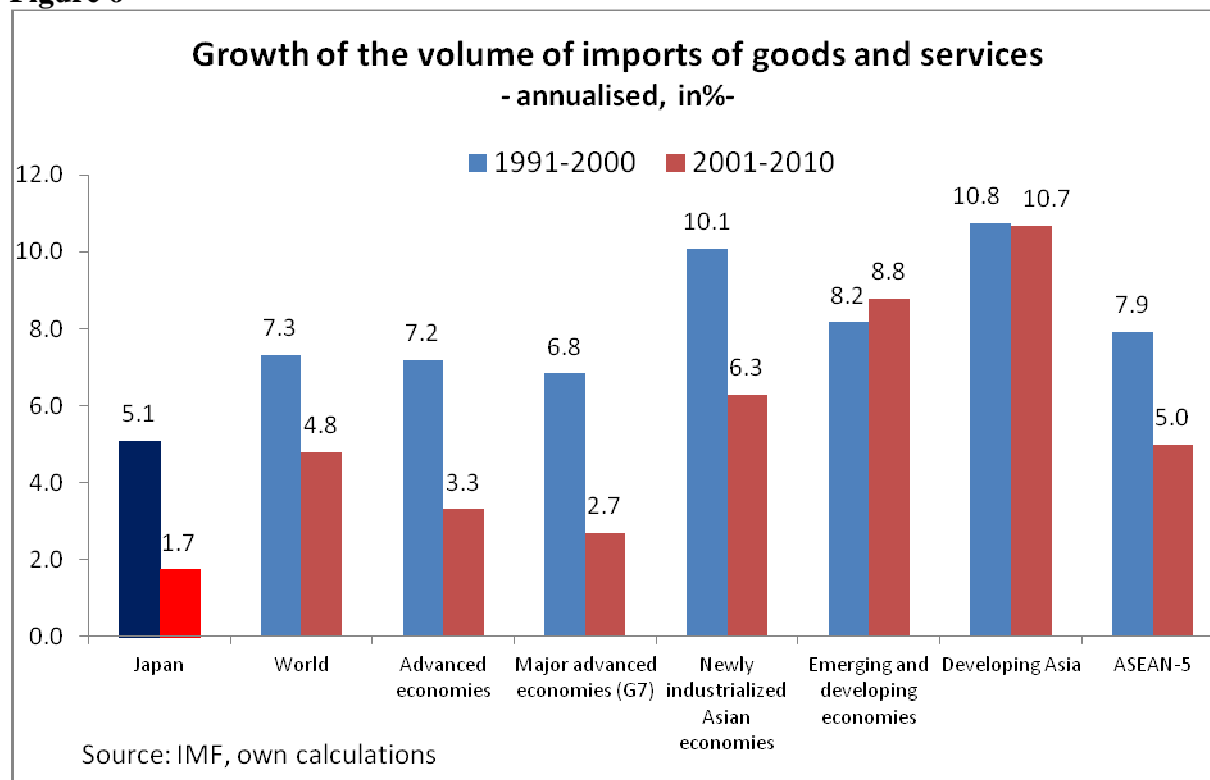
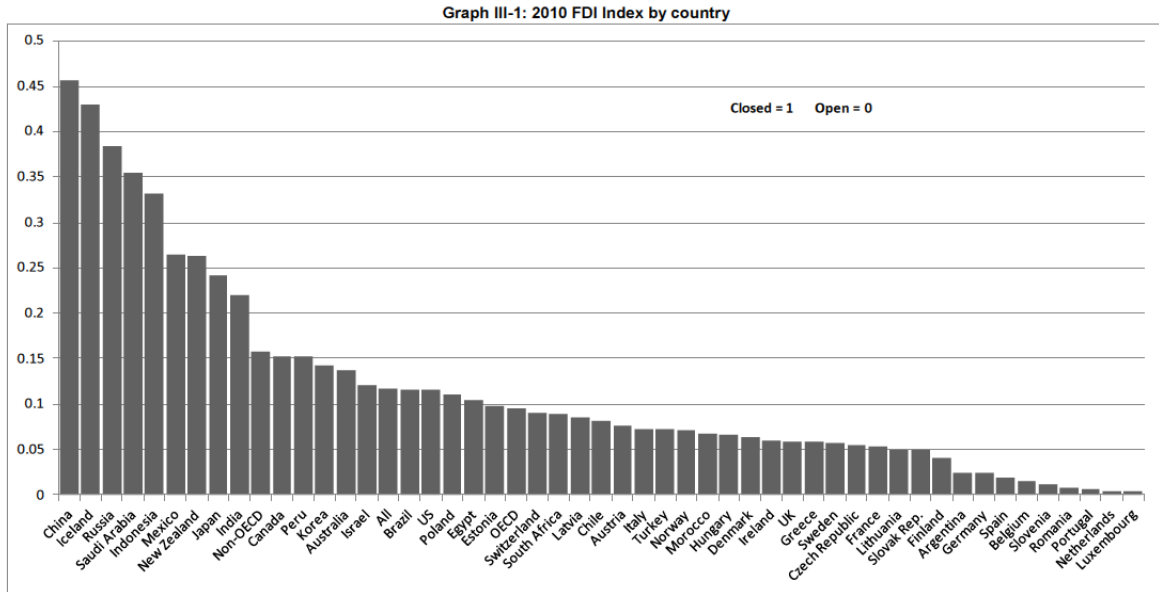


Figure 7



OECD, 2010: OECD's FDI restrictiveness index: 2010 update

Tables

Table 1: Tariff barriers in Japan

Part A.2 Tariffs and imports by product groups									
Product groups	Final bound duties				MFN applied duties			Imports	
	AVG	Duty-free in %	Max	Binding in %	AVG	Duty-free in %	Max	Share in %	Duty-free in %
Animal products	14.3	45.7	271	100	18.9	43.8	271	1.8	2.9
Dairy products	118.1	0	660	100	93.3	9.5	640	0.2	27.5
Fruit, vegetables, plants	10.2	19.6	394	100	10.6	19.7	394	1.4	13.3
Coffee, tea	14.3	22.2	184	100	15.3	22.7	184	0.4	61.5
Cereals & preparations	69.7	8.2	618	100	42.0	16.3	618	1.8	68.1
Oilseeds, fats & oils	10.0	46.2	613	100	9.0	41.9	613	1.0	79.7
Sugars and confectionery	44.7	7.3	225	100	27.2	12.7	94	0.1	68.7
Beverages & tobacco	16.4	19.1	54	100	14.6	32.3	54	1.3	66.2
Cotton	0.0	100.0	0	100	0.0	100.0	0	0.0	100.0
Other agricultural products	5.3	66.6	562	100	4.4	70.6	562	0.9	71.4
Fish & fish products	4.9	3.5	12	91.2	5.5	3.3	15	2.5	3.1
Minerals & metals	1.0	69.9	10	99.9	1.0	70.4	10	21.9	93.4
Petroleum	11.9	54.2	248	80.0	0.6	72.1	8	17.5	97.6
Chemicals	2.3	37.4	7	100	2.2	38.5	7	8.0	71.5
Wood, paper, etc.	1.0	78.8	10	97.6	0.8	80.9	10	3.4	72.3
Textiles	5.6	7.6	25	100	5.5	7.5	25	2.3	6.3
Clothing	9.2	0	13	100	9.2	0	13	4.5	0
Leather, footwear, etc.	8.8	50.3	476	100	9.0	54.1	476	1.2	5.9
Non-electrical machinery	0.0	100.0	0	100	0.0	100.0	0	8.8	100.0
Electrical machinery	0.2	95.5	5	100	0.2	96.4	5	11.3	97.5
Transport equipment	0.0	100.0	0	100	0.0	100.0	0	3.0	100.0
Manufactures, n.e.s.	1.1	77.0	8	100	1.2	74.6	8	6.4	90.1

Source: WTO/ITC/UNCTAD Tariff Profiles 2011

Table 2: Tariff barriers in the EU

Part A.2 Tariffs and imports by product groups									
Product groups	Final bound duties				MFN applied duties			Imports	
	AVG	Duty-free in %	Max	Binding in %	AVG	Duty-free in %	Max	Share in %	Duty-free in %
Animal products	22.9	20.6	191	100	22.2	23.7	191	0.5	9.0
Dairy products	50.5	0	172	100	48.3	0	156	0.0	0
Fruit, vegetables, plants	10.0	22.8	119	100	11.1	18.8	119	1.8	11.7
Coffee, tea	6.5	27.1	40	100	6.5	27.1	40	1.0	77.6
Cereals & preparations	16.5	6.3	118	100	14.3	9.1	118	0.5	3.8
Oilseeds, fats & oils	5.4	48.2	92	100	5.7	43.5	92	1.6	74.5
Sugars and confectionery	21.0	0	106	100	21.6	0	106	0.2	0
Beverages & tobacco	20.1	23.4	174	100	20.0	19.8	147	0.7	14.9
Cotton	0.0	100.0	0	100	0.0	100.0	0	0.0	100.0
Other agricultural products	3.8	66.4	99	100	4.1	65.6	99	0.4	64.0
Fish & fish products	11.2	10.7	26	100	10.5	15.1	26	1.4	5.4
Minerals & metals	2.0	49.5	12	100	2.0	49.9	12	15.4	48.0
Petroleum	2.0	50.0	5	100	2.0	49.7	5	18.4	81.9
Chemicals	4.6	20.0	7	100	4.6	21.6	13	10.0	49.5
Wood, paper, etc.	0.9	84.1	10	100	0.9	81.2	10	3.0	86.2
Textiles	6.5	3.4	12	100	6.6	2.1	12	2.3	2.4
Clothing	11.5	0	12	100	11.5	0	12	5.1	0
Leather, footwear, etc.	4.2	27.8	17	100	4.2	22.7	17	2.3	11.9
Non-electrical machinery	1.7	26.5	10	100	1.9	21.4	10	10.9	53.5
Electrical machinery	2.4	31.5	14	100	2.8	20.3	14	11.4	56.4
Transport equipment	4.1	15.7	22	100	4.3	12.5	22	5.8	21.5
Manufactures, n.e.s.	2.5	25.7	14	100	2.7	20.5	14	7.2	55.6

Source: WTO/ITC/UNCTAD Tariff Profiles 2011

Table 3
Overall relevance of NTMs according to different studies

	Japan	EU	USA
Share of affected tariff lines*	17.0	17.2	21.9
Share of affected imports*	7.4	14.4	31.6
Overall trade restrictiveness due to NTMs (% of added trade costs)**	8.5	9.6	5.5
Overall trade restrictiveness - relation between NTMs and tariffs**	2.5	4.2	3.0
Price gap for similar products (%)***	61	35	15
Fraser Institute Relevance of NTBs (scale 0-10, 10 most restrictive)	5.6	6.5	6.0
CIAR: estimated total trade costs of NTMs (%)	15.6	13.3	-
CIAR: estimated trade costs of NTMs (maximum actionable)	9.2	7.4	-

Sources: * Source Kommerskollegium, 2008, p 106-111; ** Kee et al., 2006; ***Bradford/Lawrence, 2004; all quoted from Copenhagen Economics, 2009; CIAR, 2012

Source: own compilation

Table 4: Sources of specific information about NTMS

	Copenhagen Economics, 2009	European Business Council (2010 / 2008)	EU Public Consultation on EU-Japan FTA
Automotive	Motor vehicles and transport equipment (sector studies) Automotive industry (Inventory of NTMs)	Automobiles, Automotive Components	e.g. CLEPA, ACEA and CCFA
Chemicals	n.a. see cosmetics and pharmaceuticals (sector studies)	n.a. See cosmetics and pharmaceuticals	e.g. BASF, BAYER also see cosmetics and pharmaceuticals
Pharmaceuticals	Pharmaceuticals (sector study) Health Care items (Inventory of NTMs)	Pharmaceuticals Vaccines	e.g. BASF, BAYER Novo Nordisk
Cosmetics	Cosmetic items (Inventory of NTMs)	Health Science (2010) and Cosmetics (2008)	e.g. BASF, BAYER
IT	See ICT items (Inventory of NTMs)	n.a.	e.g. Digital Europe Infineon
Telecommunications	Communication services (sector study)	Telecommunications and -equipment, Media and Communications	e.g. Digital Europe, British Telecommunications Group
Food	Processed food (sector study)	Food	More than a dozen contributions
<i>Organic</i>		Organic products	
<i>Food safety</i>		Food	
<i>Beverages</i>		Liquor	
Medical devices	Medical devices (sector study)	Medical equipment Medical diagnostics	e.g. BAYER
Clothes	n.a.	n.a.	e.g. EURATEX, UK Leather Federation
Financial Services	Financial services (sector study)	Asset Management, Banking and Insurance	e.g. CEA (Insurance), EBF (Banking)

n.a.: not available

Source: own compilation based on the depicted studies

Table 5: Scenarios of COM Impact Assessment Report (CIAR)

Extent of reduction of non tariff measures (NTMs) in%

	Asymmetric	Symmetric
Conservative	20 % in Japan and in EU service sectors 6.6. % in EU goods sectors	20 % in Japan and in EU in all sectors
Ambitious	50 % in Japan and in EU service sectors 16.6. % in EU goods sectors	50 % in Japan and in EU for all sectors

All scenarios include full tariff liberalisation

Source: own compilation based on CIAR (2012)

Table 6: Main results for EU and Japan of the COM Impact Assessment Report (CIAR)

(asymmetric scenarios only)

Percentage change (long term effects)

	EU	Japan
	Conservative scenario	
GDP	0.34	0.27
Bilateral exports	22.6	17.1
Wages (low / high skilled)	0,32/0,31	0,35/0,38
	Ambitious scenario	
GDP	0.79	0.67
Bilateral exports	32.7	23.5
Wages (low / high skilled)	0,75/0,74	0,71/0,75

Both scenarios with complete tariff elimination

Source: own compilation based on CIAR (2012)

Table 7: COM Impact Assessment Report

EU: Sectoral impact of the asymmetric scenarios (% change, long term)

	Conservative scenario			Ambitious scenario		
	Output	Exports to Japan	Employment lower skilled	Output	Exports to Japan	Employment lower skilled
Electrical machinery	3.5	8.1	3.1	9.3	20.8	8.2
Processed foods	0.6	182.6	0.4	0.6	202.2	0.1
Water transport	0.3	0.5	0.0	0.6	0.9	-0.1
Construction	0.3	2.2	0.1	0.8	4.4	0.2
Other services	0.2	0.1	0.0	0.5	-0.8	0.1
Insurance	0.2	2.3	0.0	0.4	4.7	0.1
Communications	0.2	1.2	0.0	0.4	2.1	-0.1
Wood and paper products	0.2	7.8	0.0	0.3	11.1	-0.1
Business Services	0.2	8.9	-0.1	0.3	22.2	-0.3
Personal Services	0.2	4.3	0.0	0.3	9.9	-0.1
Agr./Forestry/Fisheries	0.1	8.8	0.1	0.2	5.8	0.1
Other machinery	0.1	3.3	0.0	0.6	7.6	0.3
Finance	0.1	0.9	-0.1	0.1	1.3	-0.3
Other primary sectors	0.0	0.8	0.0	0.0	1.3	0.0
Other transport equipment	-0.1	20.6	-0.2	-0.1	47.3	-0.3
Other manufactures	-0.1	19.8	-0.2	-0.3	15.6	-0.6
Metals and metal products	-0.2	13.4	-0.3	-0.3	25.1	-0.7
Chemicals	-0.3	21.9	-0.5	-0.5	51.8	-1.0
Motor Vehicles	-0.3	8.2	-0.4	0.0	18.1	-0.2
Air transport	-0.4	2.1	-0.5	-0.9	4.7	-1.3

Ranking according to output effects in the conservative scenario

Results for employment of highly skilled employees are very similar

Source: own compilation based on CIAR (2012)

Table 8a: Impact on EU sectors and relevance of tariffs and NTM barriers
Scenario: asymmetric conservative
(percentage change)

	Output	Output effect of tariff reduction (with DDA)	Output effect of NTM reduction in EU and Japan	Bilateral exports to Japan	Trade costs of NTMs in Japan	Global imports	Trade costs of NTMs in EU
Electrical machinery	3.46	-0.30	3.76	8.1	11.6	-0.14	4.5
Water transport	0.34	0.18	0.16	0.5	8.0	0.66	8.0
Construction	0.34	0.06	0.28	2.2	2.5	1.59	4.6
Insurance	0.19	0.03	0.16	2.3	2.5	1.85	10.8
Communications	0.17	0.03	0.14	1.2	24.7	1.12	11.7
Wood and paper products	0.15	0.05	0.10	7.8	15.4	1.00	11.3
Business Services	0.15	0.03	0.12	8.9	6.5	3.79	14.9
Personal Services	0.15	0.03	0.12	4.3	6.5	3.19	4.4
Other machinery	0.12	-0.23	0.35	3.3		1.20	
Finance	0.07	0.03	0.04	0.9	15.8	2.51	11.3
Other transport equipment	-0.10	-0.15	0.05	20.6	45.0	1.64	18.9
Other manufactures	-0.10	-0.01	-0.09	19.8		0.62	
Metals and metal products	-0.16	-0.07	-0.09	13.4	21.3	1.03	6.0
Chemicals	-0.27	-0.06	-0.21	21.9	22.0	1.35	18.0
Motor Vehicles	-0.31	-0.52	0.21	8.2	10.0	1.32	16.3
Air transport	-0.36	0.01	-0.37	2.1	2.0	2.05	2.0

Ranking according to output effects

Source: own compilation based on CIAR (2012)

Table 8b: Impact on EU sectors and relevance of tariffs and NTM barriers
Scenario: asymmetric ambitious
(percentage change)

	Output	Output effect of tariff reduction (with DDA)	Output effect of NTM reduction in EU and Japan	Bilateral exports to Japan	Trade costs of NTMs in Japan	Global imports	Trade costs of NTMs in EU
Electrical machinery	9.33	-0.30	9.63	20.8	11.6	-0.44	4.5
Construction	0.78	0.06	0.72	4.4	2.5	4.03	4.6
Other machinery	0.64	-0.23	0.87	7.6		2.66	
Water transport	0.61	0.18	0.43	0.9	8.0	1.54	8.0
Insurance	0.43	0.03	0.40	4.7	2.5	4.66	10.8
Communications	0.39	0.03	0.36	2.1	24.7	2.84	11.7
Personal Services	0.33	0.03	0.30	9.9	6.5	8.12	4.4
Wood and paper products	0.32	0.05	0.27	11.1	15.4	2.42	11.3
Business Services	0.32	0.03	0.29	22.2	6.5	9.71	14.9
Finance	0.14	0.03	0.11	1.3	15.8	6.38	11.3
Motor Vehicles	0.03	-0.52	0.55	18.1	10.0	2.65	16.3
Other transport equipment	-0.08	-0.15	0.07	47.3	45.0	3.47	18.9
Other manufactures	-0.25	-0.01	-0.24	15.6		1.38	
Metals and metal products	-0.30	-0.07	-0.23	25.1	21.3	2.72	6.0
Chemicals	-0.52	-0.06	-0.46	51.8	22.0	3.23	18.0
Air transport	-0.93	0.01	-0.94	4.7	2.0	5.10	2.0

Ranking according to output effects

Source: own compilation based on CIAR (2012)

Table 9: Main long term results for EU and Japan of Copenhagen Economics, 2009

	EU	Japan
Welfare	+20.5 to +33.2 bn € (~0.12 % to 0.2 %)	+9.7 to +18.2 bn € (~0.26 % to 0.48 %)
<i>Due to</i>		
- Tariffs	+11.2 bn € (0.07 %pts.)	+2.8 bn € (0.07 %pts.)
- NTMs	+9.4 to +22.1 bn € (0.05 %pts to 0.13 %pts)	+6.9 to +15.4 bn € (0.19 %pts to 0.41 %pts)
Output	+ 0.14 %	+ 0.31 %
Bilateral exports	+27.8 to +43.4 bn € (n.a.)	+35.3 to +53.8 bn € (n.a.)
<i>Due to</i>		
- Tariffs	+14.1 bn € -23%	+25.2 bn € (nearly 30%)
- NTMs	+13.7 to +29.4 bn € (~ 23 % to 50 %)	+10.1 to +28.5 bn € (~11 % to 32 %)

For some items no%age changes available (n.a.)

Ranges are based on the results from different NTM liberalisation scenarios

Source: own compilation based on Copenhagen Economics, 2009, chapter 6, pp. 68ff.

Table 10: Main long term results for EU and Japan of Ecorys, 2009

	EU-26	Japan
National Income	-14.0 bn €	+45.3 bn €
Output (GDP)	-0.10%	3.20%
Bilateral Exports	0.40%	9.80%

Source: own compilation based on Ecorys, 2009, p. 70, Annex C, pp. 108ff.

Table 11: Main results for EU and Japan from Swedish National Board of Trade, 2009

	EU-26	Japan
National Income	-7.8 bn US \$	+4.8 bn US \$
Output (GDP)	-0.01%	+0.1%
Bilateral Exports	33.9%	33.3%

Source: own compilation based on Swedish National Board of Trade, 2009, table 1, 2

Table 12: The CGE studies in comparison

	CIAR, 2012	Copenhagen Economics, 2009	Eco- Ecorys, 2009a	Swedish National Board of Trade, 2009
Characteristics of economic CGE model				
Inclusion of DDA conclusion	Yes	No	No	No
Inclusion of EU FTAs with Korea, ASEAN, India, Canada	Yes	No	No	No
Main Assumptions				
Tariff elimination	Complete	Complete	Near complete (except some sensitive agric. tariffs)	Complete
NTM estimation	Updated NTM inventory for Japan, but same NTM estimates employed as in Copenhagen Economics, 2009**	Based on business survey and gravity model estimates	Gravity model based estimation of Ad valorem tariff equivalents without regarding individual NTMs	None
NTM liberalisation	<u>Asymmetric scenario:</u> <u>Conservative:</u> 20% reduction <u>Ambitious:</u> 50% reduction Except EU goods: one third of reduction in Japan in both scenarios	Reduction sector specific Two scenarios: *** <i>Unweighted average:</i> <i>Japan: -41% to -60%</i> <i>EU: -27% to -55%</i> <i>(own calculation, interpret with caution)</i>	Reduction of 75% of service trade barriers and of 2.5 % in NTMs in goods (labelled a significant level of regulatory harmonisation)	None
Inclusion of NTM spillovers	Yes, 2/3 of NTM liberalisation on MFN basis	No	No	No
Main overall results for EU (change vs. baseline)				
Welfare / Output* - (in %)	<u>Asymmetric scenarios:</u> GDP: 0.34 to 0.79%	GDP: 0.10 to 0.14% Nat. inc.: 0.12 to 0.2%	GDP: -0.1%	GDP: -0.06%
- absolute change	Nat.inc: +42 to 100 bn €	Nat. inc: 20 to 33 bn €	Nat. income: -14 bn €	Nat.inc.: -7.8 bn \$
Exports EU- Japan* - (in %)	22.6 to 32.7%	+45 to +71%***	+0.4%	Trade flows: +34%
- absolute change	15.5 to 22.4 bn. €***	+27.8 to 43.4 bn €	n.a.	n.a.
Employment in % - low skilled	0.002 to -0.001***	n.a.	-7.8%	n.a., (only for sectors)
- high skilled	0.002 to 0.0001***	n.a.	-7.8%	
Real wages in % - low skilled	+0.32 to 0.75%	+0.17 to 0.25%	-0.1%	n.a.
- high skilled	+0.31 to 0.74%	+0.17 to 0.25%	-0.1%	n.a.
Note:	90% of macroeconomic benefits due to NTM spillovers			

n.a.: not available

*Results not directly comparable due to different baseline scenarios and benchmark years; all studies except SNBT with long-run effects with capital accumulation, all models with combination of sectors with perfect and imperfect competition; Results of SNBT for EU-26 (EU-27 without Sweden)

**Except slight changes in maximum reduction potential for motor vehicles

***Own calculations; the unweighted average of the NTM reductions in Copenhagen Economics are shown only for illustrative purposes and do not account for the sectoral differences in trade volumes.

Sources: own summary of quoted studies