

Initial appraisal of a European Commission Impact Assessment

European Commission proposal to authorise the opening of negotiations on a Free Trade Agreement between the European Union and Japan

Impact Assessment (SWD (2012) 209, SWD (2012) 210 (summary)) for a Recommendation for a Council Decision authorising the opening of negotiations on a Free Trade Agreement between the European Union and Japan (COM (2012) 390).

• Background

This note seeks to provide an initial analysis of the strengths and weaknesses of the European Commission's Impact Assessment accompanying the proposal for a recommendation for the Council to open negotiations on a Free Trade Agreement between the European Union and Japan.

• Objective of the legislative proposal

At the Japan-EU summit on 28 May 2011, it was agreed to start the process of parallel negotiations for:

- a deep and comprehensive Free Trade Agreement (FTA)/Economic Partnership Agreement (EPA), addressing all issues of shared interest to both sides including tariffs, non-tariff barriers, services, investment, intellectual property rights, competition policy and public procurement; and
- a binding agreement, covering political, global and other sectoral cooperation in a comprehensive manner, underpinned by a shared commitment to fundamental values and principles.

It was also decided to start a scoping exercise to define the breadth and level of ambition of both negotiations. This scoping exercise was concluded successfully, and the European Commission is now seeking the necessary negotiation authorization from the Council. To help define the content of such an authorization and its accompanying negotiation guidelines, the IA analyses the impact that FTAs with varying degrees of ambition might have on both partners (executive summary p. 1-2).

• Identification of the issue at stake/ problem drivers

The IA clearly identifies the issue at stake (bilateral trade is not fulfilling its potential) by providing a detailed overview of the EU-Japan trade relations. It recalls in this context that trade between the EU and Japan has been declining and 'this underperformance in the bilateral trade and investment relationship between two such major developed economies leads to losses in competitiveness, productivity and welfare, both bilaterally and in the global economic

context; reduced choice and higher prices for consumers; weak support for employment and depressed wages.' The bilateral EU/Japan trade and investment relationship is not fulfilling its potential. The main reasons are a combination of tariffs and non-tariff measures (NTMs), (executive summary p. 1).

The IA also clarifies the drivers underlying the identified problem. 'Both the EU and Japan have low tariffs on goods, however, Japan's tariffs remain high in the agricultural and processed food sectors and for beverages, where the EU is a major global exporter. [...] EU tariffs on the main Japanese exports are higher. Japanese exports to the EU largely fall in a small number of manufacturing sectors, e.g. motor vehicles, electronics and machinery. Thus, Japan's main interests focus on tariff elimination, particularly since the entry into force of the EU-Korea FTA, given the competition between Japan and Korea in similar export sectors. Public consultation and studies stress that NTMs are major barriers to EU exports to Japan. Parts of the Japanese market, e.g. some agricultural products and some transport equipment and aeronautical products, are almost totally closed to EU exports. The business sectors that cover the bulk of EU exports to Japan and that are the most affected by existing NTMs are: chemicals (including pharmaceuticals), automotive products, medical devices, processed foods, transport equipment, telecommunications and financial services. The lack of transparency in public procurement, and problems relating to IPR, have also been identified as important NTMs that make the Japanese market effectively inaccessible for EU companies' (executive summary p. 2).

• **Range of the options considered**

The options analysed in the IA are the following:

1. The baseline scenario is the "no policy change" option, envisaging modest progress under a framework similar to the current one - maintaining the on-going, bilateral economic dialogues and business cooperation programmes, such as the Regulatory Reform Dialogue, High Level Trade Dialogue, and other sectoral dialogues.
2. A deep and comprehensive Free Trade Agreement. This option looks at four different scenarios - two 'conservative' and two 'ambitious' (depending on which the costs of NTBs could be removed), with a 'symmetric' and an 'asymmetric' scenario in each case. The symmetric scenarios provide a view of complete parity. The conservative and ambitious scenarios are intended to show a range of possible results: the 20% reduction on the costs of NTMs provides a minimum below the results achieved in the EU-Korea FTA, while the 50% cost reduction provides the potential of a very ambitious outcome in negotiations concerning NTBs.

The baseline scenario, given the very limited results achieved over many years, is not likely to bring any substantial growth in trade and investment, therefore no significant GDP gains could be expected in either the EU or Japan. According to the Commission, the FTA option shows important gains in the EU's GDP, as well in the GDP of Japan by 2020. Under both conservative and ambitious scenarios, EU global exports would increase especially in the processed food, electrical machinery and business services sectors. The FTA is the selected option, as it would be expected to bring increases in GDP, in exports, in employment, in wages, and a better place for the two economies on the global stage.

• **Subsidiarity**

Trade policy and the negotiation of international trade agreements are areas of exclusive EU competence (Article 207 TFEU), therefore the principle of subsidiary does not apply in this case.

- **Scope of the Impact Assessment**

The Commission assesses the overall economic impact of a FTA, and the expected sectoral impact of a conservative and ambitious FTA in financial services, business services and motor vehicles sectors. Cost-benefit considerations for both EU and Japanese economies are mentioned in the discussions regarding the impacts on different fields. The IA does not systematically include explicit cost-benefit analyses but does so to a limited degree.

The IA also includes a concise assessment of environmental and social impacts, as well as an assessment of the impact on human rights.

- **Budgetary or public finance implications**

An FTA with Japan would affect the EU budget through the loss of own resources in the form of customs duties. The loss from tariff revenues could be around 1.9 billion euro (based on the value of the duty income in 2009). According to the Commission, the actual loss figure would be lower, since the EU budget would profit from possible benefits deriving from the future gains in the EU GDP.

- **SME test**

The expected impact on SMEs is explicitly included in the IA. The Commission expects SMEs to gain from an EU-Japan FTA, since regulatory compliance costs represent a bigger burden for them than for larger firms. In addition, SMEs are prominent in sectors most likely to benefit from such an agreement (they make up more than 50% of food industry companies and are prominent in the electrical machinery sector).

- **Environmental implications**

The IA contains a section analysing the expected environmental impact of the FTA on the EU, Japan and the rest of the world, in particular examining three possible effects of trade opening on the environment: 'scale effects' (expansion of economic activity), 'composition effects' (changes in production and consumption patterns) and 'technique effects' (improvement in emission efficiency). According to the Commission, negative impacts on waste, biodiversity and natural resources are mitigated to some extent by trade increases in environmentally sustainable goods and services. Increases in global emissions following an FTA appear to be close to zero.

- **Social implications**

The IA analyses briefly the expected effects of the FTA on welfare in general, including on gender equality, and provides a sectoral analysis of the impact on employment.

An EU-Japan FTA should result in increased trade, which should generate a bigger workforce and increased welfare. The Commission expects employment in the EU to considerably increase e.g. in the electrical machinery sector (by 3% under the conservative FTA scenario or by up to 8% under the ambitious FTA scenario), even if limited losses would occur in the motor vehicle sectors.

- **Simplification and other regulatory implications**

An EU-Japan FTA would require an implementation process in the EU. In Japan, a removal of NTMs requires a complex set of administrative and legislative procedures. On the other hand, the ambitious scenarios should bring simplification benefits and reduce administrative costs in

both Japan and the EU. The elimination of NTMs and the cooperation in harmonizing standards between the two partners could reduce administrative costs and create mutual benefits.

- **Relations with third countries**

Erasing trade barriers between the EU and Japan will not have a direct impact on trade barriers with third countries, but reductions of NTMs on either side could bring simplification effects for third parties, in particular, by reducing administrative costs when trading with the EU or/and Japan.

- **Stakeholder consultation**

To support this IA, DG Trade commissioned a complementary study to compare the results of existing studies on barriers to trade and investment and the potential economic impact of trade liberalisation between the EU and Japan, and to explain the differences in their findings. Extensive consultation was held with stakeholders, including representatives of Member States, civil society and industry. An on-line public consultation, in the form of a web-based questionnaire, took place in September-November 2010. Summaries of the contributions are presented in Annex 7 of the IA. The majority of respondents favoured strengthening trade ties between Japan and the EU.

- **Quality of data, research and analysis**

The IA overall contains a balanced assessment, rich both in quantitative, as well and qualitative, data, using a computable general equilibrium (CGE) model. However, the use by DG Trade of this CGE model has been criticised because of its highly complex nature and doubts about the obtained results being reliable and realistic, especially in view of the closed character of the Japanese economy. A workshop 'Towards a Free Trade Agreement with Japan?' was organized in the EP on 29 September 2012. Some of the issues raised related to the quality of the IA. Considerable differences to existing studies need to be pointed out. Could tariff measures on goods be completely eliminated? Some assumptions on NTM reductions could also appear equally optimistic.

- **Commission Impact Assessment Board**

The Commission's IA Board issued its opinion on the draft IA on 9 December 2011. This opinion stated that the IA showed an adequate analysis to support action in the area, but made some recommendations for improvement. The nature of the Commission decision pursuant to the IA, authorizing an FTA, and the relation between the process of IA and the scoping exercise needed to be better explained. This has subsequently been done. The IA Board inter alia requested DG Trade to provide more information on the model and assumptions which constitute the basis of estimated impacts. This information has been added in Annex 2.

Also in response to the IA Board's critical remarks, clarification has been provided in the areas of public procurement and the contribution of spill-over effects and their impacts on certain sectors (Annex 1 Complementary Study assessing barriers to trade and investment between the EU and Japan). Annex 1 also presents differences with previous studies.

Author: Alina-Alexandra Georgescu

Impact Assessment Unit

Directorate G for Impact Assessment and European Added Value
Directorate General for Internal Policies of the Union (DG IPOL)
European Parliament.

This note, prepared by the Impact Assessment Unit for the European Parliament's Committee on International Trade (INTA), analyses whether the principal criteria laid down in the Commission's own Impact Assessment Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal. It is drafted for informational and background purposes to assist the relevant parliamentary committee(s) and Members more widely in their work. This document is also available on the internet at: <http://www.europarl.europa.eu/activities/committees/studies.html>

To contact the Impact Assessment Unit, please e-mail: impa-secretariat@ep.europa.eu

The opinions expressed in this document are the sole responsibility of the author(s) and do not represent an official position of the European Parliament. Reproduction and translation of this document for non-commercial purposes are authorized, provided the source is acknowledged and the publisher is given prior notice and sent a copy.

Manuscript completed in November 2012
Brussels © European Union, 2012.

ISBN 978-92-823-3959-6
DOI 10.2861/4768