

## SNAPSHOT

# EU-Japan FTA: a step towards a seamless business environment

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### INTRODUCTION

The potential for closer links between the European Union and Japan is too important to ignore, not only for both parties but for the world economy. Brussels and Tokyo are now intensively working on strengthening their economic and political ties. At present the EU and Japan are working towards a Framework Agreement covering not only political dialogue and policy cooperation, but also on regional and global issues.

Furthermore, negotiations have been launched on an EU-Japan Free Trade Agreement (FTA) / Economic Partnership Agreement (EPA). The eventual agreement aims to strengthen economic relations, create stronger trade ties and stimulate growth in both economic regions, and is expected to be concluded soon.

As an important review of the negotiation process approaches in April 2014 – when the EU may decide to leave the table – this snapshot analyses the current negotiating positions of both the EU and Japan and reviews the timeframe by which an agreement could become a reality.

### EU-Japan FTA negotiations: ready for prime time

At a political summit in May 2011 the EU and Japan agreed to work towards a new framework for bilateral relations and endorsed the possibility of pursuing free trade talks. Following a scoping exercise to establish the ambition for any eventual FTA, negotiations were finally launched in March 2013. On the table are the free trade of goods, services and investments, as well as transparent rules on trade-related issues.

In the face of the South Korea-EU free trade pact (July 2011) Japan is eager to strike a deal with the EU as soon as possible. However, an eventual FTA with Japan has become quite topical within the EU, with key European industries, such as the automotive and the medical equipment sectors, calling on the European Commission (EC) to push Tokyo to immediately scrap a number of trade barriers, even before trade negotiations had begun.

So far four rounds of negotiations have been held. Given that tariff barriers between both parties are already relatively low, negotiations have concentrated on certain sensitive areas, including non-tariff barriers (NTBs), standards, and the public procurement sector.

### EU expectations and ambitions

Japan is the EU's second largest trading partner in Asia (after China). According to the European Commission's impact assessment report, an agreement between the two economic giants could boost Europe's economy by 0.6 - 0.8% of GDP and could result in the creation of 400,000 jobs. It is expected that the EU's exports to Japan could increase by 32.7%, while those of Japan to the EU would increase by 23.5%.

On average, Foreign Direct Investment (FDI) in most EU Member States represents about 20% of their GDP: conversely, Japan's inward FDI as a proportion of GDP stands at a meagre 4%. Europeans have repeatedly denounced the closure of Japan's markets to foreign investments and certain imports, describing the country as a "fortress". According to the EC, the lack of access to the Japanese market costs Europe an annual €40bn.

Several key Member States such as France and Germany have raised concerns over the business potential of an EU-Japan FTA. Particular scepticism has been expressed in relation to agriculture and the automotive sector. To address these concerns, the EC has asserted the principle of parallelism, tying the removals of EU tariffs to the revision of key Japanese barriers to European exports. Member States have requested that Europe put an end to the talks if no substantial breakthrough is achieved after one year, and the EC has stated that progress must be achieved in its key sectors for the talks to be completed.

Additionally, the EU has insisted on a safeguard clause that can be triggered as an emergency measure with respect to increased imports of particular products, where such imports can cause serious injury to the importing Member State's domestic industry. Such a mechanism has already been included in the EU-South Korea FTA but has never been activated. France had also requested that the European Commission monitored Korean auto exports to the EU, but this was rejected.

The burning issue in current discussions with Japan is the public procurement market, in particular the railway sector. The European Commission has agreed with Japan on a roadmap to remove NTBs, as well as to open up public procurement for Japan's railway and urban transport market.

### Japanese expectations and ambitions

It has been more than a year since Japan's Prime Minister Shinzo Abe (Liberal Democratic Party) first set out his ambitious turnaround plan for Japan. He publicly designated his economic and financial strategy as "the only choice" for Japan to achieve mildly inflationary and sustained growth. He wants to reduce the budget deficit through tax increases to counteract the negative effects of a declining population.

In the longer term Japan is keen to increase trade with partners other than China given the difficulties with that relationship and the fact that China is not part of the TPP. Skilful leveraging of the ambitious trade agreements that Japan is negotiating at the moment (Trans-Pacific Partnership/TPP, China-Japan-South Korea Free Trade Agreement and economic partnerships with ASEAN and the EU) is key to creating a tailwind for parallel domestic reform efforts. The government is thus using an ambitious trade liberalisation policy as a catalyst for domestic transformation,

promoting lower tariffs and prices, as well as improved productivity and competitiveness. The CESifo Group in Munich predicts that the impact of liberalisation flowing from the EU-Japan FTA would increase Japan's GDP by 0.86%.

In a spirit of proactive trade diplomacy and responding to Europe's concerns, the Japanese government has already made some concessions in several key areas, including beef exports, alcohol retail, food additives and automotive products. However, since the Liberal Democratic Party has traditionally been inclined to protect farmers and domestic industries from foreign competition, the Abe government has declared that some agricultural commodities are off-limits for tariff elimination in the TPP – namely rice, sugar, dairy, beef, pork and wheat. It remains to be seen whether the Japanese will insist on protecting these commodities in their negotiations with Europe.

Japan is keen on reducing tariffs on cars and car parts. Japan's export sectors are hoping that the negotiations will conclude quickly, not least because the Korea-EU FTA has directly affected their competitiveness relative to Korean conglomerates. In return, the Japanese government has decided to increase the tax on small cars by 50% from 2015, and will offer reduced tariffs on imported wine and cheese over 10 years.

Separately, the Japanese government is concerned that various international standards will be developed among regions that have concluded regional trade agreements (Korea-EU FTA, TTIP, etc.) and that Japan will miss the opportunity to participate. For these reasons there is a sense of urgency from Japan's side in the majority of current trade negotiations.

### **Implications for other FTA negotiations (mainly NTBs)**

Non-tariff barriers have been a longstanding source of dispute between Japan and its main trading partners the US and the EU, in a whole range of sectors. There is significant overlap between the current FTA negotiations and those on NTBs between the EU, US and Japan. This includes areas such as the adoption of international standards, the procurement market, regulatory transparency, mergers and acquisitions, corporate governance, and authorisation of drugs and medical devices.

Kojiro Shiojiri, Japanese Ambassador to the EU, said last October that TTIP negotiations between the EU and the US could serve as a global economic model, and he called for a linkage between TTIP and an eventual EU-Japan FTA. Shiojiri argued that the EU could "connect with Asia" through bilateral negotiations with Japan. It is evident that Tokyo views TTIP as not simply a system for tariff reduction but more broadly as an international framework of standards and regulations, and that it would like to be involved in developing standards and regulations through the TPP and the EU-Japan FTA.

The TPP negotiations are also likely to impact the EU-Japan FTA. The TPP negotiations are progressing apace, and the details of the eventual deal will provide an indication of where Japan is willing to compromise. The Abe government is simultaneously deregulating the agricultural sector, allowing farms to become more efficient and encouraging farming enterprises to move up the value chain.

### **Fourth-round talks outcomes**

The fourth round of negotiations (finalised at the end of January 2014) covered a wide range of areas such as trade in goods and services (including market access, general rules, and trade defence instruments); investments; non-tariff measures and technical barriers to trade; rules of origin; customs and trade facilitation; sanitary and phytosanitary measures; public procurement; intellectual property; competition policy; trade and sustainable development, and dispute settlement. Japan and the EU are now aiming to jointly draft a final agreement on as many of these as possible.

Other issues discussed were general and regulatory cooperation; corporate governance and the business environment; electronic commerce, and animal welfare.

The EU repeated its demand that Japan remove its tariffs on imported wine and cheese, while Japan is asking for the elimination of EU tariffs on automobiles and electronic devices. Japan is also being urged to reduce NTBs mainly in the procurement sector.

### **When could the deal be struck?**

Japan and the EU have set no specific deadline for the conclusion of their talks. Japan is keen on successfully concluding a range of trade liberalisation talks, including those with the EU. The next round of negotiations will take place by end-March 2014.

A key milestone will be reached in April 2014, one year after the talks were launched, when the EU may decide to abandon a deal if it judges progress in Japan's market liberalisation roadmap to be unsatisfactory. A new European Commission will be charged with concluding EU-Japan FTA negotiations, and the establishment of a new INTA Committee in the European Parliament will have a decisive role in the subsequent ratification process.

Even though negotiations seem to be proceeding well, it could take several years before a final agreement is reached, and talks are expected to wrap up no earlier than 2015: after all, it took three-and-a-half years for the EU to reach an agreement with South Korea.



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