

An assessment of the EU-Japan EPA and its implications for a UK-Japan Free Trade Agreement

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Introduction

Negotiations between the EU and Japan on a free trade agreement were launched in March 2013. After 18 rounds of negotiations, a political agreement in principle was reached during the EU-Japan Summit in Brussels in 2017. The consolidated text of the agreement was finalised at the end of 2017 and not much later, on 18 April 2018, the Commission proposed to the Council the signature and conclusion of the Economic Partnership Agreement (EPA) with Japan. The Council adopted the decision to sign the agreement on 6 July 2018 and forwarded the draft Council decision on the conclusion of the EPA and the agreement itself to the European Parliament for approval. The EPA was signed at the EU–Japan Summit in Tokyo, on 17 July 2018.¹

In this document I will analyse the EU-Japan EPA, focusing in particular on what the agreement covers (e.g. tariff liberalisation, services provisions, technical barriers to trade); the MFN provisions relating to services and goods included in the EU-Japan EPA, and its implications for the UK; and how the EU-Japan EPA could be enhanced or improved to benefit businesses and specific sectors in Wales.

This analysis is based on an assessment of the Agreement itself,² a series of reports on the agreement and analyses comparing the EPA to other EU trade agreements, as well as some of my own research on EU trade agreements/policy.

¹ <https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-eu-japan-epa>

² <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018PC0192#document2>

Coverage of the EU-Japan EPA

Tariffs

Tariffs were one of the most controversial negotiation topics³ and are covered in Chapter 2 and Annex 2-A of the agreement. Japan demanded *inter alia* duty-free exports of motor vehicles, automotive parts, and electronics, while the EU pushed for liberalization of Japanese agricultural imports, as well as dismantling of the remaining industrial tariffs on textiles, clothing, cosmetics and chemicals.

General observations on tariff elimination/reduction:

- EU and Japan have agreed to liberalize almost all their bilateral trade (i.e. ca. 95–99%) on the basis of tariff lines and imports. That is, Japan eliminates 86 % of tariff lines on EU goods on entry into force and 97 % of tariff lines within 15 years. The EU will liberalise 96 % of tariff lines for Japanese goods on entry into force and 99 % of tariff lines by the end of the staging period.⁴
- Exceptions were made for rice and seaweed, which are excluded, but all other agriculture/food products are included
- It must be said that for some products there are relatively long (up to 15 years) transition periods

Observations on EU's tariff elimination/reduction:

- Transition period for many electric machineries 3 years but tariffs already very low, with the exceptions of certain monitors (up to 10 years)
- For most fish, 15 years transition and also on other food stuff relatively long transition periods
- Tariffs on leather goods/footwear will be eliminated within 10 years
- Tariffs on imports of motor vehicles and vehicle parts will go down to 0% after a transitional period of seven years

Observations on Japan's tariff elimination/reduction:

³ See also: <https://www.cesifo.org/DocDL/CESifo-Forum-2019-2-june.pdf>

⁴ https://bruegel.org/wp-content/uploads/2018/10/EXPO_STU2018603880_EN.pdf

- Japan immediately eliminates tariffs for EU producers in chemicals, textiles, apparel, metals, plastics and jewellery;
- Imports of leather goods/shoes will go down to 0% only after 10 years;
- Japan will apply similar long or even longer transition periods for food/agriculture goods such as wood (7 years), chocolate, confectionery, pasta, pork (10 years), cheese and beef (15 years). Only the import of European wine into Japan was made duty-free immediately upon the agreement's entering into force.

Non-Tariff Barriers (NTBs)

NTBs are covered in Chapter 7 of the Agreement. Most significantly, Japan is aligning itself with international standards on:

- medical devices (Quality Management Systems);
- textile labelling (ISO8 international care labelling);
- motor vehicles (UNECE9 international vehicle regulations), which means it will eliminate all legal barriers to market access in the sector and recognize European test procedures and product standards, as well as cooperate with Europe in setting international motor vehicle standards in the future;
- and pharmaceuticals (ICH10).

In addition, Japan will simplify approval and clearance procedures for sanitary and phytosanitary (SPS) and will allow several food supplements, while also agreeing on no longer treating imported beer from Europe as an alcoholic soft drink for tax and regulatory purposes.

This is a significant regulatory shift for Japan, which will promote EU exports by reducing the financial and administrative burden for firms, arising from dual testing and complex conformity assessment procedures. It is important to note that provisions in the agreement allows the EU to reintroduce tariffs on cars if Japan reneges on its commitments on NTBs.

Services

In the services chapter (chapter 8), both parties agreed on a rational, transparent, non-discriminatory regulation that would improve mutual market access and limit regulatory discrimination but would not override national regulatory sovereignty. Concrete agreements were reached in the areas of:

- telecommunications;
- financial services;
- insurance;
- and postal and courier services.

Notably, both sides allow not just service providers and corporate transferees to enter each other's' markets, but also their spouses and children to accompany them (mode 4). This is a far-reaching provision.

Various areas were, however, explicitly excluded from the agreement:

- public services;
- audio-visual services;
- maritime cabotage,
- parts of air transport

Finally, in the field of e-commerce, both sides were able to largely agree on uniform standards but could not bridge the differences in data protection (see also next section on "Investment").

Investment

The agreement also contains provisions to promote and facilitate bilateral investment (Chapter 8) and, as no prior investment agreement existed between any of the EU Member States and Japan, the investment provisions are expected to "play an important role in establishing a fair and predictable investment climate between the partners."⁵

⁵ https://bruegel.org/wp-content/uploads/2018/10/EXPO_STU2018603880_EN.pdf

However, one of the factors which contributed to reaching an agreement between the EU and Japan is that the EPA did not include investment protection standards, and their negotiations take place outside the framework of the EPA.⁶ If the EU and Japan had pressed to include investment protection in the deal, this would have caused a non-agreement due to how important this aspect is to both parties. Both parties suggested different mechanisms: the EU pushed for an investment court system (ICS), which is open to receive disputes,⁷ while Japan preferred a traditional "investor-state dispute settlement" mechanism through binding arbitration.⁸

In the end, a special Committee on Trade in Services, Investment Liberalization, and Electronic Commerce was set up (see Art. 8.4 in the Agreement).

Public procurement

The provisions on Public Procurement go further than commitments by the EU and Japan in the WTO's Government Procurement Agreement (GPA). That is, both parties commit to transparent, electronically supported tender texts, mutual recognition of test results and selection criteria, and a further opening of procurement markets through the inclusion of hospitals, universities, and all municipalities with more than 300,000 inhabitants. In the construction industry, Japan has assured a fair tendering practice. The national railway procurement markets are to be opened up on both sides. The privatized railway companies of Japan are explicitly included. Japan's Operation Safety Clause, whose deliberately broad interpretation regularly led to European tenders not being considered, is to be lifted one year after the agreement enters into force.⁹

Non-trade issues (NTIs)

Another noteworthy element of the Agreement is the chapter on Sustainable Development (Chapter 16). From the 2002 European Commission Communication underlining the contribution of trade policy to sustainable development, through to its more recent "Trade

⁶ <https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-eu-japan-epa>

⁷ <https://www.hoganlovellsbrent.com/blog/eu-japan-economic-partnership-agreement>

⁸ <https://www.thenewfederalist.eu/essay-the-success-of-the-eu-japan-epa-negotiations?lang=fr>

⁹ <https://www.cesifo.org/DocDL/CESifo-Forum-2019-2-june.pdf>

for All' strategy, the EU has sought to combine market opening with sustainable development and trade objectives for quite a while now. In light of this, the EU has indicated that ratification of future trade agreements will be contingent on partners adhering to the Paris Climate Accord, with the EU Japan EPA being the first to incorporate such a requirement.

Yet, chapter 16 does preserve parties' right to regulate and determine their own domestic policies to protect human, animal and plant health. The chapter calls for upholding existing standards for protecting consumers, labour rights and the environment while preventing the parties from waiving these protections in order to promote trade and investment. In the case of labour standards, the Agreement contains obligations for parties to make sustained efforts to ratify fundamental ILO conventions. Japan has ratified six of the eight fundamental conventions and hence must make progress on ratification of the remaining two, which concern the abolition of forced labour (C105) and discrimination in employment and occupation (C111).¹⁰

MFN provisions

The EU-Japan EPA includes MFN provisions in both goods and services.

The MFN in goods is covered in Art 2.8.4 and applies to certain goods where tariff reduction is incomplete/phased in. MFN may apply if the parties grant quicker/larger tariff reduction to a third party. The agreement states the following:

“Where a Party reduces its most-favoured-nation applied rate of customs duty, that duty rate shall apply to an originating good of the other Party if, and for as long as, it is lower than the customs duty rate on the same good calculated in accordance with Annex 2-A.”

With respect to services and investment, the EU has included MFN provisions in most of its recent trade agreements. These provisions commit both parties to granting the other party any more favourable treatment accorded to a third country, irrespective of whether this is

¹⁰ https://bruegel.org/wp-content/uploads/2018/10/EXPO_STU2018603880_EN.pdf

done through a trade agreement or not. EU's trade agreements with Canada, South Korea and Japan all contain such MFN clauses and are therefore the most far reaching EU agreements when it comes to MFN in services.

In the EU-Japan EPA, MFN is included in the following ways:

- Mode 1 (Cross border trade in services) – covered in art 8.17
- Mode 2 (Consumption of services abroad) – covered in art 8.17
- Mode 3 (Commercial presence) – covered in art 8.9
- Mode 4 (Presence of natural persons) – covered in art 8.24 and incorporates MFN provisions from art 8.17 and 8.24

The implications for the UK are significant. Not so much in trade in goods because the EU-Japan EPA already liberalises close to 100% of tariffs on goods, so Japan can't give the UK a much better deal than the EU. However, when it comes to services, Japan's hands are tied. That is, the MFN clauses in the agreement with the EU prohibit Japan from granting any better treatment to the UK than has already been granted to the EU. If they would give the UK a more favourable deal, they would be required to extend the same concessions to the EU, an economy six times the size of the UK without getting anything in return. This is almost certainly out of the question for Japan.¹¹ There are some exceptions, which I outline below in the next section.

Could the EU-Japan EPA be enhanced/ improved to benefit businesses and specific sectors in Wales?

In order to assess the importance of a UK-Japan free trade agreement and whether the EU-Japan EPA could be enhanced/improved, it is useful to look at some trade figures. In 2018, total UK exports to Japan were \$8,4bn making it the UK's 15th largest export destination (with 1.72% of all UK exports going to Japan). In terms of imports, in 2018 UK imported \$12.9bn from Japan (or 1.93% of all imports), making it the UK's 13th most important importer. The UK runs a trade deficit of \$4.5bn with Japan.

¹¹ For a further discussion see: <https://blogs.sussex.ac.uk/uktpo/publications/most-favoured-nation-clauses-in-eu-trade-agreements-one-more-hurdle-for-uk-negotiators/>

UK's top 15 export partners, and UK imports to those countries (2018)

| Partner | Export (\$) | Export (%) | Import (\$) | Import (%) | Balance |
|---------------|------------------------|--------------|-------------------------|--------------|-------------------------|
| United States | \$65,314,679,369 | 13.40% | \$63,254,031,855 | 9.45% | \$2,060,647,514 |
| Germany | \$46,747,014,385 | 9.60% | \$91,572,791,790 | 13.70% | -\$44,825,777,405 |
| Netherlands | \$33,141,747,062 | 6.80% | \$55,191,792,154 | 8.24% | -\$22,050,045,092 |
| France | \$31,893,335,257 | 6.55% | \$37,684,580,890 | 5.63% | -\$5,791,245,633 |
| Ireland | \$28,189,852,970 | 5.79% | \$18,782,081,311 | 2.80% | \$9,407,771,659 |
| China | \$27,701,127,815 | 5.69% | \$63,377,249,212 | 9.46% | -\$35,676,121,397 |
| Switzerland | \$25,595,567,707 | 5.26% | \$7,408,327,492 | 1.11% | \$18,187,240,215 |
| Belgium | \$18,948,870,157 | 3.89% | \$34,648,283,261 | 5.17% | -\$15,699,413,104 |
| Italy | \$13,960,746,895 | 2.87% | \$26,547,720,582 | 3.96% | -\$12,586,973,687 |
| Spain | \$13,933,328,007 | 2.86% | \$21,071,045,073 | 3.15% | -\$7,137,717,066 |
| Turkey | \$13,672,463,759 | 2.81% | \$11,543,920,899 | 1.72% | \$2,128,542,860 |
| Hong Kong | \$10,302,330,407 | 2.12% | \$2,455,292,416 | 0.37% | \$7,847,037,991 |
| UAE | \$10,102,093,053 | 2.07% | \$2,217,444,194 | 0.33% | \$7,884,648,859 |
| Japan | \$8,394,471,904 | 1.72% | \$12,914,918,761 | 1.93% | -\$4,520,446,857 |

Source: [UN Comtrade](#) (2018)

Wales' trade figures show that that Wales exported £296mn worth of goods and services to Japan, up from £177mn in 2013, making Japan its 15th most important export destination.

Table 2: Wales exports to Japan (£m) 2013-2019

| | |
|------|-----|
| 2013 | 177 |
| 2014 | 195 |
| 2015 | 158 |
| 2016 | 282 |
| 2017 | 199 |
| 2018 | 250 |
| 2019 | 296 |

Source: data obtained from <https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/Businesses/Exports/welshexports-by-quarter-destination>

Although Japan is not in the top 10 of the UK's (and Wales) most important trading partners, it is one of its most important investors. With more than 1,000 Japanese companies operating in the UK, employing nearly 100,000 people (up since June 2016) — Japan is a crucial contributor to the UK economy. In fact, with a value of more than £60bn, Japan is the second-largest non-EU investor in the UK.¹² The figures for Wales are even more impressive: Japan is the third-highest provider of FDI, on par with France and Germany.¹³

In terms of where the UK can improve the EU-Japan EPA, it is important to state that in almost all areas it's highly unlikely that the UK will improve on the EU-Japan EPA. If improvement is possible, it will be mainly in the area of investments and trade in services. That is the, the EU agreement with Japan produced most gains for manufacturing sectors, as well as agriculture and fishery, and fewer gains for the services and investment-oriented UK economy. Although there is the issue of MFN provisions (see above), the agreement could be improved from a UK/Wales perspective in those sectors/areas that are not included in the agreement, as they fall outside MFN. This is definitely the case for E-commerce (where there are outstanding issues related to EU data protection laws) and some part of the services industries. To be sure, E-commerce is included in the EU-Japan agreement but covers only certain areas (see chapter 8, section F, articles 8.72 and further) and in the areas that are not covered the UK could potentially get a better deal. Having said this, the EU and Japan have agreed to continue their negotiations on this and other issues, as part of the "Committee on Trade in Services, Investment Liberalization, and Electronic Commerce," so this could change in the foreseeable future. As part of these negotiations, the EU and Japan are also engaged in further negotiations on investment protection standards and the adoption of an Investment Court System (ICS). The latter is preferred by the EU, in response to criticism on ISDS, while the Japanese govt prefers standard ISDS. I think the ICS is an interesting idea, but the UK/Wales could opt for standard ISDS, which would make it easier to reach agreement on this issue with Japan than the EU.

¹² <https://www.cityam.com/why-the-uk-should-upgrade-the-eu-trade-deal-with-japan/>

¹³ <https://tradeandinvest.wales/wales-and-japan-overview>

A final remark about the future EU-UK trade deal is in order. That is, without a far-reaching free trade agreement between the UK and the EU, most Japanese firms (and hence Japanese negotiators) will not care too much about any UK-Japan trade agreement. Japanese companies have already started to ‘vote with their feet’ – e.g. Nissan cancelled planned investments into its UK production facilities, and Sony and Panasonic are moving their European headquarters to the Netherlands – ¹⁴ and this is likely to continue unless the EU and the UK sign a trade agreement that is as close as possible to the current arrangement.

¹⁴ <https://blogs.lse.ac.uk/brexit/2019/03/22/why-the-eu-japan-trade-deal-matters-for-brexit/>