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EUROPEAN COMMISSION SERVICES' POSITION PAPER ON THE TRADE SUSTAINABILITY IMPACT ASSESSMENT IN SUPPORT OF NEGOTIATIONS OF A FREE TRADE AGREEMENT BETWEEN THE EUROPEAN UNION AND JAPAN

1. Introduction

This paper sets out the European Commission services' position on the Trade Sustainability Impact Assessment (SIA) of a Free Trade Agreement (FTA) between the European Union (EU) and Japan. The Trade SIA study was commissioned by the European Commission's Directorate General for Trade and was carried out by an independent consultancy company, London School of Economics (LSE) Enterprise. It was completed in March 2016.

FTA negotiations with Japan were launched in March 2013 and the 17th round of negotiations took place in September 2016.

The Trade SIA report consists of fourteen sections, plus references and annexes: 1) Abstract; 2) Working methodology; 3) Stakeholders consultation; 4) Economic Analysis; 5) Horizontal commitments; 6) Sectoral analysis: Food and feed (processed food); 7) Sectoral analysis: Motor vehicles sector; 8) Sectoral analysis: Railways; 9) Sectoral analysis: Pharmaceuticals (and related chemical products); 10) Sectoral analysis: Medical devices; 11) Sectoral analysis: business and financial services; retail and wholesale services with an impact on merchandise; 12) Social analysis including human rights; 13) Environmental analysis; 14) Conclusions of the impact assessment.

The final report is publicly available on DG Trade's website:

- <http://ec.europa.eu/trade/policy/policy-making/analysis/sustainability-impact-assessments/assessments/>

In line with the methodology guidelines, the study involved public meetings with stakeholders, targeted roundtables, bilateral contacts with experts and on-line consultation. The SIA therefore took into account views from a broad base of stakeholders from different sectors and also helped to raise awareness about the negotiations.

The present document constitutes the response from the Commission Services to the study's findings and recommendations on policy measures.

2. Framework for the Trade SIA relating to the negotiation of a FTA between the EU and Japan

2.1 Objectives of the Trade SIA

The EU-Japan Trade Sustainability Impact Assessment (Trade SIA) was conducted in support of negotiations of a comprehensive trade and investment agreement between the European Union and Japan. It was completed before the final phase of the negotiations.

The results of the SIA are therefore being taken into account in the continuing negotiations and in the decision making process.

The study provides an assessment of the potential economic, social and environmental effects, in addition to the implications for human rights, of an FTA. The effects resulting from trade and trade-related provisions of the agreement in the EU and in Japan were evaluated. The impact an FTA could have on third countries, including developing countries, and on Turkey which is in a customs union with the EU was also evaluated. The Trade SIA also includes recommendations on how to maximise the benefits of the agreement while ensuring the competitiveness of enterprises and preventing or minimising any potential negative impacts.

In essence, the Trade SIA has two purposes:

To analyze the trade and sustainable development (TSD) aspects of an FTA with Japan and to inform negotiators of the possible social, human rights, environmental and economic consequences of an FTA;

To make information on the potential TSD and economic impact of an FTA available to all stakeholders.

In light of this, the Trade SIA complements the quantitative and qualitative analysis with input from stakeholders. The objectives of the consultation process were to provide useful information on the Trade SIA, to ensure greater understanding and awareness among stakeholders of the Trade SIA methodology and also to increase transparency and accountability as set out in Trade for All¹, DG Trade's trade and investment strategy communication.

2.2 Methodology of the Trade SIA

The EU-Japan Trade SIA builds on the [Impact Assessment](#) conducted by the Commission in 2012 that accompanied the process up to the opening of negotiations on the FTA between the European Union and Japan. It adopts and extends the methodological framework described in the EC's [Handbook for Trade Sustainability Impact Assessments](#)². The Trade SIA process included a wide consultation of stakeholders. Stakeholder input was also considered in the implementation of the methodology. The Trade SIA also complements the existing analysis and quantitative studies by assessing the wider potential economic impact of the FTA on trade, output, welfare, wages and employment. It also enhances the existing studies by looking more closely at the likely

¹ http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf

² A new Handbook was released by the Commission in April 2016, i.e. after the completion of the EU-Japan Trade SIA.

impact on competitiveness, and on social, environmental and human rights³ aspects. The Trade SIA examines in depth the effects of trade negotiations on key economic sectors.

3. Overview of the Consultants' findings

3.1 Economic pillar

The report confirms the economic rationale for an EU-Japan FTA. The consultant recalls that Japan is the world's third largest national economy and was only relatively recently (in 2010) surpassed by China for the number two position. Japan is also the 3rd largest economy (in nominal terms). The market potential of Japan is high due to the high rate of private spending, which is almost twice as high as China. Much of this is spent on high end products consumption.

The consultant also explains that, while Japan's rate of imports to GDP is seen as consistently low, in reality it is comparable to other major developed economies. Imports relative to total consumption are higher in Japan than in the US (23% versus 19%). But according to the report, EU exports of goods and services are underperforming in Japan, especially in comparison to US exports. EU exports of goods and services represent 3% of Japanese consumption. US exports of goods and services represent 5% of Japanese consumption.

The consultant recalls that, according to the Impact Assessment study, the long-term GDP increase for the EU is estimated to be +0.76% in the most ambitious scenario⁴. Bilateral exports would increase by up to 34%. Export driven growth is particularly important in food and feed, which could be responsible for 50% of the export gains.

However the report also adds that the main growth component is not just exports, but also investments. Japan has transitioned from its export-driven trade towards investing in production overseas. This strategy matches Europe's need for investments and jobs. The main concern is the business environment in the EU rather than investor-state disputes. Similarly, the relatively low rate of EU Foreign Direct Investment in Japan indicates a considerable room for improvement if the business environment was also to be improved in Japan. The FTA can improve the business environment by eliminating tariffs on intermediate goods and by improving the situation with regard to non-tariff measures (NTMs) and mode 4 (movements of individual service suppliers).

The gains and losses from liberalisation are well-diversified geographically, with benefits also for regions that traditionally do not have major offensive interests in trade negotiations. The FTA would have no negative impacts on vulnerable groups, on fiscal revenues (including duties foregone) or on the informal economy. Cross-effects on the

³ For background on the human rights analysis, see the guidelines on the analysis of human rights impacts in impact assessments for trade-related policy initiatives, available at: http://trade.ec.europa.eu/doclib/docs/2015/july/tradoc_153591.pdf

⁴ Assuming full tariff liberalisation and symmetrical reduction of NTMs.

customs union with Turkey are limited to one sector (motor vehicles), which are in Europe's favour.

The consultant however sounds a note of caution about the potential impact that the TPP (Transpacific Partnership Agreement) could have on the EU's economic interests. It is noted in particular that TPP has been concluded at a level of ambition that is higher than previous Japanese FTAs. They claim that this could have negative effects on the baseline for EU-Japan trade, as trade and investments will be diverted away from Europe. The TPP agreement could be the first serious competing economic integration that could affect Europe negatively. The EU has to improve its access to Japan and to the other major economies participating in the TPP if it is to retain its current levels of market shares and economic contribution from trade. Overall the consultants conclude that a comprehensive EU-Japan FTA is necessary for the EU in order to compensate for the potential negative (trade diversion) effects of the TPP and to maintain and increase its trade and investment. It should however be noted that the recommendations by the consultants were drafted before the decision by the US to withdraw from TPP which of course greatly increased the uncertainties regarding the future of this agreement.

3.2. Social pillar

The social analysis section of the report concludes that economic gains are not created at the cost of social variables and interests. The sectoral analysis instead suggests that income will be distributed geographically to the benefit for those who traditionally do not gain from trade liberalisation, especially in food and feed. There is no negative impact on income inequality (gini coefficient). Real wages are increasing symmetrically, and in all scenarios the income gap between skill groups is never larger than 0.02% in Europe. A case study on gender equality shows that the FTA will be beneficial in addressing the gender gap in the EU. SME tests on social indicators are inconclusive as they depend on the implementation of the agreement. However, there are positive SME effects on at least two sectors (food and feed, medical devices) with no negative SME impact on any of the observed economic or social indicators. However, the no-FTA scenario would disproportionately disadvantage the agricultural sectors and exporting SMEs that are unable to mitigate the negative effects from TPP. The sectoral analysis and a simplistic macroeconomic examination of output and employment confirm the overwhelmingly positive impact on employment in the EU identified in the 2012 Impact Assessment. Japanese firms have 460 000 employees in the EU, a number that has increased by 29% in the past five years, regardless of growth in the EU. Additional jobs come also from Japanese investments in firms and joint-ventures.

The consultant also estimates that the tariff elimination on motor vehicles is not likely to significantly change the production levels or employment in the EU compared to a non-FTA scenario, with less than 0.1% of output in the passenger car segment being affected. Impact on employment is also within the same negligible range. Other impact assessments which forecast possible negative results have been found by the consultant to have methodological omissions.

Finally the sectoral analysis showed a positive impact on the ability of EU consumers to benefit from the internal market in the areas of consumer prices, safety, quality and choice. No detrimental impact could be identified on consumer protection, safety, sustainability or vulnerable consumers in the EU. No negative impact on public health (or other regulatory risks) could be identified.

3.3. Human rights aspect

Concerning human rights, stakeholder consultations did not reveal any possible negative effects on human rights from the EU-Japan FTA. The Commission services also take note of the possible positive impact on gender equality as outlined by the consultants in section 3.2. Furthermore, the analysis carried out by the consultant shows that there should be no detrimental impact on the right to privacy from increased cross-border data flows or trade in services.

3.4. Environmental pillar

According to the consultant, with no additional environmental impacts identified in the sectoral analysis, it is possible to conclude that there is no negative impact on greenhouse gases and CO₂ emissions from the FTA. In fact the FTA favours relatively less energy and emission intensive sectors, leading to a reallocation towards these cleaner sectors instead.

Lower trade barriers to environmental goods and services contribute to increased competition inducing greater innovation. This will produce positive environmental benefits with improved resource-use efficiency and pollution prevention. The FTA will not induce pressure on energy demand nor on imports of natural resources or on waste production. The only area of limited concern regards the pressure on biodiversity and the environment exercised by the increased output in the food and feed sector.

The consultant also concludes, based on the case study on forestry, that sourcing timber within the EU will not lead to negative impacts. The risks are imports from third countries as both the EU and Japan are known to import significant volumes of high-risk timber. In fisheries, the FTA will not affect trade given that both economies are highly import dependent with little surpluses to export. As of today, the quantitative import quotas are not exhausted. As in the case of timber, the risks are in third country trade, e.g. on eels.

Finally, the consultant notes that a variety of environmental organisations representing civil society interests in the EU were consulted for the overall environmental analysis and only very limited feedback was received, indicating that the EU-Japan FTA negotiations are not a major concern for environmental stakeholders.

3.5 In-depth sectoral and cross-cutting analysis

The consultant made a more detailed analysis of the FTA effects on 5 important economic sectors for EU-Japan trade i.e. the food and feed (processed food) sector; the motor vehicle sector, railway equipment, life sciences (pharmaceuticals and medical devices) and the services sector.

3.5.1 Food and feed (processed food)

The consultant notes first that the potential of Japanese food markets for EU exporters in case of liberalisation is huge since current EU exports face substantial barriers. The Japanese average ad valorem tariff for all these sectors is 23.1 percent, and very high tariffs (e.g. 38.5% for some beef tariff lines) are not uncommon. By contrast, the risks for a negative impact of a Japan-EU Agreement on EU producers are very small because the Japanese production capacities in these sectors are often limited. This point has already been outlined in the economic analysis: the food and feed sector accounts for 55 percent of the export gains according to the 2012 Impact Assessment which estimates the increase in bilateral exports for processed foods to be 276 percent (tariff-only scenario). The consultant states that, for such a positive scenario to be fulfilled, processed foods need to be taken fully into account in the negotiation and EU exporters need to improve their competitiveness.

As for addressing the potential for SMEs in the beef, pork and dairy sectors (excluding cheese) to cope in a competitive business environment the consultant recommends appropriate farm policies both in Japan and in the EU. These should address new goals in food production such as quality innovation and environmental concerns. In a similar vein the consultant sees an important role in providing income support for old farmers in particular in Japan as a way to address social issues.

As for Japanese food products, the consultant states that, due to the small size of production and mature market in Japan, Japanese farmers and food processors could benefit from finding attractive niche markets in the wide European market.

As for production of pork in Japan, the consultant estimates that the sector will undergo major changes and following a market opening the quality of Japanese products could be upgraded, requiring new skills from Japanese farmers, which could also have employment consequences.

According to the consultant, a new crucial factor also has to be taken into account by the EU: the significant to severe competition exerted by the Trans-Pacific Partnership (TPP) food exporters in the Japanese markets that are considered as the leading markets in Asia. The consultant states that the target of the EU-Japan Agreement should be to reach the same outcome as the TPP Agreement, that is, total liberalisation from both sides for agro-food products.

3.5.2 Motor vehicle sector

According to the consultant, recent developments show that the foreign imports of passenger cars or commercial vehicles do not threaten the local production inside the EU. The markets are now more stable. Japanese manufacturers produce approximately two-thirds of sales in Europe locally and use the EU as a base for regional exports. In fact Europe's trade surplus on motor vehicles is the world's largest trade surplus in any category (the car trade with Japan is also in surplus).

The consultants add that several alternative impact assessments done on the sector have exaggerated the impact on the passenger car market. Taking into account localised production, the change of EU output is negligible, at 0.1%. The environmental effects are likely to be positive: production is low energy and emissions intensive, with trade benefitting low emission technologies.

Finally the consultant stresses that data shows that producers are not likely to engage in direct price competition as a consequence of trade liberalisation in the EU or Japan, but are likely to improve profits. This applies to all segments, and more so on commercial vehicles, powered two-wheelers, parts and components.

3.5.3 Railway equipment

According to the consultant, the welfare analysis of the rail sector needs to assess the changes that the EU-Japan FTA could bring to the rail supply industry (the production side) against the gains for the passenger rail services sector (demand side). The Japanese passenger rail service market is roughly 90% of the size of the EU. Employment in the Japanese and EU rail supply industries amounts to 17,000 and 160,000 jobs, respectively. Employment in the Japanese and EU passenger rail services amounts to roughly 150,000 and 1,050,000 jobs, respectively.

The consultant recalls that, in today's baseline, the bilateral trade volumes from both sides are relatively modest. The EU-Japan trade imbalance in favour of Japan has substantially decreased in recent years. The import penetration on the Japanese rail supply industry is higher than in the EU. "Protecting" rail supply sector employment by closing bilateral trade is unlikely to be successful as the true challenges of the Japanese and EU rail supply industries come from third countries. The increased competition that the EU-Japan FTA could bring to equipment production will lead to ultimate benefits for European and Japanese passengers, given that the purchases from the railway supply industry represent a high share of the operators' investments. An efficient rail supply sector would bring more employment in the passenger rail services sector as a more efficient rail supply industry should be seen as a key contributor to passenger rail services employment. In conclusion, the social and economic benefits in passenger services outweigh trade balances in the equipment sector.

3.5.4 Life sciences (pharmaceuticals and medical devices)

The consultant first notes that in world trade in pharmaceuticals, medical devices and in-vitro diagnostics, both Japan and the EU are major markets. Both markets have great potentials but also present challenges due to the impact of demographics. For Japan, if the country could cap the costs of public healthcare provision it could have an impact of up to 0.5% of GDP from the spending ratio alone (i.e. independently from the effect from an aging population) by 2030 according to an OECD study of 2013.

The pharmaceutical sector trades duty-free, but faces duplicate testing requirements, pricing and reimbursement requirements; in addition, specific requirements apply to generics, biosimilars, vaccines and quasi-drugs (cosmetics with medical applications requiring market authorisation). Medical devices are covered by the same law and the analysis concludes that the 2012 Impact Assessment seriously understates the potential in this sector. Tariffs are also still in place on medical devices and reference pricing (i.e. the fact of limiting expenditure on the reimbursement of drugs by making use of the existence of equivalent drugs on the national market and setting a reimbursement tariff) is applied.

The consultant concludes that foreign competition, transparency and non-discrimination on reimbursement rules (as in TPP provisions) do not raise healthcare expenditure in itself.

Finally the consultant notes that there is a considerable number of SMEs in the medical devices sector. There are also supply-chain benefits where European firms use Japanese advanced components, which calls for fast track procedures of self-declaration of conformity (SDoC) in some risk categories. In particular, the actual trade turnover (as well as SME benefits and supply-chain impact) would be considerable if a “fast track procedure” for already approved new products in each legislation could allow products to bypass the redundant steps of the authorisation process.

3.5.5 Services (business and financial services; retail and wholesale services with an impact on merchandise)

The consultant first notes that, although Japan has a very large service industry in terms of output, employment and turnover, foreign participation has remained generally low. The FTA Impact Assessment estimated low relative gain for services compared to other sectors due to the high growth in the goods sector (especially in processed foods). Nonetheless, consumers will reap benefits from the agreement in terms of prices, quality and choice through the increased establishment of services providers. This affects also goods that are sold through intermediaries established in Japan. These are predominantly of high and premium quality and no detrimental impact on consumer safety is foreseen.

The low trade dependency of Japan and the low degree of internationalisation outside Japan (despite high productivity and successful services concepts) show that the potential is high also for Japanese services industries.

4. The Commission services' views on the findings and policy recommendations made by the consultants

The consultants list a set of trade-related and cooperation-related policy recommendations with the purpose of enhancing the positive impacts and preventing or mitigating the negative impacts that they have identified in their study.

The consultants' main recommendations, as presented in the Trade SIA's executive summary are presented in this chapter with the comments of the Commission services.

4.1 Economic pillar

a) Consultants' policy recommendation:

The analysis and the conclusions support the economic rationale for concluding a comprehensive FTA, with symmetrical levels of reduction of NTMs, at an ambitious level.

- Timing and negotiation sequencing is a key factor. Given the concentration of gains to the “food and feed” (processed foods) for Europe, conclusion of the market access negotiations in agriculture should be given precedence. But this option may not be feasible for the EU.
- This is particularly important for EU sectors that are not liberalised under TPP. For instance, the US applied parallelism between agriculture and motor vehicle parts tariffs, rather than linking the offers to concessions within the same sector.
- Overall, emphasis must be given to offensive interests with the intention to utilise the liberalisation achieved in the negotiation.
- There is a wide range of issues on the table, and the numerous existing bilateral forums of cooperation have by and large not been adequate to address them. Some of the NTMs are also overly complex and politically difficult to address. Therefore more horizontal and permanent instruments to address the current and future regulatory divergences between the EU and Japan may have to be developed.
- Overall the negotiation outcomes must encourage investment. In the case of EU-Japan the main concerns are not investor disputes. Nor are any issues foreseen over market access or post-establishment in general. Instead, improvements of the general business environment are more likely to promote investments. In this FTA context, this means tariffs on intermediate goods, NTMs and mode 4.

Flanking measures

- Given no negative effects on vulnerable groups, fiscal revenue or cross-cutting-effects with other agreements or third countries, no general flanking measures are identified at this level.

- Regarding SMEs, the negotiation must address the adverse impact from TPP. Apart from the sector specific recommendations in the sector analyses, a common framework for promoting a better utilisation of the benefits from the FTA for SMEs should be considered.

b) Commission services' reaction:

The Commission services have taken note of the above set of recommendations. The Commission services closely monitor the likelihood that the TPP may enter into force and Japan's internal procedures in this regard (including enabling legislation in the Japanese Diet) in order to prepare effectively for its possible impact on the EU. Impact of the TPP on EU agricultural and processed agricultural exports are covered in section 4.4.

The Commission services also fully agree with the importance of establishing appropriate mechanisms to continue addressing possible NTMs with Japan, also after the end of the negotiations. Similarly, it is among the Commission services' objectives to promote investment, both via a strong investment chapter and via specific provisions on corporate governance in the FTA. As for the specific interests of SMEs, the Commission services are aiming at agreeing with Japan specific provisions in the FTA. These provisions would aim at helping SMEs fully benefit from the opportunities of the EU-Japan Free Trade Agreement by enhancing mechanisms aimed at information sharing and by establishing a specific contact point for both parties to address SMEs related issues. As regards tariffs on intermediate goods, it is the objective of the Commission services to negotiate an agreement with a very high level of ambition on tariffs with Japan with only a very limited number of exceptions to full liberalisation. Finally, provisions on Mode 4 will certainly be inserted in the chapter on services and will address the interests of both European and Japanese services providers.

4.2. Social pillar

a) Consultants' policy recommendation:

In light of the comments above about compliance it is suggested that EU negotiators should seek to use the opportunity of the FTA to obtain greater compliance, implementation and monitoring of the ILO conventions.

- A clear priority is to seek Japan's ratification of the two core conventions to which it is not a party: Convention 111 on non-discrimination and Convention 105 on forced labour.
- Action by Japan is also needed in respect of recommendations on job creation in SMEs in the framework of Convention 189 on decent work for domestic workers.
- And, as reflected in the recommendations of the ILO and the ITUC, there is scope for action by Japan in respect of freedom of association and the right to organise.

In order to help in the implementation of this recommendation, and to foster greater compliance with ILO obligations more generally, it is also recommended that the EU-Japan FTA adopt the three distinctive features of EU-Korea FTA and EU-Canada FTA referred to above. Parties should thus:

- go beyond the practice in most FTAs of simply invoking the 1998 Declaration and make reference to the ILO conventions. The Parties should commit to ratifying the fundamental conventions and the other ‘up-to-date’ conventions and to implement effectively those already ratified. The Parties should also commit explicitly to respect, promote and realise in their laws and practices the principles concerning fundamental rights, including the elimination of discrimination in respect of employment and occupation.
- provide for the involvement of the ILO in the dispute resolution procedure.
- provide for enhanced engagement of Civil Society representatives, including employer and trade union bodies, in the monitoring and implementation of labour provisions via a Domestic Advisory Group (DAG) and a Civil Society Forum. Consideration needs to be given, however, to stakeholder concern, referred to above, about the capacities of the EU-Korea DAG.

The FTA could have a direct positive effect on the gender gap in employment and wages in the EU, whereas the effect could be negative in Japan. So as not to undermine the current strategy of Japan to close the gender gap and promote greater labour market efficiency in Japan, attention might need to focus on seeking further investment related commitments in sectors where the biggest risks for unemployment for women are foreseen in Japan, notably processed food sectors (food and feed) and retail, wholesale and other type of services. Moreover, given the relatively greater degree of gender discrimination in Japan, one or more of the various ILO instruments bearing on the question of gender imbalance in the work force warrant careful attention in the framework of the FTA:

- Discrimination (Employment and Occupation) Convention (No. 111) and Recommendation (No. 111), 1958.
- Equal Remuneration Convention (No. 100) and Recommendation (No. 90), 1951.
- Maternity Protection Convention (No. 183) and Recommendation (No. 191), 2000.
- Workers with Family Responsibilities Convention (No. 156) and Recommendation (No. 165), 1981.
- Part Time Work Convention (No. 175) and Recommendation (No. 182), 1994.
- Domestic Workers Convention (No. 189) and Recommendation (No. 201), 2011.
- Social Protection Floors Recommendation (No. 202), 2012.

To the extent that these measures address discrimination in the workplace they would also of course help other groups who may be discriminated against in the Japanese labour market.

Flanking measures

Promotion of active labour market policies:

- Particular attention needs to be paid to provisions in the FTA that deal with compliance in areas that are employment sensitive but also potentially job creating, especially on services (in particular in liberalising and facilitating mode 3) and manufacturing (chemicals/pharmaceuticals, motor vehicles).
- Consideration needs to be given to the promotion of active labour market policies to deal with trade-related structural adjustment and to the utilisation of the European Globalisation Adjustment Fund (see EESC Opinion, page 6). At the Stakeholder Roundtable on 23 April 2015 the ETUC representative spoke of the need to expand the resources of the Fund.

Support for SMEs:

- One comprehensive survey of SMEs found that the most common impediments faced by SMEs, ranked in order of importance, are the language barrier, high costs and difficulties related to business practices and local laws.
- The most common requests for assistance involved: help in meeting with potential partners, support for participation in fairs and salons, translation

b) Commission services' reaction:

The Commission services have taken note of the above set of recommendations.

As in other FTAs, the EU is seeking ambitious and comprehensive provisions regarding labour rights. This will include clear language on the right to regulate combined with a commitment to high levels of labour protection. The misuse of domestic labour legislation to gain trade and investment advantages will also be prohibited. Furthermore, the Agreement will include a strong commitment on core labour standards, notably regarding the implementation of ratified ILO fundamental conventions and progress towards the ratification of ILO fundamental conventions that have not yet been ratified. This will be complemented by a commitment between the Parties to cooperate on these labour matters. Provisions on labour aspects in other EU FTAs will be the EU's reference in this respect.

The Commission services take particular note of the Consultant's recommendations on gender equality. In particular the Commission services have sought the inclusion in the FTA of a Trade and Sustainable Development chapter providing for ambitious and comprehensive provisions regarding labour matters of importance in a trade and investment context. These include elements of specific relevance concerning gender, in

particular by addressing the four ILO core labour standards (which include the elimination of any form of discrimination in the workplace, also based on gender), the effective implementation of ratified ILO Conventions (such as, for Japan, Convention 100 on Equal remuneration) and efforts towards the ratification of ILO fundamental Conventions not yet ratified (such as, for Japan, Convention 111 on Discrimination in respect of employment and occupation).

As regards flanking measures, it should also be noted that contribution granted from the European Globalisation Adjustment Fund (EGF) for the past 10 years amounted to EUR 59.3 million per year on average. The EGF has a maximum annual budget of EUR 150 million (in 2011 prices) for the ongoing period 2014-2020. These funds can also be used to help with trade related structural adjustment.

The European Commission will continue to closely monitor the evolution and utilisation of the EGF budget and propose changes if needed. Moreover, active labour market policies receive significant support under the European Social Fund also in view of anticipating and preparing for the changing needs of the labour markets and possible restructuring events.

4.3. Environmental pillar

a) Consultants' policy recommendation:

- Exchange of information on best practice in public procurement policies for legal and sustainable timber, including efforts to reach mutually compatible and verifiable definitions of 'legal' and 'sustainable'.
- Exchange of information on the implementation of the EU Timber Regulation, with a view to providing assistance should Japan adopt similar legislation, including specific recognition of VPA (Voluntary Partnership Agreement)-licensed timber as meeting requirements for 'legal'.
- Encouragement for Japan to join existing VPAs, or negotiate similar such agreements, with countries exporting timber products to Japan, including in particular Malaysia, Indonesia and Vietnam.
- Supply-chain incentives to encourage trade and industrial cooperation across manufacturing, in particular motor vehicles. The coverage of EGA (Environmental Goods Agreement) can be expanded beyond what is assumed to be agreed plurilaterally.

b) Commission services' reaction:

The Commission services have taken note of the above set of recommendations. In particular the Commission services agree with the importance of fostering cooperation to ensure sustainable management of forests and to combat illegal logging and related trade. This includes working with various other third countries to respond to the challenge of eliminating illegally harvested timber from the global market. In this regard, it should be noted that Japan recently adopted new legislation on illegal logging. The implementation of this legislation will now be crucial, starting with the development and adoption of relevant ministerial ordinances".

More generally it should also be noted that the Commission services are negotiating with Japan an ambitious chapter on Trade and Sustainable development, including commitments to high levels of environmental protection in domestic law and effective implementation of multilateral environmental agreements. Particular emphasis is put on the conservation of biological diversity, fisheries resources and timber, with references to the Convention on Biological Diversity (CBD), the Convention on International Trade in Endangered Species (CITES) and Food and Agriculture Organisation (FAO) instruments. The EU is seeking comprehensive commitments which allow the parties to address a broad range of topics in the implementation phase.

4.4 Sector-specific: Food and feed (processed food);

a) Consultants' policy recommendation:

- Timing and negotiation sequencing is a key factor. Given the concentration of gains to the “food and feed” (processed foods) for Europe, conclusion of the market access negotiations in agriculture should be given precedence. But this option may have not been feasible for the EU.
- This is particularly important for EU sectors that are not liberalised under TPP. For instance, the US applied parallelism between agriculture and motor vehicle parts tariffs, rather than linking the offers to concessions within the same sector.
- Overall, emphasis must be given to offensive interests with the intention to utilise the liberalisation achieved in the negotiation.

b) Commission services' reaction:

The Commission services have taken note of the above set of recommendations and certainly concur with the Consultants as regards the importance of improving market access conditions for exports of agricultural and processed agricultural goods to Japan.

More specifically the Commission services can agree with the recommendations that, for the agreement to deliver maximal benefits in this sector, processed foods need to be taken fully into account in the negotiation, and EU exporters need to improve their competitiveness. Similarly, the EU agrees with the consultant's recommendation that, in order for SMEs in the beef, pork and dairy sectors (excluding cheese) to cope in a competitive business environment, appropriate farm policies should be put in place both in Japan and in the EU. These should address new goals in food production such as quality innovation and environmental concerns. The Commission services consider that this is fully valid and that both Japan and the EU are already foreseeing this, albeit in differing ways, in their respective agricultural policies and reforms.

The consultant also sees an important role in providing income support for old farmers in particular in Japan as a way to address social issues. The Commission services recognise

the importance of income support for farmers of any age, but in light of the increasing age of farmers the Commission services deem it extremely important to target support to young farmers and additionally to encourage new entrants to the sector through income support and robust farm policies. The Commission services can also agree with the consultant's assessment that, due to the small size of production and the mature market in Japan, Japanese farmers and food processors could benefit from finding attractive niche markets in the wide European market.

The consultant also considers that the pork production sector in Japan will undergo major changes and, following a market opening, the quality of Japanese products could be upgraded, requiring new skills from Japanese farmers, which could also have employment consequences. According to the Commission services' assessment, Japan is likely to continue to give some sort of protection to its domestic pork production due to food security considerations. The situation for pork production in Japan may therefore not change dramatically. The Commission services considers that, while the quality of Japanese agricultural products is already high, opening up the Japanese market to more outside competition could lead to increased productivity and increased exports on the Japanese side, to the benefit of Japanese producers.

Finally the consultant considers that a new crucial factor also has to be taken into account by the EU: the significant to severe competition exerted by the Trans-Pacific Partnership (TPP) food exporters in the Japanese markets that are considered as the leading markets in Asia. The consultant states that the target of the EU-Japan Agreement should be to reach the same outcome as the TPP Agreement, that is, total liberalisation from both sides for agro-food products. The Commission services do not agree with the view that such outcome has been reached in the TPP Agreement given notably the fact that many key agricultural products are subject to quota like safeguard measures (whey, beef, pork...). Moreover, the Commission services also believe that the EU's negotiating strategy and objectives should be tailored to the specificity of EU agricultural exports. Therefore, while the TPP outcome is a useful reference point, the composition of this outcome and its level of ambition in terms of which products Japan will liberalise and to what extent should not be replicated for the EU, as it would fail to achieve the EU's negotiating mandate in too many areas.

4.5 Sector-specific: Motor vehicles

a) Consultants' policy recommendation:

Considerable negotiation effort and political capital has been spent by the European Commission, EU Member States and the Government of Japan to cater to the sensitivities of the passenger cars market. This is a segment where the EU is enjoying a large trade surplus with the world, and (at least for now) also with Japan.

- Given the specificity of some NTMs in the passenger cars segment, there is some risk that the benefits might only apply to a very limited number of manufacturers or model types. Prioritisation among the list of NTMs is a perilous task but must be done with respect to market segments and model types with existing market potential, most

likely similar to those already exported to Japan. This should be done so that the stakeholders utilise to the maximum extent the market access that the FTA will provide.

- Japanese customers are often ready to pay high premiums (up to 30%) for European passenger cars (PCs) which are significantly higher than the levels from trade cost reductions envisaged through NTMs (at 5-6%). This relation suggests that the EU-Japan FTA may not generate new types of trade from the EU into Japan (depending on the cost structure of EU exporters), but will always expand the trade of existing types of passenger cars.

Similarly, given the export orientation of the commercial vehicles, powered two-wheelers (PTWs) and parts sub-sectors, sub-sectors not related to passenger cars must be given equal priority. These sub-sectors tend to be export-led rather than based on local production and would contribute to offset any potential negative employment effects.

- Given the globally competitive commercial vehicles manufacturers in the EU, the generally broad and horizontal NTMs in commercial vehicles (testing of emission control devices, type certifications, non-UNECE requirements) ought to be resolved. Given the extremely small share of Japanese exports destined for Europe (less than 1%), the European commercial vehicles production will be able to withstand the tariff elimination. There are also transport efficiency gains for the general economy.
- Similarly, NTMs on powered two-wheelers affects all powered two wheelers exported to Japan.

Given the already high mutual compatibility on safety standards through the 1958 UNECE agreement (which did not exist in prior FTAs) and the joint work on international whole vehicle type approval it would be logical to establish a more ambitious level of mutual recognition or equivalence between the EU and Japan in order to minimise the compliance costs for EU industry and to create pressure to harmonise outstanding divergences. It should be noted that this has not been raised by the stakeholders on either side but is nonetheless a necessity to ensure that no new NTMs hinder trade in the future. This is particularly true for commercial vehicles.

- In extension, there is a long-term logic in institutionalising regulatory cooperation and harmonisation in commercial vehicles (as well as personal cars) as Japan and the EU account for the majority of world exports. The long-term competition against UNECE-based norms comes from new entrants, including new national standards set by China and industrialisation of the ICT sector.

The analysis on parts and component trade shows an unusually high concentration of Japanese imports, while EU exports are well-diversified over products and EU Member States. Considering the majority of trade flows are intra-firm, with duty-draw back available for production destined for export, the impact of tariff elimination ought to be less detrimental than expected. Tariff cuts incentivise the extensive technology exchange already in place (especially on engine technology), industrial cooperation or “improve” margins for those assembling in Europe, rather than actually displacing local production.

- This assessment has also arrived at the conclusion that liberalisation is likely to improve profit margins. Considering the moderate growth and profitability prospects in both the EU and Japan overall, such margins are necessary to maintain investment flows (and thereby also jobs) in Europe and to maintain production. Cutting tariffs on parts may therefore be a necessity.
- In expanding exports of parts strengthening the market situation on aftermarkets (spare parts) may have been overlooked.

Flanking measures

- Given the limited impact compared to the baseline, phased liberalisation or staging periods as implemented in previous FTAs would suffice to accommodate any transition or adjustment costs on the passenger cars market. It is worth noting that the TPP agreement implemented staging periods of 25 years, but that, according to the consultant, this outcome was the result of linkage with import quotas on rice.
- TPP also includes “snapback” provisions on US car parts tariff where tariffs may be reintroduced if US market shares in Japan do not improve. If these provisions were to be invoked they could have adverse effects for the EU exporters. Unfortunately, there are few flanking measures that can be provided except for creating reciprocal opening on such products, either in Japan or on other markets.
- Flanking measures on passenger cars manufacturing are primarily possible through assisted structural adjustments and improving intra-EU labour factor mobility, through which displaced workforce can more easily move into the majority of successful passenger cars exporters, or into motor vehicle sub-sectors.

b) Commission services’ reaction:

The Commission services have taken note of the above set of recommendations.

As regards tariff liberalisation, the Commission services agree with the importance of phased liberalisation or staging periods to accommodate transition or adjustment costs in the passenger cars market.

The Commission services also concur with the Consultant's assessment that an ambitious level of reciprocal recognition between the EU and Japan is desirable, as well as with its view that the FTA should aim at establishing mechanisms to minimize the possibility of new NTMs arising in the future. In this context, the Commission services aim to agree with Japan on ambitious provisions specifically targeted at motor vehicles in the FTA, which will, among others, aim at a high degree of alignment of regulations of EU and Japan on the basis of international standards (UN ECE Regulations) and bolster EU-Japan cooperation both bilaterally and in the context of the relevant international standard-setting body (UN Working Party 29). As regards the Consultant's recommendation to prioritize among different NTMs, and its concerns that benefits from eliminating NTMs might only apply to a very limited number of manufacturers or model

types , the Commission services would like to point out that the quantification of the value of a reduction of NTMs is always very difficult and requires numerous assumptions. A prioritisation of NTM issues based on their economic value is therefore also not desirable, as each NTM presented merits its own consideration. Since these are distributed very broadly through various sub-branches of the industry, solving them will create sizeable value for a broad European industry basis, for automotive parts or for whole vehicle manufacturers.

In particular, the UNECE Regulations apply to parts and equipment, with a majority of them also being taken into account in the whole vehicle type approval process for the respective types of motor vehicles which incorporate those parts and / or equipment. In this sense every UNECE Regulation that is applied by Japan will create the possibility of new trade for this particular part or equipment to Japan without any adaptations, in addition to allowing whole vehicle manufacturers to substantially reduce the amount of supplementary certification required to obtain the necessary vehicle type approval. Many of these Regulations actually apply to passenger cars, buses or lorries in a similar way – when this is the case, the value of alignment to UNECE Regulations is not limited to specific types of vehicles. Furthermore, there is also no difference with regard to the size of the engine or the price of the cars when it comes to benefits derived from broader alignment to UNECE Regulations.

4.6 Sector-specific: Railways

a) Consultants' policy recommendation:

The main recommendation is an intense effort at industrial cooperation. The kind of industrial cooperation mentioned above concerns more the REI (Railway Equipment industry) firms than the governments since they focus on how to reap the joint benefits and compete on the increasingly large and sophisticated competitors based on huge domestic markets with enviable growth rates.

Flanking measures

Industrial cooperation could also be envisaged as a part of the flanking measures. This would consist of a dialogue between the government officials on how each partner has found solutions to make increased competition acceptable to domestic labour, including coverage of how foreign investment contribute to new employment opportunities. The sector analysis on motor vehicles and the analysis on the social impact elaborate on the role of investment in manufacturing.

Second, flanking measures work at best when they are pre-emptive. In this perspective, there is no better solution than to create an EU-Japan Observatory on the PRS activities, whose role would be to review regulation on both sides, and to suggest solutions if the existing regulations slow down reform. Such pre-emption can avoid creating distortions or 'inappropriate situations' due to delayed decisions that are then put off indefinitely because they become harder and harder, forcing the governments to take economically drastic, hence socially very costly solutions.

b) Commission services' reaction:

The Commission services have taken note of the above set of recommendations. Concerning industrial cooperation, the Commission and the Japanese Ministry for Land, Infrastructure, Transport and Tourism set up the EU-Japan Industrial Dialogue on Railways in 2014 within the framework of the FTA negotiations. The dialogue includes representatives of the private and public sectors who meet on a biannual basis. Its objective is to promote cooperation and information exchange between the participants to facilitate bilateral trade in the railway public procurement sector, to monitor mutual market developments and to facilitate the mutual recognition of safety standards. The fifth meeting took place in Brussels on 31 May 2016.

In addition, it should be noted that a technical experts group has been set up to identify convergences in the technical standards used for railway procurement on both sides. The Commission services also consider the idea of an "observatory" worth of further attention. While establishing and consolidating the Railways Industrial Dialogue is the first priority, and this requires a degree of prioritisation and industry-led choices, further thought will be given on introducing this idea in the bilateral cooperation context in the future.

4.7 Sector-specific: Pharmaceuticals (and related chemical products)

a) Consultants' policy recommendation:

- **Reimbursement:** Both the baseline and the impact have clearly identified that transparency and non-discriminatory disciplines on reimbursement do not affect healthcare costs. Unlike the TPP constituency the EU systems are similar to those in Japan and offer better reciprocity by opening up a similar publicly financed reimbursement system in return.
- **Approval procedure:** The stakeholders placed priority on enabling efficient pre-market evaluation, and notably reducing the time of clinical evaluations. Stakeholders have expressed a preference for solutions that provide a speedy pre-market approval (PMA) process before reduction of actual costs. However such a solution omits the interest of SMEs, in particular in the generics and medical devices industries (the SME ratio in Japan is particularly high). The Japan-Switzerland EPA includes a discipline that grants up to five years of compensation in case of “significant market-entry delay due to lengthy authorisation procedures for innovative pharmaceutical and plant protection products”, in order to address losses incurred on “patented invention that cannot be worked due to marketing approval process.”
- **Other regulatory aspects:** Beyond expanding current MRAs, the FTA could look to mechanisms beyond regulatory cooperation, through an institutionalised form of regulatory cooperation including a regulatory council. This is particularly true if the

situations on quasi-drugs and cosmetics are to be improved as they are not effectively negotiated in other forums.

Flanking measures

Given the public health imperative and the need for more efficient and innovative market products on both sides, trade liberalisation in pharmaceuticals has high importance. Trade liberalisation entails considerable regulatory reforms and harmonisation.

In terms of patient or consumer safety, post-market regulatory powers are retained in every form of trade liberalisation. There is no detrimental impact on consumer trust or protection on either side.

In the unlikely case of job losses occurring in the Japanese pharmaceuticals sector, European industry would be naturally incentivised to invest, in case there are no adequate measures for industrial restructuring and investment promotion by the Government of Japan.

In absence of need, no flanking measures are presented.

b) Commission services' reaction:

The Commission services have taken note of the above set of recommendations. Most of the issues raised by the consultant are being discussed in the FTA and progress has already been achieved, like for instance the recent update and extension of the Mutual Recognition Agreement annex on Good Manufacturing Practices.

On transparency of reimbursement and pricing Japan has started a pilot project that is providing non-discrimination and transparency similar to the model used in many EU Member States. In-depth discussion in the FTA may therefore not be necessary.

Overall, it is true that it is important for the EU and Japan to strengthen their regulatory cooperation in international bodies like in the International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use (ICH). Cooperation provisions in the TBT and in the Regulatory Cooperation chapter of the FTA might facilitate this process.

Other areas where trade facilitation can be achieved while maintaining and enhancing the protection of health for citizens are under discussion such as the possibility in the TBT Chapter, for both sides to agree to recognise International Council on Harmonisation of Technical Requirements for Pharmaceuticals for Human Use (ICH) as an international standard setting body. Finally, in an effort to reduce unnecessary duplication the notification procedure for cosmetics was recently abolished by Japan.

4.8 Sector-specific: Medical devices

a) Consultants' policy recommendation:

Recommendation towards regulatory harmonisation and cooperation

Similar to the pharmaceutical sector, the stakeholders of MD/IVD (Medical Devices/ In Vitro Diagnosis) give priority to the PMA (pre-market approval) process, recognition of test data and harmonising QMS to eliminate the need for on-site inspections. However, reimbursement issues should not be ignored.

An institutionalisation of the ongoing regulatory cooperation is also in the interest of the EU. This is particularly urgent for the medical devices sector, given that some MD/IVD MRAs (Mutual Recognition Agreements) with Europe have been restricted or revoked, and confidence in the European MD/IVD sector needs to be restored. Digitalisation opens up the possibility of new NTMs in both Japan and the EU.

Moreover, MD/IVD (in Class II and upwards) require the involvement of common standard setting. Aside from harmonisation, reference pricing (FAP) the fiscal measures may not be resolved through an FTA and must be resolved by long consistent institutionalised regulatory cooperation between the parties.

More trade could be facilitated if the use of SDoC (Simplified Declaration of Conformity) was granted for products already approved and in circulation in either the EU or Japan. On the side of Japan, the 510(k) like process for already existing products could thereby be extended to EU Class II products already in circulation in the Single Market. Emphasis on Class IIa and IIb is the consequential and logical conclusion from both economic and public health perspectives.

Similar to public procurement, non-market access issues such as centralised databases and communication with government agencies in other languages than Japanese should not be underestimated.

Flanking measures

As with the pharmaceutical sector there are no immediate flanking measures that can be identified. However, there are some additional social dimensions given the software and digitalisation of the MD/IVD sector concerns personal data and privacy, which will be analysed in the social section of this study.

In order to increase SME participation in the EU-Japan trading relationship, considerable supportive measures by the EU Member States trade promotion arms may be necessary in order to utilise trade liberalisation achieved by the negotiations. Measures could include support and translation of application procedures, distribution and other market activities may be necessary as well. Supply-side aspects (European SMEs sourcing amongst Japanese MD/IVDs) should not be underestimated.

b) Commission services' reaction:

The Commission services have taken note of the above set of recommendations. The EU has very competitive and innovative enterprises in the area of medical devices. Structurally this sector comprises numerous small and medium enterprises. Japan, on the

other hand, often suffers from a smaller market and lengthier approval process that hamper the entry of innovative products in the market. Nevertheless, the recent adoption of the Pharmaceutical and Medical Device Act of 2014 has improved the regulatory framework in Japan substantially and could have been reflected better by the consultant.

The recommendations of the consultant with regard to the Mutual Recognition Agreement are worth deepening. Whilst in parts the argument is made to extend the scope of the Mutual Recognition Agreement notably to cover IVD, there are other comments that criticise this same Mutual Recognition Agreement for not having been effective in addressing 'even elementary regulatory issues' such as QMS (Quality Management System), which are nevertheless outside the scope of the MRA. In the view of the Commission services, this work can already take place, independently of the FTA negotiations, since the MRA is already in existence and would only need to be updated in some areas, possibly in medical devices. This can take place in a general atmosphere of increasing regulatory cooperation fostered inter alia by the negotiating process.

4.9 Sector-specific: business and financial services; retail and wholesale services with an impact on merchandise.

a) Consultants' policy recommendation:

- Given the high welfare and employment effects from services, especially in business and retail/wholesale sectors, the negotiations should re-examine and identify areas beyond discussions on mode 4 and qualifications. Japan is highly efficient in retail, transports (with several local express services), and also in the ICT sector. However, there may be limitations on what can be achieved on issues concerned with improving the internal services integration in the EU.
- Other horizontal issues should be considered, including transfer of data, within the remit of the EU and Japanese laws.
- The negotiations ought to create a context within which JPI (Japan post Insurances) issues can be negotiated to provide EU insurers operating in Japan with equal access and negotiation leverage.
- The retail and wholesale sector needs to be reviewed together with the TBT/SPS issues. This is also the case for trade facilitation and customs.
- In terms of SME, laws and regulations should be made available in English to create a more favorable environment for EU SMEs.

Flanking measures

As the suggested job losses are a consequence of the assumptions of the econometrical model, rather than the effects of trade liberalisation, no further flanking measures were identified.

b) Commission services' reaction:

The Commission services have taken note of the above set of recommendations and note that EU exports in services have regularly increased over the last decade resulting in a trade surplus for the EU. The Commission services share the views of the consultant that appropriate commitments in the FTA could improve the situation for EU services providers, in particular on key sectors of interest like professional, postal, financial, insurance maritime or telecommunication services.

Concerning financial services and the issue of Japan Post Insurances services, the Commission services are exploring with the Japanese side the possibilities of addressing the JPI issue by way of specific measures that could be included in the FTA.

As part of the more general context for the EU services industry, it should also be noted that regarding internal services integration in the EU, on 28 October 2015 the European Commission presented a new Single Market Strategy to deliver a deeper and fairer Single Market that will benefit both consumers and businesses. As part of that strategy the Commission will launch a legislative initiative. This will introduce a services passport with a harmonised notification form and an electronic document repository to increase certainty and to reduce barriers for service providers who want to access other EU markets in order to expand their activities. It will further improve access to professional services at national and EU level by issuing periodic guidance that identifies concrete reform needs for specific Member States and professions that have unjustified regulations. The Commission will also propose an analytical framework for Member States to use when reviewing existing regulations or proposing additional ones. Finally, the Commission will propose legislative action to address regulatory barriers, such as diverging legal form and shareholding requirements, as well as multidisciplinary restrictions for key business services and, if appropriate, organisational requirements in construction companies. The Commission will review market developments and if necessary take action in connection with insurance requirements for business and construction service providers.

Finally, concerning SMEs, it should be noted that, in line with the engagement taken in the Trade for All strategy adopted in October 2015, the Commission services will propose to Japan to include a specific chapter in the FTA. The objective of this chapter with specific SME provisions would be to help SMEs fully benefit from the opportunities of the EU-Japan Free Trade Agreement. The provision would cover the creation of mechanisms for information sharing and the creation of a specific contact point to discuss SME related issues with Japan.

Conclusions

The analysis and the conclusions of this study support the economic rationale for concluding a comprehensive FTA, with symmetrical levels of reduction of NTMs, at an ambitious level. The findings of the Trade SIA confirmed the potentially very high

economic benefits, as well as the significant positive environmental and social impact that a comprehensive and ambitious EU-Japan FTA could have for the EU. This agreement would also positively contribute to the sustainability of EU-Japan trade relations from the economic, social and environmental viewpoints.

The Commission services have taken note of the findings and recommendations of the Trade SIA and have already taken them into account as much as possible during the negotiating process that started in April 2013. In general the Commission services fully agree that to ensure the best possible result it will be important not only to agree on liberalisation in trade in goods, services and investment, for which adequate transition periods will need to be agreed, but also to accompany the process of liberalisation with a strong and coherent set of rules. These rules should cover a wide range of areas including but not limited to intellectual property rights, technical barriers to trade (including precise solutions for both solving and preventing the apparition of non-tariff barriers), sanitary and phytosanitary measures, trade facilitation and sustainable development.
