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EU–Japan Free Trade Agreement: Opportunities and Challenges for Businesses in the CEE

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Japan, the third biggest global economy, is an important trade partner for the EU. However, given the existing market access barriers, common trade and investment potential is untapped. A future free trade agreement should contribute to wider access for businesses to the EU and Japanese markets, mainly by reducing non-tariff barriers and high duties imposed on selected goods. The agreement could encourage companies from Central and Eastern Europe to enter the Japanese market, particularly in the food and transport sectors, and to cooperate with Japanese partners on third markets.

Negotiations on the free trade agreement (called the Economic Partnership Agreement—EPA) with Japan, are among the most complex and thus the most difficult trade talks in which the EU is taking part. It is also one of the first deals negotiated with a highly developed country with significant bargaining power. Such an EPA could contribute to wider access for European firms to the absorbent but currently heavily protected Japanese market. This is possible due to the economic policy of Shinzo Abe's government (the so-called "Abenomics"), an important element of which is to open Japan to imports and foreign investment.

Untapped Potential. Trade relations between the EU and Japan are developed, but they do not fully tap their potential, which is hampered by existing market access barriers. In 2013, the value of bilateral trade in goods amounted to €110.7 billion, among which Japan exported products worth €56.6 billion, while trade going the other way was worth €54.1 billion (the EU deficit amounted €2.5 billion, while in 2011 it was more than €21 billion). Nevertheless, Japan is only the EU's seventh biggest trading partner, lagging behind Switzerland and Turkey. Moreover, bilateral trade in goods has been falling in recent years (in 2011 it was worth around €120 billion), which reflects the growing role of the emerging markets, such as China, India and the ASEAN grouping, in the EU's and Japan's trade.

The trade structures of the EU and Japan are similar, and embrace mostly industrial goods, such as machines, transport equipment and chemicals (the EU also exports food). Therefore, they can pose serious competition to each other on the global markets. However, there is a significant difference regarding investment stocks, as Japan is one of the leading investors in the EU (€161.5 billion in 2012), while the value of the EU's investment in Japan is much lower (€98.8 billion). This is partly an effect of hurdles for foreign capital in accessing Japanese market.

Greater Liberalisation, Greater Benefits. The EPA, under negotiation since March 2013, should enhance bilateral trade. The free trade agreement between the EU and Korea, which came into effect in 2011, was a strong incentive for Japan to take part in negotiations with the EU, as this could threaten the competitiveness of Japanese business in Europe. Increase in trade between the EU and Japan could be beneficial for both economies, which still suffer from the effect of the global financial crisis. Both sides count on increasing industrial production, creating new jobs, and rising salaries, which should result in higher internal demand.

According to the analysis prepared by the European Commission, the best result for both sides would be a far-reaching agreement that embraced not only tariff elimination but also a significant reduction in non-tariff barriers (NTBs). Depending on the scope of trade barrier reduction, the EPA could increase EU exports to Japan between

20% and 30%, especially in food (which may even see a 200% increase), chemicals (more than 50%) and transport equipment (47%). In turn, Japanese exports to the EU would rise by around 17% to 23%, particularly regarding the sale of transport equipment (by about 50%), machines (34%), motor vehicles (28%), and processed food (45%).

There have been nine negotiation rounds so far (the last one took place in February). Both sides would like to agree principles of the agreement by the end of 2015. However, they are currently engaged in talks regarding other huge free trade agreements. For the EU, this is the Transatlantic Trade and Investment Partnership (TTIP), and for Japan it is the Trans-Pacific Partnership (TPP). Given the economic importance of TTIP and TPP, both can be named as priorities for the EU and Japan, so developments in talks on those deals could slow the pace of EPA negotiations. Moreover, arrangements in the framework of TPP, where agriculture is one of the most contentious issues, could show the extent to which Japan is willing to open its market for goods from the EU.

NTBs in the Limelight. Given the relatively low level of average custom tariffs in the EU and Japan (3.4% and 1.7% respectively), reducing NTBs, through, for example, the simplification of market access procedures, or the mutual acceptance of technical, safety or phytosanitary norms, could bring the greatest benefits. These issues limit market access for foreign entities or increase the costs of doing business (in Japan, by 10–30% depending on the industry). Although some changes have been implemented in recent years, these barriers still occur in key sectors from the EU perspective, such as the machine industry, food, automotive, pharmaceuticals and medical devices. Among the EU's important goals are easier regulations for investors, wider access to the Japanese service sector (especially financial and telecommunication services), and the opening up of the public procurement market (mainly in railways and aviation) worth around €550 billion.

From Japan's perspective, the greatest benefits could be achieved by lifting high tariffs imposed on industrial goods, which are the core of Japan's exports to the EU, namely vehicles (10%) and electronic devices (14%). Japan could also insist on reducing NTBs, mainly through harmonisation of technical standards or labelling. However, it is worth mentioning that wider access to the EU market for Japanese competition could have negative results for some local industries, such as the automotive sector.

Time for European Food. The EPA would also make access to the absorbent Japanese market easier for firms from CEE countries. It could contribute to better use of bilateral economic potential, which is still untapped. This is visible in Poland's exports to Japan, which were worth €492 million in 2014, less than to South Africa (€512 million) or Algeria (€501 million). If the EPA is implemented, opportunities for increasing CEE exports to Japan could emerge in several areas.

Among the prospective sectors is agriculture, especially the export of dairy products (currently limited by tariff peaks), meat and poultry. Currently only four EU states (including Poland) are able to export beef to Japan, and there are also hurdles in selling pork meat (in Poland's case, this relates to cases of African swine fever). Mutual acceptance of sanitary and phytosanitary standards in the framework of the EPA could ease restrictions on food exports to Japan.

CEE companies may also be interested in Japan's public procurement market, especially regarding railways and public transport. Providing a level playing field for Japanese and foreign companies, mainly by improving the transparency of bidding processes and easier access to information, may create opportunities for suppliers of rolling stock (in Poland, firms such as PESA, Newag and Solaris) or elements of railway infrastructure. To increase their bargaining power, companies from CEE and other EU states can cooperate in international consortiums. In Japan there is also visible demand on pharmaceuticals and medical equipment, including specialist surgical tools and equipment for older people, which can be supplied by CEE firms. There are prospects too for cooperation in developing clean coal technologies, which could underpin the economies of CEE states, particularly Poland, in their drive to fulfil EU climate policy goals. It is also worth mentioning that wider access to Japanese market for European automotive companies, from for example Germany or the UK, could have a positive impact on their subcontractors from CEE. On the other hand, enhanced Japanese competition on the EU market could pose a serious threat to firms from CEE states, mainly from the machine and chemical industries.

Together on the Third Markets. The EPA should create business opportunities for CEE companies, especially from the food, transport and medical sectors. Therefore, Japan could contribute to the diversification of the CEE exports, based on the EU market. CEE states and businesses should monitor the state of negotiations on the EPA, and prepare themselves to seize economic opportunities stemming from the implementation of the agreement.

To enhance economic cooperation between CEE countries and Japan, high level visits could be valuable, as could frequent trade missions on the ministerial level, accompanied by representatives of small and medium enterprises that are looking for business niches in Japan. Cooperation on the regional level could also be valuable, especially in case of easier access to public procurements in Japanese prefectures and cities. CEE companies should also seek cooperation with Japanese partners on third markets. The effectiveness of this kind of cooperation has been proved by the Polish firm KGHM, and Japan's Sumitomo, which are conducting a joint mining project in Sierra Gorda, Chile. These activities could positively affect the development of CEE companies by the transfer of the most up to date technologies and innovations in organisation.