Llywodraeth Cymru
Welsh Government

# The UK-Japan Comprehensive Economic Partnership Agreement: A Welsh Government Assessment

2020

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# Executive Summary

1.1 The UK has left the EU and the transition period will end on 31 December 2020, after which EU trade agreements, such as the EU-Japan Free Trade Agreement will cease to apply to the UK. The UK is seeking to reproduce the effects of existing EU agreements in place with some 70 countries for when they no longer apply to the UK.

1.2 Although continuity is being sought with the majority of these countries, the UK and Japan decided that, rather than simply 'rolling over' the EU-Japan agreement, they would use the EU-Japan Economic Partnership Agreement (EPA), which came into force in February 2019, as the basis for a future UK-Japan free trade agreement (CEPA). It was agreed that this 'continuity plus' approach would allow for the EPA to be maintained in effect, whilst allowing scope for both parties to seek enhancement in areas of mutual interest.

1.3 Negotiations started on 9 June, and the agreement was formally signed on 23 October, allowing for both parties to begin their formal domestic ratification procedures. The UK's ratification procedure began on 2 November when the agreement text and an explanatory memorandum were laid in parliament under the Constitutional Reform and Governance Act (commonly referred to as the CRaG process). The agreement is expected to be ratified after 21 sitting days on 7 December, unless either of the Houses of Parliament chooses to pass a motion stating that it should not be ratified. On the Japanese side, we are not aware of anything that will delay their ratification process.

**1.4 The UK-Japan CEPA is approximately 80% the same as the EPA, but it goes further in a number of areas. Some of the key enhancements from the perspective of the Welsh Government include, but are not limited to:**

- Ambitious digital provisions have been agreed with the intention of reducing barriers to digital trade by promoting regulatory cooperation, enabling the two-way free flow of data and minimising costs associated with digital trade. Online protection for businesses and consumers is a key feature of these provisions. On Financial Services a focus on regulatory cooperation, clarity for business and increased transparency for short term business travel should benefit both UK and Japanese financial service suppliers and investors.
- There have been some alterations to existing chapters we support including sanitary and phytosanitary (SPS) provisions and a new chapter on Trade and Women's Economic Empowerment.
- Rules of Origin arrangements have provided continuity for UK exporters that are utilising the EU-Japan EPA arrangements in their exports to Japan, especially with the securing of the extended cumulation arrangements to allow for the use of EU materials and processing to count as originating within the UK. Some removal of the less restrictive Product Specific Rules when compared to the EU-Japan Agreement may offer more opportunities for manufacturers of both Parties in certain goods to source the raw materials they need from other countries in their exports to one another.

- The liberalisation timetable of tariffs in cars and car parts not being accelerated beyond the timetable as agreed in the EU-Japan EPA which provides a degree of continued security for domestic manufacturers of these products.

1.5 Overall, the Welsh Government supports CEPA and recognises that it provides the continuity with the EPA we sought. For example it was important that CEPA replicated the EPA where ratification of the agreement was contingent on parties adhering to the Paris Climate Accord[1]. The Senedd was the first Parliament in the world to declare a climate emergency and it was key that CEPA did not undermine our ability to regulate in order to transition to a low carbon nation and meet our climate targets[2] as well as supporting the Welsh low carbon goods and services sectors and ensuring a level playing field where we do not simply 'export' our emissions to Japan (a globally responsible Wales[3]).

**1.6 Failure to reach and ratify an agreement by the end of the transition period would have led to the UK 'falling out' of the EPA. This would mean UK businesses already exporting to Japan would have reverted to trading on Most Favoured Nation (MFN) terms under World Trade Organization (WTO) rules as of 1 January 2021. The resultant imposition of barriers to trade (tariff and non-tariff) compared to our current arrangements would have put at risk the strong trading and investment links that have been developed:**

- Trade – in 2019 goods exports to Japan were worth £296 million.
- We currently have approximately 65 Japanese-owned businesses based in Wales employing over 8,000 staff. Many of these companies are important to our manufacturing and automotive sectors.

1 Eckhardt, J 2020, *An assessment of the EU-Japan EPA and its implications for a UK-Japan Free Trade Agreement*. National Assembly for Wales.
2 Welsh Government have accepted the UK Committee on Climate Change's recommendation to increase Wales's 2050 target to 95% and have requested further advice on how the new 2050 target affects the interim targets and carbon budgets set in 2018. We expect to receive the CCC's advice in December and will ask the Senedd to update the emissions reduction pathway in Spring 2021.
3 'A globally responsible Wales' is one of the seven well-being goals put in place by The Well-being of Future Generations (Wales) Act 2015: https://www.futuregenerations.wales/a-globally-responsible-wales/

# Trade between Wales and Japan

2.1 In 2019, Welsh goods exports to Japan were valued at nearly £296m and imports from Japan valued at just over £639m[4].

2.2 In 2019, Japan was the 11th largest export market for Wales accounting for around 1.7% of Welsh exports of goods, and the 6th largest import market with around 3.5% of Wales' total goods imports coming from Japan.

2.3 Latest estimates of Welsh trade in services show imports and exports of services were valued at £5.3bn and £7.4bn respectively in 2018[5]. No country breakdown is currently available, therefore it is not possible to estimate the value of Welsh trade in services with Japan.

2.4 Further details on trade between Wales and Japan can be found in Annex A.

4 HMRC Regional Trade Statistics, 2019
5 ONS International trade in services by subnational areas of the UK: 2018 (https://www.ons.gov.uk/businessindustryandtrade/internationaltrade/articles/internationaltradeinservicesbysubnationalareasoftheuk/2018

# Welsh Government Involvement in the UK-Japan Negotiations

3.1 Although only the UK Government has the power to conclude international agreements that bind the whole of the UK, the Welsh Government has a responsibility to make representations to the UK Government about those agreements given our strong interest in them, particularly where they touch on devolved matters. In addition, the Senedd has the power to pass laws relating to the observation and implementation of international obligations, meaning that the Welsh Government and the Senedd have a legitimate and crucial interest in the negotiation and terms of any international agreements which will require Welsh implementation.

3.2 In *Trade Policy: the issues for Wales* the Welsh Government set out the importance of developing deep and sustained co-operation mechanisms between the Devolved Governments and UK Government on trade. We called for the establishment of a Ministerial Forum as well as meaningful consultation and a memorandum of understanding that all could sign up to. For our part the Welsh Government committed to being a constructive partner, sharing analysis and working with UKG to provide leadership on stakeholder engagement.

3.3 We have since worked closely with the Department for International Trade (DIT) to develop a constructive working relationship. DIT have this year established the Ministerial Forum for Trade which we fully support. However, although working relationships with DIT remain positive we have failed to formalise these relationships through a concordat. Discussions on the concordat have been ongoing now for around two years. Despite the fact that DIT are working to the spirit of the concordat, we believe it is essential to finalise the governance arrangements to enable us to feed in appropriately to the important trade negotiations which are already underway.

3.4 In terms of the CEPA, the UK Government shared draft text of chapters relating to devolved matters with the Welsh Government throughout the negotiations and before finalisation and then all legally agreed text after it had been ‘legally scrubbed’. Welsh Government lawyers and policy officials have considered aspects of these chapters throughout the negotiations.

# Analysis of CEPA Text and Impact Assessment

4.1 The UK Government has published an Impact Assessment on the deal, based on economic modelling which was externally commissioned.

4.2 The DIT modelling suggests that over 15 years the agreement could result in a 0.05% to <0.15% impact on Gross Value Added (GVA) in Wales, which is similar to other nations of the UK. Point estimates of the associated monetary value suggest a gain of around £34m for Wales, although this should be interpreted as an indicative order of magnitude rather than a precise estimate. The Welsh Government's economic assessment, which is based on the UK Government's modelling, is attached at Annex A.

4.3 Economic modelling is used to show us the estimated impact of tangible changes, including tariff and non-tariff changes. These changes will be minimal, as our tariffs were already very low under the EU-Japan agreement. Although assumptions are made to capture the long term impacts of removing non-tariff barriers, these so called 'softer' benefits are more difficult to accurately measure.

# Impact of CEPA on Key Sectors and/or Industries in Wales

5.1 Below we consider the key areas of difference between CEPA and EPA for Wales. Our economic analysis is largely based on the UK impact assessment which used results derived from Computable General Equilibrium (CGE) modelling[6]. CGE can provide a useful indication of the potential magnitude of economic impacts resulting from policy changes, however, results should not be treated as economic forecasts.

5.2 Given the complexity of producing robust estimates at lower levels of aggregation, CGE modelling results do not consider the impact of CEPA on individual sectors below the UK level. For Wales, results have only been provided at the whole economy level showing the estimated change to Gross Value Added (GVA) compared to the baseline of trading with Japan on WTO terms. These results have been produced by apportioning the UK level results to each UK nation based on employment. Whilst there are limitations associated with this approach, data limitations means that this is the most suitable option currently available to us.

**5.3 In terms of the sectors considered below, where applicable we provide:**

- The UK Government Impact Assessment GVA estimates for the sector UK-wide. Unless otherwise stated we have concluded that there is no evidence to suggest this impact would be different in Wales.
- Our assessment of the most relevant issues for Wales.

## Automotive

### UK Impact Assessment

5.4 **UK Impact Assessment Conclusion:** Negative impact of between -0.05% and <-0.5% on UK GVA associated with the manufacture of motor vehicles over 15 years.

### Most relevant issues for Wales

5.5 The agreement confirms that the liberalisation of auto tariffs and parts will continue on the basis of the timetable agreed in the EU-Japan deal but not be accelerated. Approximately 5 years remain before import duties are reduced from 10% to 0% (1 February 2026 is the end date).

5.6 We are content that this is the best possible outcome that could have been achieved in these negotiations, as it provides continuity until at least 2026 for Japanese companies that own Welsh automotive plants. If tariffs on Japanese cars and car parts had been reduced at a faster rate, this could have encouraged Japanese firms to on-shore their manufacturing operations, and sell cars and car parts directly to the UK before 2026. This could have threatened the short-term viability of Wales-based automotive plants owned by Japanese companies. An increase in competition from Japanese imported cars and parts would also have had a wider negative impact on the Welsh automotive sector as a whole.

6 This type of modelling is appropriate when there is a significant change in trade policy and an assessment of the impacts on the whole economy is needed. The model considers linkages between domestic markets within each economy and provides impacts at a sectoral and aggregate level. It also considers the knock-on consequences to trade flows of third parties, reflecting trade creation and trade diversion effects, as well as the allocation of resources within an economy.

5.7 The agreement will also see two UK import tariffs covering electrical control units, which are often used in the production of cars, being eliminated at entry into force, instead of in 2024 as agreed in the EU-Japan Agreement. The elimination of these two tariffs should be beneficial for the Welsh automotive industry based on available data, as it would help reduce the cost in importing these electrical components for use in the production of certain cars and car parts.

5.8 The CEPA also replicates the EPA in relation to the convergence of standards and regulations for motor vehicles and parts. This is especially important in helping to reduce regulatory barriers for the sector between the two Parties, as well as helping to facilitate trade with the EU going forward.

## Rules of Origin

### Most relevant issues for Wales

5.9 The ROO arrangements agreed as part of CEPA help to provide continuity for Welsh exporters that are utilising the EPA arrangements, with additional benefits achieved in some areas.

5.10 It has been agreed that EU materials and processing can be recognised (i.e. cumulated) in UK and Japan exports to one another for all products that currently rely on EU inputs to access preferential tariffs.

5.11 The UK and Japan have also agreed a provision that seeks to ensure continuity for UK exports to the EU which contain Japanese inputs. Welsh Government welcomes this provision, but recognises that it will only come into effect if a similar provision is included in the UK-EU trade deal.

5.12 There have also been positive changes to Product Specific Rules (PSR) which will be less restrictive than the EU-Japan Agreement for certain goods. For example, on various agriculture goods (such as pet food, sugar confectionary, baked goods), and other goods including certain textiles, the CEPA removes certain restrictions from the rules contained in the EPA. This will allow Welsh exporters of those goods to import key ingredients from other countries and use them in their exports to Japan. This opens up new opportunities for our exporters that previously may have not been able to access the EPA Agreement due to the strict rules for those goods.

## Agriculture and Food and Drink

### UK Impact Assessment

5.13 **UK Impact Assessment Conclusion:** Small positive impact of between 0.05% and <0.5% on UK GVA associated with the agri-food sector over 15 years.

### Most relevant issues for Wales

5.14 Geographical Indications (GIs) are names used on products that have a specific geographical origin and possess qualities or a reputation that are due to that origin. They can raise consumers' awareness and help pave the way for exporting businesses to attract and inform overseas customers.

**5.15 The UK Government has secured:**

- continuity of effect with the EU-Japan EPA, maintaining protection for three products (none of which are Welsh)
- a provision that stipulates that as soon as practically possible after entry into force, each Party shall consult and provide a list of GIs to the other Party for addition to the Agreement, subject to examination and opposition procedures.

5.16 The UK Government has publicised that it will provide Japan with a list of up to 70 additional GIs in January 2021, almost the entire register of the UK's protected products, and that these products will go through examination and opposition procedures set out in Japanese domestic law. Unless there are circumstances where a Japanese producer of a competitor product opposes a GI, the UK Government advises that this process will take approximately 5 months. Fifteen of the products the UK has said it will seek to register in Japan are of Welsh origin and include Welsh lamb and Anglesey sea salt.

5.17 These provisions could have a slightly positive, albeit limited, impact on Wales' food and drink sector in the long-term depending on the extent they are used by Welsh businesses.

5.18 The SPS chapter represents near continuity with the EU-Japan Agreement with some amendments to a few provisions. Although we are supportive of the provisions made in the chapter we were disappointed that the UK Government was unable to secure additional provisions on Anti-Microbial Resistance, which is a priority area for Welsh Government.

## Data and Digital

### UK Impact Assessment

5.19 **UK Impact Assessment Conclusion:** most services sectors associated with data and digital are found to have a small positive impact of between 0.05% and <0.5% on UK GVA over 15 years.

### Most relevant issues for Wales

5.20 The CEPA contains a number of new and forward looking provisions acknowledging the increasing volume and complexity of digital trade.

5.21 The Trade in Services, Investment Liberalisation and Electronic Commerce chapter of the CEPA focusses on building an open, secure and trustworthy online environment. It does this by supporting the improved two way cross border flow of data whilst at the same time protecting domestic regulatory and national security laws and regulations.

5.22 Provisions beneficial to Welsh business include providing assurances on the omission of onerous restrictions for two way UK-Japan cross border data transfer and support for the publication of machine-readable datasets to increase governmental transparency.

5.23 It is difficult to model how these provisions could lead to long-term economic benefits. However, we believe that these provisions will be positive for Wales' digital and cyber security cluster companies looking to export services to Japan.

## Financial Services

### UK Impact Assessment

5.24 **UK Impact Assessment Conclusion:** Small positive impact of between 0.05% and <0.5% on UK GVA associated with financial services over 15 years.

### Most relevant issues for Wales

5.25 There are a number of benefits, particularly relating to commitments on promoting regulatory and legal transparency and cooperation between both Parties that should increase certainty and clarity for UK financial services providers operating in Japan and vice versa.

5.26 In addition, the UK and Japan have committed to improved business mobility arrangements. This provision is likely to prove of particular benefit to the financial and professional services sector, as it will allow for the easier temporary movement of highly skilled professionals and family members between the two nations. Specifically, more transparent visa arrangements will be put in place with technical modifications to permitted lengths of stay and an expanded definition of intra-corporate transferees. This should help to improve business mobility across several professional services sectors.

5.27 The agreement also contains safeguards on the use, storage and processing of financial data. In practice, this means that companies setting up subsidiaries in Japan will not be obliged to store financial data in Japan. This will eliminate the barrier to trade caused by additional costs involved in setting up and maintaining computer servers in multiple markets.

5.28 Whilst it is difficult to understand the extent to which these sectoral benefits will accrue to Wales, we have a strong and highly innovative financial services sector that is well-positioned to exploit the benefits. A range of Welsh financial services suppliers either already exporting services to Japan or seeking to do so, could benefit from these provisions which could deliver a long-term positive economic impact to Wales.

## Welsh Consumers

### UK Impact Assessment

5.29 The UK Government's Impact Assessment shows that Wales imports around 7% of the UK's total imports from Japan. Whilst the modelling estimates a potential saving of up to £4m for Welsh consumers, the evidence directly linking tariffs to consumer prices is mixed and we expect the scale of the savings to be linked to the extent to which savings from lower import costs are passed onto final users.

5.30 The UK impact assessment modelling also estimates an increase in the long run average real wage[7] in the UK of around 0.09% (£0.8 billion). This is found to be consistent across most types of occupation apart from service workers (0.08%). Indicative estimates of the long run impacts on the composition of employment in UK sectors suggests the largest negative impact will be felt in the chemical, rubber and plastic sector (below -0.5%), followed by manufacture of motor vehicles, machinery & equipment, and other services sectors (-0.05 to <-0.5%). The largest positive impact will be within the textiles, apparel and leather sector (above 0.5%).

7 nominal wages adjusted for impact of inflation

### Most relevant issues for Wales

5.31 Consumer protection is woven throughout Chapter 8 on Trade in Services, Investment Liberalisation and Electronic Commerce. Provisions beneficial to consumers include extending online protection to cover commercial activities. The CEPA also contains a new article on the adoption of a legal framework to protect the personal information of users of e-commerce. In line with its forward leaning ambitions the chapter supports activity at multilateral level and seeks to facilitate cooperation in emerging technologies, Artificial Intelligence (AI) and the Internet of Things (IoT).

## Cross-cutting Issues – Social, Labour, Environmental and Animal Welfare

### Most relevant issues for Wales

#### Climate Change and the Environment

5.32 The UK-Japan CEPA largely replicates the Trade and Sustainable Development (TSD) chapter in the EU-Japan Agreement, including those related to the environment and climate change. We are supportive of these provisions.

5.33 Modelled estimates suggest the UK-Japan CEPA is not expected to have significant impacts on Greenhouse gas emissions ($CO^2$ and Non-$CO^2$), energy usage, trade-related transport emissions and wider environmental impacts such as air quality, biodiversity, and water use/quality. The agreement is estimated to increase domestic greenhouse gas emissions marginally by 0.028% compared to projected levels in 2035. However, this does not take into account future policy measures to reach net zero by 2050.

#### Social and labour provisions

5.34 The UK-Japan CEPA largely replicates the Trade and Sustainable Development (TSD) chapter in the EPA. References to labour laws and conventions have been included throughout the TSD chapter which is consistent with the EPA.

5.35 The agreement provides for the establishment of a bilateral UK – Japan joint dialogue with civil society and a panel of experts to sit, which is similar to the EU – Japan processes established by the EPA. A difference is that the UK and Japan governments have two years to establish a committee and a list of experts whereas the EU and Japan agreed to establish a committee and panel in one year.

5.36 We are awaiting clarification from the UK Government on how the domestic advisory group would work and clarification about the role of the devolved governments.

5.37 The UK-Japan CEPA has a new, additional chapter on Trade and Women's Economic Empowerment which the EU-Japan Agreement did not contain. The chapter establishes channels between the two nations to cooperate on furthering opportunities for women in roles as business owners and workers. A Working Group will support and oversee the delivery of cooperation activities. We are supportive of these provisions.

5.38 In terms of enforcing commitments within the CEPA, the UK-Japan CEPA mostly replicates the effects of the dispute settlement provisions in the EPA, but SPS provisions are not subject to the provision detailed. Both Parties agreed to seek to resolve any differences on SPS matters amicably through regular conversations and technical discussions and if these processes should fail, any dispute will then be settled using the WTO system.

### Animal welfare provisions

5.39 Animal welfare provisions are identical to provisions made in the EU-Japan Agreement, with a commitment to establish a technical working group on animal welfare. We are broadly supportive of this provision, but as animal welfare is a devolved issue, we await further clarification from UK Government on the role we will have in the working group.

### Subsidies

5.40 With the exception of the removal of references to the European Union, the Subsidies Chapter of UK-Japan CEPA is largely identical to EU-Japan.

5.41 Although Devolved Governments are not within scope of the Chapter, the Welsh Government considers subsidies to be a devolved matter, and as such has a particular interest in this Chapter. We are content that the provisions provide continuity of the existing subsidies arrangements with Japan.

# What does the UK-Japan Comprehensive Economic Partnership Agreement (CEPA) mean for Wales' economy?

**Section 1: Introduction**

**Section 2: What will be the effect on economic well-being?**

- Benefits of trade
- Wales as a trading nation
- Welsh trade with Japan
- Indirect impacts through trade with other parts of the UK
- Computable General Equilibrium (CGE) modelling results
  - Gross Value Added (GVA) Impacts
  - Sector impacts
  - Tariff reductions
  - Consumer impacts
  - Impacts on Small and Medium Enterprises (SMEs)

## Section 1: Introduction

This Annex draws on available evidence outlining the impacts of the UK-Japan Comprehensive Economic Partnership Agreement (CEPA) on Welsh and wider UK businesses, consumers, and the broader economy.

The Welsh Government has closely co-operated with UK Government to ensure the interests of the whole of the UK, including Wales are fully represented. To do this, Welsh Government has sought to develop evidenced-based positions underpinned by the key principles of the Well-being of Future Generations Act (2015).

Most of the results reported within this paper are derived from Computable General Equilibrium (CGE) modelling undertaken by CEPR (Professor Joseph Francois) on behalf of the Department for International Trade (DIT). This type of modelling is appropriate when there is a significant change in trade policy and an assessment of the impacts on the whole economy is needed. The model considers linkages between domestic markets within each economy and provides impacts at a sectoral and aggregate level. It also considers the knock-on consequences to trade flows of third parties, reflecting trade creation and trade diversion effects, as well as the allocation of resources within an economy.

CGE analysis can provide a useful indication of the potential magnitude of economic impacts resulting from policy changes. CGE results should not, however, be treated as a forecast or prediction of the future. In addition, the estimates produced from the modelling show the difference between a UK-Japan CEPA and no agreement in place over the long term – they do not account for any other impacts that might affect economic performance.

Given there is currently limited economic modelling capability for Wales of the type used for this assessment[8], the Welsh Government has been unable to conduct or commission CGE modelling of the negotiated text and its direct impact on Wales for this impact assessment. However, if this capability was available to us it's unlikely the outputs would vary from those produced at the UK level – although it is possible that alternative baselines could be explored. To this end, the UK Government's own CGE analysis for the UK, from which there are some limited results on the high level impacts on Wales, can be drawn upon. At the more detailed level, the impacts on Wales can be inferred by considering what portion of the net benefits estimated for the UK could be attributed to Wales.

In order to provide the necessary context it's important to note that UK Government's analysis presents the impacts of a UK-Japan CEPA compared to a scenario whereby the UK has no trade agreement with Japan. This fails to incorporate the UK's current agreement with Japan (via the EU-Japan agreement) and therefore may lead to over-interpretation of the benefits of the UK-Japan CEPA given that this agreement is in most parts replicating an agreement the UK still currently has access to.

It should also be noted that the results presented in UK Government's analysis is based on the baseline assumption that a UK-EU agreement will be reached. Whilst the Welsh Government considers securing a Free Trade Agreement (FTA) with the EU a top priority, it recognises the need to consider the implications of all scenarios including one whereby the UK fails to secure a deal with the EU. Given this, the implications of a no deal EU exit, (the impacts of which are well versed

8 Economic modelling for Wales poses a number of challenges. Most of these are related to data availability. There are some improvements in train here, led by both the ONS and the Welsh Government (including the experimental Trade Survey for Wales). However, the close integration of the economy in Wales with the wider UK means that modelling of the economy in Wales would probably need to be "nested" in a wider model of the UK. This kind of modelling would be relatively novel and unlikely to deliver robust results in the near term.

including in an earlier paper on the **Economic analysis of UK Government's proposals for EU exit** (https://gov.wales/sites/default/files/publications/2018-12/economic-analysis-of-uk-government-proposals-for-eu-exit.pdf)) need to be fully considered when examining the impacts of the UK signing FTAs with third countries including Japan.

As shown by the UK Government's own economic modelling, securing FTAs with third countries will do little to compensate for the loss of access to the EU market, increasing UK GDP by less than 1% compared to a loss of up to 10% should the UK fail to reach a deal with the EU. In simple terms, this would leave the Welsh economy worse off over the long term (15 years). Whilst the UK-Japan CEPA is a welcome step for facilitating increased trade between Wales and Japan, the evidence is clear that the impact of this agreement is minimal when compared with the potential loss of access to the EU market, of which Wales' goods exports are particularly reliant on. Having said that, even a small percentage change in GDP is equivalent to a considerable amount in £ terms and would be of substantial benefit to Welsh importers and exporters that trade with Japan.

## Section 2: What will be the effect on economic well-being?

### Benefits of trade

Countries engage in trade because it is mutually beneficial and can lead to several benefits to businesses, consumers and the wider economy. Businesses gain from greater revenue and profit which can lead to more investment, productivity and innovation. Consumers gain from greater choice in the variety and quality of goods and services, lower prices through increased competition, higher real wages and living standards. Trade allows countries to allocate their resources to activities in which they are more productive. Increasing openness through trade is also found to have a dynamic benefit in that it drives increased domestic productivity through greater competition and contestability. The complexity in capturing this through economic modelling may therefore lead to an underestimation of the benefits of trade.

Domestic policies may reduce trade flows between countries and the associated benefits. The most common policy measures are tariffs, tariff rate quotas (TRQs) and subsidies, but can also include complex regulations (for example, health and safety, packaging, labelling and product regulations) and customs procedures. These restrict free trade, which distorts the market price, lowering competition and reducing choice for consumers.

Given the benefits of free trade, liberalisation generally has a positive impact on GDP and citizens' welfare. However, changes in the pattern of trade does lead to some sectors expanding and some sectors declining in response to increased international competition.

## Wales as a trading nation

Trade is a vital part of ensuring the prosperity of Welsh people through fuelling the economy, generating jobs and providing choice for consumers at the most competitive prices. According to latest data, goods exports make up a considerable part of the Welsh economy, equivalent to nearly 23% of Welsh GDP in 2018.

International exports provide an important market for Welsh firms, and imports provide inputs to businesses and goods for consumers, keeping prices down and increasing choice. In 2019, Welsh goods exports were £17.8bn and in 2018 service exports were £7.4bn. 61% of goods exports went to the EU and 41% of services exports went to the EU.

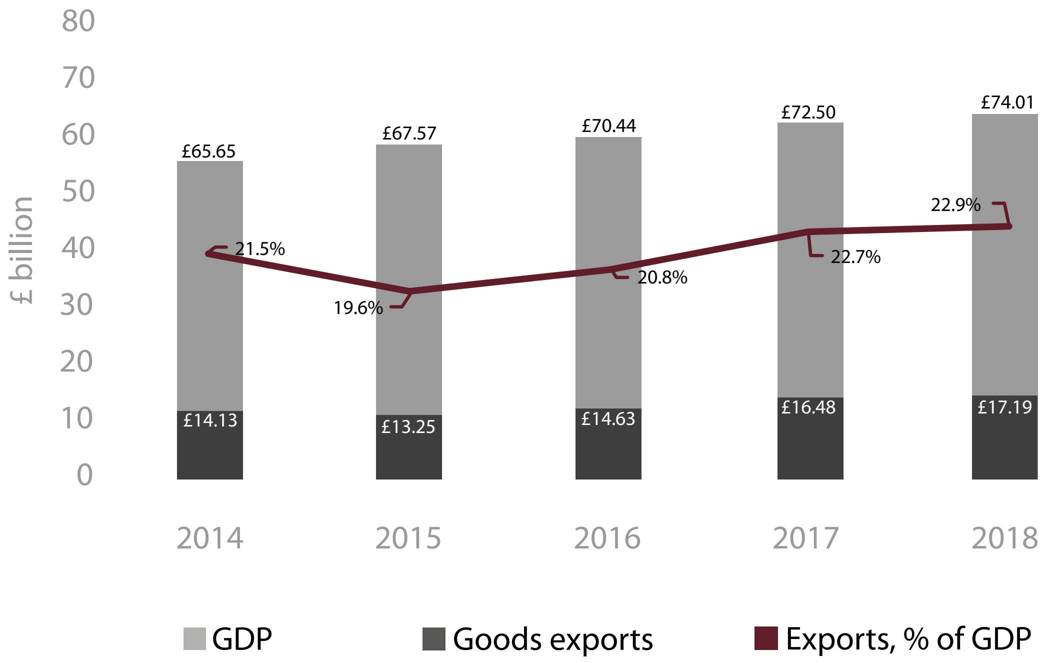
Over the last 5 years, goods exports have on average, consistently accounted for a higher proportion of GDP for Wales than any other part of the UK.This suggests Wales may be more exposed to economic shocks from changes in trading relationships than elsewhere in the UK.

### Table 1 – Goods exports as % of GDP for UK countries (5 year average)

| | Goods exports as % of GDP (2014-18 average) |
|---|---|
| Wales | 21.5 |
| Scotland | 18.2 |
| Northern Ireland | 17.2 |
| United Kingdom | 14.8 |

Source: WG analysis of ONS and HMRC RTS

### Chart 1 – Wales' goods exports as % of GDP (2018)




Source: WG analysis of ONS and HMRC RTS

This is particularly the case in the context of EU exit, given Wales is the most dependent parts of the UK in terms of the EU export market, with 60.4% of all Welsh goods exports heading there in 2019.

**Table 2 – Goods exports to the EU by UK country, 2019 (£bn and %)**

| | Goods Exports to EU (£bn) | EU exports as % of all international goods exports |
|---|---|---|
| Wales | £10.8 bn | 60.5 |
| Northern Ireland | £5.4 bn | 59.0 |
| Scotland | £16.7 bn | 49.5 |
| UK | £168.5bn | 48.4 |

Source: HMRC Regional Trade in Goods, 2019

Recent analysis of Wales' comparative advantage in goods, suggests Wales' top exporting strengths lie within transport equipment, Power generating machinery and equipment, and Iron and steel.

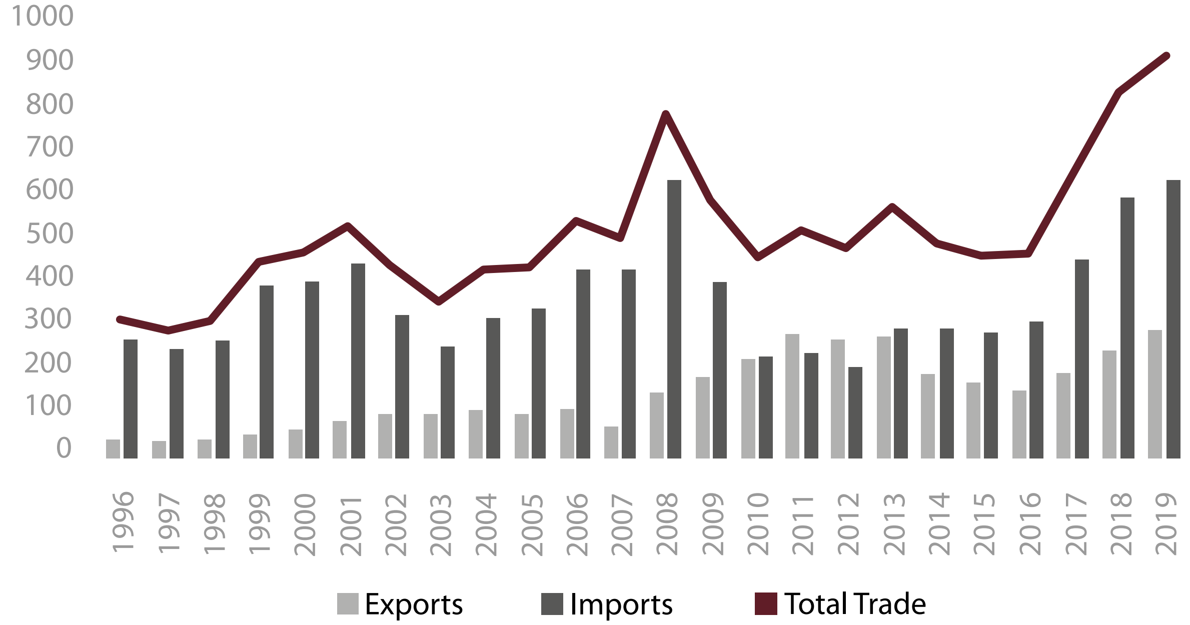
In comparison, Japan is found to have a specialisation in 'Other machinery and equipment', 'motor vehicles and parts' and 'chemicals, rubber and plastic products'[9].

The similarities across key areas of specialisation for both countries suggests increased competition within these sectors is likely, driving productivity gains which could be beneficial for consumers but less so for producers in these sectors. Having said that, whilst the broad sectors of specialisation may be similar, lack of detailed product level data means we are currently unable to identify whether the specific products produced by each country are economically complementary or not.

## Trade between Wales and Japan

Japan accounts for 2.6% of Welsh total trade in goods. In 2019, Wales had a trade deficit of just over £343m with Japan, with Welsh goods exports to Japan valued at nearly £296m and imports from Japan valued at just over £639m.

**Chart 2 – Trade in goods between Wales and Japan (£m)**




Source: HMRC RTS (https://www.uktradeinfo.com/Statistics/BuildYourOwnTables/Pages/Table.aspx)

Note: Due to methodology changes, pre-2013 data is not comparable to post-2013 data.

9 DIT calculations (2020)

In 2019, Japan was the 11th largest export market for Wales accounting for around 1.7% of Welsh exports of goods, and the 6th largest import market with around 3.5% of Wales' total goods imports coming from Japan

**Wales' top 5 goods export sectors to Japan (2019):**

- Power generating machinery and equipment – £121.5m
- Non-ferrous metals – £37.3m
- Electrical machinery and appliances and parts thereof – £25.6m
- Professional, scientific and controlling ins – £24.6m
- General industrial machinery and equipment – £15.5m

**Wales' top 5 goods import sectors from Japan (2019):**

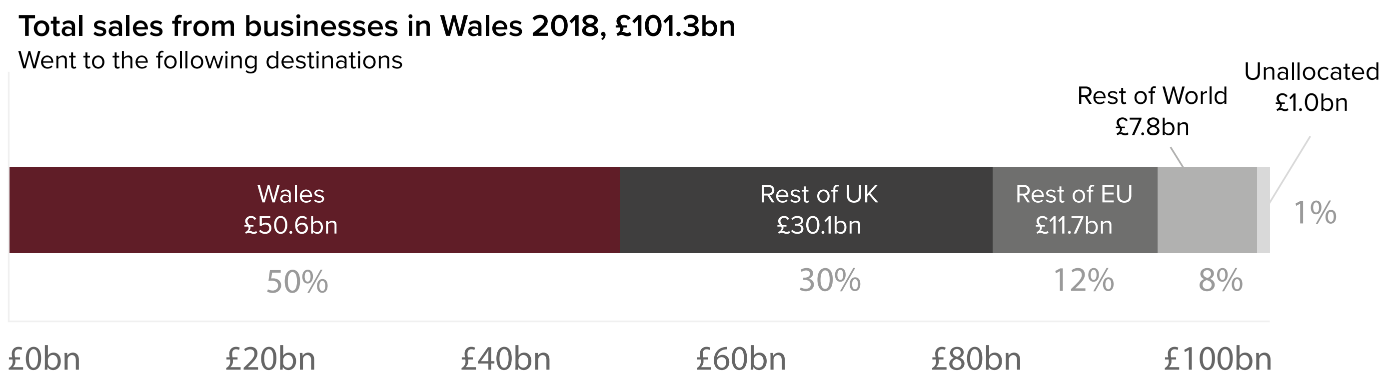
- Metalliferous ores and metal scrap – £210.4m
- Coal, coke and briquettes – £79.7m
- Electrical machinery and appliances and parts thereof – £68.8m
- Power generating machinery and equipment – £61.4m
- Road Vehicles (including air cushion vehicles) – £53.7m

Latest estimates of Welsh trade in services show imports and exports of services were valued at £5.3bn and £7.4bn respectively in 2018. No country breakdown is currently available, therefore it is not possible to estimate the value of Welsh trade in services with Japan.

## Indirect trade through other parts of the UK

In addition to the direct impact on Welsh businesses, there will also be indirect impacts through supply chains. Given the close proximity to the border with England, the Welsh economy is deeply embedded within the wider UK economy and plays a key part in UK supply chains. Latest experimental estimates from our Trade Survey for Wales indicate that 30% (£30.1bn) of the value of all sales from businesses in Wales went to the rest of the UK, of which 82% (£24.6bn) of these sales were made to England. This suggests Wales could also be exposed to impacts which are not captured by the CGE results, given the cross-border nature of supply chains.

**Figure 1 – Total Welsh Sales by destination (2018)**




Source: Trade Survey for Wales 2018

(a) Businesses making sales in 2018 (1,003).

Having said that, this also reinforces the trade gravity theory that suggests countries trade with partners who are geographically closest to them, and highlights the relatively limited impact securing a free trade agreement with such a geographically distant country such as Japan can truly have on Welsh trade.

## Computable General Equilibrium (CGE) modelling results

The scale of the macroeconomic and sectoral impacts is estimated using external Computable General Equilibrium (CGE) modelling undertaken on behalf of the Department for International Trade by CEPR (Professor Joseph Francois). Further details on the methodology can be found in Annex A of DIT's full impact assessment available here (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/929059/final-impact-assessment-UK-Japan-comprehensive-economic-partnership.pdf).

### UK, Wales and Japan Macroeconomic impacts

The macroeconomic impacts estimated using the CGE model are summarised in table 3. The impacts indicate that a combination of increased competitiveness of exports, increased competition from firms and price changes are expected to drive productivity gains in the UK and Japan. These can, in turn, lead to an expected long run increase in GDP, welfare and trade compared to the baseline. While the analysis draws on robust evidence and the best tools available for this type of analysis, there is inherent uncertainty in the results meaning they should be interpreted with caution and not considered economic forecasts for the UK economy.

**Table 3 – Summary of estimated long-run[10] macroeconomic impacts of UK-Japan CEPA compared to baseline**

| Impact | Metric | UK | | Japan | |
|---|---|---|---|---|---|
| | | % | £ | % | £ |
| **GDP** | Change in GDP | 0.07 | £1.5bn | 0.03 | – |
| **Trade** | Change in UK exports to Japan | 17.20 | – | 79.94 | – |
| | Change in UK imports from Japan | 79.94 | – | 17.20 | – |
| | Change in total UK exports | 0.58 | – | 0.50 | – |
| | Change in total UK imports | 0.51 | – | 0.50 | – |
| **Wages** | Change in real wages | 0.09 | £0.8bn | – | – |

Source: DIT modelling (2020)

10 The long run is generally assumed to mean 15 years from implementation of the agreement.

Given the complexity of producing robust estimates at lower levels of aggregation, CGE modelling results have only been provided at the Wales level showing the estimated change to Gross Value Added (GVA) compared to the baseline. These results have been produced by apportioning the UK level results to each UK nation based on employment.

In addition further analysis has been undertaken to estimate the impact of tariff reductions at the Wales level compared to trading with Japan on WTO terms. This involves identifying the proportion of tariff reductions on imports and exports that Wales will benefit from, along with estimating the overall impact of those tariff reductions on Welsh households.

**Table 4 – Estimated long run Impacts of UK-Japan CEPA on Wales**

| Estimated impact on Welsh GVA % (£m) | Estimated tariff reductions on Welsh exports to Japan 2.2% of UK tariff reductions | Estimated tariff reductions on Welsh imports from Japan | Estimated annual tariff reductions, all households, £m |
|---|---|---|---|
| 0.05% (£34m) | 2.2% of UK tariff reductions | 3.8% of UK tariff reductions | £4m |

Source: DIT modelling and calculations (2020)

### GVA Impacts

Based upon the pattern of estimated sectoral GVA changes the results suggest that the UK-Japan CEPA could increase GVA in all nations and regions of the UK, with the estimated long run impact on Wales' GVA found to be between 0.05% and <0.15%. This is similar to other nations and regions of the UK.

DIT have also provided point-estimates for the percentage change of GVA for Wales and the associated monetary value (table 5). This is intended to provide an indicative order of magnitude, based on nominal levels of GVA in 2017, which for Wales would be a gain of around £34m. Given the limitations associated with this approach and the overall uncertainty, these should be interpreted with caution and as indicative magnitudes rather than precise estimates or forecasts.

**Table 5 – Indicative change in regional value added, long run % and value changes, 2017 current prices**

| | Indicative GVA Impact % | Indicative GVA Impact £million |
|---|---|---|
| East of England | 0.06 | 96 |
| East Midlands | 0.08 | 82 |
| London | 0.09 | 398 |
| North East | 0.03 | 14 |
| North West | 0.04 | 64 |
| South East | 0.07 | 177 |
| South West | 0.07 | 90 |
| West Midlands | 0.04 | 56 |
| Yorkshire and The Humber | 0.06 | 76 |
| Northern Ireland | 0.06 | 24 |
| Scotland | 0.07 | 101 |
| Wales | 0.05 | 34 |

Source: DIT calculations (2020)

### Sector Impacts

The economy of each nation of the UK is made up of a different composition of sectors, therefore there are likely to be differences in how each one is affected by trade agreements – particularly in terms of output and employment. For example, the UK's steel production is concentrated in Wales, therefore any impacts (either positive or negative) on this sector are likely to be disproportionately felt in Wales compared to other parts of the UK. Worth noting that steel is included in the Manufactures sector in Table 6, which is found to be positively impacted with an increase of between 0.05% to <0.5% of GVA expected.

Whilst no estimates are available showing the impacts on Wales' sectors, this information is available at the UK level and can be used to infer the broad magnitude of impacts for Wales. Table 6 outlines the estimates by sector at the UK level.

### Table 6 – Changes in UK outputs (GVA, long run % change); detailed sector impacts

| | Sector | Sector GVA Share[110], % | GVA change |
|---|---|---|---|
| Agri-food | Agriculture, forestry, and fishing | <1 | + |
| | Semi-processed foods | <1 | + |
| | Other processed foods | <1 | + |
| | Beverages and tobacco products | <1 | + |
| Industry | Energy | 3 | + |
| | Textiles, apparel, and leather | <1 | ++ |
| | Manufactures | 2 | + |
| | Paper and printing products | 1 | + |
| | Chemical, rubber, plastic products | 2 | -- |
| | Manufacture of motor vehicles | <1 | - |
| | Manufacture of other transport equipment | <1 | + |
| | Manufacture of electronic equipment | <1 | |
| | Manufacture of machinery and equipment n.e.c. | 1 | |
| | Manufacturing n.e.c. | <1 | + |
| Services | Other services (transport, water, dwellings) | 5 | + |
| | Construction | 6 | + |
| | Wholesale and retail trade | 14 | |
| | Communications | 2 | + |
| | Financial services | 5 | + |
| | Insurance | 1 | + |
| | Business services | 29 | + |
| | Personal services | 4 | + |
| | Public services | 20 | |

**Key**

| | | | | |
|---|---|---|---|---|
| Above 0.5% (++) | 0.05 to <0.5% (+) | -0.05 to <0.05% | -0.05 to <0.5% (-) | Below -0.5% (--) |

Source: DIT modelling (2020)

110 - DIT calculations using ONS GVA output approach (2019 prices).

### Tariff Reductions

Reductions in tariffs on goods traded between the UK and Japan is likely to boost the flow of trade between both countries, both by increasing the value of trade from experienced traders and encouraging new exporters to trade with Japan. The modelling estimates a 17.2% (equivalent to £2.6bn) increase in UK exports to Japan and a 79.94% (equivalent to £13.0bn) increase in UK imports from Japan.  Whilst it's not possible to estimate the increase in trade between Wales and Japan, we do know that Wales makes up 4% of the UK's total goods exports to Japan and 7% of the UK's total goods imports from Japan. Additional analysis indicates that Wales reaps disproportionately less of the tariff reduction compared to its share of both imports and exports (3.8% long term tariff reduction on imports compared to a 7% proportion share of imports, and a 2.2% long term reduction on exports compared to a 4% proportion share of exports). This is most likely due to the fact that the goods Wales specialises in exporting and importing from Japan are either already facing low tariffs or are those that won't be subject to large tariff reductions as part of the agreement.

**Table 7 – Shares of potential tariff reductions on UK exports to Japan, by nations and regions of the UK**

| Region | Proportion of goods exports to Japan, % | Proportion of tariff reduction affecting each nation and region, % | |
|---|---|---|---|
| | | Short term | Long term |
| London | 9 | 17.6 | 17.4 |
| Scotland | 8 | 15.9 | 16.1 |
| East of England | 14 | 11.9 | 12.4 |
| South East | 23 | 10.7 | 9.8 |
| Yorkshire and The Humber | 3 | 10.2 | 9.9 |
| North West | 7 | 8.7 | 8.6 |
| East Midlands | 9 | 7.4 | 8.5 |
| North East | 5 | 6.6 | 6.1 |
| South West | 9 | 4.4 | 4.4 |
| West Midlands | 8 | 3.3 | 3.2 |
| Wales | 4 | 2.4 | 2.2 |
| Northern Ireland | 1 | 1.0 | 1.4 |

Source: DIT Calculations (2020). Columns may not sum to 100% due to rounding

**Table 8 – Shares of potential tariff reductions on UK imports from Japan, by nations and regions of the UK**

| Region | Proportion of goods imports from Japan, % | Proportion of tariff reduction affecting each nation and region, % | |
|---|---|---|---|
| | | Short term | Long term |
| South East | 21 | 20.4 | 20.5 |
| East Midlands | 13 | 14.8 | 14.8 |
| North East | 11 | 12.2 | 12.1 |
| East of England | 10 | 10.7 | 10.9 |
| South West | 10 | 9.2 | 9.3 |
| West Midlands | 9 | 7.1 | 7.3 |
| London | 8 | 6.5 | 6.4 |
| North West | 4 | 5.8 | 5.6 |
| Scotland | 4 | 5.4 | 5.2 |
| Wales | 6 | 3.9 | 3.8 |
| Yorkshire and The Humber | 2 | 2.4 | 2.4 |
| Northern Ireland | 2 | 1.9 | 1.8 |

Source: DIT Calculations (2020). Columns may not sum to 100% due to rounding

### Consumer impacts

The provisions set out in the UK-Japan CEPA aim to benefit UK consumers through increased consumer choice, better product quality and lower prices for imported products. Having said that, the extent to which consumers will benefit from tariff reductions will depend on the rate at which those savings in terms of lower import costs will be passed onto the end consumer.

Given variations in spending patterns across the UK, it is expected that some households will benefit more than others. Table 9 shows the estimated potential value of annual tariff reductions in the long term for each UK nation (compared to the WTO alternative) by apportioning tariff reductions to weekly household estimated spending on imports in each nation. This shows that Wales imports around 7% of the UK's total imports from Japan, and is likely to benefit from tariff reductions of around £4m over the long term.

### Table 9 – Potential tariff reductions from a UK-Japan CEPA by UK nation

| | UK | England | Wales | Scotland | Northern Ireland |
|---|---|---|---|---|---|
| Estimated annual tariff reductions, all households, £ million | 92.5 (100%) | 76.9 (83%) | 4.0 (4%) | 7.5 (8%) | 2.2 (2%) |
| Proportion of UK imports from Japan, 2019, % | 100 | 83 | 7 | 4 | 2 |

Source: DIT modelling (2020)

Table 10 shows the proportion of an average households' weekly expenditure that is spent on imports of different types of good by combining UK household expenditure survey data with UK Input-Output Analytical Tables (IOATs)[11]. Overall households across the UK have a broadly similar demand for imported goods. Welsh households on average spend 25.5% of their weekly household spending on imported goods – marginally more than Scottish and English households but slightly less than Northern Irish households.

Breaking this down by sector shows that the largest long run tariff reductions are in recreation and culture (including sports, and pets), and Transport goods. Compared with the UK average, Welsh households spend a higher proportion of their total weekly household expenditure on consumer goods within these sectors. This suggests Welsh households may benefit marginally more than the average UK household as a result of the tariff reductions in these sectors.

### Table 10 – Comparison of potential tariff reductions from a UK-Japan CEPA to average UK household weekly expenditure by nation

| Type of Consumer Good | Estimated national annual tariff reductions, £ million | | Estimated proportion of total weekly household spend owing to imports, % | | | | |
|---|---|---|---|---|---|---|---|
| | Short term | Long term | UK | England | Wales | Scotland | Northern Ireland |
| **All expenditure groups** | **43.1** | **92.5** | **24.4** | **24.2** | **25.5** | **24.9** | **26.5** |
| Recreation and culture | 16.6 | 41.1 | 2.8 | 2.8 | 2.9 | 3.0 | 2.3 |
| Transport | 16.2 | 40.5 | 4.4 | 4.4 | 4.6 | 4.3 | 4.5 |
| Clothing and footwear | 3.5 | 3.5 | 3.2 | 3.2 | 3.3 | 3.3 | 4.4 |
| Food and non-alcoholic beverages | 2.6 | 2.6 | 6.2 | 6.1 | 6.6 | 6.4 | 7.3 |
| Furnishings, household equipment and routine household maintenance | 1.7 | 2.0 | 3.8 | 3.8 | 4.1 | 3.7 | 3.4 |

Source: DIT analysis (2020), UK input-output analytical tables, ONS (2019) and Living Costs and Food Survey (LCF), ONS (2019))

11 ONS, UK input-output analytical tables- industry by industry (April 2020)

### Impact on Small and Medium Enterprises (SMEs)

Small and Medium Enterprises (SMEs) represent a key component of the Welsh economy; in 2019 these made up around 99.4% of the total number of private sector businesses, representing 62.4% of private sector employment and 37.9% of private sector turnover. With the exception of employment, SMEs make up a slightly smaller proportion of these components in Wales compared with the UK as a whole. This indicates that Wales is slightly more reliant on larger businesses for private sector turnover but is more reliant on SMEs for employment, than the UK. In addition, latest data from BEIS' Longitudinal Small Business survey (https://www.gov.uk/government/statistics/small-business-survey-2019-businesses-with-employees) shows that in 2019, Wales had the lowest proportion of exporting SMEs across the UK with some 13% exporting goods or services compared to a UK average of 20%. This difference is found be to be driven by exports of services, with a much smaller proportion of SMEs in Wales exporting services than the UK average. The proportion of Welsh SMEs exporting goods is similar to the UK average.

SMEs generally operate at a small scale and therefore tend to face higher trading costs relative to output. This means that they can be disproportionately affected by trade barriers. This would help explain why SMEs tend to display a lower propensity to export relative to larger firms. Provisions aimed at improving trade facilitation for SMEs could help reduce the costs that these businesses face and thereby positively impact their propensity to export.

SMEs have reported issues relating to limited information about how foreign markets work, difficulties in accessing export-distribution channels and in contacting overseas customers. In addition, SMEs reported costly product standards and certification procedures, and a lack of information about requirements in the foreign country as barriers to trade.

### Environmental impacts

A bilateral trade agreement with Japan is expected to increase UK production in the long run which is expected to impact the environment by expanding economic activity, shifting economic output between more and less energy-intensive sectors, and through efficiency gains and technological progress.

The economic analysis suggests that changes in UK trading patterns will cause a shift from more to less Green House Gas (GHG) emissions intensive sectors. For example, the agreement is expected to reduce production in GHG emission intensive sectors such as agriculture (which would grow less than the national output), manufacturing (which would see a decrease in output) and other services (which would see its production grow less than the national output) whereas less GHG emission intensive sectors such as financial and insurance services and business services are expected to grow more than the national output.

Modelled estimates suggest that the change in production of 0.07% due to freer trade may result in an increase of 0.028% for both GHG emissions and energy consumption from fossil fuels. The change in the composition of the economy as a result of the UK-Japan CEPA and the improvement to processes expected to be made to meet policy requirements helps mitigate the negative environmental impact of the overall increase in trade.

Overall, the analysis suggest the UK-Japan CEPA is not expected to have significant impacts on Greenhouse gas emissions ($CO^2$ and Non-$CO^2$), energy usage, trade-related transport emissions and wider environmental impacts such as air quality, biodiversity, and water use/quality.

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