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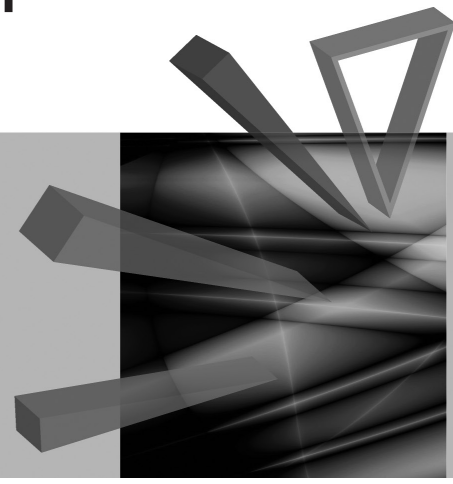

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# THE EUROPEAN UNION AND JAPAN – ON THE WAY TO A FREE TRADE AGREEMENT

**Abstract:** In 2006 the European Commission accepted a strategy "Global Europe" which presented the priorities of the EU's commercial policy. According to the strategy the EU plans to conclude a series of bilateral agreements with main trade partners, including Japan. In March 2013 the EU and Japan officially launched the negotiations for a free trade agreement. The objective of the article is to present general expectations and motives of both partners for starting negotiations on the FTA. As the Japanese side expects to secure more advantageous access for manufactured products to European market, the EU perceives the agreement as an opportunity to improve access to the Japanese market of agricultural products, food and specific manufactures. Amid the European priorities are also trade in services, FDI rules, public procurement as well as competition policy.

**Keywords:** European Union, Global Europe, Japan, free trade agreement (FTA), EU-Japan FTA negotiations.

## 1. Introduction – EU's trade regionalisation

The previous two decades have been a period of increasing importance of preferential bilateral and regional agreements within the framework of the international trade system. In spite of the declarations of the major global trade players, avowing their attachment to a multilateral system embodied by the World Trade Organisation (WTO), the number of bilateral agreements has been snowballing. The growing number of RTAs (mostly in the form of free-trade areas) concluded after the year 2000 by the major trade partners of the EU, including many Asian countries, combined with the lack of clear progress in developing the final shape of the Doha Development Round has induced the EU to redefine its strategic goals with respect to the Common Commercial Policy.[1] The particular shift of accents in cooperation

[1] J. Kaczurba, Dylematy obecnej polityki handlowej Unii Europejskiej, [in:] E. Kawecka-Wyrzykowska (Ed.), *Unia Europejska w gospodarce światowej – nowe uwarunkowania*, Szkoła Główna Handlowa w Warszawie – Oficyna Wydawnicza, Warszawa 2007.

was manifested in the 2006 EC Communication *Global Europe – Competing in the World* which presented the priorities of the EU's commercial policy in the nearest future. Among the chief elements of the new strategy it mentioned bilateral trade agreements which should acquire a new shape and dimension in the system of trade connections between the EU and its major trade partners.[2]

As an aftermath of the proposed new EU's trade strategy, the European Commission has initiated in recent years a series of trade negotiations on bilateral trade agreements (FTAs) with third countries, including among others many trade partners in Asia. The first comprehensive agreement of "new generation FTAs" was concluded and signed in 2010 with South Korea.[3] In 2012 the EU completed also FTA negotiations with Singapore and many others are under discussion, among others with India, ASEAN countries (Malaysia, Thailand and Vietnam), Canada, Mercosur, GCC[4] countries and ACP states (negotiations on Economic Partnership Agreements).[5] Becoming increasingly aware of the importance of East Asia (in terms of size and dynamics) in the global economy the European Commission launched officially also in March 2013 negotiations for a free trade agreement with Japan.[6]

## 2. Japan as a trade and investment partner of the European Union

Japan as one of the biggest and highly developed economies of the world has been a historically important trade and investment partner for the European Union. The economic size of the Japanese economy amounted in 2012 to 5963 billion USD and it is almost equal to the combined potential of Germany and France – the biggest economies of the European Union. As a country with GDP *per capita* at the level of 46 735 USD (2012) Japan also belongs to a group of highly developed and industrialized economies of the world, including i.a. G-8.[7] The Japanese GDP is produced in the services sector (72.7%; 2011), followed by industry (26.2%) and agriculture with a share of only 1.2% of GDP.[8] Although the lion's share of economy

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[2] European Commission, *Global Europe: Competing in the World*, Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, COM(2006) 567 final, Brussels, 4.10.2006.

[3] The EU-South Korea entered into force in July 2011.

[4] Gulf Cooperation Council: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates.

[5] The EC plans also to start in mid-2013 negotiations on an ambitious free-trade deal with the United States.

[6] European Commission, *Challenge and Opportunity: Starting the Negotiations for Free Trade Agreement between the EU and Japan*, 25.03.2013, http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150791.pdf.

[7] IMF, *World Economic Outlook Database*, April 2013, http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/index.aspx.

[8] European Commission, *Japan – Trade Statistics*, DG Trade, 2.05.2013, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111836.pdf.

is created by services, Japan has still a strongly developed and competitive industrial sector. Japan is the world's third largest car manufacturer (almost 10 million vehicles in 2012[9]), after China and the USA, as well as the world's biggest producer of consumer electronic goods. The country is also home for 68 international corporations classified in the list of 500 biggest global corporations.[10] The Japanese economy has been also recognized as one of the most innovative – expenditure on research and development in 2009 amounted to 3.36% GDP.[11]

The economic potential and high competitiveness of Japanese goods make the country a world scale trader and investor. The value of exported goods from Japan amounted to 822 564 million USD in 2011, which makes this country world's fourth biggest exporter (4.51% of the world total export, 2011). The most important export markets for Japan are China (19.7% of total export), the United States (15.5%), the European Union (11.7%), South Korea (8.0%) and Taiwan (6.2%). The Japanese export focuses strongly on manufactured goods, constituting 88.2% of the total export value (1.3% for agricultural products; 4.6% for fuels and mining products) Japan is also a significant importer (the 4th in the world) of goods with the value of 854 998 million USD (4.64 % of the world total import, 2011). The biggest import partners are China (21.5%), the European Union (9.4%), the United States (8.9%), Australia (6.6%) and Saudi Arabia (5.9%). The main imported commodity groups are manufactures (47%), fuels and mining products (40.1%).[12]

Japan is also an important source of foreign direct investments in many both developed and developing countries. According to investment promotion agencies Japan was ranked the 6th most promising investor home economy in the world in 2012–2014 and the 2nd in Asia, after China.[13] As a home for many world scale international corporations and appreciation of Japanese yen, Japan was in 2012 the 2nd largest investor in the world, after the USA. The total value of FDI flows from Japan amounted to 122.5 billion USD (2012). Contrary to this Japan is a modest place for hosting FDI, attracting in 2012 only 2.1 billion USD of FDI – one of the lowest levels among developed economies.[14]

Japan's position as one of the most important trade partners of the European Union is linked to trade and investment potential of its economy. In 2012 Japan was ranked as the 7th biggest trade partner of the European Union with a share in EU total

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[9] Organisation Internationale des Constructeurs d'Automobiles, *World Motor Vehicle Production by Country and Type 2012*, http://oica.net/wp-content/uploads/total-2012.pdf.

[10] Global 500 in 2012, *Fortune*, http://money.cnn.com/magazines/fortune/global500/2012/countries/Japan.html.

[11] World Bank, *World Bank Databank 2013*, http://data.worldbank.org/indicator/GB.XPD.RSDV.GD.ZS?order=wbapi_data_value_2011+wbapi_data_value+wbapi_data_value-last&sort=asc.

[12] World Trade Organization, *Trade Profiles 2012*, WTO Publications, Geneva 2012.

[13] UNCTAD, *World Investment Report 2011. Towards a new generation of investment policies*, United Nations Publication, 2012.

[14] OECD, *FDI in Figures*, April 2013, http://www.oecd.org/daf/inv/FDI%20in%20figures.pdf.

trade of 3.4% (respectively 3.6% and 3.3% of total import and total export). The importance of the EU among main Japanese trade partners is asymmetrically higher. The European Union is the 2nd import partner of Japan (after China) and the 3rd biggest export market for Japanese goods (Table 1).

**Table 1.** Main trade partners of the EU and Japan (% of total trade)

| European Union (2012) | | | | Japan (2011) | | | |
|---|---|---|---|---|---|---|---|
| Import | | Export | | Import | | Export | |
| China | 16.2 | USA | 17.3 | China | 22.1 | China | 21.0 |
| Russia | 11.9 | China | 8.5 | **EU-27** | **9.7** | USA | 16.6 |
| USA | 11.5 | Switzerland | 7.9 | USA | 9.2 | **EU-27** | **12.4** |
| Switzerland | 5.8 | Russia | 7.3 | Australia | 6.8 | South Korea | 8.5 |
| Norway | 5.6 | Turkey | 4.5 | Saudi Arabia | 6.1 | Hong Kong | 5.6 |
| **Japan** | **3.6** | **Japan** | **3.3** | UAE | 5.1 | Thailand | 4.8 |
| Turkey | 2.7 | Norway | 3.0 | South Korea | 4.8 | Singapore | 3.5 |
| South Korea | 2.1 | Brazil | 2.3 | Indonesia | 4.1 | Malaysia | 2.4 |
| India | 2.1 | India | 2.3 | Malaysia | 3.7 | Australia | 2.3 |
| Brazil | 2.1 | South Korea | 2.2 | Qatar | 3.6 | Indonesia | 2.3 |

Source: European Commission, *Japan – Trade Statistics*, DG Trade, 2.05.2013, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111836.pdf, based on Eurostat data.

The total value of bilateral trade in goods between the European Union and Japan amounted to 119 303 million EUR (Figure 1). The EU countries exported in 2012 to Japan goods of the value of 55 490 million EUR, importing at the same time goods of the value of 63 813 million EUR. In 2008–2012, the EU export to Japan grew at an average annual rate of 7%, while import declined an average of 4.3% per year. This has resulted in declining deficit of the European Union in trade with Japan from 33 830 million EUR in 2008 to only 8 323 million EUR in 2012 – the lowest level for more than three decades. The EU export to Japan concentrates strongly on machinery and transport equipment[15] (34.8% of the total EU exports to Japan), chemicals and related products (26.1%) and miscellaneous manufactured articles (16.7%). As far as European import from Japan is concerned, the lion's share goes to machinery and transport equipment section (64.6%).[16]

The EU trade deficit with Japan in trade of goods has been traditionally offset by equivalent EU surplus in trade of services. In 2011 the EU countries exported to Japan services of the value of 24.1 billion EUR, importing at the same time from this country services for 15.5 billion EUR. As far as direct investment flows are concerned,

[15] Product groups according to SITC Rev. 3.

[16] European Commission, *Japan. EU bilateral trade and trade with the world*, DG Trade, 5.07.2013, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113403.pdf.

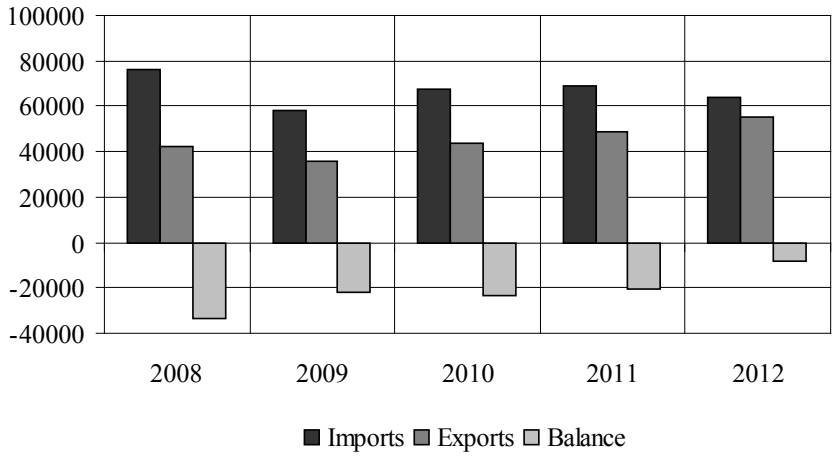


**Figure 1.** EU trade in goods with Japan in 2008–2012 (millions EUR)

Source: European Commission, *Japan – Trade…*, based on Eurostat data.

a different trend was observed. The EU countries hosted 12.1 billion EUR (2011) of Japanese FDI and outward investments amounted only to 2.4 billion EUR, which resulted in FDI flows deficit of 9.7 billion EUR.[17]

## 3. EU-Japan negotiations – towards a free trade agreement

Economic importance and mutual interests of both partners as well as growing pressure on bilateralisation of trade relations around the world have persuaded the EU and Japan to redefine the nature of their relationship and create a new historical perspective for economic co-operation model. At the summit held on 28 May 2011 in Brussels, commemorating the 20th anniversary of EU-Japan summits, the representatives of both sides agreed to redefine and strengthen the framework of their co-operation. They announced that the European Union and Japan would start negotiations for "a deep and comprehensive Free Trade Agreement (FTA)/Economic Partnership Agreement (EPA), addressing all issues of shared interest to both sides including tariffs, non-tariff measures, services, investment, Intellectual Property Rights, competition and public procurement."[18] To this end both parties agreed to conduct a joint definition of the scope and level of ambition and the European Commission declared to seek the necessary authorization from the Council to start the negotiations with Japan.[19]

[17] European Commission, *Japan – Trade…*

[18] Council of the European Union, *20th EU-Japan Summit Brussels 28 May 2011, Joint Press Statement*, Presse 162 – 11015/11, Brussels, 28 May 2011.

[19] *Ibidem*.

As the aftermath of the above announcement and the successful completion of the scoping exercise, defining among others a number of non-tariff barriers and other obstacles considered by the EU in accessing the Japanese market, the Council adopted in November 2012 a decision authorizing the European Commission to open negotiations. According to the Council's decision negotiations on the new free trade agreement would be conducted parallelly to negotiations on a broader bilateral framework agreement with Japan, covering political, global and sectoral cooperation.[20] The negotiations were officially launched in a teleconference of leaders on 25 March 2013 and the first round of talks was held one month later in Brussels. The first official round of talks was an occasion to discuss the scope and procedures of negotiations.[21]

Both parties, joining the negotiations on the new comprehensive agreement, have their own interests and priorities to be settled within the new trade framework. Both economies, facing the problem of economic crisis and relatively low level of economic activity in reference to GDP growth, recognize the new agreement as a significant incentive for trade and investment expansion and thereby faster economic growth. Although the level of mutual tariff quotas is relatively low nowadays, there are still many obstacles to utilize mutually full potential of business and economic capability of both parties.

Japanese side perceives the new agreement as an opportunity to secure access to European market on manufactured goods that still face tariffs when entering the EU. Only 35.9% of Japanese products imported to the EU market is duty-free (against 68.7% EU products imported to Japan) and the average customs tariffs (3.4%) is higher than in the opposite direction (1.7%).[22] Thus, Japanese negotiators will focus in their negotiations mainly on tariff elimination for products of a great importance to Japanese export to the EU (e.g. motor vehicles, electronics and machinery). It is a crucial issue for the Japanese industrial sector, particularly after the EU and South Korea concluded and introduced the EU-Korea FTA in 2011 – a first agreement of this kind with an Asian partner. Japanese car manufactures, due to the abolishment of previous tariffs on the EU car imports from South Korea, have been facing a new competition on the EU market with Korean rivals (e.g Hyundai) and complain that they are being disadvantaged by the new rules.[23] In this context, the representatives of Japanese industrial sector, including most of the country's car producers, strongly support the new agreement to secure and provide more advantageous access to the EU's 500-million-consumer market for their products.

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[20] Council of the European Union, *Foreign Affairs Trade 3203rd Council meeting*, Presse 498 – 16943/12, Brussels, 29 November 2012.

[21] *Japan, EU to kick off first round of trade talks on April 15*, DPA 2013, http://en.europeonline-magazine.eu.

[22] Foreign Trade Association, *EU-Japan Trade Negotiations. Position paper*, May 2013, www.fta-intl.org.

[23] A. Fensom, A Japan-EU free trade deal?, *The Diplomat* 5.03.2013, http://thediplomat.com.

From the opposite perspective, also the European Union has a lot of arguments for concluding the new free trade agreement. Although the European export enters the Japanese market under relatively low tariffs, it still encounters many non-tariff barriers which are recognized by most of studies and public consultations as a major barrier to EU exports to Japan. The EU side argues that European exporters and investors cannot fully utilize the potential of Japanese market due to trade impediments preventing a higher degree of economic cooperation. Among the main obstacles for European business when entering and operating the Japanese market are: "unfair competition rules, strict licensing system and restrictive issuing of permits, poor quality standards for food products, punitive tariffs and quotas on liquors and leather footwear or complex procedures for outlet opening."[24] All of them account for the fact that the country still remains closed, especially for agricultural products, some transport equipment and aeronautical products. The mentioned non-tariff barriers affect mostly those business sectors which cover the lion's share of the EU export, i.e. processed foods, chemicals (including pharmaceuticals), medical devices, automotive and transport equipment, telecommunication and financial services.[25] According to a survey conducted in 2009 among 120 European firms exporting to and operating in Japan within the above mentioned sectors, ¾ of the companies perceive the Japanese market as more difficult than other ones. Language barrier, differences in consumer preferences as well as mentioned technical standards and regulatory issues were identified among main difficulties. Additional costs resulting from the indicated barriers increase the cost of exporting to Japan by 10–30%, depending on the sector, and $^{2}/_{3}$ of surveyed companies reduce the variety of exported goods due to existing barriers in access to Japanese market.[26]

In the context of the above-mentioned obstacles difficult negotiations may be expected in liberalization of trade in agricultural products, which is among priorities of the EU negotiators. The Japanese food and agricultural products market has been strongly protected. Among many barriers the most harmful to European exporters are licence regimes (e.g liquor wholesale licencing system), high import surcharges and restrictions (e.g. provisional measures law for processed raw milk) as well as restrictive and protective import permits system demanding detailed scientific analyses and specific formalities. European exporters have also complained that the food quality legislation in Japan is in many cases not compatible with internationally

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[24] Foreign Trade Association, *op. cit*.

[25] European Commission, *Commission Staff Working Document. Impact Assessment Report on EU-Japan Trade Relations Accompanying the document: Recommendation for a Council Decision authorising the opening of negotiations on a Free Trade Agreement between the European Union and Japan*, COM(2012) 390 and SWD (2012) 209, Brussels, 18.07.2012.

[26] E.R. Sunesen, J.F. Francois, M.H. Thelle, *Assessment of Barriers to Trade and Investment between the EU and Japan. Final Report*, Copenhagen, 30 November 2009, http://trade.ec.europa.eu/doclib/docs/2010/february/tradoc_145772.pdf.

recognized standards. The most restrictive measures in import of agricultural products to Japan have been applied to liquors, dairy (frozen) products, rice and soft drinks. Amid other products facing serious barriers when entering the Japanese market should be mentioned leather footwear (restrictive quota system; tax 200% for products imported out of the quota) and perfumes (import and sales licences).[27]

A matter of great importance to the European side has been also the lack of transparency and barriers in the access to public procurement in Japan. The total value of the Japanese market for public procurement in Japan amounted to 565 billion EUR in 2007 (18% of the Japan's GDP) and the additional potential value of this market accessible to foreign companies after abolishing existing access barrier has been quantified at the level of 74 billion EUR[28] – more than three times larger than the market accessible nowadays (estimated at 22 billion EUR). The main sectors affected by access barriers are the construction sector (e.g. building materials), transport equipment sector (e.g. railway equipment, trains and other urban transport equipment) as well as public service sectors (e.g. water treatment). The difficulties faced by European companies may be divided into two groups: problems of market access and problems of rules within the sectors that are formally accessible, but require specific rules hampering the EU companies and placing them at a disadvantageous position. For example "one important market access problem is the difference between the EU and Japan regarding the threshold for construction works. In the EU, this threshold is 5 million SDRs, meaning that contracts above this level are open to foreign bidders. In Japan, only construction works above 15 million SDRs are open to foreign bidders."[29] As far as the problem of rules is concerned, a good example is the so-called "operational safety clause" (sanctioned within the WTO GPA Agreement) used frequently in the procurement of railway equipment for Japan Railways. It has been systematically eliminating foreign suppliers from the competition.[30] Apart from the above, the competition in general, both in public and private sectors, will be among key priorities for the EU negotiators. As Japan lacks foreign competition in the services market and the Japanese legislation has been ambiguous and discriminatory towards foreign companies,[31] the EU as a competitive and large supplier of services has been determined to regulate this issue in the new trade agreement and secure more transparent access for European companies to Japan's market especially in financial services, telecommunications, postal services, air transport, energy and business service.[32]

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[27] Foreign Trade Association, *op. cit*.

[28] Additional profits from granting access only in railway equipment and aircraft are estimated at 2.6 billion EUR.

[29] E.R. Sunesen et al., *op. cit*.

[30] *Ibidem*.

[31] Foreign Trade Association, *op. cit*.

[32] E.R. Sunesen et al., *op. cit*.

## 4. Conclusions

The economic potential of the European Union and Japan make the future free trade agreement one of the most important trade frameworks between developed countries. Many studies and statistics present that bilateral trade and investment links between the parties, although amounting to 120 and 40 billion EUR, respectively (2012), have been recognized as not-fulfilling the potential performance. "The business interests and opportunities are limited by the current level of tariffs and NTMs."[33] The Japanese side expects from the new FTA to secure more advantageous access for manufactured products to European market in the context of growing competition pressure from other countries, including most of all those EU's partners who have already concluded a similar agreement with the EU. On the other hand, the European Union perceives the negotiations and the agreement as a unique opportunity to improve access to the Japanese market of agricultural products, food and specific manufactures. In the negotiations the EU will not only concentrate on eliminating non-tariff barriers to expand the EU's services export but also on the presence – through foreign direct investments – of European companies in Japan. The forecasted impact of the comprehensive EU-Japan free trade agreement indicates that the GDP of partners – the EU and Japan – would increase by 0.8% and 0.7%, respectively. Moreover, the EU export could increase by 32.7%, while Japan's export to the EU would expand by 23.5%.[34] As the trade relations during the last decade have been considered to be below economic potential of both partners, the new agreement should support revitalization and actuation of bilateral trade and investment links.

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[33] European Commission, *Commission Staff…*

[34] *Ibidem*.

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## UNIA EUROPEJSKA-JAPONIA – W KIERUNKU STREFY WOLNEGO HANDLU

**Streszczenie:** Zgodnie z przedstawioną w 2006 r. strategią „Globalna Europa" UE planuje zawarcie dwustronnych porozumień z najważniejszymi partnerami handlowymi, w tym z Japonią. W marcu 2013 r. rozpoczęły się oficjalnie negocjacje pomiędzy UE oraz Japonią, których celem jest wynegocjowanie i zawarcie porozumienia o utworzeniu strefy wolnego handlu. Celem niniejszego artykułu jest zaprezentowanie oczekiwań oraz motywów stron stojących za rozpoczętymi negocjacjami. O ile strona japońska pragnie zapewnić sobie lepszy dostęp do rynku UE dla swoich produktów przemysłowych, o tyle UE postrzega nową umowę jako okazję do poprawy dostępu do rynku Japonii dla swoich artykułów rolnych, żywności oraz specyficznych produktów przemysłowych. Wśród priorytetów UE znajdują się także takie kwestie, jak wymiana usług, BIZ, zamówienia publiczne oraz prawo konkurencji.

**Słowa kluczowe:** Unia Europejska, Globalna Europa, Japonia, strefa wolnego handlu, negocjacje UE-Japonia.