EU-Japan Economic Cooperation

It's Time to Unleash Partnership Power

By Malcolm HARBOUR

Introduction

The global economic crisis has highlighted the interdependency of the world's economies. The fears of a drift into protectionist policies have been, thankfully, misplaced. Indeed, the vital role played by open markets and increased trade in economic recovery, employment and investment has become ever more apparent. Dynamic, innovative economies, with a global outlook, offer the only route towards tackling climate change, supporting aging populations and meeting the rising aspirations of citizens and families.

The task of learning lessons from the global economic turbulence, and putting in place new policies in response, will fall to a new generation of leaders – notably in the United States, Japan and Europe. Those leaders should be looking for the best ways to achieve sustainable economic growth, regenerating investment in new technologies and extending their global engagement. Therefore, the potential for European and Japanese economic collaboration ought to be high on their agendas. Europe and Japan already have strong economic links, and share many values. They know each other well. There is still huge untapped potential for economic growth that would give big advantages to both partners. But, until late 2009, the political process towards achieving these benefits appeared to have stagnated.

But there are now more promising signs. A change of government in Japan and the launch of bold plans for an economic integration agreement by business leaders through the powerful business lobby Nippon Keidanren have stimulated real interest in closer links with the European Union (EU). There are new European commissioners responsible for external relations and trade. The European Parliament, following elections in 2009, has more than 300 new members (MEPs). The recent EU-Japan Summit has started a joint process of re-evaluating the barriers to a truly open EU-Japan market. This article sets out the potential to both partners from an ambitious economic partnership agreement, and the political path that would give it some real momentum. For both the EU and Japan, it's time to unleash real partnership power.

Potential for Reducing Barriers to EU-Japan Commerce

The EU and Japan are already key players in the global economy, and have a long trading and investment history. In 2008, the EU's 27 member countries imported 75 billion euros worth of goods from Japan and exported 42 billion euros. The value of their trade puts them high in the world rankings for trading partners.

It might be expected this economic relationship between two very large and developed economies would be particularly nurtured. But, despite the very high economic benefit, it appears, in recent times, to have been undervalued by both beneficiaries.

EU-Japan trade has been declining in relative importance over the last 10 years. This is clearly shown in *Table 1*. Political priorities for both the EU and Japan, linked to attractive commercial opportunities, have turned attention towards China, India, South Korea and other markets in Asia. Both partners have also been active in other fast growing economies such as Turkey and Russia. Europe's interest in South Korea is now manifested in a Free Trade Agreement, presently on the table for final approval by the European Parliament and EU governments.

The paradox about the EU-Japan trading relationship is that, despite its decline in relative importance, it still has very great economic and political potential. Stepping up collaboration between the two economies would help both partners achieve their broader long economic and societal goals. Both economies need to maintain their competitiveness in a globalizing world by investing in new technologies and repositioning themselves as "knowledge driven" economies. Both face the need to ameliorate climate change and meet the needs of an aging population.

To get things back on track, there is a need to understand the reasons

TABLE 1
EU's main export destinations (2000-2008)

Rank	2000	2001	2002	2003	2004	2005	2006	2007	2008
1	U.S.	U.S.	U.S.	U.S.	U.S.	U.S.	U.S.	U.S.	U.S.
2	**Japan**	**Japan**	**Japan**	China	China	Russia	Russia	Russia	Russia
3	Turkey	Russia	China	**Japan**	Russia	China	China	China	China
4	China	China	Russia	Russia	**Japan**	Turkey	Turkey	Turkey	Turkey
5	Russia	Canada	Turkey	Turkey	Turkey	**Japan**	**Japan**	**Japan**	**Japan**

Source: "Assessment of barriers to trade and investment between EU and Japan," Copenhagen Economics (calculations based on data from Eurostat) for the lack of dynamic growth in EU-Japan trade and investment. An excellent basis for doing this is provided by a landmark report, commissioned by the European Commission's Directorate General for Trade, from the respected consultancy Copenhagen Economics. Published in November 2009 and titled *"Assessment of barriers to trade and investment between the EU and Japan,"* it sets out a detailed examination of all aspects of the barriers and restrictions holding back trade and investment, a quantification of the costs and the potential for their removal.

The Copenhagen report confirms that formal barriers in the form of tariffs are low and Japan appears, on the surface, to be one of the more open OECD economies. On the other hand, Japan's imports and inward investment from Europe are low compared to the size of the Japanese economy. The study examines a number of practical reasons that might account for this low level – the long distance to Japan and language differences, for example. It notes that larger countries, like Japan, generally import less per unit of GDP than smaller countries. Export-driven economies with high savings rates and high investments also import less relative to GDP.

But the overall conclusion of the study is that, despite the superficially open nature of EU-Japan economic relations, there remains a complex web of nontariff measures (NTMs) and other policy differences that discourage potential investors and traders. These findings about the role of NTMs in holding back EU-Japan trade are not new. But it is a concern that, despite many years of discussions on regulatory cooperation and reform, these remain so evident. To make progress, the immediate challenge is to focus on all the barriers and come up with a political program that will make real progress in tackling them.

Starting from the most direct barriers, tariff removals are obviously a first step in fully opening up the EU-Japan trading regime. Japan and the EU have promoted the shared goal of global tariff reductions in the WTO, notably in the continuing Doha round negotiations. A tariff elimination plan ought to be an early gain from any economic partnership. But the political problem is the imbalanced benefits between the partners. As the Copenhagen study clearly shows, the major gains from tariff cuts would accrue to Japanese exporters. It is clear, therefore, that tariff elimination can only be achieved at the same time as the elimination of other nontariff and legislative barriers.

Turning to NTMs, the Copenhagen study is an invaluable resource in identifying the crucial sectors where there are constrictions on EU-Japan trade and investment flows. For example in pharmaceuticals, medical devices, food and transport, there is clear evidence that differing regulatory regimes add significant costs. These act as disincentives for EU or Japanese producers to invest in new products and new distribution channels. The Copenhagen study estimates that these can range from 10% to 30% of landed cost.

Alongside the regulatory regime, other policy barriers are also examined in the study. Foreign direct investment in Japan is much lower than it is in Europe, and there appear to be structural barriers related to company law and merger and acquisition rules. These clearly discourage potential investors due to the cost and complexity of completing transactions. Japanese competition rules play a crucial role in reinforcing the market dominance of incumbents, again working against European investors. Public markets in Japan also appear to be relatively closed to external competitors, particularly in areas like transport. These policy barriers will be harder to tackle, but they must be on the table if the full benefits are to be achieved.

TABLE 2

Full EU-Japan economic partnership: summary of impact

		EU	Japan
Export effects	Tariffs	+14	+25
	NTMs	+29	+28
Welfare effects		+33	+18

Note: in billion euros per year

Source: Computable general equilibrium (CGE) simulations from "Assessment of barriers to trade and investment between the EU and Japan," Copenhagen Economics, 2009

The Copenhagen Economics study quantifies the economic benefits of a comprehensive market-opening program, taking 2018 as a target for the full impact of the measures to accrue. The results are remarkable – 33 billion euros to the European Union and 18 billion to Japan. As a proportion of the total GDP of both partners, these benefits represent a net gain for Japan, whose economy is a third of the EU's. The Copenhagen analysis, shown in *Table 2,* shows the importance of NTMs vs. tariff reductions. Tariff cuts disproportionately favor Japan's exports to the EU; whereas NTMs are crucial for Europe to achieve a balance of gains.

Political Initiative to Unlock Economic Gains

The potential economic and welfare gains from a greatly intensified economic relationship between Europe and Japan ought to be of major interest to politicians in both regions. In a time of stagnant economic growth and rising unemployment, gains of this order could deliver early wins for both sides. There are also no other political obstacles, since Japan and Europe have for long had shared interests in foreign policy, notably in their approach to conflicts in other regions.

But, to date, there has been remarkably little interest in promoting a clear political initiative to unlock these benefits. In contrast, the EU and the United States established, in 2004, a Transatlantic Economic Council with the explicit task of tackling NTMs and paving the way to a true Transatlantic Economic Area. In Asia, the EU has focused its attention on developing free trade agreements on a bilateral basis with key partners, notably with South Korea.

There appears to have been a lull in EU-Japan economic relations, with regular, friendly dialogue but relatively little progress. In areas such as science and technology, agreements have taken a very long time to conclude. There has been work put in on regulatory dialogue, and some progress has been made. However, there appear to be no clear timetable and impetus to achieve agreement.

It is encouraging, however, that there has been a strong call on the Japanese business side for some real action to be taken on a structured approach to deepening economic relations. Keidanren presented a proposal in April 2009, followed by a call for the start of negotia-

Photo: IMCO

From left to right: Joseph Dunne, head of Internal Market & Consumer Protection (IMCO) Secretariat; Malcolm Harbour, MEP & chairman of IMCO Committee; & Commissioner Michel Barnier during an IMCO Committee meeting

tions in November 2009. The new government led by the Democratic Party of Japan (DPJ) has quickly moved to establish close relationships with its EU counterparts. In April 2010, the European Business Council in Japan gave its full support to such an initiative.

It is also remarkable that Switzerland, which adopts EU internal market rules covering many of its economic sectors, has concluded an Economic Partnership Agreement with Japan already. The pattern of this agreement, negotiated over a five-year period, provides a clear precedent for an initiative by the EU.

Part of the problem appears to stem from the political framework in which the discussions are taking place. The EU represents all 27 members in trade negotiations. It has the responsibility for proposing trade agreements and internal market rules. Up to now, the principal negotiating interface on economic cooperation has been the Japanese government and the European Commission. There have been regular summits between the prime minister of Japan, the European Commission and senior ministers of member states chairing European business, but detailed work has been dominated by officials, rather than politicians. The new fixed role of the president of the European Council, created under the Lisbon Treaty, could provide some continuity in external relations but time will tell whether this has a tangible effect on forwarding EU-Japan relations.

However, the role of elected representatives of the European Parliament in shaping and approving these trading agreements, and any changes to internal market rules, is crucial. This role has been enhanced by the Lisbon Treaty. The Parliament is a legislative assembly. A very high proportion of amendments tabled by members – up to 40%, according to a recent study – makes their way into final legislation. Arguably, more political engagement between the European Parliament and the Japanese Diet would provide the impetus that the partnership process needs.

Mobilizing Strong Support for EU-Japan Economic Partnership

There are now some encouraging signs that a new momentum on EU-Japan relations can develop. At the 19th EU-Japan Summit on April 28, 2010, the participants agreed it "provided an opportunity to renew the Japan-EU relationship, to take it to a higher level and to strengthen cooperation."

They also agreed to set up a Joint High Level Group to identify options for "the comprehensive strengthening of all aspects of Japan-EU relations." This group will conduct a joint examination of strengthening and integrating the Japan-EU economic relationship. It will cover all the key points related to trade and investment barriers, including NTMs, investment and public procurement. The Joint High Level Group will report back to the 2011 summit with its recommendations.

This is a timely step forward, but it now needs some urgency behind it. This area of political cooperation has been neglected for far too long. The areas where action needs to be taken have been clearly identified for many years. What is needed now is the political will to move the process forward and set a clear timetable for agreement and a clear commitment to make progress.

Parliamentarians on both sides must be involved. In the EU-US Transatlantic Economic Council initiative, a transatlantic legislators' dialogue was established involving members of both houses of the US Congress and those of the European Parliament. A similar arrangement should be set up between the European Parliament and both houses of the Diet. There are already official delegations from both parliaments that meet annually. They can form the basis for this dialogue, but it needs to draw in parliamentarians on both sides with an interest in the benefits of economic cooperation.

An innovation in the EU-US initiative was a parallel dialogue between consumer representatives through the Transatlantic Consumer Dialogue. In many aspects of an action plan to remove NTMs, consumer interests must be considered. In areas such as food or pharmaceuticals, consumers must be satisfied that their safety is not placed at risk by mutual recognition measures. Issues such as standards, labeling and testing are also crucial. More cooperation between consumer authorities and information sharing on potentially unsafe products should be put on the agenda of any economic partnership agreement.

The engagement of business with the work is crucial. There is a very well established Japan-EU Business Round Table that needs to be deeply involved in this initiative and to press for an ambitious outcome.

The difficulties should not be underestimated. The press statement from the April 2010 summit relegated comments on "nontariff issues" to the 26th and last place on the outcomes listed. The summit's economy and trade goals make no mention of the idea of a comprehensive agreement on the lines of the Switzerland-Japan agreement.

A window has been cracked open, but it needs a concerted effort from business, consumers and politicians to throw it open, and shine some bright sunlight onto the economic cooperation landscape so that real results can grow. JS

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