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Future Directions in the Relationship between the European Union & Japan

Interviewer: Helen FUJIMOTO

In recent years the world economy has suffered some really major tsunamis – the global financial crisis of 2008, the Middle East crisis, and this March, the Japanese earthquake. Up to 5 or 10 years ago, many people expected that growth would continue permanently, but that idea has really been shaken. In this situation, what do you think should be the role of the EU and Japan in the management of the world economy in terms of macro-policy?

EU: You mentioned that the climate a few years ago was more benign but if you look back to the time before the 2008 crisis, actually there were very severe global imbalances. These imbalances did not come as a result of the crises but pre-existed and have survived them. We now know that the financial crisis has not led to any correction of the global imbalances, even though in the G20, quite a lot of progress has been made in setting the framework for redefining the role of the IMF and other financial institutions. But the correction of global imbalances is still very much a work in progress. And as you mention, several countries in North Africa and parts of the Middle East are going through a sudden and dramatic political transition. This is a very sensitive situation in terms of the potential impact on oil prices.

Photo: Yoshiaki Sasaki



Factories in coastal areas were destroyed across the board.

As to the tragic events of March 11 in Japan, I think we must first and foremost focus on the tragedy for the people immediately affected – the loss of human life and the many people suffering from relocation. The two related questions – the nuclear crisis and the longer-term impact on the economy – have to be judged in a more nuanced way.

It is quite clear that the nuclear crisis has different angles. The short-term need is to bring the situation under control. Then there is the medium- and long-term question of the impact on Japanese energy policy and how this will influence and affect the economy. The economy can probably be expected to pick up because of reconstruction at the beginning of next year and I think this is where the European Union comes in.

The impact of Fukushima goes far beyond Japan. We will have to see what sort of discussion takes place in the framework of the G8 with regard to the re-definition of our energy policies in the medium- to long-term. Already we can see some impact. The prime minister of Japan has announced that there will be a reassessment of the role of nuclear energy and the energy mix and a rethinking of the focus and definition of the energy policy. We saw this happening even more quickly in Europe, when the German Chancellor made her statement on temporarily closing down some of the nuclear power stations and coming back to a declaration of the phasing out of nuclear energy, made in principle by the previous government.

I do not expect that we will see in the short term a convergence of views toward the phasing out of nuclear energy – this is economically not feasible – but I do expect much more emphasis in the short term on nuclear safety. I also expect a push for renewable energy to supplement existing energy sources, more focus on conservation and, in the medium- to long-term, a redefinition of the energy mix, once it becomes clearer whether renewable energy can move from a supplementary role to one of the main pillars of the energy supply.

Concerning the imbalances and the role of Japan and the EU, I think we are not the main focus of the readjustment needed. We both still have a lot to do, albeit in different ways, in terms of restructuring our economies. Globally, the current account of the EU is more or less in balance, even though that disguises quite significant differences between member states. But we still need to focus on structural policies and we are still in the process of overcoming the debt crisis.

Chinese actions on currency policy are sometimes accused of playing a role in increasing trade imbalances. What do you think about the Chinese currency – should it be appreciated?



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largest trading power, and clearly has significant impact. You cannot adjust global imbalances without the active involvement of China as a key component. Recent developments only confirm our view that currency relations should be based in market conditions. Severe fluctuations are something that should be avoided, but basically we agree that the Chinese currency is undervalued and therefore this would be part of any kind of adjustment process.

You mentioned the role of structural policy, which today seems to mean how to reduce fiscal deficit. But if the major economies are only pursuing fiscal deficit reduction, there is the risk of further slowing in the global economy. What do you think?

EU: This is an issue where views differ among major countries. One view, often expressed in the US, is that starting fiscal adjustment too early might lead to a slowdown of growth, prolong the recession and kill incipient recovery. In Europe we have taken a more nuanced approach to this. We do not want to be masochistic, but we do want to reduce budget deficits and the overall stock of debt - there comes a point when budget deficits are just not sustainable. Once we have overcome the main impact of the crisis and the economy is stabilizing and starting to show signs of growth, we must not neglect the fiscal situation.

By addressing fiscal deficits, it might actually be possible to initiate a virtuous circle of creating more confidence in the economy, while at the same time carrying out the necessary structural changes. Sooner or later the US will really have to address the issue of the budget deficit, but in combination with other factors, which would include the trade side.

With China, we have thought for a long time that the domestic consumption side will have to be part of the adjustment process, which will also be in China's own long-term interest. That includes

EU: China is a very prominent member of the capitalist group and this is one of the reasons why this criticism is becoming more acute. China is now the second largest economy, and the

not only short-term stimulus to demand but also structural policies like health and pension systems to create the necessary safety net. This security would then allow people to spend more on things other than the basics of education and health.

The fiscal situation is also clearly an issue for Japan. We all realize there are special factors like low interest rates and high private savings in Japan. But the fact is that the net debt is only half the overall debt, approaching 200% of GDP, and this magnitude goes quite a bit beyond the average in most European countries. The timing of fiscal adjustment is always problematic in periods of economic uncertainty, but there is a risk that leaving the fiscal situation unattended would create long-term unsustainability.

On the subject of energy policy, what kind of consequences may be bought about by the increasing fear of nuclear power following the earthquake and tsunami? How do you think we can stimulate technological innovation to make renewable energy sources more prevalent?

EU: I think there is a real question mark over whether nuclear energy really is the cheapest energy. It depends on how you calculate the cost. If you look at the overall situation, at the cost of decommissioning plants, at the possible disruptions and the question of permanent storage facilities, it might be relatively cheap only for big users. Nuclear energy does offer many advantages, especially in the control of CO2 emissions. I think this is the reason that it has been pursued as an important option in many countries.

In Japan, where nuclear energy was also seen as a very attractive option, especially after the first oil crisis in 1973, the motivation was mixed and it has changed over time. In the beginning, it was considered more important to provide a secure supply, and then from the time of the oil crisis, it was an attractive option in terms of cost. Over time, other aspects came into play. The development of an important industrial capacity had an impact in different sectors and it was only more recently that clean energy came to be important.

On the other hand, I do feel that the fears might have been overplayed a bit. The share of nuclear power in electricity production in Japan is not much higher than the average in industrial countries. Even in Germany, which is very critical of nuclear energy, the share of nuclear energy use in power generation is almost the same as in Japan. Only a few countries



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have a really large share, like France, which has almost 80% of electricity produced by nuclear power.

And even at this point in Japan, people are not talking about closing the nuclear power plants. What is being assessed is safety measured against worst-case scenarios, and after Fukushima, the worst-case scenarios are being reassessed. There will be a loss of capacity for a period, but I think this is a temporary gap to be closed.

If there is one thing that the earthquake and tsunami showed, it was the importance of Japan as a manufacturing force in the global supply chain. The fact that Japan has been able to keep so much of its manufacturing - and high-technology manufacturing - despite the fact that you could produce more cheaply outside, shows the strong competitive position of Japan. I do not think that temporary energy shortages will lead to the relocation of industries outside. The advantages of keeping the production base close to research and innovation facilities, the quality of the labor force and the quality of the overall environment will be very persuasive factors in keeping industry within the country. With some optimism, you could say that, given Japan's strength in many high-tech areas, including parts of technology directly related to renewable energy, this could be the start of a new period. The need to fundamentally rethink the energy supply, energy security and the energy mix could spur innovation, which could be very beneficial to parts of Japanese industry. A new start is something many outside observers are expecting more than Japanese observers, who are sometimes more pessimistic.

The question facing us now, is how to manage the economy in the post-crisis period. For Japan this means post-earthquake but in the global context it means post-Lehman shock. EU countries and Japan face the same issue of the aging population. The market should play a key role but there is a question of whether we should pursue a compromise between socialist and capitalist policies. What do you think?

EU: I am doubtful about a mix between socialist and capitalist policies. I feel more comfortable talking about social policies in the framework of market economies. I agree that when we look at the future of our societies we have to rethink the role of the state as a provider of services, and also as a provider of the regulatory framework. But I do not think that we should redefine the market economy in the direction of reining in market forces to provide longer-term support for aging societies. I think it is rather the other way round. I think we will face a need to restructure our economies and make them more efficient, precisely to provide continued strength, to enable the state to provide expanding services to a larger share of the older population. This also means that we have to think about market mechanisms to re-integrate part of the older population into the productive chain and to make sure that in our countries and also in Japan, we utilize that part of the population which has been under-utilized.

In addition to this, in both Europe and Japan, we have an unused domestic labor potential in the female population, and we also have to think about what to do about the decline in our populations. We can make better use of our existing potential, first by making sure that we have an expanding share of the population in the productive process, and second, by encouraging more population growth from indigenous efforts. Then there is the third option, of immigration. But it would be a mistake to close our eyes to the fact that choices have to be made.

Free trade is a very important principle in order to bring us prosperity. In light of the fact that the Japan-EU FTA is now under discussion, what do you think of the prospects of the discussion and what do you expect from this agreement?

EU: Both Japan and the EU have traditionally been strong supporters of free trade in the global framework, and this is the reason that we have strongly supported free trade within the framework of the World Trade Organisation. But the problem has become more far-reaching and we are faced with a situation where bilateral and regional free trade agreements (FTAs) have proliferated. This has created a situation of shifting competitive positions. The main motivation for Japan to ask for an FTA with the EU was not so much a desire to start a process of trade liberalization, but the fact that an FTA between the EU and Korea is to come into force on July 1. This agreement will offer Korea competitive advantages with regard to tariffs on automobiles and electronic goods. So it's useful to keep some perspective when talking about new initiatives.

I think that in both Japan and Europe there is agreement that further trade liberalization would lead to significant economic advantages on both sides. That is undisputed. The European side has been a bit more reluctant. For Japan the main motivation is rather clear and can easily be addressed in an FTA. But the tariffs are not the main barriers, even though they are high. The main hurdle faced by European companies in Japan is the complex of non-tariff barriers in the area of agriculture and a few sectors of industry - the issues of access to government, procurement and the harmonizing of regulatory standards. And because of the experience of the past, there has been some doubt about the extent to which Japan is really committed to opening its market. If this could be done in the framework of the negotiations it would be a very good thing for both parties. Maybe this is connected to what we could call the third opening of Japan, which is sometimes evoked after the terrible events of March 11. I hope we can jointly frame good solutions to these problems. We believe that the opening up of Japan is a very important objective, and not only for the benefit of foreign or European companies. I think this would be a stimulus to Japan's industry and economy and very beneficial to Japanese consumers - a win-win situation.



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Do you agree that with the FTA, we could attract more foreign direct investment from Europe and that, by making FTAs with other areas in the world, Japan would be able to attract more direct investment from all over the world?

EU: Yes, this is an area where many European companies are interested in seeking cooperation with Japan. It's rather an unnatural situation that foreign direct investment in Japan as a share of GDP is a mere 3%, very far below the EU average of 20%. The EU as a whole is the largest foreign investor in Japan but we see a lot of scope for further investment and considerable benefits to both sides.

Related to the question of FTAs, the WTO is an important tool to promote trade liberalization, though the current Doha negotiations are not going so well. According to some influential authorities, the WTO and the process of multilateral negotiation should be the priority, so we should eliminate FTAs as much as possible, because they are contradictory to a multilateral trading system. What do you think?

EU: In an ideal world I would agree. Europeans place importance on the WTO because people believe in the importance of an open international trading system. Japan and the EU have been strong supporters of trade liberalization in the overall framework of the WTO.

But we have come to a situation where we have to realize that Doha has become stuck and the world has become more limited. It's not so much a situation of replacing the WTO by bilateral and regional FTAs, but more one of supplementing standards reached within the WTO by agreements, regional or bilateral, which go beyond the WTO. I think the benefits of regional trade liberalization have a tendency to spill over and might sometimes even facilitate global agreements. So I don't see this as a contradiction.

Regarding the Trans-Pacific Partnership (TPP), some people say the US is trying to replace FTAs with the TTP. Do you support the TTP because you feel higher priority should be put on the WTO?

EU: I would not go that far. We will not be members, since we are outside the region, but I think it is a very legitimate undertaking. If it does go beyond the WTO then it may have a beneficial impact in widening the application of some of the achievements.

On a more personal note, this is your third visit to Tokyo. What do you find has changed most in Tokyo and among Japanese people, compared with your previous visits?

EU: Compared to the 1970s when I first visited Tokyo, the architecture of the city has become much more attractive. Tokyo has become a cosmopolitan city - truly one of the most fascinating cities in the world. That is a major change. When I was here professionally for the first time in the late 1980s, Japan was still in the middle of the boom years when the sky seemed to have no limit. That was a very special atmosphere. When I came back the second time at the end of the 1990s, I had the impression of a more sober Japan - a bit more down to earth. Also the society had undergone great changes. In some respects, Japan has become more European in terms of lifestyle and this is reflected very much in the architecture and the appearance of Tokyo. Two decades ago you would not find a coffee shop where you could sit outside, enjoy a coffee and read the newspaper. You have that now everywhere. Lifestyles have changed in small but significant ways. The role of women in society has changed very much, and also the relationship between the generations.

But what is more important now is not so much how Japan has changed, but how the world around has changed. This is also true for Europe. To a very large extent, the changes in Japan are a consequence of the rise of China and the declining weight of Japan and also of Europe in a new dynamism and a new division of labor, which was not of our making. I think that we are in a transitory phase where we have to adjust to this new situation. This is also why I think that there are many things we can do together. At a time when we still represent about 30% of global output, we both need to find how we can reposition ourselves in the world. **JS**



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