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Towards New Political and Economic Agreements with Japan: Bringing New Dynamism into the Strategic Partnership between the EU and Japan

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The forthcoming EU–Japan summit heralds a new era in the relations between these two major economic powers. Both players are focused on repairing their economies and putting growth back on track. To make this happen they are ready to negotiate legally binding agreements, which would help expand their cooperation. The negotiators will have to resolve a number of contentious issues, but the agreed outcome may result in considerable benefits for both the EU and Japan.

Introduction

The 21st EU–Japan summit was originally scheduled for 25 March, in Tokyo. Initially, it was planned as a curtain-raiser to kick-off negotiations on two major agreements, one covering political, global and sectoral issues, and the other being a deep and comprehensive free trade agreement. Unfortunately, due to the recent banking crisis in Cyprus that rattled global financial markets, the summit was postponed. Finding a solution to the financial situation in Cyprus required the presence of European Council president, Herman Van Rompuy, and European Commission president, José Manuel Barroso, in Brussels. However, the two presidents held telephone talks with Japan’s new prime minister Shinzo Abe and agreed to launch negotiations for both agreements and reschedule the summit as soon as possible. The leaders agreed that the first rounds of negotiations on both agreements would take place as planned, in April. This important political decision, an official announcement of the opening of negotiations, puts the EU at the centre of Japan’s radar screen and is a stepping stone for a new era in EU–Japan relations.

Economic Rejuvenation—The Main Shared Challenge

EU–Japan relations have developed steadily since the first summit in 1991. Trade and investment remain the anchors, but a wide range of dialogue and cooperation has developed in other areas, in particular regarding political cooperation. The EU and Japan are like-minded, strategic partners sharing common values and

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principles such as democracy, the rule of law, human rights and fundamental freedoms. Japan is one of the EU's closest allies in Asia. But both major economic powers, accounting for almost one third of global output, are also faced with similar global, regional and internal challenges.

Prime Minister Abe, who won a convincing victory in the election for the lower house of parliament in December 2012, made the revitalisation of the stagnant Japanese economy as his top priority. His new economic policy, called "Abenomics," describes "three arrows" for growth—bold monetary policy, flexible fiscal policy, and a growth strategy. Abe has, so far, enjoyed wide public support; approval of his cabinet stands at around 70%. Based on that, the new Japanese leader hopes to secure a majority in the elections to the upper house in July.

Japanese policy makers continue to follow events in Europe closely. They have a good understanding of the debate in Europe, the strength of political commitment to the euro, and the depth of the structural reforms being put in place. There is continued concern in Japan about the crisis in the eurozone and the risk of recession in Europe. The disarray in Cyprus is carefully monitored, whether or not it indirectly hinders "Abenomics."

The EU is not yet out of the crisis—no growth in 2013, sovereign-debt crises, and high unemployment in some Member States are still serious challenges. Important policy measures have been taken and significant reforms are being implemented in the EU. The main axles of the current economic strategy are based on restoring financial stability, ensuring sound public finances, fighting unemployment, especially among young people, and continuing reforms to attain long-term growth and competitiveness. This "economic fire on both sides of the river" creates momentum for further enhancement of bilateral relations between the EU and Japan.

Firm Grounds for Renewed Relations

Ten years after the EU-Japan Joint Declaration of 1991, "An Action Plan for EU-Japan Cooperation" was launched. It defined clearly the interests and values shared by the EU and Japan. A close examination of the achievements since 2001 shows that an impressive list of specific activities has been implemented under the four pillars of the Action Plan—peace and security, economy and trade, global and societal challenges, and people-to-people links. The pace of implementation has varied over the years and depended on the prevailing issues. The Joint Action Plan was not legally binding, and had a lifespan of only for ten years, after which it no longer reflected the dynamic scope of EU-Japan cooperation and the challenges of today's world. The Joint Declaration of 1991 and the Joint Action Plan of 2001, as well as a number of specific sectoral agreements, have all contributed to the progressive strengthening of bilateral cooperation.

Since the Lisbon Treaty came into force, the EU has engaged in institutional renewal, which has provided an opportunity to renew the EU-Japan relationship. At the summit in 2010, European and Japanese leaders agreed on the desirability of setting in place a new framework for bilateral relations, and set up a Joint High Level Group (JHLG) with a mandate to identify proposals for the comprehensive strengthening of all aspects of EU-Japan relations, and defining the framework for implementing this. The List of Issues, which was annexed to the JHLG report, was a comprehensive document, covering virtually all foreign policy and sectoral cooperation. It also identified the shared goals for each area of cooperation.

At the 20th EU-Japan Summit in 2011, leaders agreed to work towards a comprehensive upgrade in bilateral relations through a new framework—a package of two legally-binding agreements. They launched the process for a Framework Agreement (FA)—a binding agreement covering political, global and sectoral issues, and a parallel Free Trade Agreement (FTA)/Economic Partnership Agreement (EPA).¹ Both agreements were envisaged as the ambitious renewal of political and economic relations between the EU and Japan.

¹ The EU and Japan have different names for the two agreements: the EU normally refers to the "Framework Agreement" and "Free Trade Agreement" while Japan refers to the "Political Agreement" and "Economic Partnership Agreement". Japan still objects to "Framework" as it fears the EU could unilaterally choose to suspend the FTA in the case of alleged violations of the essential elements of the FA. No final decision on the names of agreements has been taken.

Scoping exercises were launched shortly after the 2011 summit for both of the proposed agreements, as part of a parallel, closely coordinated process. Leaders decided that the two sides would start discussions with a view to defining the scope and level of ambition of both negotiations, and that in parallel with this, the European Commission would seek the necessary authorisation for the negotiations of these agreements on the basis of successful scoping.

The Scoping exercise was a very intense preparatory phase, during which both sides made concrete commitments to demonstrate their willingness and capacity to establish a common platform for the substance of future agreements. The scoping exercise for the FA was completed in April 2012, and for the FTA in May 2012.

Next, on 18 July 2012, the Commission decided to ask Member States for the green light to open the FA and FTA negotiations with Japan. The negotiating directives for both agreements were adopted by the EU Foreign Affairs Council on 29 November 2012. With the Council's decision (a clear mandate from Member States), the European Commission obtained the negotiating mandate for the EU–Japan FA and FTA. This was not an easy task, given the persistence of non-tariff barriers (NTBs) in Japan, and Member States therefore requested a review clause to be included in the mandate (one year from the start of the negotiations, the EU negotiators will report on progress on Japan's fulfilment on its commitments to remove NTBs). Finally, the negotiations for both agreements were formally launched by the EU and Japan leaders on 25 March.

A Wake Up Call For Japan

The EU–Japan FTA's *raison d'être* must be analysed in the context of the trade policies of both major economic powers and emerging international trade initiatives. The EU and Japan are likely to conclude a number of FTAs, with third-party countries or joint block trade agreements in the coming years.

As the WTO has become unable to perform its role of promoting freer global trade, the focus of international trade negotiations has been shifting towards bilateral or regional economic partnership agreements and free-trade agreements. Nevertheless, the EU–Japan FTA is considered not as a substitute, but as a complement to the multi-lateral system of the Doha Development Agenda (DDA) in the WTO. Bilateral negotiations with Japan do not in any way alter the EU's commitment to a successful conclusion of the DDA in the WTO. The EU only negotiates trade agreements which are compatible with WTO rules. Difficulties in moving the DDA agenda forward have nothing to do with the EU or Japan's engagement in bilateral negotiations.

There is a barely a corner of the world where the EU is not negotiating trade deals, but the bloc has yet to seal an accord with a major economy. A deal with Japan would probably follow a pact with Canada, Mercosur and Asian countries (the EU has just concluded an ambitious FTA with Singapore, talks are on-going with India, Vietnam and Malaysia, and are in an exploratory phase with Thailand and Indonesia), following on from an agreement with South Korea in 2011.

The EU and the U.S. announced on 13 February that both parties would start internal procedures necessary to launch negotiations on the EU–U.S. FTA (a game-changer and a wake-up call for Japan). It would result in a trade zone encompassing some 50% of global production and 30% of global trade. Japan could, potentially, see its importance diminish if the EU–U.S. deal reaches fruition without Tokyo's participation in the TPP. The partnership with the EU is the framework that Washington envisions for the Atlantic, while the TPP is its trading regime for the Pacific.

The EU–Korea FTA came into force in July 2011, and was the first EU trade agreement with an Asian country. The EU–Korea FTA poses specific threats to Japanese businesses trading with the EU in direct competition with South Korean firms (automobile and electronic industries). South Korean products, such as cars and electronic equipment, now have a significant competitive advantage over similar Japanese items in the European market. The EU–Korea FTA has provided a momentum which has mobilised Japan and the EU to come up with a similar agreement. While it is still too early, after only one year, to draw conclusions on the long-term impact of the EU–Korea FTA, the first signs are promising. EU exports to Korea increased by 37% overall, while at the same time EU imports from Korea have increased only marginally, by

1% (mainly due to the negative impact of the current economic climate in Europe and shifting production by Korean firms to the EU countries). A trade deal with Japan is likely to resemble the EU–Korea FTA.

Japan is a late-comer to the game of FTAs involving large, modern economies. The coming years will see Japan engaged in trade negotiations with all of its key trade partners, namely, the EU, the U.S. and Pacific, ASEAN, Korea and China. These parallel negotiations, with some of the world's largest economies, could, if realised, mark a significant shift away from Japan's tradition of low-ambition FTAs, which have been aimed principally at protecting its production supply chains while shielding its heavily regulated agricultural sector. The combined impact of pressure from TPP and EU partners could justify radical decisions in Japan. This "gaiatsu" or external pressure could precipitate significant changes in Japan.

Japan—one of the world's major exporters—recorded a trade deficit for 2012, as exports were hit by a bitter diplomatic spat with its biggest market, China, and plunging demand in Europe. In addition, Japan is struggling to cement its recovery after the 2011 quake-tsunami (which resulted in high fuel imports) and with its strong yen. Official figures showed Japan's trade shortfall last year totalled 6.92 trillion yen (\$78 billion). The data marked a second consecutive annual trade deficit for the export-reliant economy.

Japan is trying hard to find a balance between its Asian/China centred and its U.S.-centred interests. Japan does not want to be left outside any important regional initiatives (such as the TPP, China–Japan–Korea Trilateral FTA [CJK] and Regional Comprehensive Economic Partnership [RCEP]). On 26 March, China, Japan and South Korea began a first round of negotiations on a trilateral FTA (talks were largely procedural). A trilateral FTA is crucial in constructing a free trade zone in Asia—the three economies account for around 20% of global gross domestic product. The initiative to boost economic ties comes amid territorial rifts between Japan and China over the Japanese-controlled Senkaku Islands, and between Japan and South Korea over the South Korean-controlled islets called Dokdo by Seoul and Takeshima by Tokyo. Nevertheless, as regards initiatives involving China, progress of the trilateral CJK and RCEP is expected to be slow.

On 15 March, Prime Minister Abe announced that Japan would participate in on-going negotiations for a TPP.² Shinzo Abe was able to announce Japan's intention to join TPP talks mainly because he obtained confirmation from President Barack Obama at their February summit meeting that eliminating all tariffs would not be a precondition for joining the talks. Also, the ruling Liberal Democratic Party in Japan passed a resolution in favour of Abe's announcement that Japan was ready to participate in the TPP negotiations. The TPP talks have overshadowed the negotiations with the EU in Japan, in the sense of capturing public attention. Japan needs to involve itself actively in the on-going negotiations on TPP agreement if it wants to remain involved in the process of defining global standards for trade. The combination of Japan joining the TPP and the launch of the EU–U.S. FTA would reshape the world of trade. The parallel negotiations between the U.S. and Japan, the EU and Japan, and the U.S. and the EU creates an interesting mix of potential conflicts and mutual interests. The TPP is too big to ignore and too ambitious to fit into Japan's existing FTA framework.

Joining the TPP was welcomed by major Japanese business lobbies. Agricultural interests remain radically opposed to the TPP, while there are number of sectors which are quite suspicious of future U.S. demands (for example, regarding insurance and healthcare). Abe will have to tread carefully to avoid alienating farmers before the July election. Meeting the expectations of its major trading partners while steering a path through domestic interest groups will present formidable challenges to Japan. Agricultural issues have already led to a stalemate in Japan's negotiations with Australia, and could also prove a sticking point with Canada.

Framework Agreement: Beyond Trade

An ambitious and comprehensive FA is intended to further develop political relations—from dialogue to more operational outcomes—across a wide range of political, global and sectoral issues. FA provisions will create a solid base for more concrete actions as regards political dialogue, human rights, security matters

² Currently, 11 countries, including US, Australia and Canada, are conducting TPP negotiations, and 29 areas are under discussion.

(crisis management, non-proliferation of WMD, counter terrorism), global issues (climate change, development, humanitarian aid, civil protection, environment), economic issues (industrial cooperation, customs, taxation, competition), sectoral cooperation (energy, transport, agriculture, fisheries and maritime affairs), cooperation in the area of justice, freedom and security (cyber crime, the fight against transnational crime, migration and asylum), cooperation in the fields of research, innovation, space, education and culture. EU Member States have been almost entirely supportive of the EU's attempts to broaden cooperation with Japan outside of the trade sphere. FA stakeholders have reacted similarly, but nevertheless, FA has been overshadowed by strong interest in the FTA. This will be the first agreement of this kind for Japan.

The legally-binding FA is of a different nature than the political Joint Declaration of 1991 and Action Plan of 2011. It has a much longer-term perspective than summit statements, which reflect the priorities of the moment, which summarise areas of cooperation and deliverables from summit to summit. A future FA should therefore contain no overly detailed provisions, which would rapidly become outdated. It is likely to be contentious whether FA will be an EU-only agreement or a mixed agreement³—the Commission wants an EU-only agreement (EU exclusive competence) while by contrast some Member States are of the view that the FA should be a mixed agreement (shared competence with Member States regarding, for example, provisions on energy or education where Member States are in the driving seat). Amending an international agreement is a long and cumbersome procedure, even more so if it eventually becomes a mixed agreement ratified by all Member States. Even in the field of trade, the FA will contain broad enabling provisions. However, the detailed modalities will be set out in the FTA. When sector-specific agreements already exist, they will remain in place, but the FA offers an opportunity to update and expand areas of cooperation.

The structure of the FA will have to be agreed with Japan. As other recent comprehensive agreements with advanced and like-minded partners of the EU, the FA will probably consist of about 60 articles grouped under ten titles (most of which are already spelled out in the negotiating directives). From the EU perspective it should contain references to common values; political dialogue on a bilateral level, commitment to address regional and global challenges, sector-specific cooperation, and institutional clauses (including linking with FTA).

The principle of parallelism with the FTA negotiations (although absolute parallelism is not essential) offers a generous timeframe. The first round of the FA negotiations is planned for April, which would match the planned FTA first round. Rounds would occur every four months, in the EU and in Japan alternately. While there could be an early harvest in several areas, some chapters will require extensive discussions—and the first round will identify our main areas of convergence and divergence. The EU's experience in negotiating FAs with like-minded countries suggests that four to six rounds of negotiations are needed. The length of the negotiations correlates with their level of ambition. The senior official meeting (on the level of EEAS chief operating officer) is an instrument to monitor the negotiation process, while the summits and the ministerial meetings may provide impetus and general guidance.

The negotiators will be faced with a number of controversial issues. Japan had previously wanted a much more narrowly-focused “political agreement” and for almost all sectoral cooperation to be included in what it termed an Economic Partnership Agreement. They have particular sensitivity on the inclusion of the essential elements (standard clauses such as human rights—the EU decides on standards to which other countries object, or non-proliferation) in line with other advanced industrialised countries (such as Canada and Australia), with which the EU has been pursuing FA negotiations.

Above all, Japan is not ready to accept that there could be a legal link between the agreements (as with South Korea), which in theory would allow the FTA to be suspended for breaches in the FA. For this reason Japan fiercely objects to the term “Framework” which to them implies the subordination of the FTA. The EU's intention is to ensure a legal link between the FTA and the FA, in line with established EU policy approved by COREPER in May 2009, for example, the “possibility of suspending the Free Trade

³ The division of competences between the EU and Member States is also expressed at international level. Where the EU negotiates and concludes an international agreement, it has either exclusive competence or competence which is shared with Member States. Where it has exclusive competence, the EU alone has the power to negotiate and conclude the agreement. Where its competence is shared with Member States, the agreement is concluded both by the EU and by the Member States. It is therefore a mixed agreement to which Member States must give their consent.

Agreement in case of serious violations of human rights or non-proliferation commitments under the Framework Agreement.” This issue, as is the case in other negotiations, remains controversial.

Free Trade Agreement: “Low Hanging Fruit” with Enormous Benefits?

There is a strong appetite in Tokyo to open FTA negotiations as an opportunity to build a stronger economic partnership with the EU and counterbalance competition from South Korean industry. The prospect of an FTA with the EU will continue to be a priority and the Abe government is as keen to start negotiations as was the previous one. An EU–Japan FTA enjoys bipartisan support in Japan, whereas participation in the U.S.-driven TPP is more controversial (opposition from the agricultural sector—a strong election base for the ruling Liberal Democratic Party). On the other hand, some EU Member States have been rather reluctant to accept the idea of an EU–Japan FTA. The automotive sector was the elephant in the room and countries such as France, Germany, Italy and Spain initially refused to start negotiations, but finally moved from their positions and all EU Member States finally reached consensus. In general, future EU–Japan trade agreement stands out in that it is highly ambitious, comprehensive and politically uncontested.

The FTA’s main objectives for unlocking the potential of bilateral economic relationship are increasing the volume of bilateral trade in goods and services by reducing barriers, and increasing investment flows between the EU and Japan. Trade between the EU and Japan, major global economic players, has been in decline for a number of years. This underperformance in the bilateral trade and investment relationship leads to losses, both bilaterally and in the global economic context. Today, the EU is Japan’s third largest trading partner, while Japan is EU’s seventh. Two-way trade in goods totalled €116.5bn in 2011. The EU has a recurrent trade deficit with Japan (€20 billion in 2011). Foreign direct investments (including from the EU) are still low in Japan when compared with other industrialised economies. The stock of EU FDI in Japan reached €85.8bn in 2011, while the comparative figure for Japan in the EU was €144.2bn.

Despite the huge size of the Japanese market, EU companies are facing serious barriers to trade and investment in the form of discriminatory regulation, unique standards, anti-competitive behaviour, and discriminatory public procurement practices. Japan has one of the lowest import penetration rates of any country in the OECD and has the lowest degree of inward FDI in the OECD. Opening up Japan to European trade and investment would yield very considerable gains for the European economy, while also giving a clear strategic signal of the EU’s determination to strengthen its economic links with East Asia. The project of a comprehensive EU–Japan FTA is a key pillar of this strategy.

Not all major issues of concern have been resolved during the most ambitious scoping exercise that the Commission had ever carried out ahead of an FTA, but this was never to be expected in a pre-negotiation phase. However, the scoping package constitutes a strong basis for negotiations and includes some upfront commitments from Japan. During the scoping exercise it was important to secure a reasonably good package on the EU priority list of NTBs and on public procurement in the railways market, which were the most difficult issues during the discussion. Public consultation and studies stress that NTBs are major barriers to EU exports to Japan. The Commission has arrived at a settlement with Japan on “roadmaps” for the removal of 30 NTBs, as well as on public procurement, which should open up Japan’s railways and urban transport market in the context of the negotiations. Satisfactory solutions have been found for a number of NTBs raised by EU industries (the automotive, food and pharmaceutical sectors). After years of lack of progress, France and the Netherlands are now able to export their beef to Japan and the applications of other Member States (the UK, Ireland, Poland and Denmark) are now being examined. Hopefully, this positive trend will continue.

The negotiating directives foresee that the most significant Japanese NTBs will have to be eliminated parallel to any tariff reductions on the EU side. Moreover, the Commission may suspend negotiations (the “rendezvous” clause) if progress as defined in the NTB, railways and urban transport roadmaps does not materialise within one year of the start of the negotiations.

According to the impact assessment of the Commission, full-scale FTA negotiations will result in considerable benefits in both the EU and Japan. These include increases in GDP (EU GDP would increase by 0.6–0.8%), increases in exports (EU exports to Japan would rise by one third), overall increases in

employment (420,000 additional jobs are expected in the EU alone), increases in competitiveness, and an improved standing for both the EU and Japan in respect of other global competitors.

Among the sectors of EU industry which would benefit most from the FTA are processed foods, chemicals, electrical machinery, transport equipment and business services. The EU's automotive industry would see a rise in both exports (18%) and imports (28%).

The first round of intense negotiations will start in April. It is very difficult to predict how long negotiations will take as more important is to have good quality provisions than to focus on speeding to a conclusion of the negotiations but certainly they will last longer than negotiations on FA. It depends whether the EU and Japan can deliver on their pledges. Japan's top priority in the EU talks is to eliminate tariffs on Japanese products. The EU still imposes a high tariff of 10% on automotive imports from Japan. The most important remaining problematic issues are NTBs, public procurement in the railway sector, the elimination of Japanese tariffs on agricultural products, and the elimination of EU tariffs on cars. Failure to deliver on any of these will have a very negative impact on the negotiations.

Poland—Active Participant, Beneficiary or Bystander?

Poland advocated moving towards launching FA and FTA negotiations with Japan, and from now on will be involved in the process of negotiations of both agreements. It is now in the hands of Polish policy-makers if Poland brings any added value to the negotiations and gains individually from the new EU-Japan framework. As regards political agreement, a future FA can be a good model and benchmark for Poland to shape its own bilateral relations with Japan. The joint statement "Towards a strategic partnership between Poland and Japan" from 2003, as well as successive statements, do not reflect the reality of today. There is a need for a new political document defining state of play and challenges for the Polish-Japanese relationship.

An EU-Japan FTA may create considerable economic benefits for Poland in terms of better access to the Japanese market, increase of Japanese investments in Poland and bilateral trade—all contributing to spurring economic growth in Poland and Japan. From the perspective of Polish interests it is important to open the Japanese market for Polish beef, eliminate NTBs in Japanese industry, service and investment sectors, facilitate access of Polish agricultural products to the Japanese market by reducing high duty tariffs and liberalise the Japanese chemical and pharmaceutical sectors (including the reform of technical standards to international levels). The automotive sector is a sensitive area for Poland, mainly regarding customs duty. With Japanese food already winning popularity in Europe, Kobe beef and other high-grade Japanese beef brands are likely to see solid demand in Poland. Hopefully, soon we will see excellent Polish beef in *yakiniku*⁴ restaurants in Japan.

⁴ A Japanese term, which refers to Japanese style grilled meat dishes (usually beef).