EU-Japan: Advanced Economies Shaping the Next Stage of Inclusive Globalisation

The new EU-Japan Economic Partnership is part of a joint effort to shape globalisation, drive inclusive growth and enshrine high standards in international trade. The timing of its conclusion is not coincidental. The world is at a tipping point, with some leading powers touting protectionism as the answer to the uneven distribution of benefits stemming from globalisation and trade. Others seek a global realignment around the interests of illiberal, authoritarian states. In short, there is existential pressure on the rules-based, international order that guided the decades following World War II.

In this state of intense geopolitical uncertainty, an economic partnership like the one concluded between the EU and Japan surpasses mere business interests. It is a vow of collaboration between democracies and advanced economies that have among the world’s highest environmental, regulatory and social standards. By strengthening economic and trade ties, the deal will also provide increased political clout when defending these high standards vis-à-vis other powers which might want to challenge them or undercut multilateralism going forward.

Above all, the new EU-Japan partnership demonstrates to the world at large that mature economies do not have to be at the mercy of broader forces shaping the global economy and international governance system. There are many challenges that responsible global players can only tackle together, ranging from protecting the environment and tackling climate change to ensuring regional stability and reaffirming the rules-based, international order. Against this backdrop, the EU-Japan agreement is a forceful and timely joint statement of intent in acting for multilateralism and choosing strategic cooperation at a time when confrontation is all too prevalent.

The EU and Japan: one third of the world economy

The EU and Japan are natural trading partners: both similarly wealthy, developed economies and mature democracies. Japan is the world’s fourth largest national economy in the world; the EU is the world’s largest trading bloc. They jointly represent over a third of the world’s GDP (Figure 1). Bilateral ties have strengthened between the two economic powerhouses since the 1990s, after a series of European treaty reforms made it clear that Europe was heading toward deeper economic and political integration. The EU and Japanese economies are already very closely inter-linked: the EU is Japan’s third most important trading partner (after China and the US). Japan is the EU’s second most important Asian trade partner, behind China and ahead of South Korea. The EU absorbs over 11% of all Japan’s exports, while Japan accounts for slightly more than 3% of the EU’s total exports (Figure 2).
This difference largely reflects the fact that the EU market is over three times the size of that of Japan. In absolute terms, **EU imports from Japan totalled around 82.9 billion euro in 2016** (of which 66.6 billion euro in goods and 16.3 billion in services), while **EU exports to Japan totalled 87.5 billion euro** (of which 58.1 billion euro in goods and 29.4 billion euro in services). The main sectors of export were chemical products, machinery and appliances, transport equipment, optical and photographic instruments, and foodstuffs. The main sectors of import were machinery and appliances, transport equipment, chemical products, optical and photographic instruments and plastics and rubber.

Japanese import tariffs for some types of EU goods are often significant. Import levies for meat and cheese can be as high as 40%. Additionally, Japan applies a range of ‘non-tariff measures’ that further hinder the export of European goods and services. These include, for example, complex and national-specific approval processes for EU food and agricultural products, restrictions on EU firms bidding for public contracts in Japan, and many sector-specific limitations on their capacity to provide services for Japanese customers. Altogether, they add up and result in high trade costs to EU exports, making them less competitive in the Japanese market (Table 1).

Different studies estimate that the combined potential gains from reducing tariffs and non-tariff barriers through an EU-Japan economic partnership could be substantial – with European exports to Japan increasing by as much as 70% – or 43 billion euro – per year. Japan would also benefit significantly, with its exports to the EU increasing by up to 60% in the most far-reaching scenario (Table 2). This estimate is in line with assessments of the EU and South Korea free trade agreement five years after its entry into force. Whereas the EU registered a trade deficit with Korea in 2010, by 2015 the EU experienced a trade surplus of nearly 6 billion euro, owing to a 55% increase in European exports to South Korea (Box 1).²
Table 2: Estimated gains from an EU-Japan economic partnership

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<th>Source</th>
<th>EU</th>
<th>Japan</th>
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<td>Exports increases (%)</td>
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<td>Bertelsmann Stiftung, 2017</td>
<td>Min 12.5</td>
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<td>European Commission, 2012</td>
<td>Min 22.6</td>
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<td>Copenhagen Economics, 2009</td>
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Box 1: Trade openness driving innovation, productivity and growth in the car sector

Similarly to the negotiation of the EU-South Korea free trade agreement, which took effect six years ago in July 2011, cars feature among some of the trickiest issues that had to be settled in the talks between the EU and Japan.

Indeed, the Japanese car industry suffered from the Korean cost advantage created by the EU-Korea trade agreement, and Japan is very keen for the EU to remove its tariffs on imports of Japanese cars and components, making Japanese cars and components more competitive. This is of course contentious for EU car manufacturing countries, which fear that this could result in a flood of Japanese car imports to Europe.

However, the deal with South Korea suggests that this need not be the case. In fact, since the agreement was signed, there has been a sharp rise in EU car exports to South Korea (EU exports soared from a mere 2 billion euro in 2006 to over 8 billion euro in 2015, with most of this 400% increase corresponding to the post-free trade agreement period), turning what used to be a trade deficit into a surplus. What is more, the increased competition on EU markets has driven innovation and productivity gains in the European automotive sector, making it more competitive worldwide.

At the same time, more than two-thirds of all Japanese-brand vehicles sold in the EU are actually manufactured in the EU, and many of these are exported to third countries. Japanese car-makers have 14 production plants and 16 research and development centres in the EU, employing 34,000 people and a further 127,000 indirectly. Therefore, removing tariffs could also provide a significant boost to production and jobs in Japanese-owned car plants in Europe.

A partnership to address some of the 21st century’s most profound societal challenges

In spite of their different journeys, the EU and Japan have striking similarities when it comes to the challenges they face in the medium to long term (Figure 3). Deepening the partnership can help both economies to find workable and sustainable solutions that are of mutual interest.

Need for new sources of growth

Japan and the EU are the super-ageing regions of the world. With population size in Japan already shrinking, and populations across EU Member States set to decline, both regions will represent ever smaller shares of the global population in relative terms. In both cases, populations will not only be smaller, but also much older, with more than one quarter of the Japanese population and almost a fifth of all Europeans already aged over 65. This represents an almost fivefold increase since 1960 for Japan, and a doubling for the EU (Figure 4).
These demographic trends are putting pressure on healthcare and welfare systems, and threatening the sustainability of public finances in both regions. By 2060, there will be only 1.3 working age Japanese (15-64) for every person over 65. In the EU, the number of workers per pensioner will be halved, from four in 2015 to just 2 in 2060. The near absence of immigration makes Japan’s situation significantly more demanding.

This reality means that both Europe and Japan will need to maximise their growth potential while ensuring that it benefits a broad cross-section of their population.

The new EU-Japan economic partnership will open opportunities for growth in key sectors relating to healthcare and welfare provision, such as pharmaceuticals, medical devices, or the ‘silver economy’, but also in many other areas, such as agri-food, motor vehicles and transport equipment. The agreement will also open up Japan’s services market to EU firms, while a dedicated chapter will be devoted to helping small and medium-sized enterprises that are disproportionately affected by unnecessary barriers to trade. Altogether, these key market openings on both sides could increase EU GDP growth by 0.76%, which is likely to have positive spillover effects on the job market. Already today more than 600,000 jobs are linked to exports to Japan, while Japanese companies employ more than half a million people in the EU.

Sustaining high labour, environmental, consumer standards

The EU often sets the global standards when it comes to labour, environment and consumer safety, but Japan is not far behind (Figures 5 and 6). Of the eight International Labour Organisation (ILO) Fundamental Conventions that make up core labour standards, Japan has ratified all but two (among them the convention on non-discrimination, pointing to the continued challenge for Japanese women to advance in the labour market).

When it comes to the environment, Japan is improving its record. In the latest Environmental Performance Index (EPI), the country moved up to 39th place, slightly behind Germany and the Netherlands (ranked 30 and 36 respectively) but ahead of Belgium (which ranks 41). Within East Asia and the Pacific, Japan is one of the top environmental performers, ranking only behind New Zealand, Australia and Singapore. Finally, on consumer standards, Japan is largely on par with the EU, with both sides having the highest consumer protection standards in the world. The EU-Japan Economic Partnership should reinforce these standards, not only for the territories it covers but potentially also outside, as both are committed to working more closely with each other in international cooperation.

Source: Organisation for Economic Cooperation and Development (OECD), United Nations, European Commission
standard-setting bodies. This means that rather than lowering standards, this kind of economic partnership can spearhead a race to the top and thereby not only help sustain high European standards but also bring these benefits to others.\(^5\)

**Figure 5: Japan shares European high standards on employment...**

Indicator of Employment Protection Legislation

![Graph showing employment protection legislation in various countries.](image)

Notes: This is a composite indicator that takes into account four areas of labour protection. Figures are represented on a scale of 0 (least restrictions) to 6 (most restrictions). The EU average only includes 18 EU Member States. Data is from 2013. Data for UK and Slovenia from 2014. Data for Croatia and Lithuania from 2015.

Source: Organisation for Economic Cooperation and Development (OECD)

**Figure 6: ...and on food safety**

2014 World Ranking of Food Safety Performance

![Graph showing food safety rankings in various countries.](image)

Note: The EU average only includes the average of EU Member States present in the study.

Source: The Conference Board of Canada

**Shaping technology standards, especially in industry and manufacturing**

The world is on the cusp of a new wave of technological change that is transforming the way people live, work and interact. Digitisation is reshaping entire industries and spreading to sectors that for a long time seemed unlikely to digitise, like the healthcare industry or transport. With the United States and China now leading the world’s most valuable digital technology companies, it is important for Japan and Europe to find ways to collaborate and find their own niche. By teaming up, they have a unique opportunity to shape the next phase of digital disruption that may accompany the spread of the Internet of Things. Operating at the intersection of world-class manufacturing, big data and ubiquitous connectivity – and combining this with the world’s highest privacy standards and set of digital rights – can give this partnership a competitive edge over other players. It is not without reason that Japan has expressed interest in adopting a similar regulatory approach to data as the European Union.

Together – and against the backdrop of the EU-Japan Economic Partnership – the two territories now have an opportunity to shape the next production revolution, ensuring that the ‘things’ that connect via the Internet do so safely and in full respect of the fundamental right of data protection. In the absence of a solid joint EU-Japan approach to digital standards for manufacturing, it is very likely that either the United States or China – as the world’s largest industrial players (Figure 7) – will set the tone and enforce their approach towards data and privacy on others. By acting first, the EU and Japan can both set higher standards and reap important economic opportunities from their first-mover-advantage. This is subject to continued talks on the future of data flows between our two economies.

**Figure 7: Top ten manufacturers now and in 2020**

![Bar chart showing top ten manufacturers in 2016 and 2020.](image)

Source: Deloitte, Global CEO survey: 2016 Global Manufacturing Competitiveness Index
Working together to better harness globalisation and uphold the multilateral world order

As modern, open and industrialised democracies, the EU and Japan share common values and cooperate closely with one another in international and multilateral fora such as the United Nations, the World Trade Organisation (WTO), and the G7 and G20. The scope of their relationship has broadened in recent years, going far beyond the earlier trade-related focus of the 1970s and 1980s. Building on a far-reaching basis of shared interests, the EU established a Strategic Partnership with Japan in 2001, and top leaders have been meeting at the annual EU-Japan Summit since 1991. Over time, EU-Japan relations have also deepened, due to a strong convergence of interests and mutual trust. The same cannot be said for all of the EU’s strategic relationships – and, in this particular time of global uncertainty, trusted friends are more valuable than ever.

Combatting climate change is for instance one area where both regions have a strategic joint interest and can achieve more together than apart. Following the US announcement that it is withdrawing from the Paris Agreement, Japan and EU both reaffirmed their unflinching ambition and commitment to the global institutions set up to tackle climate change. In fact, Japanese industry is already a key global actor in the global value chains of clean technologies, including being the host of the largest production capacities for lithium-ion battery cells, a key enabling technology for electric cars. Already in 2016, Japan had the third largest electric vehicle fleet on its roads, only after China and the United States, and Japanese car producers Toyota and Honda dominate the global market for Hydrogen Fuel Cell Vehicles, together with Korean producer Hyundai.

Shared security and regional strategic interests

While seemingly unrelated, trade and economic relationships between territories do matter and have spill-over effects on security and regional stability. This is particularly true with regard to new security risks – such as the proliferation of international terrorism, Russia’s annexation of Crimea, China’s assertive military presence in the South Chinese Sea and North Korea’s nuclear and ballistic missile programme – which create new challenges both in the European and Japanese neighbourhoods. The sky-rocketing numbers of daily cyberattacks on public and private infrastructure are equally harmful to advanced and open societies. The EU and Japan are in the process of strengthening their respective internal and external response capacities. In parallel, multilateral teaming-up is much needed. The scope for reinforcing EU-Japan security cooperation is considerable, from jointly building cyberattack resilience to aligning economic sanctions regimes and cooperating on counter-terrorism, maritime security, the rule of law, human rights and regional dispute-resolution.

Political dialogue and policy coordination are in the centre of the EU-Japan partnership, but also cooperation on regional and global challenges, including environment and climate change, development policy, disaster relief and security policy. Regular dialogues are held on information society, cyberspace, science and technology, trade, financial services and industrial policy. Additionally, the EU and Japan have a regular dialogue on human rights and cooperate in various forums, such as the UN Human Rights Council and in the UN 3rd Committee. These political collaborations now hold the promise of being reinforced by stronger economic ties, leading to a virtuous circle in which the many shared interests will not only provide tangible benefits to both sides but will also enable more resonance on the global scale.

Conclusion: The strengthened EU-Japan partnership is about much more than trade

The EU-Japan Economic Partnership is a mission statement about the willingness of two of the world’s major economic powerhouses to continue to develop close ties based on trade openness, fairness and a strong commitment to multilateralism. It will make economic exchanges easier for European and Japanese firms but it will also bring the EU and Japan together in an active campaign for the world of rules and shared interests, rather than protectionism and go-it-alone solutions to pressing problems.
Notes and References

1. European Commission, 2017 'Countries and Regions – Japan'
2. As a comparison, a study of the effects of the EU-Korea Free Trade Agreement previous to its entry into effect estimate exports gains of up to 83% (or 41 billion euro) for the EU and of 38% (or 34 billion euro) for Korea. See Decreu, Y., Milner, C., and Péridy, N., 'The Economic Impact of the Free Trade Agreement between the European Union and Korea', Report for the European Commission, May 2010.