

# The EU-Japan Economic Partnership Agreement

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**The EU-Japan Economic Partnership Agreement: Second Best Option or New Generation of Preferential Trade Arrangements?**

## INTRODUCTION

The EU-Japan Economic Partnership Agreement, the trade parts of which came into force in February 2019 (European Commission 2018a; DG Trade 2019), was the result of one of the most swiftly negotiated bilateral trade agreement initiatives since the European Union launched its ‘Global Europe’ initiative in 2006. At the same time, it was a beautiful feather in the cap for Japan’s Prime Minister Abe, who had put significant prestige on concluding the deal. After an impact assessment on the potential FTA had been conducted, the negotiations were launched in March 2013. The two parties held 18 rounds of negotiations, reaching an agreement in principle in July 2017, and finalizing negotiations in December 2017 (DG Trade 2018a), yet continuing to negotiate a Strategic Partnership Agreement. When the trade part, covering both goods and services, entered into force, it bypassed the EU’s FTAs with Singapore and Vietnam, which were concluded earlier but are still waiting to be ratified. Despite the obvious mutual benefits of such a far-reaching liberalization of trade in goods and services, and with indisputable economic and commercial advantages for both the EU and Japan, the issue remains that both parties, each one separately, had during the last years put considerable effort into carrying out much other, larger endeavors to further liberalize international trade and investment – the Transatlantic Trade and Investment Partnership and the Trans-Pacific Partnership respectively. The TPP, comprising 12 countries and covering 40 percent of global GDP and one-third of

world trade, had been under negotiation since 2008, with Japan as a late entrant in 2013. It was signed by the 12 countries in May 2016; Japan was the first signatory to ratify it, on 20 January 2017. Three days later, on 23 January, the new American president signed a Presidential Memorandum to withdraw the United States from TPP, whereupon it could not come into force. Just before that, the comprehensive trade and investment partnership negotiations between the EU and the United States had been put on ice after 15 negotiation rounds in December 2016, awaiting further signals from the new American trade administration (DG Trade 2018b). There was, accordingly, under these disappointing circumstances, a window of opportunity for both the EU and Japan to put greater focus on other ongoing talks. From Japan’s viewpoint, the successful completion of the Korea-EU Free Trade Agreement, which was provisionally applied in 2011 and formally ratified in December 2015, became an important motive to not lag behind its main local competitor when it came to market entry to the European Union (Kleimann 2015). The EU, for its part, had launched a number of preferential trade agreement negotiations with various Asian partners in accordance with the ‘Global Europe’ policy, which at this time had been further revised and updated in its ‘Trade for All – Towards a More Responsible Trade and Investment Policy’ in 2015 (European Commission 2015). This latest strategy was followed by a reflection paper in May 2017 (European Commission 2017).

The EU’s original ambition to launch a free trade agreement with the entire ASEAN bloc had been put on hold, whereupon bilateral talks had been commenced with separate member states, initially Singapore and Vietnam. These FTAs also came to serve as models for later negotiations (Pollet-Fort 2011; Alvstam et al. 2017). In parallel, negotiations with India had been ongoing without progress for some time, while talks with South Korea were successfully brought to an end.

Japan’s preferred option was still to conclude the TPP agreement with the ten remaining partners, despite the fact that a TPP without the United States was much less attractive. In this situation, the EU route proved to be a sufficient ‘second best’ opportunity, which is why these negotiations were ‘brought



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back from the shadows' and intensified rapidly during the first half of 2017 (Suzuki 2017).

Since they were held at the same time as two notably larger FTA negotiations involving the United States and the EU, the Japan-EU negotiations encountered surprisingly little criticism from civil society organizations (Suzuki 2017), as the two simultaneous mega-processes overshadowed the talks between the EU and Japan. As Kleimann (2015) notes, this was evident in Europe, in particular, as a disproportionate bias in the public interest, as the TTIP gained most of the subsequent media attention.

One major reason for this attention was the change made in the EU's own institutional structure regarding preparation and decision-making on international trade agreements. The Lisbon Treaty of 2009 made the European Parliament central in the EU's trade partnerships; this was a notable alteration to the prior structure under which the European Commission took care of the Common Commercial Policy and various bilateral arrangements (Nelson 2012). This had resulted in a relatively low degree of transparency, as the Commission wanted to protect the evolving negotiations from lobbyists, stakeholders, and the public in order to retain room for maneuver in bargaining with the counterpart (Kleimann 2015). After the Lisbon Treaty, the situation changed dramatically (Cremona 2018). It opened the possibility for public debate, including in the now more powerful European Parliament. However, such a debate did not materialize in the case of the EU-Japan negotiations, which began just before the first round of the geo-strategically important TTIP talks. They were also in the shadow of the very advanced and far-reaching agreement with Canada – the Comprehensive Economic and Trade Agreement (CETA) – which can be seen as a role model for the new generation of EU economic partnership agreements. CETA was approved by the European Parliament in February 2017, shortly after the disappointment concerning the freezing of TTIP negotiations. The agreement was accepted despite strong resistance from a number of party groups, not only within the European Parliament but also at the national and regional level in some member states. A similar shadow was cast in Japan, where public interest was drawn to the negotiations with the United States in the TPP constellation and the ambiguous economic relations with China, which meant that the EU-Japan talks were almost completely ignored.

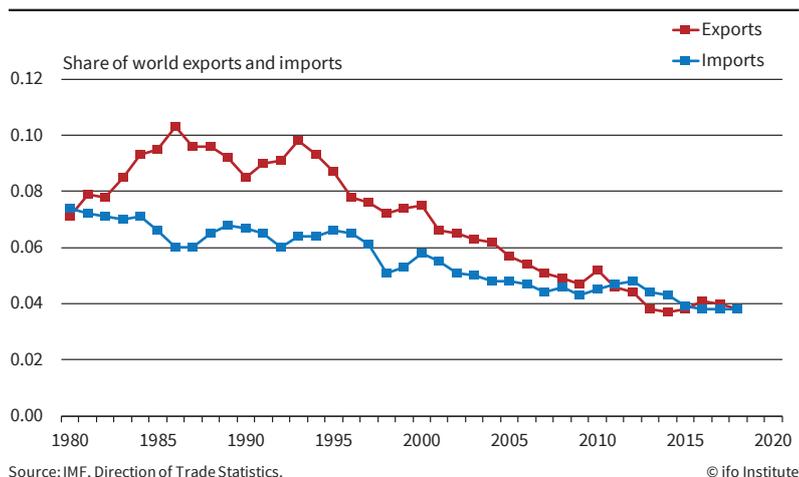
#### **PAST AND PRESENT ECONOMIC RELATIONS BETWEEN THE EU AND JAPAN**

The launching of EU-Japan negotiations was originally the result of a change in approach by Japan and the EU to their bilateral relations in 2011. As Söderberg (2012) notes, for two decades prior to that, the relationship had been governed by detailed documents

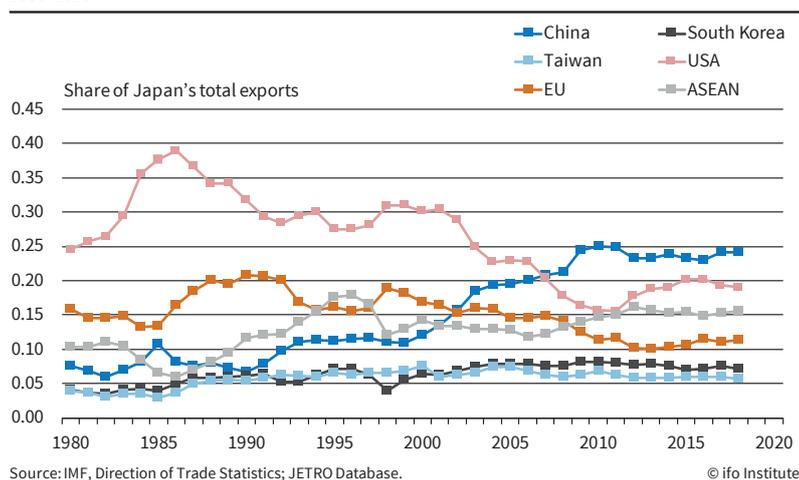
that provided the framework and exact guidelines to the dialogue. After the 2011 EU-Japan summit, however, a statement was published in which Japan and the EU agreed to begin negotiations on two fronts: i.e., for an FTA or an economic partnership agreement (EPA) and for a binding agreement on political, global, and sectoral cooperation. Also instrumental was Japan's new government, led by Prime Minister Abe Shinzo, and the emphasis on FTA talks as part of the 'third arrow' of the so-called Abenomics policy (Alvstam and Nakamura 2014). This was a turning point in the governance of the bilateral relations – even more so since the actual trade negotiations were opened in a relatively quick pace.

Japan's traditionally export-oriented economy has grown at a lower rate than the global economy during the past three decades, and its share of world trade in goods has accordingly decreased at an alarming pace, from around 9–10 percent of world exports and 6–7 percent of imports in the 1980s and early 1990s to 4 percent of exports and imports in 2018 (Figure 1). There has at the same time been a remarkable shift away from a focus on trade outside the East and Southeast Asian area in the past to a more balanced pattern today. The most important shift in the direction of intra-regional trade has been the decline of trade with the United States and the soaring share of trade with China (Figures 2 and 3). The roughly 50/50 balance between intra- and extra-regional trade in goods was generally reached in the early 2010s (Table 1), and since then there has been a clear although not officially explicit policy to restrain dependence on China while maintaining the US share at a stable level. Trade with the EU had also decreased in relative terms over a long period. The EU's share of Japanese exports was normally around 20 percent in the early 1990s but had declined to 10 percent twenty years later. The EU's share in Japanese imports, which had been around 15 percent in the 1990s, had tumbled to less than 10 percent in the early 2010s (Figures 2 and 3). The mirror image in EU statistics reflected the same pattern. Japan's share of the EU's extra-regional imports was around 12–13 percent in the late 1980s but had declined to 3–4 percent in the 2010s. Japan's share in the EU's extra-regional exports declined from about 6 percent to 3 percent over the same period (Figure 4). Considering this negative development, the initiative to launch a broad free trade agreement between the EU and Japan in order to improve trade in both directions was indeed mutual. From the EU's perspective, the more active policy of launching regional and bilateral trade and investment agreements with non-European partners can also be seen as a result of the stalled talks at the multilateral level within the Doha Development Agreement (DDA) and the fact that the intra-regional trade ratio among the EU member states had stagnated at the level of 60–65 percent of total trade since the 1980s

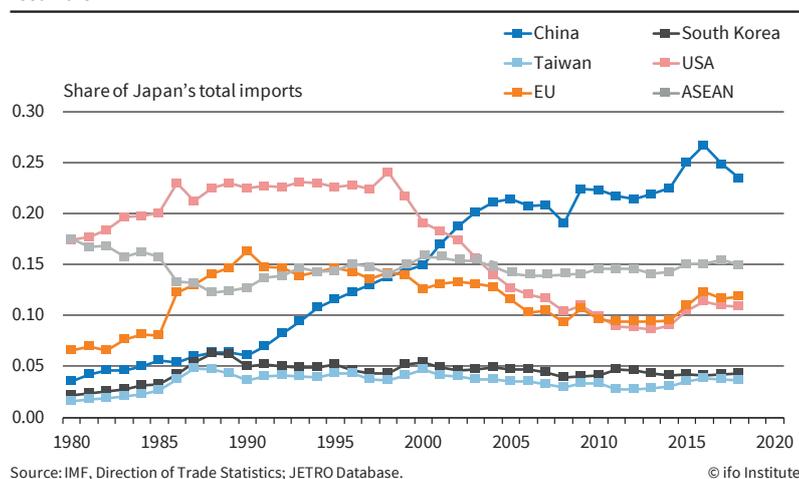
**Figure 1**  
**Japan's Exports and Imports of Goods**  
 1980–2018



**Figure 2**  
**Japan's Exports of Goods by Main Destinations**  
 1980–2018



**Figure 3**  
**Japan's Imports of Goods by Main Origins**  
 1980–2018



mid-2000s, the EU found itself lagging behind when it came to the development of strategic trade relations in Asia and forced into a reactive rather than a proactive policy (Ahnlid et al. 2011; Ahnlid 2012). The commencement of trade talks between the EU and Japan immediately resulted in improved shares of mutual foreign trade in goods, while it should be noted that both parties report deficits in their respective bilateral trade balance (Figure 6). Such discrepancies are not unusual; they are normally the result of indirect trade and of differences in the reporting of origin and final destination in trade statistics by the respective parties, but can be used in the public debate to argue for protectionist measures and to accuse the partner of 'unfair' trade practices that should be corrected.

The commodity composition of trade in goods between the EU and Japan reflects differences with regard to industrial policy and relative competitive strengths between the parties. While Japanese exports are heavily concentrated on advanced manufacturing products within the electronics and automotive sectors, as well as general machinery, the EU's exports are much more diverse, with larger shares for basic manufacturing and the agricultural and food sectors. Consequently, market access for various food products to Japan became the main hurdle in the final negotiation rounds, and threatened also to delay the whole process, despite their insignificance in terms of value. Food products account for less than 10 percent of Japan's imports, but play an important role as symbols of national self-sufficiency and identity.

despite continuous enlargement (Figure 5). When the multilateral DDA negotiations ran into trouble in the

expressed regarding further market access for Japa-

Table 1

**Japanese Intra- and Extra-regional Trade of Goods, 1980-2018 (%)**

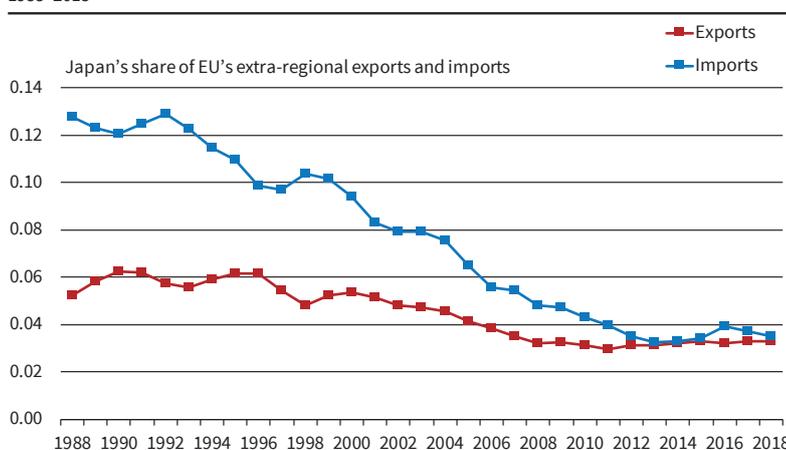
	Exports		Imports	
	Intra-regional <sup>(a)</sup>	Extra-regional	Intra-regional <sup>(a)</sup>	Extra-regional
1980	23	77	25	75
1985	24	76	27	73
1990	30	70	27	73
1995	42	58	35	65
2000	40	60	41	59
2005	48	52	44	56
2010	55	45	44	56
2015	52	48	48	52
2018	53	47	46	54

Note: <sup>(a)</sup> The intra-region includes China (Mainland, Hong Kong, Macau), South Korea, Taiwan, and 10 ASEAN countries.

Source: IMF, Direction of Trade Statistics; JETRO Database.

Figure 4

**EU Trade with Japan — Shares of Total Extra-regional Exports and Imports (Goods) 1988–2018**

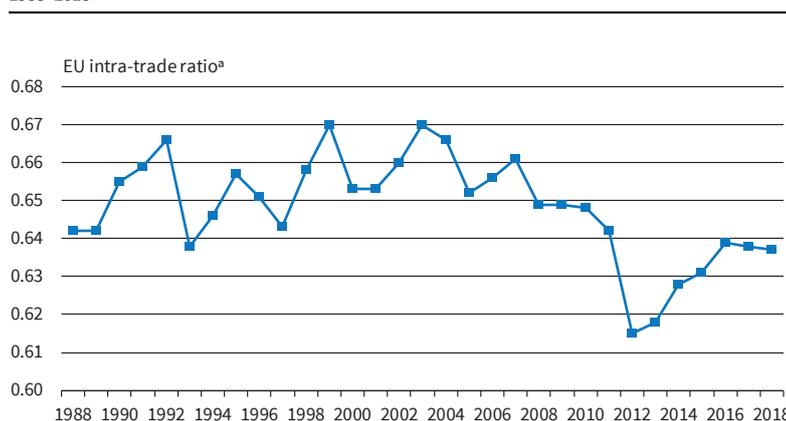


Source: IMF, Direction of Trade Statistics.

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Figure 5

**EU Intra-trade Ratio (Goods) 1988–2018**



Note: <sup>(a)</sup> The intra-trade ratio = (intra-exports and intra-imports) / (total exports + total imports).

Source: IMF, Direction of Trade Statistics.

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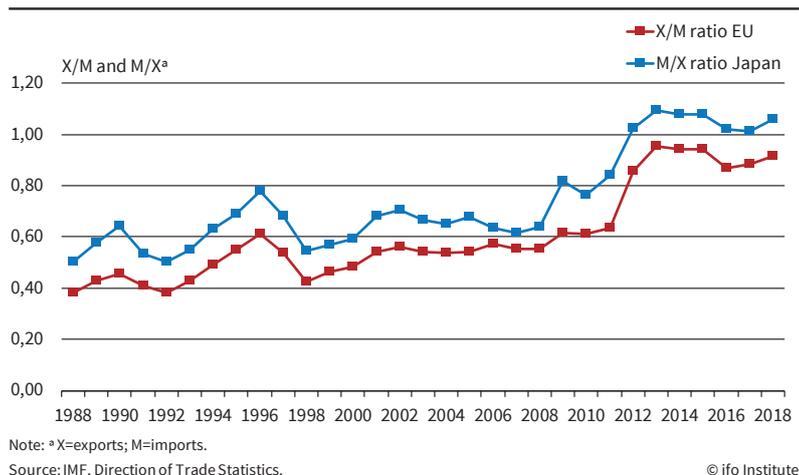
tion has been paid in the public debate to a sector that has a much higher potential for further efficiency enhancing and mutual harmonization and standardization: i.e., the vast service sector.

When it comes to trade in services, Japan has been notoriously underrepresented compared to trade in goods. This imbalance is also typical when it comes to trade in services with the EU. While trade in goods is basically balanced between the two parties, the EU reports a massive surplus in trade in services with Japan, comprising an export/import ratio of about 1.8 during the years 2015–2017. Accordingly, the services share of the EU’s total exports to Japan in goods and services accounted for about 36 percent in 2017, compared to the service share of total exports in goods and services, which usually amounts to 20–25 percent in most trade relations. While the service sector is described in official statistics as production and trade by companies that are classified as service firms, in fact an increasing share of services are ‘embedded’ within physical products in functions such as R&D, design, product development, maintenance, etc. This equivocal role of services has made them more complex to assess, to regulate, and to harmonize, and the effect has been that the service sector has often ‘run under the radar’ and remained protected at the national level, despite far-reaching liberalization of trade in goods in general. One important step in the direc-

nese car brands could be seen as a paradox, given the fact that a large share of Japanese passenger cars for the European market were already being assembled in Europe and that two of the largest Japanese and European car companies were merged. Thus, the general description of the negotiations as ‘cars for cheese’ is heavily exaggerated. Notably less atten-

tion of removing various technical barriers to trade was taken in the EPA with the decision to create a special Committee on Trade in Services, Investment Liberalization, and Electronic Commerce (Article 8.4 in the Agreement (European Commission 2018a)). Whether such a committee will make a real impact when it comes to implementing the intentions in the

Figure 6  
Trade Ratio between EU and Japan (Goods)  
1988–2018



agreement remains to be seen, but it clearly is a step in the right direction. Another major issue that is built in to the Committee's mandate is the distinction between trade and foreign direct investment (FDI).

The FDI pattern is historically balanced in Japan's favor. Given the high barriers to entry for FDI to Japan, inward FDI in Japan is usually much lower in relation to GDP than in most other advanced economies. The outward/inward FDI stock ratio with Japan as seen from the EU's perspective amounted to 0.43, or about EUR 130 billion, in 2017. This imbalance was one of the crucial issues in the EPA negotiations, and several of the issues are still open, including standardization and harmonization of rules and regulations regarding foreign companies, as well as settlements on intellectual property rights.

This imbalance in the FDI pattern between the EU and Japan has indirectly been a major problem in the trade negotiations. While European companies mainly enter the Japanese market through exports and only to a limited extent through FDI, the strategy of Japanese firms, particularly in the automotive industry, has been to build manufacturing platforms in Europe, and in this respect not only to export CBU (completely-built-up) vehicles but also essential parts and components for local assembly. The flows of parts and components were not necessarily shipped directly from Japan, but to a certain degree also from other locations by Japanese companies, e.g., in Southeast Asia and Turkey. These indirect exports are not explicitly considered in the EPA; they offer a higher degree of flexibility when it comes to market access for Japanese firms in the EU compared with their European competitors in Japan (Alvstam and Nakamura 2016). Furthermore, the extensive stock of Japanese FDI in European industry, particularly the UK, has given Japanese firms in the EU a wide range of opportunities regarding local sourcing of parts and components within the single internal market. On the other hand, Japanese firms

are more vulnerable with regard to changes in rules and regulations for foreign enterprise, which, while more directed towards China than Japan, affect Japan equally. Since concerns had grown in Europe about Chinese investments in certain key sectors, in June 2017 the European Council welcomed a Commission initiative suggesting that third-country investments in strategic sectors should be analyzed. A new EU framework for the screening of FDI subsequently entered into force in April 2019 (Alvstam and Lindberg 2019). The British

decision to leave the EU came as a shock for Japanese business, which had seen the UK as its prime location within the European single market (Angelescu 2018). At the same time, despite the trade part of the EPA having entered into force in February 2019, negotiations on investment protection and the EU's new model for dispute settlement (the Investment Court System) have continued, and will become an important litmus test regarding the general strength of and mutual trust in the EPA.

One of the main ambitions in the new generation of economic partnership agreements between the European Union and external trade and investment partners has been the objective of also incorporating a wider spectrum of issues – such as human rights, labor standards, environmental protection, sustainable development, etc. – within the general framework of the agreement. These ambitions can be seen as an example of the EU's self-representation as an ethical and normative power that can be summarized in a general shift from 'trade *and* responsibility' to 'trade *for* responsibility' in the EU's external trade policy (Poletti and Sicurelli 2018; Zurek 2019). In this respect, each new negotiation has been used as a laboratory and a 'normative spearhead' for pushing these trade and sustainable development (TSD) issues further. For example, the EU's consecutive agreements with three Asian countries – South Korea, Singapore, and Vietnam – show an evolution from vague to more detailed notions in the final FTA texts (Kettunen and Alvstam 2018). This ambition is further enhanced in the EU-Japan EPA (Kettunen and Alvstam 2019).

#### IMPLEMENTATION OF THE EPA AND THE NEW TWISTS AND TURNS IN INTERNATIONAL TRADE POLICY

Despite the sudden US withdrawal from the TPP, the remaining 11 partner countries had already decid-

ed during spring 2017 to proceed with their efforts to close a far-reaching deal. In March 2018 they succeeded in signing a ‘Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)’, which entered into force for six members, among them Japan, Canada, and Mexico, in January 2019. The relatively smooth completion of the CPTPP sent a strong signal of further advocating free trade, but it can also be viewed in the context of a competing regional free trade initiative led by China, the ‘Regional Comprehensive Economic Partnership (RCEP)’, comprising, in addition to China and Japan, the ten member states of ASEAN, plus South Korea, India, Australia, and New Zealand. Compared to the CPTPP and the EU-Japan EPA, the RCEP did not have the objective of incorporating broader TSD issues; its main attraction from a regional trade viewpoint is that it includes China, South Korea, and India, which were visibly absent from the TPP talks. The ambition is to conclude the agreement before the end of 2019.

In this respect, Japan has managed to keep its doors open to both its TPP partners after the US withdrawal, secure improved market access to the EU, and at the same time take steps to further institutionalize its trade relations with China. Even though the RCEP can be seen as a more ‘hollow’ agreement and one that has been criticized for being an instrument of China’s geopolitical ambitions, it has the potential to become a stepping-stone to closer harmonization with the CPTPP in order to form a large free trade area in the Pacific in the absence of a functioning multilateral framework. For its part, the EU has a strong motive to build further on its existing and potential FTA/EPAs with the CPTPP members, albeit with China as the main uncertain factor.

An open question for both the EU and Japan remains how to deal with the United States, which has strongly preferred bilateral over interregional or multilateral negotiations. In the wake of the current trade conflict between China and the United States, and the present American instinct to treat its traditional allies as foes and competitors, it may nevertheless be a promising sign that both the EU and Japan have commenced low-intensity talks with the United States in order to solve the multitude of outstanding issues caused by the aggressive unilateral ‘America First’ policy (Japan Times 2019; Politico 2019). These recent developments clearly demonstrate that all ongoing trade negotiations as well as finalized agreements should be seen in a broader global context and not only as isolated ventures limited to the partners involved. The EU-Japan EPA is a good example of how to promote bilateral trade relations while at the same time maintaining a subtle balance with other partners and also aiming higher when it comes to using trade as a tool for sustainable development.

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