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# The Japan-EU Economic Partnership Agreement: Opportunities and Pitfalls

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After nearly six years of tough negotiations, Japan and the EU have concluded a free trade agreement. The Japan-EU Economic Partnership Agreement (JEEPA), as it is officially called, was ceremonially signed at the Japan-EU summit in Tokyo in July 2018. Subsequently, it was ratified by the European Parliament and the Japanese Diet in December 2018 and entered into force on 1 February 2019. The agreement establishes the world's largest free trade zone. The question arises as to the effects of the agreement on EU-Japan trade. In this respect, this article focuses particularly on Japan.

Japan used to have the reputation of being a closed economy. To be sure, Japan has become more open over the past few years: formal trade barriers have largely disappeared, imports from overseas have increased significantly, and more foreign companies have established themselves successfully in the Japanese market. However, relatively speaking, Japan still exports and imports less than other countries. Foreign companies claim that entering the Japanese market is unusually difficult. From the outside, the country's economic structures appear to be opaque, culturally different, and difficult to access.

Certainly, the below-average integration of the Japanese economy into the international division of labor is an even greater problem for Japan itself than for its trading partners. Japan is forgoing potentially large gains from foreign trade, thereby inflicting harm on its national competitiveness and economic growth. To its credit, Japan has recognized the problem and is actively countering it through a policy of foreign trade liberalization. It was also this motivation that prompted Japan to abandon its once strictly multilateral trade policy and to conclude several bilateral trade agreements, starting with countries in Southeast Asia, Latin America, as well as Switzerland and Australia. Against this backdrop, the conclusion of JEEPA as well as Japan's participation in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) can be regarded as major trade policy breakthroughs. In both negotiations, Japan was confronted with trade policy heavyweights and had to consent to substantially opening up its market in order to reach an agreement.

In light of these developments, JEEPA needs a closer look. For an economic and political assessment, this article examines (1) Japan's special position in international trade, (2) Japan's market entry barriers, (3) the state of EU-Japan trade relations, and (4) the trade liberalization and facilitation measures actually agreed in the JEEPA treaty. The final section concludes the assessment with a summary of the opportunities and pitfalls.

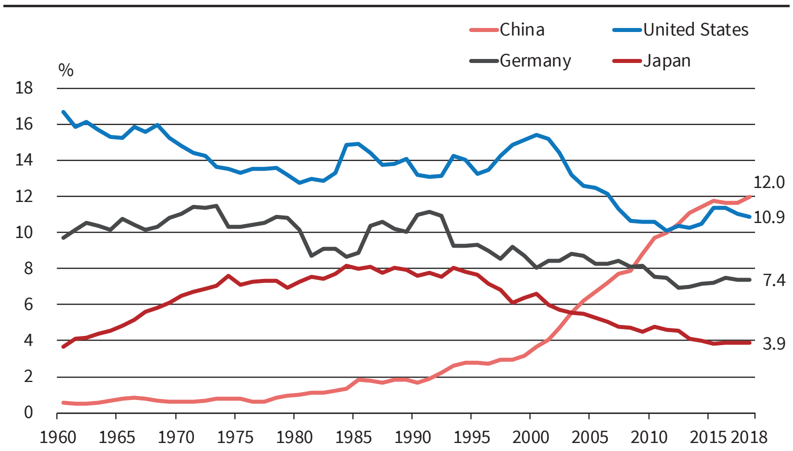
## JAPAN'S SPECIAL POSITION IN INTERNATIONAL TRADE

Japan is the world's fourth-largest trading nation, accounting for 3.8 percent of global exports and 3.9 percent of global imports in 2018 (IMF 2019). However, Japan's importance in world trade has long since passed its zenith. The years of stormy postwar growth (1950–1990) were followed by a period of stagnating foreign trade volumes and declining relative weight (Figure 1). In the wake of the global economic rise of China and other emerging countries, but also due to a decline of competitiveness, Japan has lost market share worldwide and is no longer the largest importer of raw materials and food.

In the course of these structural changes, Japan's share of industrial goods imported by major industrial and emerging countries has declined significantly from 1990 to the present (Table 1). Japanese offshore production compensates only partially for these losses.

Despite this relative loss of weight, Japan is still an eminently important partner in world trade. With

Figure 1
**Japan in World Trade, 1960–2018**
Share of China, Germany, Japan and the US in world trade in goods




Source: International Monetary Fund, Direction of Trade Statistics. © ifo Institute

Table 1
**Japan's Share of Industrial Goods[a)] Imported by Selected Countries – 1990 and 2015 Compared (%)**

| | 1990 | 2015 |
|---|---|---|
| *OECD countries* | | |
| US | 24.6 | 7.2 |
| EU28 | 6.0 | 2.2 |
| - Germany | 8.0 | 3.0 |
| Australia | 21.7 | 7.6 |
| Canada | 8.6 | 3.5 |
| South Korea | 39.2 | 15.4 |
| *Asia* | | |
| China | 16.8 | 12.4 |
| Hong Kong | 18.2 | 6.3 |
| India | 15.0 | 4.8 |
| ASEAN | 30.7 | 11.0 |
| World total | 12.3 | 5.6 |
| World total excluding intra-EU trade | 16.4 | 5.5 |

Note: [a)] SITC 5 to 8 without 667 and 68.

Source: Author's calculations from UNCTAD, UN Comtrade Database.

almost 127 million inhabitants and an annual per capita income of around USD 44,000, Japan has highly developed industrial and service markets, a sophisticated consumer and corporate demand structure, and proven competitive strengths in various high-tech sectors. It exports predominantly industrial goods (86.5%) with a focus on road vehicles (20.7%), machinery and transport equipment (19.0%), plus chemicals and pharmaceuticals (10.2%), while imports are more evenly distributed among energy (21.1%), raw materials (6.8%), food (10.1%), and industry (58.9%) (UNCTAD 2019). The unique position of Japanese industrial suppliers in the international division of labor became clear after the major Tohoku earthquake of 2011, when companies in the automotive and electrical industries worldwide suffered production stoppages due to interruptions in the supply of critical components from Japan (e.g., automotive microcontrollers, silicon wafers, inkjet print heads).

In regional terms, 49.7 percent of Japan's foreign trade is concentrated in neighboring East and Southeast Asia. Its most important trading partner is China (21.5%), followed by the United States (15.0%), the ASEAN community (15.3%), and the EU (11.5%) (UNCTAD 2019). Japan has played a key role in the development and industrialization of its neighboring countries and is enjoying sustainable benefits from Asia's unbroken economic momentum. Since the beginning of the 1970s, Japan has achieved stable high surpluses in its trade and current account balances and now has the largest accumulated foreign assets in the world.

With a total stock of USD 1,226 billion in direct investments abroad (2015), Japan is also one of the world's leading investor countries (JETRO 2017). Japan's industrial manufacturing companies are firmly anchored in North America, Europe, and Asia with their own production sites and distribution facilities. They have a sophisticated system of crossborder production and supply chains in East and Southeast Asia at their disposal to supply world markets or to reimport into Japan. Almost 25 percent of the industrial production of Japanese companies is now located abroad (METI 2015).

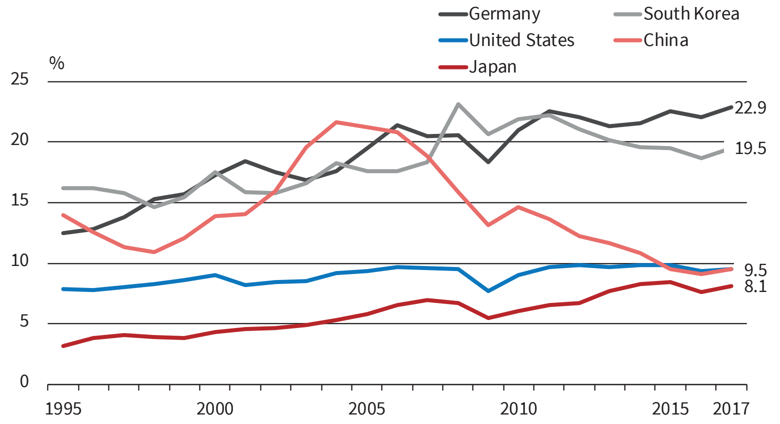
Geography, history, and culture have decisively influenced Japan's foreign trade and foreign trade relations. Until 1853, the island nation of Japan was closed to foreign trade. Back then, only a limited number of Dutch and Chinese merchants were allowed controlled trade through Nagasaki harbor. Japan's opening to foreign trade took place under military pressure in the 19th century, and then under political pressure in the decades after 1945. As a result, Japan's industrialization and modernization occurred geographically far away from the world's economic centers in North America and Europe, initially without being embedded in a regional division of labor. Japan developed its own industrial culture and capitalist institutions distinct from those in the West. These differences, in conjunction with the country's self-referential and insular culture, still stand in the way of Japan's closer economic exchange with other countries and make it more difficult for the country to adapt to the challenges of globalization.

Japan's foreign trade, like its economy in general, is characterized by a dual structure. Foreign trade is dominated by the often highly profitable industrial export sector, typically represented by hierarchically structured global conglomerates and internationally specialized trading companies. The traditional general trading houses *(sogo shosha),* which focus on high volumes and high margins, still play an important role. In contrast, Japan's domestically oriented companies (in agriculture, construction, retail trade, transport, utilities, and small enterprises) are less competitive, less efficient, and only weakly integrated into the international division of labor.

Adapted to the dual structure of its domestic economy, Japan's trade policy is mixed. On the one hand, it aggressively promotes foreign trade and actively supports exports and investments abroad. In the postwar era, exports were even regarded as essential to ensure the survival of the Japanese nation, as the earlier battle cry 'export or die' makes clear. On the other hand, the uncompetitive sectors are protected from foreign competition by non-tariff trade barriers, informal market barriers, and – in the case of agriculture – by prohibitive tariffs.

As a result, Japan is still a relatively closed economy with below-average integration into the global economic division of labor. It is approaching the foreign trade structures of comparable trading nations only slowly. Japan's imports account for a strikingly low share of its gross domestic product (GDP): at 12.8 percent of GDP, Japan imported significantly less in relative terms in 2017 than countries that are similarly dependent on energy and raw material

Figure 2
**Share of Manufactures Imports in Gross Domestic Product**
1995–2017




Source: IMF, World Economic Outlook Database; UNCTADstat. © ifo Institute

imports, such as France (24.1%), Germany (29.8%), or Korea (29.9%). Japan's figure is, however, more on a par with the far larger economies of the United States (12.1%) and China (14.4%) (IMF 2019).[1]

To account for the differences in the import dependencies of energy, raw materials, and agricultural products, a comparison of the proportion of GDP made up by imported industrial goods may provide a more meaningful picture. Figure 2 better illustrates Japan's special position in world trade. In no other country do industrial imports play such a minor role for domestic market supply as they do in Japan. The longer-term comparison also shows, however, that Japan's share has risen continuously since 1990 and have almost reached the level of the United States and China.

The percentage of Japan's GDP accounted for by foreign direct investment is also unusually low at only 3.7 percent (2015), while the corresponding figure for China is 10.8%, 12.9% for Korea, 19.3% for Germany, 25.6% for France, 30.9% for the United States, and a whopping 56.4% for the UK (IMF 2019; UNCTAD 2019). Obviously, foreign investment in market development, for example by setting up local production, services sales, or acquiring a local company, is much more difficult or unprofitable in Japan than elsewhere.

## JAPAN'S MARKET ENTRY BARRIERS

The macroeconomic comparison with other major trading nations has shown that penetration of the Japanese market via imports and foreign direct investment is unusually low. In line with this finding are the skeptical economic assessments of individual foreign entrepreneurs and exporters with regard to market access in Japan.[2] It is true that Japan's low level of imports is related to the large size of the economy in absolute terms and to the country's insular location. These two factors, however, are hardly enough to explain it. There may also be other causes, such as specific barriers to market access that hinder Japan's deeper integration into the world economy. A distinction can be made between tariffs, non-tariff trade barriers, and informal barriers.

### Tariffs

In the industrial sector, high tariffs or import quotas are certainly not the reason for the low import penetration. Import quotas have been completely abolished, and Japan's tied average tariff rate for industrial goods was just 2.5 percent in 2016, making it one of the lowest in the world (WTO 2019). Only Hong Kong and Switzerland have a more liberal industrial tariff regime. In 2013, 82.9 percent of all industrial imports and 55.9 percent of all customs lines were duty-free (WTO 2015).

While there are some high tariff peaks in the industrial sector, they are found only in textiles and clothing (embroidery: 14.2%), footwear (leather shoes: 30%), chemicals (ethyl and butane compounds: 5.5%), and weapons and ammunition (pistols and military weapons: 8.4%) (WTO 2019). In the agricultural sector, on the other hand, high average tariffs do effectively constitute an import protection. Japan's average tariff rate of 18.0% for agricultural goods is significantly higher than in the United States (4.9%) or in the EU (11.8%). However, it is lower than in other comparable countries, such as Korea (57.9%), Norway (133.5%), or Switzerland (45.5%) (WTO 2019). In view of Japan's extensive agricultural imports and low food self-sufficiency rate, the characteristic feature of Japanese agricultural trade policy is not a high degree of protection per se, but rather an extraordinarily high level of protection for selected agricultural products (Hilpert 2000; Yamashita 2015). On the one hand, some agricultural products enjoy little or no tariff protection, e.g., soy, maize, and bananas. On the other hand, tariff quotas in the agricultural sector are still widespread and extremely high tariff peaks can be found. Examples include rice, wheat, barley, starch, beef, pork, milk powder, butter, yogurt, chocolate, sugar, and peanuts (WTO 2015). Especially for

[1] Japan's imports as well as its exports have a comparatively below-average level. With goods exports accounting for 14.1 percent of GDP, Japan exported relatively more than the United States (8.1%) in 2017, but less than China (17.9%), France (21.3%), Italy (25.6%), Canada (26.2%), Korea (37.7%), and Germany (37.9%) (IMF 2019).

[2] A survey of 128 European companies conducted by the Danish research institute Copenhagen Economics showed that exports to Japan were perceived to be more difficult (51%) or much more difficult (25%) than exports to other markets, see Sunesen et al. (2009).

the agricultural products mentioned above, but also for various fruit and vegetable products such as cherries, grapes, and onions, Japan's customs duties are an effective import protection.

## Non-tariff Barriers

Japan's non-tariff barriers to trade (NTBs) are far more effective market-access barriers than its tariffs (Böhmer et al. 2009; Sunesen et al. 2009). In general, NTBs are all non-tariff restrictive measures, regardless of whether they are applied directly at the border crossing point or take effect past the border. Since the 1970s, Japan's NTBs have been the subject of laborious, sometimes conflict-laden bilateral market-opening efforts, particularly on the part of the United States and the EU. Japan's trading partners have been able to achieve significant successes, for example in deregulating the retail trade system, eliminating discriminatory excise taxes, liberalizing financial markets, and strengthening the national IPR system. But many NTBs still effectively hinder access to the Japanese market, even if their original purpose was not protectionist.

Japan's NTBs are regularly recorded by the WTO and the European Business Council in Japan, and occasionally by the US authorities as well. The following list is a condensed selection of the most important ones (EBC 2015; Hanson 2010; Sunesen et al. 2009):[3]

- Japan-specific norms, standards, and labeling requirements constitute competitive disadvantages for foreign suppliers by coercing them to make costly product adjustments specifically for the Japanese market.
- Approval and licensing procedures, product certifications, and approvals are time-consuming, lengthy, and sometimes not very transparent. Foreign certificates and testing procedures are mostly not recognized, although they often deviate only slightly from Japanese requirements.
- Sectoral regulation is often rigid, bureaucratic, non-transparent, sometimes not independent, and informally geared to the interests of Japanese suppliers. Some excise duty rates discriminate against foreign suppliers.
- Foreign lawyers, journalists, shipowners, advertising, power generation and transmission, and the space industry are subject to restrictions on business activities.
- Some of the infrastructure in Japan's ports and airports is inadequate, with a lack of capacity for goods handling and warehousing. Fees are unusually high, and the business practices of the Japan Harbor Transportation Association restrict competition in port logistics.
- Complicated, non-transparent customs procedures and Japan's division into nine different customs territories discriminate against foreign logistics companies and make imports more expensive – for example, through rigid customs procedures or arbitrary classifications into customs classes.
- In public procurement (railways, medical technology, infrastructure), foreign suppliers are discriminated against in tendering and awarding contracts. In the aerospace and defense sectors, American companies are favored.
- The vertical manufacturer-controlled supplier systems of the automotive and railway industries discriminate against foreign manufacturers in their research and development and standardization activities.
- Distribution systems disadvantage newcomers because of their exclusivity (e.g., car tires) or discriminatory regulation (e.g., alcoholic beverages). The establishment of independent distribution structures faces numerous administrative obstacles.
- The acquisition of majority stakes in Japanese companies, which is very difficult to achieve anyway due to stock corporation law, widespread cross-ownership, and the strong position of banks, is made even more difficult by tax discrimination against foreign companies.

## Informal Barriers

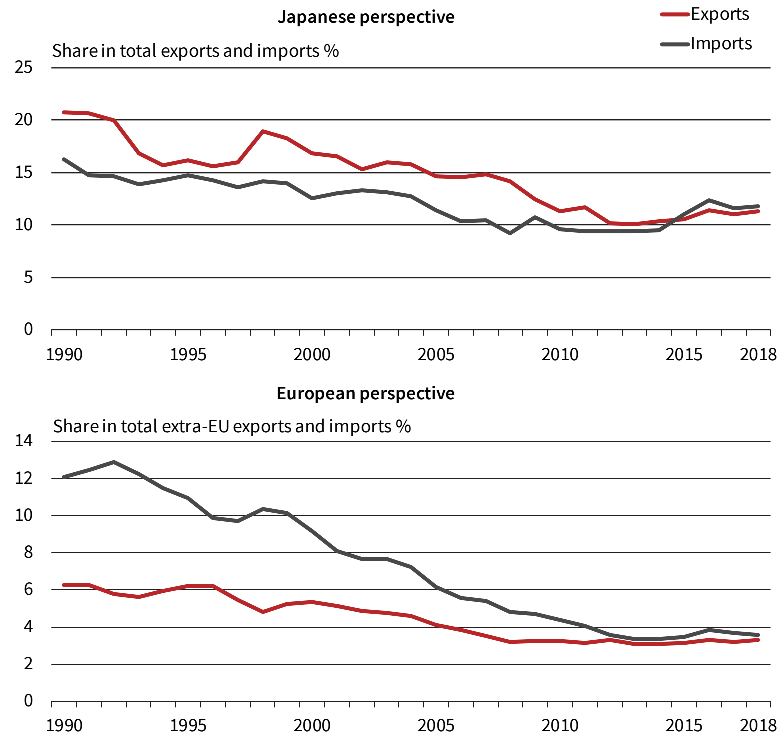
It is certain that Japan's non-tariff barriers effectively hinder access to the Japanese market. However, when compared to other markets, Japan's NTBs are not unusual in their nature or intensity, and so they alone cannot explain the below-average penetration of imported goods on the Japanese market (Böhmer et al. 2009; Hanson 2010; Sunesen et al. 2009). Another convincing explanatory factor for Japan's low import penetration is its informal barriers. In a general sense, informal barriers are related to the sociocultural and socioeconomic conditions of business activity in Japan. In comparison to other industrialized countries, market access in Japan is complicated by at least four factors (Hilpert et al. 1999):

1. Adapting to Japanese business culture is difficult for foreign newcomers. They need to have a perfect command of Japanese (both written and spoken), invest an unusually high amount of time and money in establishing and maintaining contacts and business relationships, adapt the product to Japanese needs, and above all fulfill the extremely high quality and service requirements of Japanese customers and consumers. In general, economic relations (between and within companies) in Japan are more long-term

3 For a quantification of the impact on European exports to Japan, see Sunesen et al. (2009); for the quantification of the economic effects of the dismantling of tariffs and NTBs on European-Japanese trade, see Benz and Yalcin (2015).

than elsewhere, so that newcomers can break into existing business relationships only with considerable time and financial effort. In addition, Japan's domestic market is subject to fierce and intense competition, which is fought out not only through price, but also and above all through quality, service, and relationship management. In this climate, a foreign newcomer can succeed only with a decisive advantage in the price-performance ratio or with a convincing product innovation.
2. Japan's economy and society have a distinct insider culture. Foreigners are regarded as outsiders. In a society that is characterized by pressure for conformity and unity, it is especially difficult for foreign products and foreign firms to find acceptance. This is also one of many reasons why foreign companies rarely succeed in acquiring a Japanese competitor.
3. The Japanese legal system and practice tend to discriminate against foreign companies (against outsiders or the economically weaker party in general). In the legal practice of the country, companies are often effectively denied legal recourse or have only limited access to it (not in formal legal terms, but de facto) if they wish to respond to breaches of contract, infringements of intangible property rights, unfair competition, bidding cartels, or administrative discrimination. The reasons for this lie in the small number of lawyers, the usual practice of preferring a settlement – judicial or extrajudicial – to an otherwise excessively long litigation period, bias of judges against special interests, poorly developed legalistic thinking, and the consensus mentality of society.
4. The costs of opening up and doing business in Japan are exceptionally high, not least because of the barriers to market access mentioned above. In addition, there are high prices for land and real estate, considerable sales and distribution costs, and top tax rates of over 50 percent – all in a stagnating domestic market. The consequence is that investments in Japan promise lower returns and lower growth rates than alternative investments.

Figure 3
**Trade in Goods between Japan and the EU28**
1990–2018




Source: International Monetary Fund, Direction of Trade Statistics. © ifo Institute

The removal or at least the dismantling of tariffs and NTBs is the legitimate and rightful claim and goal of JEEPA. Informal barriers to trade, however, cannot really be overcome by a free trade agreement. This requires a change in business culture, mentality, consumer behavior, as well as long-term structural reforms; such factors cannot be the subject of negotiations on free trade agreements. The ongoing efforts in Japan to carry out structural reforms and internationalize the business culture show that the conditions for foreign companies are improving and that Japan is moving in this direction. However, JEEPA can at best support this process.

## UNTAPPED POTENTIAL IN EU-JAPAN TRADE

Without doubt, Japan and Europe are important trading partners for each other, although this importance is declining. In 2018, Japan was the EU's seventh-largest destination and supplier country with an export value (FOB) of USD 73.8 billion and an import value (CIF) of USD 75.6 billion – following the United States, China, Switzerland, Russia, Turkey, and Norway. Germany accounted for about a quarter of EU28 exports and imports. In reverse, the EU is Japan's third most important export destination (after China and the United States) and second most important source of imports (after China, ahead of the United States) (IMF 2019).

However, for Japan and Europe, the relative importance of their bilateral trade has been declining for several years. The proportion of EU exports that go to Japan fell from 6.3% (1990) to 3.3% (2018), while the proportion of EU imports from Japan fell from 12.1% (1990) to 3.6% (2018) (see Figure 3). Although higher overall, the proportion of Japan's exports going to the EU fell from 20.8% (1990) to 11.3% (2018), and the proportion of Japan's imports from the EU declined from 16.3% (1990) to 11.7% (2018) (see also Figure 3). Even taking into account the declining weight of Europe and Japan in international trade, the level of EU-Japan trade seems to be far too low, indicating considerable untapped potential.

## THE JEEPA AGREEMENT – WHAT HAS BEEN AGREED?

The crucial question is whether the market-opening and liberalization measures as agreed in the framework of JEEPA will be sufficient to counter the trend of declining mutual trade dependency, if not reverse it altogether. It is therefore worth taking a closer look at the main results of the agreement.[4]

### Tariff Dismantling

Tariff dismantling was one of the most controversial negotiation topics. This was where Japan's core demands for duty-free exports of motor vehicles, automotive parts, and electronics met with those of Europe for a liberalization of Japanese agricultural imports and the dismantling of the remaining industrial tariffs (textiles, clothing, cosmetics, chemicals). As a result of the negotiations, both sides were able to agree to liberalize almost all their bilateral trade, i.e., about 95–99 percent, on the basis of tariff lines and imports. The only exceptions to tariff dismantling are rice and seaweed. However, the transitional periods of up to 15 years extend far into the future. For example, Europe's imports of motor vehicles and vehicle parts will be duty-free only after a transitional period of seven years, Japan's imports of leather goods and shoes will be duty-free only after ten years. And Japan will apply similar long or even longer transition periods for wood (7 years), chocolate, confectionery, pasta, pork (10 years), cheese and beef (15 years). Only the import of European wine into Japan was made duty-free immediately upon the agreement's entering into force.

### Non-tariff Barriers to Trade

The abolition or at least the reduction of NTBs was a major European demand that is far more difficult to negotiate than tariff dismantling. Whether NTBs constitute barriers to market access at all needs to be clarified on a case-by-case basis. The trade-restrictive effect of NTBs is not measurable and, if eliminated, will benefit not only European companies but also those from third countries. Still, the European Commission was able to push through some important demands: Japan conceded to recognize the UN-ECE international motor vehicle standards for passenger cars, to remove all legal barriers to market access in the motor vehicle sector, to recognize European test procedures and product standards, and to cooperate with Europe in setting international motor vehicle standards in the future. Japan will also allow several food supplements and that it would no longer treat imported beer from Europe as an alcoholic soft drink for tax and regulatory purposes. Both sides also agreed to mutually recognize each other's pharmaceutical manufacturing processes and ingredients.

### Services

In the services chapter, Japan and the EU agreed on a rational, transparent, non-discriminatory regulation that would improve mutual market access and limit regulatory discrimination but would not override national regulatory sovereignty. Concrete agreements were reached in the areas of telecommunications, financial services, insurance, and postal and courier services. The areas of public services, audiovisual services, maritime cabotage, and parts of air transport are explicitly excluded. In ecommerce, both sides were able to largely agree on uniform standards, but could not bridge the differences in data protection. The issuance of visas for Japanese businesspeople and their relatives will be facilitated.

### Public Procurement

Beyond the WTO procurement agreement signed by both sides, the EU and Japan commit themselves to transparent, electronically supported tender texts, mutual recognition of test results and selection criteria, and a further opening of procurement markets through the inclusion of hospitals, universities, and all municipalities with more than 300,000 inhabitants. In the construction industry, Japan has assured a fair tendering practice. The national railway procurement markets are to be opened up on both sides. The privatized railway companies of Japan (JR Central, JR East, JR West) will be explicitly included. Japan's Operation Safety Clause, whose deliberately broad interpretation regularly led to European tenders not being considered, is to be lifted one year after the agreement enters into force.

## OPPORTUNITIES AND PITFALLS

There is a good chance that JEEPA will prompt considerable trade-creating effects. Even though it will remove only some of Japan's market-access barriers

[4] The full text of the agreement, consisting of 23 chapters, see EU Commission (2017/2018).

and will not meet all the liberalization demands of business, the agreement should increase intra-industrial trade in goods and create new opportunities for cooperation between European and Japanese companies. The exchange of bilateral services and investment is likely to become broader and deeper. As a result, JEEPA may reverse the trend of declining mutual trade dependency.

Japan and Europe are regions with a high per capita income, highly developed industrial and service industries, and sophisticated consumer markets. Both parties are strongly committed to similar future areas such as digitization, interconnectivity robotics, mobility, life science, and energy efficiency. The potential for positive synergies and network effects is therefore significant. The dynamic development of trade between Korea and Europe after the Korean-European Free Trade Agreement came into force illustrates how lifting trade barriers between two developed industrial regions can stimulate bilateral exchanges far beyond what is expected.

The expected positive effects of JEEPA cannot and should not obscure the limitations and risks of the intended trade integration, however. It is worth noting three critical points: first, JEEPA will produce losers as well as winners. This is because liberalization will lead to displacement effects on both sides. In Europe, the automotive industry will have to deal with tougher import competition from Japan as a result of removing the 10%-tariff. In Japan, the dismantling of agricultural tariffs will affect agriculture, which is not a particularly competitive industry. The dairy industry, in particular, will face difficult structural adjustments.

Second, JEEPA contains plenty of fuel for political and societal conflict. The free trade agreement could face opposition from civil society, if it includes a kind of regulatory cooperation that might jeopardize the precautionary principle. It is feared that multinational corporations will benefit from special rights that would undermine consumer protection and could lead to a loss of national regulatory sovereignty. Another criticism of the agreement is the low level of liability in its sustainability chapter, for example with regards to illegal logging imports from third countries.

Third, JEEPA can be only a first step towards achieving better market access in Japan. Politics and business must also ensure that its implementation is in line with the content and spirit of the agreement and that no new, currently unforeseen barriers to trade are created. A great deal of stamina will be needed to overcome opposition to Japan's liberalizing of its industry and agriculture, since those lobbyists are well-connected in civil society, the governing party LDP, and the ministries.

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