

Chapter

THE EU-JAPAN ECONOMIC PARTNERSHIP AGREEMENT: MULTILATERALIZING REGIONALISM?

Erja Kettunen*, PhD

Turku School of Economics, University of Turku, Finland

ABSTRACT

Nowadays, most countries engage in bilateral and regional free trade agreements arguably due to the slowness of the multilateral process. This chapter analyzes the recent EU-Japan Economic Partnership Agreement (EPA) in light of the conceptual idea *multilateralizing regionalism* that refers to a gradual harmonizing of regional trade agreements to new country constellations and eventually to the multilateral level. Exploring Japan and the EU as trade partners, their networks of trade agreements and the contents of the EPA, the findings indicate that this agreement represents a step towards extending mutually agreed trade policies. It has the potential to further enlarge the geographical coverage of the comprehensive ‘new generation’ FTAs, despite skepticism of its effects among European businesses in Japan.

* Corresponding Author’s Email: erja.kettunen-matilainen@utu.fi.

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1. INTRODUCTION

The continuing increase in the number of free trade agreements (FTAs) is nowadays regarded as a prominent feature of the international trade system. Countries seek a faster route to market access with strategically important trade partners instead of waiting for the recovery of the stalled Doha Development Agenda negotiations at the World Trade Organization (WTO). This trend has created a ‘spaghetti bowl’ of bilateral trade agreements (Bhagwati, 2008), or a ‘noodle bowl’, as it has been called in the Asian context (e.g., Kawai and Wignaraja, 2009). By 2019, a total of 450 regional trade agreements (customs union, economic integration and free trade agreements) were notified to the WTO (WTO, 2019). These agreements enhance, on their part, the interconnectedness of the world’s economies by liberalizing foreign trade – this trend being particularly strong in Asia (e.g., Alvstam et al., 2014; Andreosso-O’Callaghan et al., 2014; Brennan and Murray, 2015; Fujita et al., 2011; Kawai and Wignaraja, 2011; 2013). For example, Japan is a member of 17 regional trade agreements, including the recent Economic Partnership Agreement (EPA) in force with the European Union (EU), and has ongoing negotiations on several more FTAs. However, Japan is one of the countries that used to, until recently, maintain a somewhat cautious approach to bilateral and regional trade negotiations.

The ‘noodle bowl’ effect has caused concern that the multitude of intertwined and overlapping agreements undermine the multilateral process. However, regional FTAs may also have the potential of *multilateralizing regionalism* (Baldwin, 2006), i.e., agreeing on trade issues first bilaterally or regionally, and later gradually achieving broader agreement for harmonizing them at multilateral level. The EU’s aim in concluding ‘new

generation' comprehensive FTAs with Asian countries has put the normative and regulatory barriers to trade at the forefront (Kettunen-M. and Alvstam, 2018; Young, 2017). The EU aims to reduce barriers not only on merchandise trade but also on services, public procurement, and foreign investment, and to address normative issues such as sustainable development and transparency in regulations.

Therefore, this chapter explores the EU-Japan EPA, in force since 1st February 2019, as an example of the EU's intention to reach broad and deep FTAs with Asian trade partners. The aim is to analyze this EPA in its global context, as well as to assess some of the challenges related to the features of Japan's regulatory environment from the viewpoint of European businesses. Based on the analysis, it is argued that the EU-Japan EPA can contribute to multilateralization of regionalism at the level of the agreement, whereas its enforcement in removing some behind-the-border barriers, i.e., non-tariff barriers (NTBs) related to national legislation in Japan, remains to be seen. These relate to technical barriers to trade such as standards and conformity assessment, in particular.

The chapter continues as follows. The next section discusses the conceptual approach of the study, followed by empirical findings illustrating the EU and Japan as trade partners, their networks of trade partnerships, and the market access barriers in Japan for foreign businesses. The chapter concludes by discussing the main results and their implications.

2. MULTILATERALIZING REGIONALISM?

Since the 1970s, East and Southeast Asia appeared as a location of economic *regionalization* based on cross-border production chains created by companies from the USA and Japan, in particular (e.g., Alvstam et al., 2014; Kuroiwa and Toh, 2008; Kuroiwa and Kumagai, 2011; WTO, 2011; Teh, 2015). These networks gradually extended from East Asia to the countries of the Association of Southeast Asian Nations (ASEAN). *Regionalism* as a form of state-led integration, however, gained momentum only after the launch of the ASEAN Free Trade Area in the early 1990s

(Fujita et al., 2011). Nowadays, Asia is one of the centers of activity of bilateral and regional FTAs, and Japan has also been transformed from “one of the last hard core multilateralists” to a negotiator of bilateral FTAs (Solís, 2010). The EU has continued both with pan-European regional integration and, after its 2007 ‘Global Europe’ strategy, with extra-European bilateral negotiations to conclude FTAs with Asian countries, in particular (Nelson, 2012).

It has been argued that the current global geopolitical and geoeconomic context leads to a specific strategy in bilateral trade negotiations: governments are prone to negotiate with smaller trading partners first in order to gain benefits in the contemporary setting (Kleimann, 2015). In this way, they can gain leverage over larger trading partners who will be more motivated to negotiate as a consequence of diminishing preferential margins. This may have been the strategy of Japan which has concluded EPAs with smaller Asian economies first. When it comes to finding a resolution on trade policies at a *multilateral* level, one possibility is to proceed step-by-step in bilateral and regional FTAs, and to harmonize them gradually in order to come to an agreement on a larger front. This idea of ‘multilateralizing regionalism’ was put forward as a reaction to the flourishing of bilateral FTAs (Baldwin, 2006; Baldwin and Low, 2009; Baldwin and Thornton 2008; Kawai and Wignaraja, 2009; Lindberg and Alvstam, 2012; Baldwin, 2014; Baldwin and Robert-Nicoud, 2014). In the language of ‘noodle bowls’, gradual multilateralization entails that the bilateral and regional FTAs create ‘sticky rice’ that would be useful in the ultimate effort towards a homogenous agreement within the WTO, a ‘rice dumpling’, as Lindberg and Alvstam (2012: 173) have put it. The EU-Japan EPA might produce ‘sticky rice’ in this process.

In order to analyze multilateralizing regionalism in the case of the EU-Japan EPA, this chapter draws from FTA documents, WTO databases, the World Bank’s ‘doing business’ indicators, and a business confidence survey of the Foreign Chambers of Commerce in Japan. The study covers the FTAs of both parties, the contents of the EPA, and the specific barriers that European firms face in the Japanese business environment. The hypothesis is that while policies directly affecting cross-border trade are eased, there

will be challenges in reforming policies that affect the regulatory environment, especially in a Japan that is known to be less open to foreign businesses. The findings point at the different spheres of ‘trade policy’, which will potentially help close the gap between the state and business sector realities (Alvstam et al., 2017; Kettunen, 2016) and highlight different aspects of regionalism.

3. GLOBAL NETWORKS OF JAPAN’S AND THE EU’S TRADE PARTNERSHIPS

Compared to many other countries and regions, Japan and the EU were quite late in opening mutual FTA negotiations in 2013. Yet both are currently active in the multilateral, regional and bilateral spheres, and have several ongoing trade negotiations with multiple trade partners. At the same time the two economies are significant actors in the global economy, as discussed next.

3.1. The Significance of Japan and the EU in Global Trade

In the international context, Japan and the EU are two major economic powers: together they account for about a quarter of global gross domestic product (GDP) (European Commission, 2019). Japan is the world’s third largest national economy, and the EU as an economic unit is somewhat bigger: the three major EU-27 member states combined together are double the size of Japan’s economy (WEF, 2018). As Kleimann (2015) notes, the EU-Japan EPA is one of the most significant free-trade corridors ever created.

Japan and the EU are important trade partners for each other as well. When it comes to trade in goods, the EU imports from Japan were 70.4 billion EUR in 2018 whereas exports stood at 64.7 billion EUR (European Commission, 2019). Trade in services is still at a lower level, particularly

EU imports from Japan that amounted to 18.3 billion EUR, while exports reached 34.7 billion EUR in 2017 (*ibid.*). Trade in goods shows a deficit for the EU while the opposite holds for trade in services.

A further imbalance can be found when looking at foreign direct investments (FDI). Japan has significant investments in the EU region: as much as 23% of Japan's total stock of outward FDI have been located in the EU-28, the second largest destination for Japanese FDI. The opposite is true for European investments in Japan that have represented only 1.9% of the EU's total outward FDI stock (EPRS, 2016). The stock of EU outward FDI in Japan amounts to 99.4 billion EUR, which is much less compared to the stock of EU inward FDI from Japan, 228.9 billion EUR in 2017 (European Commission, 2019).

Further, one can observe a long-term decline in the share of Japan in the EU's overall trade. This is particularly true for imports from Japan: back in 1999, the share of Japan in EU imports was over 10%, while in 2015 it was a mere 3.5% (EPRS, 2016). One of the main reasons for the desire to reach an FTA may have been related to the drastic change in the big picture. The long-term development in EU-Japan trade in the global context is somewhat of concern, particularly for the EU. While intra-regional trade in the Asia-Pacific has increased three-fold since 2000, indicating a strong regionalization trend, the share of EU trade with Asia-Pacific countries has almost halved at the same time (*ibid.*, 2). This created a desire within the EU to strengthen economic ties with the region, including Japan, and it became a strategic priority for the EU to reinforce trade relations with Asia. This was also recognized in 2015 in the EU's trade strategy "Trade for All – Towards a more responsible trade and investment policy". In comparison, Japan aims to promote economic partnerships and free trade agreements and has engaged in FTA negotiations with different trade partners, mostly its Asian neighbors.

3.2. Japan's Trade Agreements

In its current trade policy, Japan aims to promote both the multilateral system and bilateral and regional trade agreements. It actively participates in the WTO's multilateral negotiations and is a party to plurilateral agreements, such as the Information Technology Agreement (ITA). At regional level, Japan is an active participant in the Asia-Pacific Economic Cooperation (APEC) and the Asia-Europe Meeting (ASEM) fora.

However, this policy of proceeding on two tracks - the multilateral and regional - is relatively new for Japan. Up to the late 1990s, Japan relied solely on the multilateral system in trade policy. The only exception was the intergovernmental APEC that, despite its ambitious aims, ended up short of its aspirations for trade liberalization. After its failure to realize free trade, several Asian countries, including Japan, began to negotiate bilateral FTAs in the early 2000s (Manger, 2005). Japan's first EPAs were signed with Singapore and Mexico in 2003 and 2004, and it had started negotiations with South Korea,¹ Thailand and Malaysia by 2005, as well.

Currently, Japan has a network of 18 free trade agreements or EPAs in force or signed. Most of these are with Asian countries (MOFA, 2020; Reuters, 2016), indicating an evolving regionalism in Japan.² Japan has also ongoing negotiations for agreements with Colombia, Turkey and the RCEP partners and for a tripartite agreement with China and Korea, whereas negotiations have been postponed or suspended with Canada, Korea, and the Gulf Cooperation Council (GCC) partners (MOFA, 2020).

How big a role would these EPAs play, considering the size of Japan's actual trade with different trade partners? Recent negotiations have involved Japan's biggest trade partners, China (21% of Japan's total trade), the US (15%), the EU (11%) and Korea (6%) (WTO, 2017a). The 16th round of trade negotiations between Japan, Korea and China were held in November 2019. In contrast, despite the news about a 'partial trade agreement' with the US (e.g., FT, 2019; NYT, 2019), Japan's MOFA (2020) does not list this as an EPA, and its impact on future trade remain somewhat obscure. The EPA

¹ Republic of Korea; hereafter, Korea.

² Japan's FTA partners are Australia, Brunei, Chile, India, Indonesia, Malaysia, Mexico, Mongolia, Peru, the Philippines, Singapore, Switzerland, Thailand, Vietnam, ASEAN, the EU, and the two Trans-Pacific Partnership agreements (TPP11 and TPP12).

in force with the EU, will in turn support Japan's trade with its third biggest trade partner.

3.3. The EU's Trade Agreements

The EU is the world's most integrated regional grouping with its "unprecedented results" in creating common institutions and mechanisms for cooperation (Capannelli and Kawai, 2014), being a global role model of regionalism. The EU is one of the WTO's founding members - each EU member state being an individual member - and is represented by the European Commission in WTO negotiations. Institutionally, the member states have given a mandate to the Commission to negotiate trade policies with third parties on behalf of all members.

At bilateral and regional level, the EU has a large network of regional trade and cooperation agreements. Besides FTAs, these include customs unions (e.g., with Turkey), association agreements (e.g., with the Mediterranean countries), economic partnership agreements (with African, Caribbean and Pacific countries), and the European Economic Area (with Iceland, Liechtenstein and Norway). These agreements vary in their coverage of issues and depth of cooperation.

When it comes to free trade agreements, the EU has a number of FTAs with its "key trade partners". By February 2020, it had notified to the WTO a total of 42 regional trade agreements as being in force, around half of which cover both goods and services (WTO, 2020). This process has a long history, originally starting with the pan-European regional integration. Regional cooperation first involved trade agreements mainly with countries in Europe, Africa and Latin America. In the 2000s, the EU's orientation expanded to Asia: it launched negotiations with Korea, and on an inter-regional basis, with ASEAN in 2007. The EU-Korea FTA came provisionally into force in 2011, but the talks with ASEAN were halted due to various disagreement points in 2009 and continued instead on a bilateral basis with individual ASEAN members (e.g., Pollet-Fort, 2011). This led to the successful conclusion of the EU-Singapore FTA in 2014 that was

important especially in the services sector (Alvstam et al., 2017). In addition, the EU has concluded FTA negotiations with Vietnam and has ongoing negotiations with Indonesia.

To what extent do the EU's free trade agreements support its actual trade? The lion's share of the EU's external trade is conducted with its two biggest trade partners with which there are no agreements in force: the USA (18% of the EU external trade) and China (15%) (WTO, 2017b). In contrast, trade with Switzerland (7%), the third largest trade partner, is supported by an FTA.

To summarize, both Japan and the EU are part of the ongoing phenomenon of bilateralism and regionalism. This is a relatively new course of action for Japan, but part of a long process for the EU. However, recent adverse developments within larger regional FTA attempts, such as the United States' withdrawal from the Trans-Pacific Partnership (TPP) are shaking the rule-based global trade policies. In this situation, it can be expected that Japan and the EU as two major economies – in the current geopolitical context – are motivated to advance bilateral FTA talks on different fronts.

4. THE EU-JAPAN EPA AND MARKET ACCESS IN JAPAN

4.1. The Contents of the EPA

After the EU-Japan negotiations were concluded, the EPA was reported as bringing major benefits especially to European farmers exporting dairy products to Japan and to Japanese carmakers exporting to the EU (e.g., FT, 2017) and therefore, the agreement was called the “cars for cheese” deal. However, agriculture and automobiles were not the only sectors that benefit from the EPA. While the pre-EPA barriers in EU-Japan trade were bearable, the EU's specific aim was to ease Japan's regulatory environment that is in many ways challenging for foreign firms. In addition to the removal of customs tariffs, the EPA aimed at improving the predictability of the regulatory environment for companies on both sides. This feature has been

included in a number of the EU's recent "new generation" FTAs (with Korea and Singapore, in particular) that are ambitious in removing restrictions not only on merchandise trade, but also on services, public procurement and technical barriers, such as national certificates and standards that are time-consuming and expensive for firms to conform to.

As it turns out, the EU-Japan EPA is in many ways similar to the EU's three prior free trade agreements with Asian countries (Korea, Singapore and Vietnam). All provide increased market access in services and investments, and include provisions in areas such as government procurement, intellectual property rights, and transparency in regulations. In the case of Japan, the agreement specifically includes provisions on technical requirements and certifications, as well as standards, in an attempt to bring them as close to the international ones as possible (European Commission, 2019). Furthermore, the FTAs contain provisions on normative issues such as sustainable development (Kettunen-M. and Alvstam, 2018). The number of topics covered are broader than in Japan's prior free trade agreements (WTO, 2020).

4.2. Specific Issues in Japan's Market Access

Many facets of the Japanese regulatory environment are burdensome for foreign firms, in particular. Table 1 presents a comparison of the 'ease of doing business' in the EU's Asian FTA partner countries in 2019, both overall and in selected sub-categories that affect the smoothness of doing business. These indicators, assessed by the World Bank annually since 2004, reflect the efficiency of the regulatory environments among the world's economies in order to rank them accordingly. The indicators measure the time spent and cost for firms to follow formal regulations (such as the nominal number of procedures, or number of days required to complete all formalities for a specific permit). Thus, they focus on regulations that either enhance or constrain doing business in the 190 countries. Countries are ranked from 1 to 190 based on these indicators which are indicative of the formal regulatory environment in the respective economies.

**Table 1. Ease of doing business in Japan,
in comparison to Korea, Singapore, and Vietnam**

| | Japan | Korea | Singapore | Vietnam |
|-----------------------------------|-------|-------|-----------|---------|
| Overall rank (N = 190) | 39 | 5 | 2 | 69 |
| Starting a business | 93 | 11 | 3 | 104 |
| Dealing with construction permits | 44 | 10 | 8 | 21 |
| Trading across borders | 56 | 33 | 45 | 100 |
| Enforcing contracts | 52 | 2 | 1 | 62 |

Source: World Bank (2019).

In Table 1, Japan is compared with three Asian countries with which the EU has concluded FTAs, i.e., Korea, Singapore and Vietnam. It can be seen that Japan's overall rank, 39, is relatively good, but especially starting a business is very difficult (93). Also, dealing with construction permits (44) takes more time and money compared to the other three countries. Singapore and Korea apply remarkably easier regulations in construction permits, trading across borders, and enforcing contracts. In this comparison, Japan is a much more difficult business environment than Singapore and Korea, yet somewhat easier than Vietnam.

The indicators for Japan highlight the challenges to be faced both in the negotiation and in the future enforcement of the elimination of behind-the-border barriers. Foreseeing this, the EU insisted that some of them were already addressed in the preparatory stages before the actual FTA talks started. The European side took three separate steps at this stage, as described by Kleimann (2015, 5). First, the EU made the launch of FTA negotiations conditional upon the elimination of a number of Japanese non-tariff barriers – noted also in the EU-Japan Summit declarations in 2009 and 2010. Second, the EU's 'FTA scoping exercise' to determine negotiation objectives before the actual talks opening presented "roadmaps" for sectoral NTB elimination in targeted sectors. Third, the concept of "parallelism" was established making the EU tariff reductions contingent on expanded market access through effective regulatory reforms in Japan (*ibid.*).

The market access demands replicated the issues that were on the table in the EU's earlier negotiations with the other Asian economies. Even for a famously open economy like Singapore, the FTA talks included difficult areas especially concerning services (Alvstam et al., 2017). These difficulties related to the valuation of services, i.e., the adaptation of rules of origin to take the real value added of services input into account, and, determining the location of services value-added because of the mobility of production and consumption. In addition, major questions to be addressed were the elimination and/or reduction of technical barriers to trade and the adjustment of rules related to the international provision of services within the public sector, i.e., government procurement.

Some observers claim that the EU's demands on parallelism were successful. They were strongly supported by the European Council and Parliament and resulted in notable progress being made through concessions on the Japanese side (Kleimann, 2015). The idea of parallel concessions on different types of trade barriers, may prove to be a good approach in advancing negotiations in the future as well.

4.3. European Firms' Views on the EU-Japan EPA

Foreign chambers of commerce in Japan regularly conduct business confidence surveys among foreign firms operating in Japan. Altogether, 172 firms took part in the survey in 2018; of these 80% were European firms (FCIJ, 2018). In addition to general questions, European firms were asked how the EU-Japan EPA would affect their business. The results show a surprisingly small expectation level of positive effects among the companies: only 9% of the respondents think that the EPA will have a strong positive impact, whereas 42% expect some positive effect, and as many as 47% foresee no impact at all. Three firms expect either some or strong negative impact from the EPA. Those respondents who do not expect any positive effect from the agreement, commented, for example:

- the EU had not addressed non-tariff barriers sufficiently, especially with respect to harmonization of industrial standards,
- there was no detailed information available about the EPA for each industry sector,
- the companies already benefitted from zero-tariff imports.

In addition, companies provided further feedback on the EPA in the general comments section of the survey. They highlighted the challenges related to Japan's regulatory framework and industrial standards, in particular (*ibid.*):

- the regulatory issues not being sufficiently covered in the FTA,
- the lack of harmonization of industrial standards in the FTA,
- the need for government engagement in de-regulation.

Therefore, European companies established in Japan seem quite pessimistic about the potential benefits of the EPA for their business. The agreement remains too vague, in their view, regarding the traditional problems of the Japanese regulatory framework. In addition, it can be asked how the agreement will be implemented and enforced at 'practice' level. Here the EU's prior FTA with Korea may give some indication. The EU-Korea FTA, provisionally in force since 2011 and fully in force since 2017, can be assessed as to its enforcability and as to business sentiment on how well the FTA has opened up the Korean market, previously known for being difficult for foreign firms to access. According to a recent European business survey in Korea (ECCK, 2018), the business environment has also remained discriminatory and challenging for the firms after the FTA. This raises questions about the efficiency of the enforcement of the FTA by the Korean side.

How, then, will Japan enforce the proposed reforms of the FTA, given the nature of the reforms as major changes to the existing regulatory framework? As regards the final outcome, one possibility is that even if the issues are agreed upon in the FTA text, they may not be realized at grassroots level. The outcome will depend on how the Japanese local authorities

implement and enforce the new regulations and how the foreign firms actually encounter the rules and practices at local level (cf. Alvstam et al., 2017; Kettunen, 2016).

CONCLUSION

This chapter has explored the recent EPA between Japan and the EU in relation to mutual trade, the other trade partnerships of both parties, as well as the specific features of Japan's regulatory environment. The aim has been to assess some of the challenges arising from the global geopolitical context of the EPA and the realities of bilateral trade relations. The findings of the study indicate that the EU-Japan EPA drives forward 'multilateralizing regionalism', i.e., it enlarges the geographical coverage of the comprehensive "new generation" FTAs that include not only the elimination of tariffs but also of barriers to goods and services, investment and public procurement. The EPA also contains regulations and norms similar to the EU's prior FTAs with Asian countries.

Three specific findings support this interpretation. First, the US' withdrawal from the TPP and at the same time, the importance of both Japan and the EU as global trade giants, provide an obvious opportunity for them to take a more visible role in the global networks of trade partnerships. As both are also supportive of a regulation-based global trade regime, they may act as stabilizing forces in the currently otherwise shaky international trade policy environment characterized by increasing tariffs, sanctions, and trade wars between the US and China, in particular.

The second finding relates to the networks of FTAs of both Japan and the EU. Compared to Japan's 18 recent FTAs, mostly with Asian neighbors, the EU manages a network of 42 regional trade agreements with backgrounds of neighborhood policy, development cooperation, and trade. While there is a stark difference between the two sides as to what has been the driving force in integrating their respective regions, both Japan and the EU are nowadays part of the global phenomenon of bilateralism and regionalism.

Third, the content of the recent EU-Japan EPA itself is notably similar to the EU's prior FTAs in Asia. The agreement removes barriers on goods, services and investment, enlarges the public procurement market access and removes some non-tariff barriers to trade. In this way, the sphere of trade policies extends from the mere export/import regime into 'broad and deep' regulatory issues. However, the eventual enforcement of the EU-Japan EPA remains uncertain especially in relation to Japan's regulatory framework with its famous behind-the-border barriers, such as national standards. While some of these have been dealt with in the EPA, European businesses in Japan remain skeptical about the effectiveness of the agreement in removing these barriers.

In conclusion, as both the EU and Japan favor a regulation-based global trade framework and are also active parties in the WTO, their efforts at bilateral and regional FTAs could pave the way for harmonizing the rules at multilateral level as well, thus creating the opportunity of multilateralizing regionalism. Given the success of the EU and Japan in negotiating FTAs, further geographical extensions of these policies are very possible through other forthcoming agreements. This trend may pave the way for gradually coming to terms with broader country constellations, and seems a realistic scenario in the case of the EU and Japan, both of which are on the route towards agreeing more FTAs.

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