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Free Trade Agreements as a Strategy of Growth Revival for Japan

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Abstract This study highlights the broad industrial areas that are supposed to benefit most from the gains arising from the Japan-Europe Free Trade Area (JEFTA) agreement which has been negotiated since March 2013, and which has recently been agreed in principle between Japan and the European Union. The JEFTA is organized around the core principle of "market access" covering areas such as non-tariff barriers, rules of origin, investment dispute resolution and corporate governance.

After a brief review of Japan's opening strategy, appraised in an historical perspective, the article will delve into the Japan-EU economic relationship and it will highlight the expected objectives of the Japan-EU free trade area. A number of key manufacturing and services areas, such as motor vehicles, electronics and financial services are highlighted because of their relative industrial weight and of their significance in terms of tariff and/or non-tariff barriers (such as for example the high tariff - 10 per cent - imposed by the EU on Japanese exports of motor vehicle parts).

Keywords Japan largest trading partner worldwide and second with EU after China, Economic agreements by Japan, EU more competitive in in new tech, aerospace agricultural as well as services sectors, Banking, Capital Flow, EPA and ASEAN

JEL Classification F5, F010, E650, O50, G1, F1, F13

1. Introduction

In spite of the many economic challenges faced by Japan since its "lost decade", the country is the sixth largest trading partner worldwide and its economy still accounts as one of the most prominent economies in the world. Because of China's ascendency as a major world economic trading nation, Japan is today the EU's second largest trading partner in Asia (after China) and the trade agreement it has agreed in principle in July with the EU marks an important step in the two partners' willingness to repel protectionist trends at the global level. For Japan, this agreement is enshrined into its contemporary and broad FTA strategy which itself is seen as an engine of economic growth revival. After a brief review of Japan's opening strategy since the fall of the Tokugawa period and of the early Japan FTA strategy (Section 2), the article will focus on the Japan-EU economic relationship (Section 3). It will briefly analyse

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the evolution of this relationship and it will then focus on the Japan Europe Free Trade Area Agreement (JEFTA) by highlighting the broad industrial areas that will benefit most from the gains emanating from the JEFTA. The Japan-EU free trade agreement falls within the category of "deep agreements" covering diverse areas such as public procurement practices, rules of origin and small and medium-sized enterprises (SMEs). Of particular interest to Japan is the manufacturing sector where the elimination of a number of non-tariff measures (NTMs) by the EU could lead to substantial gains, and of critical importance to Japan is also the issue of Brexit.

2. Background: Japan's slow growth and greater opening

By the advent of the 18th century, Japan had managed to keep its sovereignty – unlike other countries in Asia - , but the country was more isolated than in the early Tokugawa period (Jansen, 2000). The relaxation of book imports during the 18th century allowed European knowledge to flow into Japan, starting with the areas of history, institutions and military science; however, all western attempts at wining trade privileges were militarily repelled, until Perry's mission in July 1853. The opening up of two ports (Shimoda in Edo bay and Hakodate in Hokkaido) symbolises the connection of modern Japan to the West, including Europe. The country soon became a locomotive of economic growth in the Pacific area as well as a potent competitor for Europe and the USA in many industries particularly after World War 2 (WW2). Since the late 1970s, internationalisation (*kokusaika*) became a buzz word in official discourse, and the economy was reshaped by several liberalisation and privatisation waves so as to respond to the external forces (*gurobaruka*) that became more pronounced after the oil shocks of the 1970s. After a prolonged period of slow growth and of lost decade(s), the now globalised actor is nevertheless still relatively closed, at least by international standards. When assessing the openness ratio (defined as the trade/GDP ratio), based on a group comprising 75 countries, Japan held a median position in 2013. Understandably, the rise of China and of other emerging economies led to a decline of Japan's share of world merchandise exports (from 8 per cent in 1983 to 4.5 per cent in 2012) and of world merchandise imports (from 6.7 per cent to 4.9 per cent respectively) (WTO, 2013). With a declining population since 2009, and a lack of breakthrough technological change at world level, trade and investment abroad (i.e. further opening) have therefore been mooted as the possible future engines of economic growth by various governments. The Free Trade Area (FTA) strategy is therefore seen as a strategy of growth revival.

2.1. Theoretical motives for greater integration

Much has been written on the trade-growth and trade-convergence relationship following the theoretical insights of Jacob Viner (1950) and the empirical work done by Ben-David (1994) and his followers (for a critical approach of the trade-convergence relationship, see for example Gaulier, 2003). Dynamic customs unions models later borrowed elements from the fields of industrial and regional economics and included elements such as economies of scale arising from more capital accumulation, showing thereby the positive impact of investment (and in particular of foreign direct investment) on growth (Krugman, 1979). Beyond the well-known and dominant economic arguments that clarify the rationale for signing up comprehensive free trade agreements[1] such as trade creation and efficiency effects, one needs to consider

[1] Comprehensive in the sense that they deal with trade in the industrial, agricultural and services sectors and in that they encompass areas such as non-tariff barriers, rules of origin, intellectual property rights, investment dispute resolution, corporate governance, competition policy, as well as safeguard measures and dispute settlement mechanisms. These agreements do not generally embrace the movement of people.

also non-economic arguments. These are the political and diplomatic advantages, which help reduce the likelihood of economic frictions becoming political issues (Pareto, 1889) as well as Japan's increasing global diplomatic influence and interests such as its bargaining power in WTO negotiations. Finally, FTA agreements would help Japan re-balance – and perhaps contain - China in the region as a matter of competitive leadership. According to some analysts (Munakata 2003), Japan's main interest in pursuing greater economic integration is mostly explained by economic motives such as transaction costs minimisation, and adding stimulus to domestic growth, whereas China's motives are rather different. China's moves are mainly aimed at reassuring neighbouring countries such as the countries from the Association of South East Asian Nations (ASEAN) and at expanding its political influence in the region.

2.2. Economic agreements already signed by Japan

Compared with Singapore and South-Korea, Japan is a late comer in the league of modern FTA promoters in the Asia Pacific region. Japan‘s relatively recent interest in signing FTA deals started cautiously under Prime Minister Koizumi in the early 2000s with the approval by the Council of Ministers for the promotion of Economic Partnership Agreements in December 2004. A more dynamic FTA strategy is credited to Prime Minister Hatoyama (September 2009 – June 2010) who favoured the idea of a trilateral FTA with China and South-Korea, in opposition to his predecessor Koizumi who was reluctant to move on this issue. Hatoyama proposed also an investment pact among the three East-Asian countries, in order to protect intellectual property, and to promote manufacturing techniques and brand names. Hatoyama's FTA strategy signalled a rupture with the position of the Liberal Democratic Party (LDP), who had been in power for most of the years after WW2. By early 2017, Japan had signed 15 economic partnership agreements with the following countries: Singapore (effective since 2002), Mexico (2005), Malaysia (2006), Chile (2007), Thailand (2007), Indonesia (2008), the Philippine (2006), ASEAN (2008), Vietnam (2008), Switzerland (2009), Brunei, Peru, India, Australia and Mongolia.

In particular, the Japan-Singapore economic partnership agreement (JSEPA) opened a new era in Japan's trade policy as well as in trade policy in Asia in general, since it was the first bilateral free trade agreement signed between Asian countries (Terada, 2006). According to Itoh (2005), this agreement also signalled the changing attitude of Japan from favouring a multilateral free trade approach towards one of increasing efforts in terms of bilateral and regional trade negotiations. This agreement allowed each party to eliminate customs duties on goods (Ministry of Foreign Affairs, 2007), allowing for the exclusion of agricultural products (Terada, 2006), a rather non critical area for Singapore. Tariffs were eliminated on 30 November 2002 for 6,928 items, whereas for another 8,315 tariff lines, tariffs were to be phased out gradually by 2022 (International Enterprise Singapore, 2012). Other areas covered by the agreement were services, investment as well as economic cooperation. Proximity, the relatively small size of the Singaporean economy as well as the lack of any serious agricultural issues between the two parties – the latter sector being a relatively protected sector in Japan – explain the choice of Singapore as the first "test" of the new Japan FTA policy (Itoh, 2005). The effects were to be small and were to include the promotion of closer economic ties in the region (KEIDANREN, 2000).

The following agreement was the one with Mexico enacted on the 1st of April 2005 after circa two years of rather difficult negotiations. The choice of Mexico was the result of fierce pressures emanating from the Japanese business community which felt it was being discriminated against on the Mexican market *vis-à-vis* their US and European counterparts, because of NAFTA in the first case and because of the EU-Mexico agreement that entered into force in 1997 in the second case (Itoh, 2005; Solis and Katada, 2007; Ando and Urata, 2011). Understandably, Japan's agreement with Mexico would, at the time, also help many Japanese firms strengthen their exports in the US and Canadian markets, via Mexico. Another country, which was then extremely keen to sign up trade liberalisation and economic agreements in the South American region, was Chile – a country that had FTAs operating with some 50 partners in the world - and this led to the signature of the Japan-Chile economic partnership agreement in March 2007 and to its enforcement since September of the same year.

In the Asian region *per se*, the countries from the ASEAN were, at the time, an important target for Japan's FTA strategy, and *vice versa*. This explains the signing of economic partnership agreements between Japan and a number of these countries: Malaysia and the Philippines in 2006; Thailand and Brunei-Darussalam in 2007; Indonesia and the ASEAN as a whole in 2008; and Vietnam in 2009, leaving out only Cambodia, Laos and Burma. For most of these countries, Malaysia, the Philippines, Indonesia, Brunei and Vietnam, the trade partnership signed with Japan was the first of the kind. In particular, the Malaysia-Japan Economic Partnership Agreement (MJEPA), which came into force on July 2006 the 13th, did not however influence significantly the bilateral trade relationship between the two nations during the first two years of the FTA (Rahman, 2008). The Philippines signed an economic partnership agreement (EPA) with Japan (in 2006) after more than 6 years of negotiations owing to the difficult positioning of sensitive sectors in the Philippines such as motor vehicles (Van De Haar, 2011). This EPA allowed the Philippino party to secure more concessions on tariff reductions than Japan's other bilateral partners.[2] The Japan – Thailand EPA signed in April 2007 and in force since November of that same year has enabled a substantial reduction or elimination of tariffs for 99.51 per cent of Japanese imports in Thailand in 2006 and for 92.95 per cent of Thai exports to Japan.[3] Of specific note is the Japan-Indonesia EPA signed in 2007, which covers some 90 per cent of all agricultural and industrial Japanese exports to Indonesia (Indonesia Ministry of Trade, 2007). This is a critical partnership for Japan given its high degree of energy dependency and the rich underground resources such as natural gas and oil detained by Indonesia. Consequently and not surprisingly, the Japan-Indonesia EPA incorporates a chapter on energy and mineral resources. This EPA was one of the most significant partnerships from the ASEAN region for Japan, since Indonesia was in 2012 Japan's ninth largest trading partner showing strong economic ties between the two countries. Also mineral-rich and inexperienced in the area of FTAs/EPAs, Brunei Darussalam signed its first EPA with Japan on 18 June 2007 with the aim of enhancing Brunei's investment climate, encouraging foreign direct investment and improving market access with Japan (MOFAT, 2016a). Interestingly, Japan's first EPA signed with a regional bloc, namely ASEAN countries in 2008, appears as a "me-too" strategy given the fact that China and South Korea had already signed comprehensive trade deals with ASEAN, one of the largest trading blocs in the world. The agreement is aimed at complementing and broadening the scope of economic partnerships in the region so as to include the other ASEAN members that had not yet signed bilateral EPAs with Japan at the time. In addition to trade liberalisation, the agreement with ASEAN is aimed at promoting cooperation in fields such as Information and Communications Technology (ICT), intellectual property and SMEs (MOFAT, 2016b). The agreement does not however compel Japan to repeal tariffs on key farm products such as rice, beef and dairy products. This agreement was narrowly followed by the bilateral Japan-Vietnam agreement signed in January 2008. Vietnam is of particular significance to Japan given the importance of Japanese direct investment in Vietnam's industries such as motor vehicles, electronics and electrical equipment and given the then high tariff rates on parts and materials. Under the EPA, Vietnam endeavoured to liberalise imports at a level surpassing that attained in either the China-ASEAN FTA or the Korea-

[2] http://www.businessmirror.com.ph/philippines-reaps-benefits-of-lopsided-free-trade-agreement-with-japan/

[3] http://www.thaifta.com/english/eng_jp.html

ASEAN FTA (JETRO, 2014). The second step in Japan's FTA strategy has been to reach countries further afield than its own region of influence. It is in that spirit that Japan signed in September 2009 its first EPA with a Western economy, namely Switzerland. With tariff levels in the manufacturing sector and between the two parties below average, the agreement implied that most industrial goods benefited immediately from the dismantling of tariffs at the time, leaving a transitional period for a small number of industrial goods. Of all Japan's EPAs, the agreement with Switzerland is one that contains the most advanced customs procedures allowing exporters to issue certificates of origin, as well provisions governing electronic commerce. Expected benefits are a boost to Japan's exports of motor vehicles and household electrical appliances whereas Switzerland would benefit in areas such as instant coffee, aromatherapy oils, cheese and chocolate.[4]

Of a rather different nature is the Japan-India Comprehensive Economic Partnership Agreement (CEPA) that entered into force on August 1st 2011, after five years of negotiations. Critical issues in negotiating market access clauses have been in the areas of generic drugs, durians, sweet corn, curry, black tea, lumber, shrimps (on the Indian export side) as well as in areas such as automobile parts, steel products, electric/electronic goods such as DVD players and video cameras (on the Japan exports to India side). Owing to its size, India is an uneasy partner to negotiate with, and many Japanese firms are concerned that the tariff reduction for many items might occur only in the final tenth year, with no results prior to that. Also, motor vehicles (MV) and MV parts have been excluded from tariff reduction; these are precisely the areas that were to provide the highest gains for Japanese firms (Kondo, 2012).

Another regional dimension in which Japan was keen to participate from December 2011 was the Trans-Pacific Partnership (TPP) which aimed at setting up a multilateral FTA in the Pacific region with countries such as Australia, Brunei, Chile, Peru, Singapore, New Zealand and the USA. The agreement was signed in February 2016 but it became jeopardised since the US withdrawal of the agreement less than a year after. The fact that Japan was negotiating in parallel with some of the TPP countries during the early 2010s shows that the TPP was not a priority for the Japanese government. In this category, one should mention the EPAs signed with Peru in June 2011 (in force since March 2012) and with Australia signed in July 2014 (and in force since January 2015). The Japan-Peru agreement allows the elimination of tariffs on sensitive products such as passenger cars over four to nine years, on motorcycles in five to nine years, and on televisions at the time of implementation. This agreement shows how Japan has been consolidating its zone of influence in the Central and South American region, building on the FTAs concluded with both Mexico and Chile. Again, this strategy is partly motivated by a mimetic effect, so as not to be disadvantaged in that region of the world when compared to Japan's competitors, including the European Union (Gonzalez-Vigil and Shimizu, 2012). The Japan-Australia Economic Partnership Agreement (JAEPA) signed in July 2014 and in force since January 2015 also falls in that category. This is the most wide-ranging trade agreement that Japan ever concluded as it includes also sensitive agricultural products such as beef, sugar, dairy products, wheat and barley (Australian Government Department of Foreign Affairs and Trade, 2017a). The structural complementarity existing between Australia and Japan makes the two partners natural partners (Australia Department of Foreign Affairs and Trade, 2017a and 2017b). With this agreement, Japanese cars would, for example, cost about AUS$2,500 less on the Australian market when the 5 per cent ad valorem tariff is abolished.[5] Finally, the last EPA signed by Japan before the JEFTA is the Japan-Mongolia Economic Partnership Agreement

[4] http://www.japantimes.co.jp/news/2009/02/20/business/japan-switzerland-sign-epa-paving-the-way-for-tariff-free-trade/#.WK3eOn_GC2s

[5] https://www.japantoday.com/category/politics/view/free-trade-agreement-between-japan-australia-goes-into-effect

(EPA) which was signed in 2015 and which entered into force on June 7, 2016. This again was the first EPA for Mongolia (Ministry of Foreign Affairs, 2016a). The agreement calls for an elimination of import tariffs within 10 years on most products traded between the two parties. The trade balance between the two countries is in favour of Japan with Japan's main export items including motor vehicles, construction products and mining machinery.[6]

2.3. Currently negotiated agreements

Other agreements that are currently under negotiation involve Canada and Colombia. The seventh round of the Japan-Canada talks - which were initiated in March 2012 - took place in November 2014 in Tokyo. An internal memo from the Canadian Department of Foreign Affairs, Trade and Development highlights the slow progress of the negotiations, which have not met the expectations given Japan's interest, at the time, in the Trans-Pacific Partnership talks with countries such as Canada.[7] The Japan-Colombia deal is another one that has made sluggish progress since the launch of the talks in December 2012, with the thirteenth and latest round occurring in September 2015 (Ministry of Foreign Affairs, 2015).

Other failed attempts at negotiating trade and investment liberalisation include the negotiations with the Gulf Cooperation Council since 2006, which eventually were suspended. Also, negotiations with Japan's immediate neighbours (in East Asia) have also proved to be rather difficult. In particular, negotiations with South Korea had started in 2003 but broke down. FTAs with East Asia are nevertheless thought to produce the greatest additional benefits for Japan. East Asia is indeed the region where Japanese products account for the highest percentage of trade, and where tariffs have traditionally been among the highest. Consequently, trade liberalization with East Asia would boost activities of Japanese businesses, which are facing competition from ASEAN and China and which, in many cases, have shifted their production bases to locations in East Asia. Finally, a FTA joint study involving China-Japan-Korea (CJK) was undertaken in 2011 after Hatoyama's announcement at a Trilateral summit, an initiative that was warmly welcomed by the PRC. As a consequence, CJK FTA talks were launched in 2012. Among the motivations for Japan in signing a China Japan Korea FTA would be an increase between 0.03 to 1.24 percent of Japan's GDP (Cui, 2013), and an increase of economic welfare by US$ 19.1 billion. Moreover, the agreement could stabilize Japan´s position in Asia by enhancing its economic growth.

From a brief analysis of Japan's FTA strategy, it can be inferred that Japan has used its FTA strategy to address three main challenges: first to boost the competitive advantage of its internationally-oriented firms in selected overseas markets, in line with standard economic theory; second, to suggest a distinct approach to economic integration different from that of both the US and Chinese approaches; and third to stimulate its regional leadership credentials internationally vis-à-vis China (Solis 2008). The focus of these FTAs on Southeast Asian nations shows how Japan is keen to counter-balance China's influence in the broad Asian region and worldwide.

3. The Japan EU economic relationship

Compared with China, Japan possesses an indisputable advantage in negotiating liberalisation talks with the EU in that it is a well-functioning democracy abiding by the rule of law. The EU global strategy launched in the mid-1990s entails indeed the selection of EU partner countries based on economic as well as political criteria (Andreosso-O'Callaghan, 2013). This leaves

[6] http://www.joc.com/international-trade-news/japan-and-mongolia-sign-free-trade-agreement_20150210.html
[7] http://www.huffingtonpost.ca/2015/05/25/japan-canada-trade-talks-_n_7431710.html

China in a secondary position when dealing with economic partnership deals with the EU and when compared with Japan or indeed Canada for example. The EU global strategy entails the strengthening of economic and diplomatic relations with a number of carefully selected partner countries. It therefore builds on the agreements signed between the EU and these countries over the years. In the case of Japan, the two parties were holding regular Japan-EU summits, a graduation from the Japan-EC Joint Declaration of 1991 and from the Japan-EU Action Plan (2001-2010); it is at the May 2011 Summit that the idea of a more legally binding and deep agreement was mooted, provisionally titled a “Strategic Partnership Agreement” (MoFA, 2017a). Consequently, negotiations between the EU and Japan were launched in March 2013 with the aim of concluding the deal by 2016. Of note is the shared aim of a long lasting cooperation between the two parties that would sustain peace, stability and world prosperity.

Before delving into an analysis of the main issues in the talks and in the agreement, this section will first suggest a brief history of the Japan-EU relationship and then a discussion on the strength of the current economic relationship based on a set of macro-economic data.

3.1. Brief history

Owing to the nature of its 20th century history, Japan has not tended to concede an important place to European countries in its post WWII foreign policy when compared to other countries such as the USA in particular. Post WWII Japan-Europe history can be summarised by the emergence of Japanese global firms in key industrial sectors, and by what was perceived in Europe as an excessive penetration of Japanese competitive products in European markets, leading to trade frictions. As a result, Voluntary Export Restraints (VERs) were introduced in sensitive industries such as motor vehicles in order to minimise the soaring Japanese trade surplus with EU countries and to lessen the trade frictions between the two parties. The many anti-Japanese incidents taking place in the EU during the 1970s and early 1980s led the Japanese firms to rethink and reshuffle their international strategies.[8] In addition, the appreciation of the Yen as the result of the 1985 Plaza Accord, and the concomitant de-industrialisation of Japan (*kudoka*) meant that Japanese firms' strategies had to embrace a global strategy based on foreign direct investment. On the EU side, the end of the cold war unleashed “more comprehensive” ties between Japan and the EU (Watanabe, 2013: 4). In July 1991, the first Japan-EC summit took place in The Hague, where Japan's Prime Minister Toshiki Kaifu and the President of the European Commission Jacques Delors signed a Joint Declaration on Relations between the EC – and its members - and Japan. More comprehensive ties were built on the basis of the EU-Japan Centre for Industrial Cooperation which had been set up in 1987 and they implied, for the EU, the definition of a “new strategy” vis-à-vis Asia (European Commission, 1994); this new strategy signified the EU renewed interest in the Asian continent, admittedly because of China's rising economic power. Nevertheless, the steps taken from the 1990s were major building blocks in strengthening the Japanese (and Asian) relationship, which had been limited by then to a “Statement on Relations between the Community and Japan”, issued in April 1988. Consequently, diplomatic efforts, economic ties and cultural exchanges began to deepen, encompassing cooperation in the political and foreign-policy spheres.

3.2. Strengths of the current Japan-EU relationship

With a total GDP of about 24 per cent of the world total, the EU-28 is an important economic partner of Japan. Both Japan and/or selected EU member countries are present in major international frameworks such as the UN Security Council (with UK and France being Permanent Members),

[8] The reader interested in the post WWII history of Japan-EU economic relations can refer to Watanabe (2013).

and the G7 (including Japan, the UK, France, Germany and Italy). According to recent data released by Japan's Ministry of Foreign Affairs (MoFA, 2017a), total trade between Japan and the EU-28 reached approximately euro 108 billion in 2016 (16 trillion yen), making the EU the 3rd trading partner for Japan. Conversely, Japan is the 6th main trading partner of the EU-28 in terms of goods. As can be seen from Table 1, the perennial EU trade deficit (in goods) with Japan has tended to shrink since the global financial crisis (GFC) of 2008/09 whereas "Abe's monetary arrow" encompassing the objective of a more competitive exchange rate has been translated into more expensive imports from the EU explaining in part the quasi equilibrium towards the end of the period.

Table 1. EU-Japan bilateral trade flows in goods (1999-2015, mio euros)

Eurozone (18 countries): trade with Japan (all goods)									
Year	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
EU exports to Japan (in million €)	26.935	34.455	34.649	33.350	31.482	33.491	34.228	34.682	34.338
EU imports from Japan (in million €)	55.897	67.725	59.522	53.632	53.075	55.078	53.720	57.560	59.245
Acount Balance (in million €)	-28.962	-33.270	-24.874	-20.283	-21.593	-21.557	-19.492	-22.878	-24.907
Year	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	
EU exports to Japan (in million €)	33.692	28.800	34.816	39.470	44.810	43.798	42.997	45.305	
EU imports from Japan (in million €)	57.429	44.353	51.510	53.518	49.243	43.679	44.049	45.305	
Acount Balance (in million €)	-23.736	-15.533	-16.694	-14.048	-4.433	119	-1.053	-401	

Source: Eurostat Database: Extra-Euro area trade by partner and by SITC product group (last update 01.04.2016). http://ec.europa.eu/eurostat/web/international-trade-in-goods/data/database

A refined analysis at product or industry level reveals the following: 1). EU exports to Japan have been catching up in the last years. 2). Japan has been specialized in machinery products to a remarkable degree, a specialisation that has been consolidated in the post GFC years; according to EUROSTAT trade data, the EU's trade deficit in machinery exceeded euros 21 billion in 2016 in spite of a shrinking overall bilateral trade deficit. 3). Bilateral trade in agricultural products is small; in 2016, the EU had a euros 5.4bn surplus in this product category suggesting that there might be greater scope for more bilateral trade in this area; however, protectionism through quality standards is an issue that the opponents to the FTA tend to highlight. In terms of the bilateral trade in services, the EU tends to have a positive balance vis-à-vis Japan. For instance, bilateral trade figures with Germany and the UK, - Japan's two major EU trade partners -, show a strong position of the service industries of these two EU countries in Japan. In the case of these countries, trade deficits turned into surpluses in 2005 for the UK and in 2007 for Germany, denoting thereby a comparative EU strength in the services and in particular in business/financial services.

On the direct investment front, the EU represented in 2012 about one third of all developed economies' share of Japanese outward FDI, with the UK alone representing about 40 per cent of the EU share (UNCTAD, 2014). A longitudinal analysis, over the period 1990-2010 (Table 2) and still from the viewpoint of Japan, shows the relative importance of a few key EU countries in the Japan-EU direct investment relationship; these are the UK, Germany, the Netherlands owing to their favourable corporate tax regime, and more marginally France.

Table 2. Japanese outward FDI flows (2001 – 2012; in mn US dollars)

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Table 4. FDI stock abroad, by geographical destination

(Millions of US dollars)

Region / economy	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
World	300 115	304 234	335 504	370 541	386 585	449 567	542 618	680 330	740 927	831 076	962 790	1 037 698
Developed economies	222 160	222 915	242 987	262 255	259 634	296 166	346 371	416 451	451 621	488 882	556 944	606 418
Europe	70 430	72 084	87 467	102 118	92 623	119 807	145 268	162 270	176 569	184 191	219 533	242 415
European Union	68 549	70 219	85 687	101 086	91 758	118 822	144 159	160 945	175 013	182 328	215 068	237 169
Belgium	3 647	5 125	7 148	8 819	7 742	9 628	11 978	13 936	14 515	14 130	14 724	16 002
France	2 902	5 387	7 270	12 895	11 278	13 061	12 320	14 843	16 824	16 224	15 782	20 024
Germany	3 930	4 668	6 863	6 967	6 171	7 413	9 450	11 930	15 108	15 327	16 683	16 862
Italy	711	1 053	843	1 089	841	806	830	877	1 101	1 411	2 503	2 698
Luxembourg	902	1 163	895	1 104	760	1 128	3 510	4 309	7 241	9 639	6 982	6 915
Netherlands	19 494	22 815	33 658	36 380	34 447	45 407	63 448	71 798	77 529	76 051	84 786	94 193
Spain	591	847	968	1 146	1 384	1 348	1 723	1 269	1 569	1 564	1 514	1 472
Sweden	1 139	1 062	1 313	1 555	1 557	2 199	2 933	3 038	2 567	1 989	2 669	3 325
United Kingdom	33 116	26 183	24 399	26 757	24 163	31 605	31 774	32 407	31 306	37 984	48 101	53 812
Other developed Europe	1 139	1 260	1 172	1 032	865	985	1 110	1 325	1 556	1 863	4 465	5 247
Switzerland	1 139	1 260	1 172	1 032	865	985	1 110	1 325	1 556	1 863	4 465	5 247

(Source: UNCTAD April 2014 – Bilateral FDI Statistics 2014

In terms of FDI stocks, the EU-Japan balance is in favour of Japan with US$156.1bn in 2012. This is clearly an area where an FTA between the two parties could be advantageous to EU firms. In this unbalanced relationship, a few EU countries only stand out as the main hosts and senders of direct investment with Japan. Again, and in the aftermath of BREXIT, it should be noted that the UK emerges as a main direct investor with 18.5 per cent of all EU direct investment stock in Japan by 2012. This places the UK as the third main EU investor in Japan in stock terms, shouldering closely France (20.9 per cent) and the Netherlands (38.3) although the figures are not entirely comparable and meaningful in the latter case. The UK is the main host for Japanese firms (again after the Netherlands) with 22.4 per cent of all Japanese direct invested stock in the EU-28 by 2102 (UNCTAD, 2014). The economic relationship between Japan and the EU has shifted from trade to direct investment. At the time of writing, more than two-thirds of Japanese vehicles sold in the EU are manufactured in EU countries, stimulating thereby job creation. As noted by Japan's Ministry of Foreign Affairs (MoFA, 2017a), the EU-28 as a whole represents nevertheless the largest share of all inward FDI stocks in Japan (about 10 trillion yen).

3.3. Expected impact of the partnership

An examination of Japan's FTA strategy with other countries than the EU shows that: 1). The highly protected agricultural sector has been gradually integrated in the talks; 2) Apart from Switzerland, other deals have not been that challenging because they were signed with less developed countries presenting therefore a high degree of structural dissimilarity with Japan.

The FTA deal with the EU seems therefore of a more challenging nature, owing to the EU size and also given the industrial specialisation of both regions in similar industries and sectors (such as transport equipment for example). The FTA agreement sought by Japan and the EU belongs to the category of deep agreements covering areas such as public procurement, market access, non-tariff measures (NTMs), technical barriers to trade (TBTs), intellectual property rights, rules of origin, competition policy, dispute settlement mechanisms, investment, SMEs, trade and sustainable development, etc. During the 18 rounds of negotiations, the Japanese delegation has been keen to see progress on the elimination of high tariffs on industrial products, reaching for example 10 percent for motor vehicles and 14 percent for electronic devices (Akaichi, 2015). The EU was keen to see progress on NTMs affecting industries such as motor vehicles, food safety, medical devices and pharmaceuticals as well as on government procurement and the protection of geographical indications. Technical standards in many industries are a dominant issue but the adoption of the 37/47 passenger vehicle regulation during the negotiations is an example of how the interests of the two parties have been converging since the opening of the talks. The weight of the European automotive industry lobby on the discussions might be seen as an influential force explaining some of the progress in this domain (Olsson de Koning, 2012). Also, and as part of the third arrow of Abenomics, some sectors such as medical equipment have been subject to new policies making a deal with the EU easier.

After some 18 rounds of negotiations, an agreement in principle was finally concluded at an EU-Japan summit on the 6th of July 2017, although some technical points still need some fine-tuning and a final version of the economic partnership agreement's (EPA) text needs still to be drafted, at the time of writing. Since then, both parties have been working towards the finalisation of the agreement in a timely manner so that legal revision and translation in EU member languages can be done by mid-2018. This schedule would allow the agreement to enter into force by early 2019 (European Commission, 2017a). In addition to greater openness, there are several projected economic benefits for both sides. The agreement will lift most customs duties representing about 1 billion euro per annum. This estimated gain stems from an elimination of 90 per cent of tariffs for European exports to Japan as well as of 97 per cent of customs duties (European Commission, 2017b). For the EU, exports of processed foods may rise by up to as much as 180 per cent, whereas EU exports of chemical products are expected to increase by 20 per cent; EU exports of electrical machinery are estimated to rise by as much as 16 per cent, according to one simulation exercise. Furthermore, the Japanese market is regarded as an adequate and optimal market for high-tech and high-quality goods such as pharmaceuticals, medical devices, agri-food products, motor vehicles and transport equipment. The expected steep increase in processed food exports can be explained by the fact that 85 per cent of all agri-food products will be entirely duty-free. Additionally, one of the EU's major export interests is pork meat, which in fact is the main agricultural export to Japan. After the agreement, processed pork meat will be duty-free and fresh pork meat exports almost duty-free. Wine is the second most important agricultural export to Japan, benefitting from an elimination of tariffs on alcoholic beverages from day one. Another important export benefitting from the elimination of tariffs is cheese, a market where the EU is already the dominant player in Japan. Tariffs on products from industries where the EU is very competitive will also be abolished such as the above-mentioned chemicals but also plastics, cosmetics, textiles and clothing. Non-tariffs barriers such as technical requirements will also be addressed, for example in the motor vehicles industry and also in the medical devices industry. To facilitate trade in services, horizontal provisions across the services sector are envisaged such as a provision to reaffirm the right to regulate for example (European Commission, 2017b).
From the Japanese perspective, the JEFTA is one of the pillars of the country's growth strategy as

it is enshrined in the ‘Global Outreach Strategy’ which is one of the three ‘arrows’ of Abenomics (GoJ, 2014). The agreement is expected to promote trade as well as investment which in turn should lead to higher employment and competitiveness. The most important issue is the elimination of high tariffs on industrial products, especially for motor-vehicles and electrical machinery. The agreement is seen as an opportunity to stimulate competition in Japanese industries as a whole. Just as the EU, Japan has an interest in improving the regulatory issues for Japanese companies operating in the EU with regards to non-tariff barriers. Of particular concern to Japan is the issue of Brexit since the UK is a key trade and investment partner of Japan. For example, in 2012, the UK was host to as much Japanese direct investment as Germany, France and Belgium together (Table 2) and in 2015, nearly 50 per cent of all Japanese direct investment to the EU was flowing to the UK (MOFA, 2016b). As Table 3 shows, the UK is a core trading partner for Japan, particularly in the area of services, the sector in which the EU as a whole holds a strong global competitive position. Japanese services exports to Germany amounted in 2013 only to about 60 per cent of Japanese services exports to the UK. This implies that Japan is very keen to enjoy freer access to the EU market, including the UK market. This shows the strong commitment of the Japanese authorities to the FTA strategy as a means to consolidate peace, stability and economic prosperity at the global level.

Table 3. Japan’s Trade in services with Germany and the UK (1996-2013)

Dataset: EBOPS 2002 - Trade in services by partner country

Country: Japan
Service: TOTAL SERVICES
Measure: Millions of US dollars
Unit: US Dollar, Millions

Partner	Expression	1996	1997	1998	1999	2000	2001	2002	2003	2004
Germany	Net	-2.463	-1.990	-1.130	-1.366	-1.234	-1.187	-1.196	-758	-1.024
	Exports	2.411	2.513	2.396	2.280	2.396	2.207	2.327	3.287	4.208
	Imports	4.874	4.502	3.526	3.646	3.630	3.395	3.523	4.045	5.232
United Kingdom	Net	-5.070	-3.952	-2.940	-3.288	-3.637	-2.640	-3.554	-3.145	-2.415
	Exports	3.908	4.373	4.081	3.939	3.610	4.949	4.312	5.231	7.311
	Imports	8.978	8.325	7.021	7.227	7.247	7.588	7.866	8.376	9.725

Partner	Expression	2005	2006	2007	2008	2009	2010	2011	2012	2013
Germany	Net	-902	-606	882	4.327	3.005	2.064	1.715	193	660
	Exports	4.560	5.325	7.793	11.398	9.128	7.843	7.697	6.501	6.484
	Imports	5.462	5.931	6.911	7.071	6.123	5.779	5.982	6.309	5.824
United Kingdom	Net	1.708	899	942	2.962	835	2.087	1.483	13	641
	Exports	10.471	10.651	11.935	14.118	11.064	11.945	10.854	9.521	10.299
	Imports	8.763	9.751	10.994	11.157	10.229	9.858	9.371	9.507	9.657

Data extracted on 18 Mar 2017 12:57 UTC (GMT) from OECD.Stat

Source: OECD Statistical Database: “Trade in services by partner country”

Conclusion

Japan’s contemporary free trade area strategy can be seen as both an important ingredient and further step in Japan’s internationalisation strategy that started after the fall of the Tokugawa period. This contemporary strategy is motivated by the persistence of low growth rates since the outburst of the “lost decade” and it is seen as a pillar of Japan’s current growth strategy. From Japan’s perspective, the July 2017 FTA signed in principle with the EU adds to the list of FTA or/and economic partnership agreements that Japan has been signing with a number of developed and emerging countries in the last 10 years or so. The agreement with the EU-28 is challenging in that both Japan and the EU are specialised in similar manufacturing industries such as transport equipment for example. However, substantial gains are expected for the EU in the newest tech, aerospace, defence industry, agricultural as well as services sectors, two sectors where Japan’s bilateral specialisation is less pronounced.

With the prospective agreement entering into force by early 2019, economic benefits are estimated to be as follows: the elimination of most tariffs would have a positive impact on EU food, chemicals and electrical machinery exports. For Japan, an important issue has been the elimination of tariff and NTMs in industries such as motor vehicles and machinery, where competitiveness gains would materialise. A greater opening of the Japanese economy to the EU - including the UK - would ultimately stimulate competitiveness at the macroeconomic level, creating employment and boosting economic growth. The FTA agreement with the EU certainly strengthens Japan’s contemporary economic relationship with the EU. It is however debatable whether this agreement will reinstitute Japan as the EU’s main economic partner in East Asia, as was the case shortly after World War II. The Japanese Government has already signed some 15 FTA and EPA agreements with countries in the East Asian region and further afield (including Switzerland), and the JEFTA can be viewed therefore as one element only in this broad FTA strategy. Ultimately, the JEFTA initiative is critical in counteracting protectionist trends visible at the world level.

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