

## Global context and European motivations for the EU-Japan Partnership Agreement (EPA)<sup>1</sup>

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### 1. Introduction

There is a general agreement among economists that free international trade is sub-optimal in most theoretical cases when more than two countries are involved, and more than two goods are traded. The canonical Ricardian model with two countries and two goods traded is a special case that is far from typical. However, reversing international trade agreements could result in the escalation of trade wars with profound consequences. This is particularly the case when multilateral agreements sponsored by the international institutions including the World Trade Organization (WTO) reach a stalemate.

The standard contemporary economic theory of international trade is based on the approach proposed by Krugman (1979) in his seminal article titled *Increasing returns, monopolistic competition, and international trade*. Domestic economic policies and microeconomics conditions contribute to explain comparative advantages of firms, and implications for the countries in which they operate. Since the conviction of optimality of free trade is not explained by science, it is essentially an act of faith (McCulloch 1993) that does not easily tolerate dissident views. The gap commonly observed between theory and trade policy can be analyzed as the consequence of ideology and, more importantly, political agenda and decisions influenced by lobbies. Economists formulate recommendations on international trade agreement, but the political decision-making process is essentially determined by the messages conveyed by lobbyists acting on behalf of business associations and individual firms. The influence of lobbies is facilitated by the fact that most bureaucrats and politicians involved in the decision-making process have limited or no training in economics, as indicated by remarks such as “*of course free trade is best in theory but ...*” commonly made in discussions regarding the difficulties to negotiate free trade agreements.

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There is also a consensus among economists to acknowledge that most simulations gauging the economic consequences of trade liberalization indicate that net macroeconomic gains account for a small percentage of GDP, with large margins of error ; this is confirmed by ex post estimates. Another major limitation of most studies attempting to assess gains from trade is that they adopt a macroeconomic static comparative approach. It is notoriously difficult to assess macroeconomic dynamic gains and even more to simulate or assess the distribution of gains and losses among different individual firms and households, and across regions. The distribution of gains and losses among individuals and across districts that may result from trade liberalization is rather unpredictable. The only certainty is that it is unlikely that there will be only winners.

Against this background, a number of bilateral trade agreements have recently been negotiated. The EU-Japan Partnership Agreement (EPA) is the one of the most important agreements owing to the aggregate size of the economies involved and the magnitude of the trading flows.

It is therefore legitimate to wonder what the motivations for the EPA have been. The commitment of both sides to reach an agreement, despite uncertainties regarding the outcomes, suggests that geopolitical rather than economic motivations dominate. This is certainly the case for the Japanese side, but the present article focuses on the motivations of the EU side. Section 2 presents the global context of free trade agreements and the scope of the EPA ; section 3 discusses the EU's perception of Japanese motivations and its own motivations for the EPA ; section 4 presents concluding remarks.

## **2. Global context of free trade agreements and scope of the EPA**

While the global arrangement in international trade liberalization between the 1960s and the 1990s was characterized by some regionalism agreements (e.g., the European Union), in a multilateral world based on WTO agreements (Ethier 1998), the stalemate at the WTO since the 2000s resulted in a reinforcement of multilateral regionalism (Baldwin 2006). A proliferation of bilateral FTA was observed in East and Southeast Asia in particular, with some of the most important agreements involving the ASEAN as a whole<sup>2</sup>, but most were signed by pairs of individual countries. The complexity and lack of transparency, which have been described as a “noodle soup bowl” of bilateral agreements, resulted in not only sizable costs incurred by the firms involved in international trade in terms of collecting, processing, and analysing information, but also opportunities to take advantage of differentials tariff rates. The complexity resulting from the proliferation of bilateral FTA did not prevent the main trading partners from negotiating new treaties. For ex-

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2 With Japan in 2008 ; with China, India, and Australia in 2010.

ample, in the case of Japan, with Australia (2008), Chile (2006), India (2011), Mexico (2005), and more recently Switzerland and the EU (2018). The EU has also contributed to this proliferation by establishing FTA with neighbouring countries and also with more distant emerging economies.<sup>3</sup> More recently, the EU has also negotiated FTA with South Korea (2015) and Canada (2016) before signing the EPA with Japan.

The trade agreement between the EU and Japan is of paramount importance considering the economic size of the two partners and the magnitude of the bilateral flows of goods and services. The official statement of the European Commission indicates that the aim of the trade agreement with Japan is to remove (in fact, drastically reduce) trade barriers to stimulate growth on both sides (in fact, create new business opportunities for firms, which could stimulate growth). The two partners have also reaffirmed their commitment to achieve an ambitious and comprehensive agreement to help shape global trade rules and to send a powerful signal that two of the world's largest economies reject protectionism.

The negotiation process with the EPA has been relatively smooth and rapid. In 2013, the EU governments instructed the European Commission to start negotiations with Japan. On 6 July 2017, the European Union and Japan reached an agreement in principle on the main elements of the EU-Japan Economic Partnership Agreement. On 8 December 2017, the negotiations were finalized. After the legal verification and translation processes, the European Commission then submitted the agreement for the approval of the European Parliament and EU member states.<sup>4</sup>

The EU has also negotiated a Strategic Partnership Agreement in parallel with Japan. The official statement of the European Commission indicates that the aim is to broaden the partnership in order to cooperate closely with one another in international and multilateral fora including the UN, WTO, and the G7 and G20. The rationale is that, as advanced, industrialized democracies, the EU and Japan share fundamental values and have common interests.<sup>5</sup> The Strategic Partnership Agreement (SPA), a legally binding pact, covers not only political dialogue and policy cooperation, but also cooperation on regional and global challenges, including the environment and climate change, development policy and disaster relief, and security policy.

Associating economic and strategic agreements is in line with the policy of the EU Commission, implemented not only within the EU but also with external partners. This is however a relatively new experience for Japan, which has been involved in a bilateral strategic partnership with

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3 With Turkey in 1996, Tunisia in 1998, Mexico and Morocco in 2000, South Africa in 2000, Chile in 2003, Egypt in 2004, and Algeria in 2005.

4 [http://ec.europa.eu/trade/policy/in-focus/eu-japan-economic-partnership-agreement/index\\_en.htm](http://ec.europa.eu/trade/policy/in-focus/eu-japan-economic-partnership-agreement/index_en.htm)

5 [https://eeas.europa.eu/headquarters/headquarters-homepage/19223/eu-japan-political-relations\\_en](https://eeas.europa.eu/headquarters/headquarters-homepage/19223/eu-japan-political-relations_en)

the United States of America (USA) since the post-war era, but with no economic equivalent with this key partner since the trade relations between the two countries were essentially defined by their commitment to multilateral agreements.

### **3. The EU's perception of Japanese motivations for the EPA, and its own motivations**

There is no official statement of the European Commission regarding its perception of the Japanese motivations for signing the EPA. It is nevertheless reasonable to consider that the following conditions have been regarded by EU members countries and the European Commission as critical :

- Japan is one of the few countries in the world that is not involved (at least officially) in a regional economic agreement (APEC is not a regional economic agreement but a Forum) ;
- The Japanese economy is not complementary with the EU economy, but Japanese firms are interested in enhanced access to the European market ;
- As a way to promote productivity gains (resulting from enhanced competition), the Japanese government is willing to open market access not only for goods but also for services ;
- To enhance productivity in manufacturing and services, the Japanese government is keen to promote investment in Japan (for the local market and for export) by European firms ;
- The Japanese government is willing to cooperate with the EU to strengthen the Japanese geopolitical position in the framework of the United Nations (lobbying for a permanent seat on the Security Council), as well as vis-à-vis China, North Korea, Russia, and more recently the USA.

These considerations help to understanding the willingness of the Japanese side to consider economic and political commitments, which is, as mentioned above, the traditional approach of the EU.

The EU's economic motivations are less obvious. The main reason is that the Japanese industrial structure is as diversified as the European one with the same type of specialisation in human capital-intensive productions. In particular, the Japanese manufacturing sector is specialised in the production of high-quality capital and consumer goods for the global market, which is exactly the same specialization as the German manufacturing sector. Overall, very limited gains from trade can be expected. It is likely that there will be winners and losers, but the magnitude of gains and losses is difficult to anticipate, and it is difficult to predict the distribution of gains and losses among firms. The most likely outcome is that there will be gains for most large European firms (enhanced access to the Japanese market), and losses for a number of smaller European firms

(higher exposure to competition from Japanese firms on the European market). It is even more difficult to predict the regional distribution of gains and losses; the most likely outcome is that there will be net gains in a number of already very successful industrial districts, particularly in Germany, and net losses in most other regions.

It can be therefore argued that major motivations of the EU for the EPA are related to the global vision of the European Commission, its internal difficulties and its geopolitical concerns. Until the 2000s, the EU's objectives in terms of international relations have been to promote integration of central European countries,<sup>6</sup> economic regionalism (promoting the EU model of integration, particularly in the ASEAN and the MERCOSUR), and bilateral cooperation with neighbouring countries.<sup>7</sup> The enlargement has been successful in economic terms but the European Commission is experiencing increasingly conflictual relations with a number of central European countries; ASEAN and MERCOSUR have not been receptive to the EU proposals and the neighbouring policy has been a failure, particularly in the East where it has resulted in tension with Russia. The same remarks apply to the relations with a number of Arab countries and Turkey.

This helps to understand a shift in the international agenda of the EU in favor of FTA with countries not involved in regional agreements (particularly Japan and South Korea). This objective has become more relevant since 2008, in the context of the Eurozone crisis and strong perception of democratic deficit and lack of legitimacy of the European Commission, as it contributed to fostering the position of the European Commission with some tangible success in international relations, which go some way to compensating for the internal difficulties and failures.

From the viewpoint of the European member states, the EPA also has some attractive features related to geopolitical issues. In the context of uneasy relations between the European Commission and a number of EU countries with the USA, the EPA is a way to strengthen the relations with a rather dependable partner. Until then, European NATO countries and Japan, as allies of the USA, were implicitly allies but had limited bilateral cooperation in issues related to international security. The EPA creates an explicit framework of strategic cooperation, although an ambiguous coalition of countries exists on the European side since not all NATO countries are EU members (Turkey in particular is a major NATO country), and vice versa.

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6 Enlargement of the EU resulting in the inclusion of Hungary, Poland, the Czech Republic, Slovakia, the three Baltics countries, Slovenia, Malta, and Cyprus in 2004, Bulgaria and Romania in 2007, and Croatia in 2013.

7 Middle East and North Africa, Ukraine, Georgia, and former Soviet Republics excluding Russia.

#### 4. Conclusion

Considering that the economic gains from trade liberalization are at best case rather modest, and potentially damaging for a number of firms on both sides, the SPA between the EU and Japan can be regarded as the most important component of the EPA. Although the content of the SPA remains to be defined to a large extent, it appears that there is potential for a cooperative positive sum game. It is likely that, in relations with Japan, the next objective of the EU will be to promote cooperation in political fora (e.g., permanent seats for Germany and Japan at the UN Security Council), scientific cooperation (possibly with the same type of involvement in EU research programmes as Switzerland and Norway), and military cooperation (particularly with the proposed “European Army”).

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