Hosuk Lee-Makiyama, Co-Director of ECIPE
Presented at JETRO EU-Japan Business Summit

March 8, 2012

As delivered

Distinguished guests and speakers,

European trade policy towards Asia is based on the premises of delivering growth. The EU share of world GDP will be halved by 2030, and further divided by three by 2050. Need for growth, even before the crises, was urgent.

The EU-Korea FTA delivered a landmark agreement and a major political accomplishment. But as EU has 12 times larger GDP than Korea, and the impact on the European economy will be about 0.08% of GDP, or 7 euros per person […].

The current list of small- to mid-sized economies and emerging economies are fast growing, but their share of world GDP would have any significant impact until 2030, and it is very much conditioned on India able to sustain its growth – something that cannot be taken for granted.

Given the prospects of the Single Market in the wake of the Euro crisis, the need to tap into overseas growth to sustain jobs and industrial capacities is urgent in the short term. In that respect, market integration with large, developed economies, the US and Japan may be the only FTAs that could have significant impact on EU economy.

Since it seems like a transatlantic agreement might take different form than an orthodox FTA, the EU-Japan FTA will indeed be the largest FTA would ever to be attempted. It would cover one-third of world GDP. According to a recent study by my colleague Professor Patrick Messerlin, the market expansion of EU-Japan FTA will remain bigger than all of our current FTA prospects until 2030.

After all, Japan is one of world's largest economies, vying neck to neck in terms of GDP with China. And the size of private consumption is 60% in Japan, compared to just 30% in China. Furthermore, China in its current phase of development is mainly investment driven, with strong demand for industrial equipment. Meanwhile services market access is practically non-existent.

At this stage, the EU simply does not export to China – Germany does. Without German exports, China would barely rank in EU top ten of export markets. From that perspective, Japan offers bigger growth opportunities that EU urgently needs in short term. It will also help to adjust internal imbalances that have been puts to strain by the crises, while diversifying our exports.

However, to strike deep and meaningful FTAs in the shockwave of the crisis is increasingly difficult – the cliché of EU being the largest global player in trade and investment is still valid and true. But it has lost its meaning and attraction for businesses outside Brussels. Also, inside Brussels, we see that the major players find it increasingly difficult to make concessions that are necessary to conclude FTAs amongst themselves.

All forms of market liberalisation, including trade agreements, encourage competition that award competitive actors, and phase out old ones. Trade agreements leads to increased exports and also better efficiencies and restructuring. However, these two-sided gains, the crisis-struck EU finds it more difficult to make the necessary trade-offs between them, between competitive exporters and sunset firms.

Unlike when we are negotiating with smaller economies, we cannot expect we can win in every sector, especially where we are less efficient – one repeating problem in FTA talks are some portions of the European car industry where the crisis have created overcapacities of 20-30% and led to the biggest bailouts in Europe's history. Same interests also attempted to veto on EU-Korea agreement.

Imports did not cause, or even worsen, the crisis since Asian brands produce their cars in the EU using European workers and subcontractors, mostly due to currency fluctuations that affects trade more than tariffs.

Overcapacities in the EU are also concentrated to a couple of countries where manufacturing is focused on low-margin volume production. Meanwhile, a majority of car producers in Europe is filing record profits, and our biggest trade surplus in one product – cars. In fact, EU exports three times more cars than in it imports.

As innovation and production becomes increasingly fragmented, there is a strong correlation between European economies that import components and technology from high-value added countries, and our recent report on car industry shows that the highest correlation is component imports from Japan. About 50-60 percent of Japanese and Korean supply chains are globalised, while only 3% of EU. This means we turn a blind eye to 70% of world R&D, and EU is left with the least efficient 30%.

This pattern is emerging in almost every sector. To sustain industry sector and jobs at home in the EU, we need to tap into markets as well as supply-chains and technologies. This works other way around too – if Japan is serious about increasing services exports, it needs to import European efficiencies, just to take one of many examples.

However, an FTA access to high consumption markets with high regulatory quality needs to tackle new trade issues, and in particular regulatory barriers (or non-tariff barriers), an area WTO has yielded little results. The level of NTBs in both EU, Japan and the US are several times higher than tariffs imposed, and scaling them down provides the biggest benefits.

The EU-Korea agreement focused on NTBs in five sectors, where at least 4 were almost exclusively on the request of the EU. It is clear neither EU or Japan will not – and should not – accept any discrimination of their exports, and it is clear that most NTBs in developed world is of different nature than in the emerging economies. They are regulatory divergences between the Single Market and economies that are of same scale.
Tackling these divergences are difficult, for various reasons:

First, there are significant differences in views on the division of responsibility between the manufacturer and the regulators in different cultures. For instance, the double-approval of EU pharmaceuticals in the US is a sovereignty issue, not a question of manufacturers product responsibility. Similarly, the role of the regulator in most Asian economies is extending into what we in the EU consider corporate accountability.

Second, in trade negotiations, non-discriminatory measures are also a question of political economy, meaning priorities. The EU-Korea agreement focused on NTBs in five sectors, where at least 4 were almost exclusively on the request of the EU. However, it is almost unlikely that any party within EU, US, China and Japan would accept to replace their own standards – regulatory divergences will in a larger extent addressed through mutual recognition – accepting and trusting each others products – which was also the modus operandi of European integration.

This concludes the bigger picture of EU-Japan FTA in the current climate of economic and geopolitical reality. Large-scale FTA has a important systemic role in absence of new trade liberalisation in the WTO. In that respect, the Transatlantic Working Group, TPP and plurliateral agreements create a common framework of non-discriminatory, market liberal and transparent framework of trade rules based on rule of law. To multilateralise gains from our FTAs and plurilaterals is the longterm primary objective.

This ought to be something that both Japanese and European policy communities should have in mind before they subject themselves to mercantilist sentiments at home instead of pursuing comprehensive agreements. Whatever political blackmail we use against each other, or whatever we leave out of trade agreements between US, EU and Japan, will be used against us by third countries when the geopolitical realities have turned against us. This reality is only ten, twenty years away.

Thank you.