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The Unabated Proliferation of Preferential Trade Agreements. The Case of EU and Japan

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Abstract *The steady spread of preferential trade agreements is not a new phenomenon in the multilateral trading system. Striking is, however, the outstanding dynamics of the new bilateral and regional initiatives among the traditional trading powers - the EU, U.S. and Japan - in the most recent period. Our paper aims to address these new deals, as illustrated by the current negotiations for a deep and comprehensive Free Trade Agreement (FTA) between the EU and Japan launched in March 2013. It sheds light on the main factors behind the unabated march towards FTAs and reveals some of its effects on both bilateral trade relations and the multilateral trading system. It argues that the fast move towards FTAs should be seen as a means of rapid market opening within the broader context of reforming the very fundamentals of the major trading powers' economic and trade policies in response to the consequences of the financial crisis.*

Key words:

Trade policy, trade negotiations, FTA, EU, Japan, multilateral trading system.

JEL Codes:
F10, F13, F14, O52, O53

1. The unabated march towards FTAs worldwide

On 25 March 2013 the EU and Japan have officially launched the negotiations for a deep and comprehensive FTA. The ambitious negotiating agenda covers the progressive and reciprocal liberalization of trade in goods, services and investment, with the aim to eliminate tariffs, non-tariff barriers and tackle other trade-related issues, such as public procurement, regulatory issues, competition, and sustainable development. Shortly after this event, the EU also announced starting of negotiations for a FTA with the United States, EU's main trading partner, in the near future (EC, 2013b).

Presently, the EU is engaged in a series of FTA negotiations in Asia: with India, Vietnam, Malaysia, Indonesia and more recently Thailand. Furthermore, an ambitious FTA with Korea entered into force in July 2011, and the negotiations with Singapore have been completed in December 2012. In the long term, the EU seeks to establish a free trade agreement with the whole ASEAN group, but it prefers first to make more substantial progress in terms of completing the individual FTAs with all the countries of the group. The EU has also concluded FTAs with Peru, Colombia and Central America, and is in the last stretch with negotiations with Canada.

Japan is pursuing similar strategies, having at present 13 FTAs. It is also negotiating with Canada, China and Korea trilaterally and is involved in Regional Comprehensive Economic Partnership negotiations in the Asian region (ASEAN+6). Besides, it recently announced its intention to join also the Transpacific Partnership Negotiations (EC, 2013b).

These dynamics clearly demonstrate the fundamental decision of both the EU and Japan to move towards FTAs as a means of a rapid market opening to promote business opportunities for their companies. But it also confirms that the process of multilateral market opening is in a deadlock not only because the Doha Round negotiations are in a stalemate, but also owing to the fact that major trading powers are apparently not likely to assume leadership in the multilateral liberalization of markets.

Despite reassuring formal declarations by all parties involved that these initiatives are not going to prejudice multilateral trade cooperation within the WTO, the forthcoming FTAs will undoubtedly add to the already severe challenges facing the multilateral trading system. According to WTO estimates, some 300 bilateral and regional preferential trade agreements are currently in operation and many more under negotiation. While these undertakings are not new to the GATT/WTO system, they show every sign of continuing to increase in number and trade coverage. Already in 2008, the share of world trade conducted under PTAs has increased to 51% from 28% in 1990.

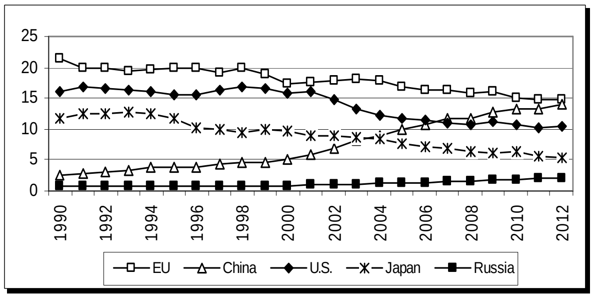
2. Main reasons behind the remarkable push for FTAs

According to expectations, the new EU-Japan FTA would boost bilateral trade and investment flows between the two partners and also exert a beneficial effect on global trade growth. Indeed, the recent EU-Japan initiative and the numerous similar undertakings worldwide cannot be dissociated from the current state of the world economy and the ongoing dynamic structural changes in the global economy and international trade.

Firstly, the launch of bilateral negotiations between the two major trading powers occurs against the background of severe difficulties that still face the world economy as a consequence of the global financial crisis, including macroeconomic imbalances, persistent debt crises in some major economies, and high unemployment in numerous countries.

As a result of weak economic activity, particularly in developed economies, global GDP growth has decelerated from 3.8% in 2010 to 2.4% in 2011, and 2.1% in 2012, according to WTO estimates (WTO, 2013a). Consequently, global trade growth recorded a sharp slowdown in the last two years, to 5.2% in 2011 and again to 2.0% in 2012, following its vigorous recovery in 2010 (13.9%). Against the background of a subdued global growth trajectory, the WTO's projected trade growth of 3.3% in 2013 and 5.0% in 2014 is well below the precrisis trend of 6.0%. Furthermore, global FDI inflows – the main driving force behind steady trade expansion over the last decade – declined by 18% to USD 1.3 trillion in 2012, a level close to the trough reached in 2009, according to UNCTAD (2013) estimates. Almost 90% of global FDI decline was accounted for by developed countries, with FDI inflows to developing economies remaining resilient, declining by only 3%. While the major developed economies are mainly responsible for weak economic activity globally and restrained import demand growth in the past two years, the developing countries have been also increasingly affected through their deep integration into global production networks operated by TNCs. Nevertheless, these countries continue to remain the main source of global growth and trade expansion.

Secondly, the weak and uneven recovery of the global economy and trade following the deepest postwar recession has further accelerated the rapid structural shifts under way in the world economy. The shift of economic power from industrialized economies towards emerging economies, particularly China and India, lies at the heart of these transformations. As a result, developing countries' share of world trade has risen from 25% in 1990 to 45% in 2011, at the expense of advanced economies, with their share plummeting from 75% to 55%. Hence, the traditional trading powers – the EU, U.S. and Japan – are confronted with a visible drop in their relative market shares, and the redistribution thereof in favour of developing economies *(Figure 1).* On the other hand, we may see a strategic reorientation of the major trading powers' trade flows towards the more dynamic emerging markets and a visible decline of trade with their traditional partners. These dynamics are particularly evident in the case of EU-China trade relations, the share of which increased dramatically in the last decade at the expense of advanced economies' market shares, especially the U.S. and Japan.



Note: [1] Excluding intra-EU trade.
Source: Own calculations based on WTO (2001, 2011, 2012, 2013a) database.

Figure 1. Evolution of relative merchandise export market shares of the EU[1], U.S., Japan, China, and Russia, 1990-2012 (% of world total[1])

Thirdly, the policy reactions of the countries worldwide to the adverse effects of the 2008/09 crisis, and the growing difficulties in the world economy have led to increasing protectionism and rising trade tensions between the major trading powers. Available data confirm the steady increase in the number and incidence of the new trade restrictive measures introduced by numerous governments since 2008. These are further enhancing the risks and uncertainties in the global economy, with the potential to slow growth and trade expansion. But even more alarming are the trends currently shaping the evolution of trade protectionism. Most of the new protectionist measures are not traditional forms of protectionism, that are relatively well covered by WTO rules (tariffs or trade defense measures), but rather new forms, that are more subtle and less transparent. These include non-tariff measures and domestic regulations that are either circumventing WTO rules, or are not covered at all.

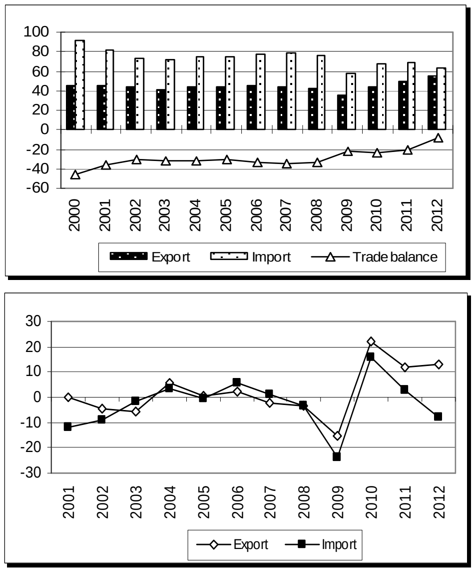
On the other hand, the multilateral trading system and the WTO failed to keep pace with the dramatic changes in the global trade landscape in last decade. Multilateral trade rules remained stuck in the 20th century trade issues, reflecting the results of the Uruguay Round (1986-1994). While adjusting multilateral trade rules ranked among the main objectives of the Doha Round, trade negotiations are blocked since 2008. Hence, the major trading powers have reconsidered their strategic options in trade policy terms. In recent years, their efforts have been directed towards enhancing their companies' competitiveness via bilateral negotiations. FTA deals can be concluded much faster than multilateral agreements and also address non-tariff barriers that prevail in contemporary trade. FTAs allow for a more substantial market opening, as they may cover topics that transcend the multilateral approach, such as investment, government procurement, intellectual property rights, competition, etc. The negotiating agenda agreed by the EU and Japan is focused precisely on these so-called "new generation trade issues".

Finally, the relentless promotion of FTAs is part of the new strategic guidelines of EU's common trade policy adopted in 2006 and revisited in 2010. The launch of bilateral trade negotiations with Japan – the world's third-biggest national economy and one of the strategic partners for the EU – comes in a moment when the EU has been accelerating its push for preferential trade deals in Asia. The reasons are both economic and geopolitic. First, the euro zone has slidden into recession for the second time in the last three years, so the EU has been insistently seeking to enlarge market access for its companies outside the EU to spur growth. Second, the EU is deeply concerned about falling behind the U.S. in boosting trade links with Asia, that remains the most dynamic market in the world. The EU's concerns are justified when considering the high dynamics related to the Transpacific Strategic Economic Partnership initiated in Asia-Pacific under the leadership of the U.S. To this adds Japan's recently expressed intention to join this quite ambitious undertaking.

3. EU - Japan bilateral trade relations

The EU and Japan together account for over a third of world GDP, which reflects the huge potential for cooperation between the two countries. Japan is the EU's 7th largest trading partner globally and the EU's 2nd biggest trading partner in Asia, after China. Conversely, the EU is Japan's 3rd largest trading partner globally, after China and the U.S.

Along with the geographical reorientation of extra-EU trade flows towards the more dynamic emerging markets in the last decade, bilateral trade relations with its traditional partners have witnessed a downward trend. Bilateral trade relations with Japan are not an exception. While Japan was the EU's third most important export destination in 2003, today, it ranks only seventh. Also Japanese exports to the EU have been declining during the past decade, even if the EU is still the third largest trading partner of Japan, and Japan still has a trade surplus with the EU of 8 billion euro (EC, 2013b).



Source: Own calculations based on Eurostat (2013).

Figure 2. EU-Japan bilateral trade in 2000-2012 (in billion EUR) and its dynamics over 2001-2012 (%)

Nevertheless, since 2010 the declining trend in EU exports to Japan has made a substantial recovery (*Figure 2*). In 2012 EU merchandise exports have reached a value of 55.5 billion EUR, mainly in the sectors of machinery and transport equipment, chemical products and agricultural products. EU imports from Japan accounted for 63.8 billion EUR in the same year, with mostly machinery and transport equipment and chemical products.

In 2011, EU imports and exports of services from and to Japan were 15.9 billion EUR and 21.8 billion EUR, respectively (EC, 2013a). In the area of services trade, both parties have increased their exports to each other's markets. In services trade, the EU has a surplus of around 6 billion EUR, so in conclusion, the total trade is rather balanced (EC, 2013b). Japan is also a major investor in the EU. In 2011 EU's inward FDI stocks with Japan had reached a value of 144.2 billion EUR, while Japan's inward stocks with the EU stood at 85.8 billion EUR (EC, 2013b).

EU-Japan bilateral trade and investment relations are well below their potential. While trade figures have become much more balanced recently, Japan continues to be a country where, due to specific structural features of Japanese society and the economy, doing business or investing is often difficult

(EC, 2013c). The main reason lies in the combination of tariff and non-tariff measures affecting mutual trade. In particular the latter are raising major concern for European exporters and investors. Therefore, the EU considers that a deep and comprehensive FTA could address all issues of common interest.

4. Japan, determined to move towards FTAs

Japan's share in extra-EU trade flows diminished substantially during 2000-2012. A similar trend may be observed also at the global level, as reflected by its decreasing share in world merchandise trade. In order to keep pace with countries like China and Russia, which expanded tremendously their trade with the EU and other trading blocks, Japan decided to pursue a strategy of "conquering" the external markets by means of economic partnership agreements (EPAs), including FTAs as a main component.

According to the Government's mission statement, Japan "is absolutely resolved to open up the country and pioneer a new future. It will take major steps forward from its present posture and promote high-level economic partnerships with major trading powers that will withstand comparison with the trend of other such relationships. At the same time, it will first press ahead with fundamental domestic reforms in order to strengthen the competitiveness it will need for economic partnerships of this kind".

Since 2002, Japan has concluded 13 FTAs (with ASEAN as a whole, seven individual ASEAN countries, Mexico, Chile, Switzerland, India and Peru) and is negotiating other agreements, which can be classified in four categories (Yamada, 2012):

- With ASEAN countries, on which markets the Japanese companies have an active presence and where they participate in regional production networks;
- With countries that represent "hubs" of the global FTA network (for instance, Mexico, Chile, Singapore);
- "Large scale" agreements, which suppose the integration of major markets (e.g.: Japan-EU, Regional Comprehensive Economic Partnership in the Asian region - RCEP or ASEAN+6 -, Japan-China-South Korea);
- Trade agreements with major suppliers of resources, which could ensure its energetic security (with countries like Australia and Indonesia).

Japan's FTAs are increasingly comprehensive, covering trade in goods and services, investment, intellectual property rights, agriculture, and competition policy. Nevertheless, the excepted sectors are numerous. Some of the already concluded agreements required a long negotiation period and encountered a strong opposition from representatives of some sectors (automotive industry, agriculture and certain services). Due to divergent opinions or interests, negotiations were suspended in some cases (with GCC countries and Korea).

Japan lags behind other countries or groups of countries in terms of already concluded FTAs and their coverage. For instance, in 2011, its FTA coverage was only 18.6% (Yamada, 2012; Jetro, 2012), much below the levels recorded by South Korea (over 34%) or the U.S. (about 38.8%) or the EU (26.4%), considering only extra-EU trade (JETRO, 2012). Nevertheless, taking into account the same indicator, Japan was better situated than countries like China (16.2%) or India (17.9%) (JETRO, 2012).

On March 15, 2013, Japanese Prime Minister Shinzo Abe announced that Japan would formally seek to participate in the negotiations to establish the Transpacific Strategic Economic Partnership (TPP). Although he acknowledged the sensitivity of agricultural groups, he insisted that Japan needed to take advantage of "this last window of opportunity" to enter the negotiations, if it is to grow economically (Cooper *et al.*, 2013).

5. Conclusions

The recent outstanding push for concluding new FTAs by the traditional trading powers – the EU, U.S. and Japan – is part of their endeavors to exit the financial crisis and overcome its consequences. It also reflects their definite policy responses to the ongoing structural transformations in the global economy, at the heart of which lies the shift of economic power from industrialized economies towards emerging ones.

While preferential trade agreements may be beneficial for the respective countries, their impact on the multilateral trading system is largely questionable. The new FTA initiatives are pushing bilateralism and related preferentialism further than ever before in the history of the GATT/WTO (WTO, 2013b). It goes without saying that they will further erode the multilateral trading system.

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