

# COMMISSION OF THE EUROPEAN COMMUNITIES

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Brussels, 15 March 1988

RELATIONS BETWEEN THE COMMUNITY AND JAPAN

(Communication from the Commission)

EXPLANATORY MEMORANDUM

The aim of the Communication is to review the development of general and trade relations with Japan and the progress of the policy initiatives the Community has launched in the fields of trade and cooperation; it follows earlier general reviews, the latest being that of 11th of March 1987 (SEC 87/414).

The Communication also responds to the request the Council of 20th July 1987 made for a progress report on the initiatives to improve access to the Japanese markets for motor vehicles, medical devices and cosmetics.

## COMMUNICATION TO THE COUNCIL

### RELATIONS BETWEEN THE COMMUNITY AND JAPAN

#### COMMUNITY POLICY

1. The aim of the Community's policy towards Japan, as it has developed in recent years, is to construct a balanced relationship, while safeguarding the interests of the Community. It has extended beyond trade to cooperation to lay the ground for closer ties on a wider basis, so strengthening the third side of the triangle formed by the Community, the United States and Japan. The political importance of this is growing, as Japan has now firmly established herself as a great economic power with political influence and the Community is advancing to closer integration and the creation of a single market of 320 million people.
2. The Community's approach towards Japan has consisted of a combination of trade and cooperation policies. The general aim has been to induce Japan to integrate herself better into the world economy and to assume the responsibilities of a great economic power. Like Japan's other partners, the Community has constantly pressed her to reduce dependence on exports and move towards an economy led by domestic demand, with all the structural reforms, opening of markets and internationalisation that should accompany it. This should lead to a lasting improvement in Japan's propensity to import and to a reduction in her surplus.
3. In bilateral trade the Community has tried to achieve a balance of benefits, which at present does not exist because of the difficulty of penetrating the Japanese market, greater than in the case of any other member of the OECD. Hence the main thrust of the Community's policy has been the elimination of trade barriers, which should lead to an increase in European exports to Japan and a fall in the bilateral trade deficit. It has developed the sectoral approach to the elimination of identifiable obstacles to exports of goods and services to Japan. Where bilateral discussions have not given results, it has not hesitated to use the GATT procedures for settling disputes (as in the case of taxation on wines and spirits).
4. The Commission feels strongly that a consistent and firm approach is needed to obtain results. While many leaders in Japan, including those of the previous and the present government, seem convinced that Japan must make a greater contribution to free trade, there is often strong resistance to specific moves to improve access to markets. A firm line will certainly help overcome this resistance and strengthen the position of those committed to a policy of reform and opening.
5. Convinced that a closer and more widely based relationship would benefit both sides, the Community has also developed an active policy of cooperation which should be seen as a complement to rather than a substitute for a better balance of benefits in trade. It has built up cooperation in the fields of industry, of science and technology and of telecommunications and information technology. Development aid is an area where collaboration would be beneficial, as it would increase the effectiveness of the resources available. Finally, the political dialogue with Japan has been strengthened, for example through regular Troika meetings at ministerial level.

## RESULTS

### A. General economic and trade relations

6. It is fair to say that the general relationship between the Community and Japan is moving in the right direction. There is closer consultation and cooperation, although the "reflex of consultation" remains underdeveloped compared to that between the Community and the United States or between the latter and Japan. Japan, however, has publicly expressed its desire to strengthen its relationship with Europe. This partly reflects a wish to lessen dependence on the United States and partly an awareness of the growing importance of the Community as a trade partner, which the completion of the single market will heighten.
7. On the economic side, it is encouraging that the revaluation of the yen and the stimulatory package announced last May have had an effect on the growth of domestic demand in Japan. Last year domestic demand led the growth of GNP (3.7%), while the external side made a negative contribution. The Commission's forecasts for 1988 show similar results. The latest figures for Japan's world trade corroborate these trends. Japan's exports fell in yen terms, so that her total surplus is somewhat lower than last year.
8. Turning to bilateral trade, 1987 saw a satisfactory increase in Japan's imports from the Community which grew by nearly 20% in yen terms (1). Consequently, there was for the first time in years a slight drop in her surplus with the Community (1). That said, the Community's exports to Japan still cover little more than one third of its imports (2), which is out of step with trade in general among major industrialised countries. Besides, this fall was much smaller than that in Japan's surplus with the world as a whole. In fact, Japan's trade with the Community developed differently from that with the world as a whole, as her exports to the latter fell significantly while those to the Community increased. Thus, there is a growing concentration of Japanese exports on the Community, which is now her main profitable, open market following exchange rate realignments.
9. While this 20% increase in Japan's imports from the Community is encouraging, it does not represent a balanced improvement. It did not benefit all Member States in the same way and relied heavily on the growth of sales of luxury cars. Although textile products, pharmaceuticals and organic chemicals also contributed, there is clearly a need to broaden the range of Japan's imports from the Community.
10. The Commission is aware of the difficulties that the Community will face in achieving a turn-around in trade with Japan. First, the low cover ratio implies that for some time the Community's exports to Japan have to grow three times faster than its imports even to stabilise the deficit. Second, there are signs that the competitiveness of Japan's exports may

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(1) Excluding non-monetary gold, which is traded though not produced in the Community. Statistics in yen from Japanese sources.

(2) In ECU terms, the cover ratio was 37% in 1987 as against 33% in 1986. Community statistics.

well recover, so compromising the process of adjustment. Third, the concentration of Japan's exports on the Community is likely to continue because of the relations between exchange rates. Fourth, the Community's traditional modest surplus on invisible trade is likely to shrink in future.

11. All this implies that the Community should continue to press the Japanese government adequately to support domestic demand, implement structural reforms and improve access to markets. The Japanese government must also avoid resorting to bilateral, discriminatory arrangements with the United States. Otherwise, the dangerous conclusion could be drawn that credible threats of protectionism are the only effective means of obtaining trade concessions.

B. Specific actions

12. In 1987 the Commission's sectoral actions covered motor vehicles, medical devices and cosmetics(1). The results of the discussions with the Japanese authorities was generally favourable. On cosmetics the Commission is satisfied with the progress achieved and proposes a monitoring approach, further discussions to take place only if necessary. While progress was also made on medical devices, several problems remain, on which further discussions would be appropriate. As for motor vehicles, many changes were achieved. At the same time, a number of serious barriers still exist. The Commission proposes to continue giving full attention to this important sector through further discussions. As for Japanese taxation on wines and spirits, the Community's complaint to GATT was successful. It is now essential that the Japanese government fully and rapidly implements the panel's conclusions which were adopted by the GATT Council; there are unfortunately signs that it may only do so partially. Unresolved questions concerning leather and footwear will also be followed up.
13. The Commission has prepared for further sectoral actions in the field of industry, on pharmaceuticals and the protection of intellectual property. Moreover, it intends to intensify its dialogue with the Japanese authorities on agricultural matters, both multilateral and bilateral. The multilateral side involves in particular the Uruguay Round negotiations; the bilateral discussions will cover dairy products, pigmeat and phytosanitary questions. Discussions are expected soon to begin, in the first half of 1988.
14. There has been very little progress, however, in ensuring fair conditions of access to large Japanese infrastructure projects such as Kansai International Airport. So far the Commission has only won a vague commitment by the Japanese authorities to an open multilateral approach that would be subject to reciprocity. To assure the participation of European firms, it will be necessary not only to obtain more specific commitments from the Japanese authorities but also to achieve an effective organisation of Community industry interested in such projects. The Community will also have to insist that bilateral, discriminatory arrangements with the United States be avoided.
15. Several other developments in 1987 are worth mentioning. In the context of the settlement with Japan on the consequences of enlargement (Article XXIV:6 of GATT), the Community obtained some improvements in market access

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(1) The annexe gives a detailed appreciation of these discussions.

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for products of interest to Spain and Portugal. It reacted speedily to the risk of trade diversion from products subjected to the punitive tariffs imposed by the United States for Japan's alleged non-respect of the arrangement on semi-conductors; to date, no diversion has been observed. It has obtained the creation of a GATT panel on the legality of this arrangement, whose report is expected soon. The Commission is actively developing its programme of export promotion (EXPROM). One element is a programme under which the Commission sends around fifty young executives a year to Japan for intensive language training and and experience of work in Japanese firms. The other is assistance for Community industry to promote exports to Japan, which can back up the sectoral initiatives to improve access to the Japanese market.

16. With the support of the Member States, the Commission has pressed the Japanese authorities for further liberalisation of financial markets, in particular the further deregulation of interest rates and the improvement of the inter-bank market. While welcoming certain steps taken by the Japanese authorities, the Commission believes that more extensive and rapid liberalisation is needed and continues to press the Japanese authorities for this. As for the proposal to improve the opportunities for European banks to finance imports into Japan, the Japanese authorities have promised to show greater flexibility in the operation of their import financing scheme.

### C. Cooperation

17. There has been progress in most fields in which concrete initiatives have been launched. In 1987 the most visible signs of this were the creation of the Centre for Industrial Cooperation, the promising initial results of the Scientific Training Programme in Japan, the progress made in negotiating an agreement on nuclear fusion and the creation of joint working parties on international standards for digital telecommunications, for the interconnection of data processing systems and for high definition television. These are encouraging examples of cooperation where both sides have an interest in achieving results; where interests did not coincide, as with development aid, there was a lack of progress.

### CONCLUSIONS

18. It is clear that changes are taking place in Japan's economic and trade relations with the world as a whole and that these generally go in the right direction. The problem is rather that change is not fast enough to reduce tensions significantly - the danger of a general turn to bilateralism or protectionism is still present.
19. In the case of Japan's relations with the Community, there has been an encouraging increase in her imports which shows the value of trying to improve conditions of access. Here the Community has achieved some reasonable results and should intensify its efforts. However, there are grounds for concern about the persistence of Japan's large surplus and the growing concentration of her trade on the Community market. To avoid tensions, this must be balanced by Japan's increasing imports from the Community. Japan also has to fully accept her responsibilities so far as surges of exports of sensitive products are concerned, in particular in the period leading up to the completion of the internal market. As for

cooperation, the initiatives that have been launched are generally encouraging and should be extended.

20. There is no realistic alternative to the balanced policy that the Community has been pursuing, but it does need to intensify its efforts and show the firmness and consistency needed to achieve concrete results. An active and coherent policy is the surest way both to improve the balance of benefits in trade and to contain the pressures for protectionism, which could rebound on the Community. It is also the best means of ensuring that Japan gives proper weight to the Community's growing importance as a partner.
21. In the coming years, the Community will face new challenges in its relations with Japan. The increase expected in Japan's direct investment will have both costs and benefits for the Community. The completion of the single market will open new perspectives and it is essential to ensure that it primarily contributes to the strengthening of the Community's economic capacity. The Japanese market will offer growing opportunities, and there is a need to induce European industry increasingly to strengthen its presence on it. It is time for the Community to reflect on how best to face these challenges. This can only be done by strengthening dialogue and cooperation between the Member States and the Commission at all levels, so as to ensure a unified coherent approach.

GENERAL AFFAIRS COUNCIL 25 AND 26 APRIL, 1988

RELATIONS WITH JAPAN

DRAFT CONCLUSIONS

1. The Council takes note of recent economic and trade developments that could contribute to the improvement of relations with Japan, in particular the present growth of the Japanese economy and the fact that this is led by domestic rather than export demand. It urges Japan to continue to support domestic demand adequately, so as to make a significant and lasting contribution to the process of international adjustment.
2. The Council welcomes the confirmation by the new Japanese government of its commitment to structural reforms and hopes that greater progress will be made in putting them into effect.
3. The Council, concerned by the persistence of Japan's large surplus with the Community, the growing concentration of her exports on the Community's markets and the continuing difficulties of access to her markets, confirms the general guidelines of the conclusions on relations with Japan adopted at its meeting of 16 March 1987. It emphasises the need to create a real balance of benefits in trade with Japan which must now be considered in the light of the creation of a single market.
4. The Council calls on the Japanese government to take specific measures further to improve access to markets, on an open and non-discriminatory basis, and to avoid dealing with trade problems on a bilateral basis.
5. The Council calls on the Japanese government to ensure open and non-discriminatory conditions of competition for Kansai International Airport and for other large infrastructure projects, for which procurement procedures should be fair and transparent.
6. The Council expects the Japanese government fully and rapidly to implement the recommendations of the GATT panel on wines and spirits.
7. The Council emphasises the importance of developing cooperation in different fields and of strengthening dialogue with Japan, so as to create a closer and more widely based relationship.
8. The Council, therefore, strongly supports the Commission's intentions:
  - to continue discussions with the Japanese authorities on the unsolved problems of access to the markets for motor vehicles and

medical devices and to monitor the implementation of the commitments made on cosmetics;

- to have discussions with the Japanese authorities which should start as soon as possible in the first half of 1988 and will involve :

- . on the industrial side, the launching of discussions on pharmaceuticals and the protection of intellectual property
- . on the agricultural side, the intensification of the dialogue on both multilateral and bilateral questions, the latter including dairy products, pigmeat and phytosanitary questions

- to follow closely the implementation of the commitments made by the Japanese authorities on the occasion of consultations related to Article XXIV:6 of GATT and to safeguard the Community's interest as regards the implementation of the recommendations of the GATT panel on quantitative restrictions on agricultural products;

- to ensure that Community suppliers are given fair, non-discriminatory access to procurement for Kansai International Airport and other major infrastructure projects, and to support the efforts of Community industry to that effect;

- to develop cooperation in the fields of telecommunications and information technology, so as to further the application of open standards by Japan in the interests of international competition.

- to reinforce industrial cooperation, inter alia with the aim of strengthening European companies' understanding of and presence in the Japanese economy;

- to further develop scientific and technological cooperation in the interests of both partners;

- to continue to pursue its different measures to promote exports to Japan.

- to continue to develop an active programme of information in the regions of Japan.

9. The Council requests the Commission and the competent authorities of the Member States to continue their efforts to impress on the Japanese authorities the need to improve the funding situation of Community banks in Japan and to further liberalise financial markets, in particular through the further deregulation of interest rates and the improvement of the inter-bank market.