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ON JAPAN

WORKING PAPER ON JAPAN

1. INTRODUCTION

This working paper responds to the request of the Council to be regularly updated on developments in EU-Japan relations and on the extent to which the strategy set out in the 1995 Commission Communication on Japan, "Europe and Japan: The Next Steps", has been fulfilled¹.

The paper will show that EU-Japan relations have evolved positively, if cautiously, since 1995. The relationship has moved beyond one that is dominated by trade issues to a broader and more strategic dialogue encompassing political, economic and co-operation matters. This is a reflection in part of a greater and welcome engagement by Japan in world affairs and with the EU in particular. There remains however considerable scope to develop relations further.

The paper begins by reviewing the main influences on Japan since 1995, and then examines how these have affected political, economic and co-operative relations with the EU. It also examines the adequacy of existing institutional arrangements in relation to our policies. It concludes by outlining ways to strengthen the EU's relationship with Japan into the new Millennium while also calling on Japan to advance its own ideas.

2. FACTORS INFLUENCING JAPAN SINCE 1995

The last four years have seen continuing adjustments in Asia to the new conditions of the post Cold War era, against the backdrop of increasing economic globalisation which has brought dramatic change in the region. Domestically, Japanese leaders have faced the difficult challenge of dealing with a stagnant and now declining economy. In the last two years, Japan has had to confront economic and political instability in Asia. Japanese foreign policy has been gradually evolving in response to these influences, to new developments in the US, Korea, Russia, Europe and, in particular, to the challenge of China's growing regional and global influence.

2.1. Domestic Factors

2.1.1 Economic recession in Japan

The most striking domestic feature in Japan over the last four years has been the slide of the economy into a serious recession, which culminated in five consecutive negative quarters of growth to December 1998. Consumer and business confidence have been seriously affected and a sense of pessimism has developed as the realisation has grown that Japan is facing a systemic economic crisis with national and international ramifications which cannot be fixed by short-term reactive policy measures.

¹ Council Conclusions of 29 May 1995 on Commission Communication to the Council "Europe and Japan: The Next Steps".

Japan has had to deal simultaneously with:

- The aftermath of the collapse of the bubble economy of the 1980's which has led to severe asset price deflation, especially the collapse of real estate prices and a weak stock market. This has resulted in the accumulation of bad debts in the banking system on a scale large enough to threaten the stability of the financial system as a whole, and has obliged the authorities to take far-reaching measures to underpin the financial system and combat the credit crunch;
- Sharply reduced corporate profitability and falling investment - despite very low nominal interest rates;
- Deteriorating public finances and the postponement of medium term fiscal stabilisation due to the need to pump prime the economy with a succession of fiscal stimulus measures;
- The need to undertake far-reaching economic structural reforms and deregulation in order to make Japan a more open, transparent and competitive economy;
- An increase in unemployment (to 4.6%², or 3.1 million people, in February 1999, with further increases widely expected, from an average of around 2.5% over the preceding 20 years);
- Structural factors impairing consumer confidence such as the beginning of a breakdown in the lifetime employment system and concerns over the viability of the social safety net faced with an ageing society and an underfunded pension system;
- The need to address other weaknesses impairing Japan's modernisation, including reform of the education system to promote more creative and independent thinking.

Japan's actions to deal with these fundamental issues have been at the heart of the government's programme and have influenced external relations including with the EU.

2.1.2 Political strains in Japan

The daunting challenges confronting Japan are not just economic. Japan's political system has also been under strain. As Prime Minister Obuchi stated in his policy speech to the Diet in January 1999, as values in Japan diversify and the world undergoes great transformation, the systems and decision-making processes which once allowed Japan to effectively manage the country are now holding back progress.

What was an asset in the past - the closeness between the public and private sector as well as the tradition of consensus in decision-making - can also be a hindrance to rapid policy formulation and actions. This has contributed to tensions in Japan's international economic relations. It has also undermined public confidence, particularly amongst the young, in the government's ability to restore economic growth. The ruling Liberal Democratic Party (LDP), which represents traditional lobby groups such as agriculture and

² The Japanese figure for the level of unemployment would be higher according to Western measurement techniques.

construction, has presided over Japan throughout most of the post-war period and has had to take responsibility for the difficult situation the country finds itself in today.

The LDP, which regained power in 1995, received a severe jolt in July 1998 through heavy losses in elections for the Upper House of the Diet, especially in large cities. It has been obliged to form coalitions with other political parties to enact key legislation ever since. The LDP's new coalition with the Liberal Party should ensure the smooth passage of legislation in the lower House of the Diet, but it will still be short of a majority in the Upper House. New parliamentary elections for the Lower House must be held before Autumn 2000.

The Japanese political system is also experiencing an "inter-generational" divide between older politicians and young up-and-coming politicians anxious to effect more far reaching change by exercising greater control over the bureaucracy. This desire to restore authority to elected politicians has been reinforced by measures forming part of the LDP-Liberal Party coalition agreement, such as limitations on officials testifying before Diet Committees. The question of administrative reform has also figured in discussions between the parties, and the decision has been taken to streamline the half-century-old structure of central government, to take effect in January 2001.

2.2. External Factors -Japan's changing foreign policy environment

2.2.1 Asia

Japan's external environment has been changing rapidly, obliging Japan to adjust its foreign policy to new strategic developments. The sternest test has been in Asia, where the financial crisis affecting the region has obliged Japan to seek ways to mitigate the negative effects of regional economic instability. Japan's ability to respond to the crisis has been undermined by its own domestic economic weakness which has prevented it, as by far the largest Asian economy accounting for 2/3 of regional GDP, from leading Asia out of recession by absorbing more imports and investing in Asia.

Japan accounts for 20% of East Asia's trade, 20% of its investment, 30% of its external financing and 60% of ODA to the region. Yet Japanese exports to the 5 East Asian Countries most affected by the financial crisis (Korea, Thailand, Malaysia, Philippines and Indonesia) fell by 34% in 1998 whilst Japanese imports from these countries fell by 14%. Japan's direct investment in Asia in the second half of fiscal year 1998 was 40% below that of the corresponding period in 1997. Lending by Japanese banks to the five Asian countries mentioned above has also fallen sharply (by 25% at the end of June 1998 compared to one year earlier).

Japan has sought to devise an Asian regional response to this crisis, but ideas such as creating an Asian Monetary Fund have been rebuffed. Japan therefore has had to assume the mantle of major provider of economic assistance to affected Asian countries. Japan has done this through bilateral and multilateral means, and as of February 1999, had provided assistance measures amounting to \$57 billion. This figure includes contributions to the international assistance package harmonised with the IMF (\$19 billion), assistance for private sector activities and trade financing (\$23 billion) and a part of the \$30 billion "Miyazawa" initiative designed to give financial support to Asian countries. Despite these efforts, Japan has faced difficulties in fulfilling the expectations of the crisis hit countries

in South-East Asia. This may have political consequences on Japan's role in Asia at both a national and regional level.

2.2.2 China

Japan's relations with its immediate neighbours have shown contrasting developments. China is the region's growing power. It has been able to take advantage of Japan's economic difficulties by pursuing more assertive policies in the Asian region and by projecting itself as a reliable Asian partner with a stable currency. The visit of Chinese President Jiang to Japan in November did not lead to a strengthening of mutual ties and was noteworthy because of Chinese emphasis on the past. While economic links between the countries should not be underestimated, there has in recent times been diminished enthusiasm in the Japanese business community to develop further investments in China, inter alia because of uncertainties over the regulatory environment. Japan is also concerned about environmental issues in China and the risk of increased migration that could result from instability in China.

Taiwan remains an issue of the utmost sensitivity between the two countries in particular in relation to the outreach of the US-Japan defence guidelines.

Both Japan and the EU share the objective of seeing greater Chinese integration in the world system and in particular in seeing China join the WTO on commercially appropriate conditions. The EU has been more exacting in its requests in this context than Japan.

2.2.3 The Korean Peninsula

Japan's greatest security concern is North Korea, a point brought home after the firing of a missile across Japanese territory at the end of August 1998. To combat the threat of nuclear proliferation in North Korea, Japan, South Korea, the US and the EU have been co-operating as executive board members of KEDO with a view to ensuring that nuclear energy in North Korea is used peacefully. Japan's commitment to fund KEDO was temporarily suspended following the missile incident and could be put in serious jeopardy by another such incident. Although formal talks on normalisation of relations between North Korea and Japan are still suspended, there have recently been a number of contacts through parliamentarians. The Japanese authorities have made it known that they would be in favour of improving ties if Pyongyang takes "constructive steps".

Following a successful visit by President Kim to Japan in October 1998, Japan's traditionally difficult relations with South Korea have improved markedly. Negotiations on a bilateral agreement on investment are due to commence shortly and a mutual recognition agreement is under negotiation as well as a study on the possibility of establishing a free trade area. This could constitute a significant departure for Japan which has traditionally expressed doubts on the consistency of regional trade agreements with multilateral trading rules.

2.2.4 The US dimension

Economic and political instability in Asia has heightened Japan's overall security concerns in the region and has reinforced the importance of Japan's longstanding Security Treaty with the US. The implementation of this Treaty will be redefined through the enactment of legislative bills to complement the new defence guidelines which are expected to be passed in the Diet session ending in June 1999.

While the US/Japan security relationship remains fundamentally strong, and is the cornerstone of the relationship, there have been tensions with the US in other areas. Japan has been concerned by closer ties between China and the US and fears being usurped as the US' main partner in Asia. The economic and trade relationship is strained, and is more likely to deteriorate than improve in the near future. The US has been critical of Japan's efforts to relaunch its economy and has continued to pressure Japan strongly on improving market access. Trade relations became particularly strained when Japan refused to endorse an APEC sectoral liberalisation initiative in November 1998 covering forestry and fish. The US has also reacted strongly against Japan's ballooning merchandise trade surplus with the US, which reached \$ 64 billion in 1998 (an increase of 14% on the 1997 level), and in particular against growing Japanese exports of steel which doubled in volume last year. For its part, Japan has supported the EU in coming out strongly against US unilateralism in trade and has reacted strongly to the reincarnation of "Super-301".

Overall, Japan has followed a slightly more assertive policy towards the US and has shown greater willingness to oppose US policies at bilateral, regional and multilateral level. Difficulties in US-Japan relations may influence the tone of Japan's relations with the EU.

2.2.5 Rapprochement with Russia

Japan is endeavouring to stabilise relations with Russia by concluding a Peace Treaty which should include a resolution of the territorial dispute over the Northern territories. The initial target date was the year 2000. From the Japanese standpoint, such a Treaty would facilitate the positive engagement of Russia in the region and help stabilise it. Japan and Russia have common interests also in economic co-operation particularly in the energy sector, where Russia has rich resources but lacks the capital to exploit its mineral deposits. Japan and the EU share the objective of seeing Russia's integration into the world system and the return of economic and financial stability.

2.2.6 Engagements further afield

Reflecting a more internationalist policy, Japan's engagement in world affairs has been exercised principally through economic and political instruments. Japan has been showing an increased commitment to bring assistance to world trouble spots, by working in tandem with the EU and the US. In Bosnia Herzegovina, Japan has committed restructuring assistance estimated at \$800 million, whilst in the Middle East Japan is raising its public profile through giving assistance to Palestine (\$200 million in the next 2 years) and by supporting US and European efforts to relaunch the Peace Process. Japan has also been the largest nation state provider of ODA despite a 10% cutback in fiscal year 1998 and a freezing of the budget planned for fiscal year 1999. While Japan has become more active in its external relations, there is no short term prospect of Japan becoming a significant international military player, despite limited internal changes to the constitution.

2.2.7 The multilateral dimension

Japan has consistently pursued a policy of advancing its foreign policy interests through multilateral as well as bilateral channels and has been a strong advocate of multilateral means to solve disputes. On the plurilateral front, Japan has been an active member of ASEM and has played a prominent role in ASEM work to promote business facilitation and to deepen dialogue on investment related regulatory issues.

Japan has also pursued close ties with ASEAN and the ARF, as well as pursuing its search for a permanent Security Council seat at the UN and a rebalancing of Member contributions to the organisation.

Through its membership of the G7/G8, Japan is engaged on all key international issues. It will host the G7/G8 Summit meetings in 2000. Japan is also an important “partner for co-operation” in the OSCE (Organisation for Security and Co-operation in Europe) and has endeavoured to ensure that its foreign policy complements that of the OSCE in Europe.

In the WTO, Japan is a strong proponent of the multilateral system and shares the EU’s view with regard to the need for a comprehensive New Millennium Round of multilateral trade negotiations in the form of a single undertaking covering all subjects with a time frame of approximately 3 years. Japan has also stood up for multilateral dispute resolution in the WTO, and has recently taken a more prominent role in this field. Reflecting this new assertiveness, Japan is also challenging aspects of the trading regimes of its international partners, for example, the US 1916 anti-dumping legislation.

Overall, Japan is becoming increasingly proactive in the WTO, and, where there is a commonality of interest, is now more willing to work closely with the EU and others to advance its position.

2.2.8 Japan’s attitude towards Europe

Hitherto, the EU as such has not been among Japan’s first order foreign policy priorities although a number of Member States have developed significant bilateral relationships with Japan. Traditionally it has been the EU which has been “demandeur” in relations with Japan, particularly in the economic sphere. Recently, however, Japan has shown greater interest in its relations with the EU.

Japan has been supportive of EU enlargement to the East, while emphasising that the process should benefit the international Community as a whole. Japan has also played a constructive role in G24 assistance measures to Central and East European countries. In the medium term, the Amsterdam Treaty is likely to further improve EU-Japan relations through the strengthening of the CFSP.

The arrival of the euro has had a noticeable impact on Japan, as was clearly indicated during Prime Minister Obuchi’s visit to Germany, France and Italy in January 1999. In commenting on the launch of the euro, Japan has emphasised the need for the euro to become a stable and accessible currency. The euro offers both an opportunity and a challenge to Japan. An opportunity because a stable euro acting as a second major international reserve currency could facilitate, through portfolio diversification, greater international financial stability as well as acting as a counterweight to the US dollar. A challenge because the euro will strengthen the role of the EU and its Member States in international monetary and financial matters; and could reduce Japan’s influence in this area.

These themes have been reflected in recent policy pronouncements by Japanese leaders in Europe calling for tripolar management of the world economy. Recent Japanese measures to enhance the internationalisation of the yen, notably by eliminating withholding taxes on certain government securities, and calls for European support for this objective, should also be seen in this context.

2.3. The EU and Japan – prospects for a closer partnership

From this review of domestic and external factors influencing Japan today, a number of key themes stand out which have particular relevance for EU-Japan relations:-

- (a) Japan is becoming increasingly engaged internationally, both regionally and further afield;
- (b) There is growing interdependence between Europe and Japan with events in one region increasingly having an impact on and shaping developments in the other, notably in the economic field;
- (c) The strengthening role of Europe as an international actor on the world stage is leading Japan to adjust its foreign policy pragmatically to take account of this development;
- (d) The euro, in particular, and its economic and political impact on Japan presents opportunities to enhance international financial and monetary relations with Japan and to build a stronger global partnership;
- (e) The EU and Japan have a wide range of shared interests and objectives;
 - The EU has a vital interest in seeing Japan's economy revive. Through its policy of engagement in Asia, the EU can help to promote stability in this continent; as a large and strong economy the EU is acting as a pole of stability in a changing world;
 - Japan's economic vulnerability, and instability in Asia, require it to seek understanding and partnership with other countries; Japan shares the EU's belief in the multilateral system and can be a valuable ally to the EU to counterbalance unilateralist tendencies of the US; Japan is also usefully engaged in efforts to restore peace and facilitate restructuring in Europe's trouble spots;

Objectively, therefore, there are strong reasons for a closer partnership to develop between the EU and Japan in the opening years of the new century.

It will take political will and commitment on both sides, however, to translate these opportunities into an effective new partnership for the new Millennium which demonstrates that the EU and Japan can act together and produce results. While it is too early to tell today if we are at a watershed in terms of strengthening EU-Japan relations, the present signs are that Japan is willing to work more closely with the EU.

In the next sections of the paper an examination will be made of what has been achieved so far under the strategy laid down in the 1995 Communication, the successes and failures, and what concrete steps could be taken to build relations in the future, beginning at the next EU-Japan Summit under the German Presidency.

3. EU-JAPAN POLITICAL RELATIONS

3.1. The current political dialogue

The 1995 Communication on Japan set out suggestions for achieving a more balanced relationship between the EU and Japan, within the framework of the 1991 Joint Political

Declaration, encompassing not just economic and trade aspects but also the development of political relations and co-operation. The increasing scope of the EU political dialogue with Japan since 1995 has resulted from an enhancement of political dialogue at all levels including working level. Ministerial and Political Directors' level Troikas meet in principle twice a year, whilst five Troika working groups with Japan have been set up dealing with global challenges in geographical spheres where each partner is playing an increasingly proactive role: (1) Asia and Oceania; (2) Eastern Europe and Central Asia; (3) Middle East; (4) Former Yugoslavia; and (5) Africa. Furthermore, political dialogue is being developed in Tokyo using informal "Troikas".

The European Parliament has also played an important role in developing EU-Japan relations, notably through the productive annual EU-Japan Interparliamentary Meeting. This dialogue, which will take place for the 20th time this year, has contributed not only to building contacts with Japanese Diet members but also to enhancing the EU's political profile amongst Japanese decision makers.

3.2. Weaknesses in the political dialogue

These political contacts, as well as our shared economic and security interests and political values, have ensured that Japan remains the main partner of Europe in Asia. However, despite this, as well as the fact that on objective grounds Japan and the EU are natural partners, there has until very recently been a lack of drive in deepening political dialogue, with the consequence that political relations between the EU and Japan are not as developed as they might be. There are three main reasons for this:

Firstly, Japan has found it difficult to work with CFSP structures and is not yet convinced of the viability and efficacy of the EU as a political interlocutor. Japan has criticised what it sees as the "lowest common denominator" approach in the CFSP. Not unnaturally, what counts at the end of the day for Japan is "who can deliver" on the European side. This practical approach has often led Japan to advance its foreign policy interests by developing political relations with large Member States. The EU for its part should be clear in its CFSP objectives towards Japan.

Secondly, with one or two notable exceptions, EU-Japan political dialogue has often not been translated into joint analysis or joint actions. Rare have been the occasions when the EU and Japan have taken centre stage to advance a joint initiative. The dialogue would benefit from some visible successes.

Thirdly, Japan's inability to adhere to a regular pattern of working group meetings has considerably hampered the preparation and strengthening of the political dialogue at a high level. While some cancellations are unavoidable, especially in view of officials' commitments to attend Diet committees and the fact that it is incumbent on the Japanese side to travel to Brussels, the loss of 5 out of 6 of the working groups planned during the Austrian Presidency was particularly disappointing. This has given the impression in some quarters of limited commitment by Japan to developing political relations with the EU.

It must be concluded therefore that the basic objective of the 1995 Communication - to develop the political dimension of the EU-Japan relationship within the framework of the 1991 Political Declaration - has only been partially achieved.

3.3. Improving the Political Dialogue

The Commission considers that a great deal can be done to improve political relations between the EU and Japan. Drawing on the report of the Tokyo Heads of Mission of September 1998, the Commission believes the following practical and procedural steps should be considered:

- Focus the political dialogue on areas which are of real topical interest to both sides where we can work together and produce results and common actions (such as for Cambodian elections and including political / humanitarian initiatives);
- Ensure continuity in the political dialogue by arranging for meetings of the Political Directors Troika and their Japanese counterpart to take place early in each Presidency to endorse EU-Japan foreign policy priorities for the period of that Presidency.
- Deepen the dialogue at all levels to enhance engagement on global issues by making greater use of multilateral fora (e.g. UN, ASEM, and ARF). Wherever possible, agreement should be reached in advance with Japan to pursue more effectively our common interests on the world stage.
- Establish informal "Troikas" with Japan in third countries and make a success of the informal political dialogue recently begun in Tokyo between representatives of the Troika and the Ministry of Foreign Affairs.
- EU-Japan CFSP working groups should agree written conclusions of a non-binding nature which would allow the two sides to follow-up the conclusions through their internal mechanisms and in further EU-Japanese contacts. Conclusions should aim to identify areas of possible co-operation.
- Encourage dialogue between EU and Japanese policy planners so as to give a clearer orientation to EU-Japan political relations.
- Ensure greater continuity in the political dialogue by using modern communication techniques, such as video conferences, when scheduling a meeting is a problem.
- Promote exchange visits between Japanese and European Commission officials.

As far as substance is concerned, the Commission considers that four subjects in particular are worthy of an intensified political dialogue. These all relate to political and security issues in East Asia, notably:-

- North Korea;
- China's evolving political, economic and security role in the region;
- Evolution of security structures in the region;
- Impact of unilateral and extraterritorial policies on Asia.

On these issues, Japan can bring to the table regional insights which would benefit the formation of foreign policy in the EU. The EU, for its part, is fully engaged in the East Asian region and has a preponderant foreign policy relationship with the US.

In addition, efforts should be made with Japan to achieve practical and visible projects for joint collaboration in the political field, for example in the fields of human rights and non-proliferation.

The practical and substantive proposals outlined above should be pursued with the aim of strengthening political dialogue based around a number of key issues and bring it to a level more commensurate with that in the field of EU-Japan economic and trade relations.

4. EU-JAPAN ECONOMIC AND TRADE RELATIONS

4.1 Japan's economic policy and EU-Japan economic dialogue

Since 1995, the focus of the EU-Japan economic and trade relationship has shifted from being one centred on trade relations and market access to a more broadly-based dialogue encompassing the state of the Japanese economy which is now a major preoccupation of the EU.

4.1.1. Japan's economic policy

Japan is a rich country with the greatest savings of any nation (¥1,200 trillion, equivalent to 250% of Japan's GDP) and the largest foreign currency reserves (US\$ 220 billion). As the world's second largest national economy, accounting for 1/7 of world GDP, it is evident that what happens in Japan affects Asia and the world as a whole. The Commission has long argued that a strong Japanese economy is in Japan's interest and those of all its partners including the EU and of course Asia. Today, however, the Japanese economy is confronted with severe difficulties. While Japan's real GDP grew by 1.4% in 1997 (in large part due to a strong first quarter resulting from strong consumer demand in advance of the sales tax increase from 3% to 5% on 1 April 1997), GDP fell by 2.9% in 1998 and is forecast by the Commission services to fall by a further 1.3% in 1999 before rising by 0.5% in 2000.

To overcome the problem of bad debts in the financial sector the government has put in place a safety net of ¥60 trillion, or around 12% of GDP, to protect depositors, to recapitalise weak banks and to liquidate failed institutions. The effectiveness of these reforms will be determined by the government's commitment to ensure their rapid, transparent and effective implementation, and that the banking sector is downsized. This should create opportunities for efficient foreign banks and financial institutions. Recent mergers and liquidations in the banking sector suggest that restructuring is at last underway. The government has also pushed forward "Big Bang" measures to modernise the financial system. The increasing foreign presence which has resulted – together with the continuing economic difficulties – is having constructive knock-on effects.

To boost domestic demand, the government switched to a more expansionary fiscal policy in 1998, undertaking a series of measures to cut taxes and boost government spending. The latest measures announced in late 1998 provide for a further stimulus to the economy with a headline figure of ¥25 trillion. The inclusion of permanent income and corporate tax reforms and cuts as a means to improve incentives in the economy are welcome.

However, the successive use of fiscal stimulus measures has led to high budget deficits (anticipated to rise to 10% of GDP in fiscal year 1999) and to increasing levels of government debt. Concerns have arisen in Japan about how to place on the market the volume of government bonds which will be necessary to fund this deficit. Pressure has been exerted on the Bank of Japan itself to purchase more government bonds and monetise a part of the government debt. There are still fears in Japan of a deflationary spiral if recovery does not take place soon.

The manifest impact of these and other events on Europe leads the Commission to the conclusion that the EU should intensify its dialogue with Japan in appropriate fora on economic matters, notably with regard to (1) the economic situation in Japan and the EU (2) the Asian Economic Crisis, and (3) international monetary developments following the launch of the euro.

4.1.2. Europe's views on Japanese economic reforms.

The Commission recognises that the Government of Japan has made significant efforts over the last year to relaunch the Japanese economy, and welcomes its stated determination to press ahead with the full implementation of banking reform and fiscal stimulus measures. However, these will not guarantee a quick turnaround nor will they be sufficient to secure the return of long-term economic growth. Bold structural reform, notably regulatory reform, is needed to achieve this through increasing the role of market forces, making the economy more open and transparent, and promoting productivity and competitiveness. An acceleration of regulatory reform efforts can also have a positive short-term impact through bolstering the credibility of the government's economic policy, as was found in the EU's Single Market Programme. For the EU, regulatory reform in Japan is also of particular importance given its beneficial impact on market access.

Greater competition resulting from regulatory reform will mean adjustments through a reallocation of resources. Sectors where productivity is poor could see some downsizing. However, if structural reform is carried out effectively and in a planned way, the overall positive economic effects will far outweigh the short-term costs. Europe's experience is that the benefits come quickly. The longer readjustment is delayed, the greater the negative effects will be. Japan's Economic Planning Agency has estimated that deregulation could boost economic growth in Japan by almost 1% per year over a six year period.

The current 3-year deregulation programme, announced in March 1998 and revised in March 1999, is potentially one of the main vehicles to effect structural change in Japan. The Commission recognises that significant progress has been made. Proposals for new public comment procedures on draft legislation and the ongoing implementation of Big Bang measures are particularly welcome. Another positive development is the increasing emergence of cross-sectoral approaches to regulatory reform, such as the adoption of international standards, which offer the prospect of making progress in a wide variety of areas. There is still, however, considerable scope for further action. Progress in the fields of telecommunications and competition policy in particular has been disappointing. Reform is advancing unevenly, in fits and starts. In addition, further efforts should be made to police the implementation of deregulation measures through "real time" control measures. The bodies charged with this task, whether ombudsmen or other structures, should act in a fully transparent way, and have real powers and real independence.

The Commission supports the call of the Prime Minister's Economic Strategy Council for a far-reaching, medium-term action plan, around which the interests of all parties in Japan could coalesce. Too often in the past reactive policy measures have been taken whose real impact has been less than claimed. This is true for both structural reform, which is being driven in part by the knock-on effects of financial crisis, and for economic measures to stimulate the economy. A clearer presentation of policy, setting out a scenario for economic recovery and establishing a road map for regulatory reform would enhance the credibility of government policy and increase confidence. The rapid and full implementation of the fiscal packages approved by the authorities last year together with an accommodating monetary policy, the restructuring of the banking sector and the acceleration of regulatory reform in key areas of the Japanese economy should bring Japan back onto a path of long-term sustainable growth.

4.2 EU-Japan trade and investment relations

4.2.1 Impact of Japan's recession on EU trade and investment.

Economic recession in Japan has important implications for the EU. Japan is the EU's third largest export market (4% of EU exports) and our second largest source of imports (9% of EU imports).

The impact of Japan's recession is reflected in sharp changes in Japan's trade and investment flows, with Japan's current account surplus rising sharply from 1.4% of GDP in 1996 to a forecast 3.3% of GDP in 1998 and forecast to rise even further in 1999 and 2000. The trends are even more striking in the bilateral EU-Japan trade flows. Due to the Asian crisis and the depreciation of Asian currencies, the EU accounts for an increasingly large share of Japanese exports. In 1998, the EU's share of Japanese exports rose from around 15% to 18% and the EU's trade deficit with Japan grew by 43% compared with 1997 (68% in yen terms according to Japanese figures), reaching the previous historic high recorded in the early '90s. Furthermore, in 1998 the EU absorbed 53% of the year-on-year increase in Japan's goods surplus, more than any other trading partner. For Japan, buoyant exports to the EU are one of the very few factors having a positive impact on its economy.

In contrast to merchandise goods, EU trade with Japan in services has always been in surplus. However, this surplus is far smaller than the EU deficit in merchandise goods and has fallen recently.

While it is clear that macroeconomic developments in Japan and Europe constitute the primary explanation for these changes in trade and services flows, the Commission has repeatedly emphasised to Japan that it should not seek to export its way out of recession. In addition, the Commission has emphasised that imbalances would be less if market access into Japan was improved.

The large imbalance between Japanese foreign direct investment (FDI) in the EU and EU FDI in Japan has shown little sign of diminishing. The stock of Japanese FDI in Europe stands around 7 times higher than the stock of European FDI in Japan. Traditionally, FDI in Japan has been hindered by the near-impossibility of mergers and acquisitions. This appears to be changing, as Japanese financial institutions and companies restructure their operations and as traditional links between "Keiretsu" partners show signs of weakening. At a time also of relative capital shortage in Japan, foreign partners and sources of capital

and know-how are now far more welcome and holding companies are now allowed. A spate of recent high profile acquisitions of Japanese companies is an encouraging sign.

4.2.2 Market access barriers in Japan

The EU's major trade preoccupation with Japan remains the need to secure better market access for competitive goods and services supplied by EU firms. The fact that Japan's trade and current account surpluses have remained high since 1995, even when the economy was growing, is a reflection in part of continuing market access problems in Japan.

Most market access barriers faced by European companies are regulatory in nature (see annex A). They are described in the EU's 1998 list of over 200 deregulation proposals for Japan. They include horizontal issues in the fields of distribution, weak application of competition policy, and administrative procedures, as well as a very large number of sectoral issues, including construction materials, agriculture, foodstuffs, transport services, financial services, professional services, machinery, electrical equipment, automobiles, telecommunications, pharmaceuticals, cosmetics and textiles.

In some traditional industries, Japan maintains very high levels of protection. In the leather sector, competitive European producers are denied market access by high levels of tariff protection outside tariff quotas which are themselves administered in dissuasive ways that the Commission believes to be incompatible with the WTO. The Community has held WTO consultations with Japan to address its complaints which also include WTO incompatible subsidies. In the field of leather shoes, Japan has not liberalised tariff quotas in accordance with earlier undertakings. The Commission has urged Japan to do so.

The Community is also very concerned with the way in which Japan implements the special emergency measures for imports of pigmeat. These caused serious disruption to European exports in 1996 and 1997, effectively eliminating them from the Japanese market at the same time as other countries were able to continue with their export trade.

4.2.3 The Commission's approach to improving market access

To improve market access in Japan, the Commission has worked bilaterally with Japan at all levels. The 2-way EU-Japan deregulation dialogue has played the key role. As part of this dialogue, the EU submits to Japan an annual list of deregulation proposals, drawn up in close co-ordination with Member States and EU industry. This is followed up by twice yearly high-level meetings on deregulation and a range of expert level discussions. Since 1995 the Commission has also worked with Japan towards the conclusion of a mutual recognition agreement (MRA) on testing and certification.

Like the EU, the US also has deregulation discussions with Japan, under its "Enhanced Initiative" on deregulation and competition policy agreed in April 1997. This is in addition to the 35 bilateral sectoral trade agreements the US has negotiated with Japan under the US-Japan Framework Agreement. The US has made considerable efforts to ensure Japan complies with these agreements. In the field of deregulation, many US proposals are analogous to those advanced by the EU. However, the US approach has tended to see deregulation as an extension of the "Framework"; i.e. a trade negotiation rather than a 2-way dialogue on regulatory issues. The WTO dispute settlement mechanism has also been employed by the Commission to tackle Japanese trade restrictions that are contrary to multilateral trade rules. Japan has in the past been particularly sensitive to WTO action. Of

course WTO dispute settlement is not a one-way street. Japan is also showing an increasing readiness to challenge the trade practices of its partners and, in doing so, is becoming a more effective player in the multilateral system.

4.2.4 Enhancing co-operation with Japan on trade and regulatory issues

Two recent initiatives have been launched in this area:

- *Working together towards the WTO Millennium Round*

The EU and Japan launched a bilateral consultation process at the end of 1998 to achieve, whenever possible, common positions on issues relating to the WTO Millennium Round with a view to ensuring its successful and early conclusion. Good progress has been made in these consultations which have shown a large degree of common understanding between Japan and the EU on the approach to be followed in the new WTO negotiations as well as on individual subjects. The dialogue now needs to be intensified in the run up to the WTO Ministerial meeting in Seattle.

The EU also attaches great importance to working with Japan bilaterally and through ASEM to build a consensus with other WTO members on the need for a future comprehensive WTO Round and to encourage the active participation of developing countries. Japan is obviously well placed to play a leadership role in the Asian region.

The launching of the new WTO Round is a key international initiative to promote economic growth and expand trade. EU-Japan co-operation in this area will be one of the most important areas of bilateral economic relations in the coming year.

- *Relaunching the business dialogue.*

A strong EU-Japan business dialogue has an important role to play in underpinning EU-Japan relations and ensuring effective business input. The Commission supports efforts underway to reinvigorate the existing dialogue to make it broad-based, business-driven, and issue-oriented. It should deal with matters of real concern to business and should, like the TABD in EU-US relations, serve as a sounding board for new initiatives in EU-Japan economic relations and provide information and guidelines for action. The best way forward would be to set up an enlarged and enhanced dialogue based around the EU-Japan Round Table of Industrialists including prominent personalities from the EU-Japan Business Forum.

The dialogue could usefully include the following subjects:-

- the improvement of the efficiency of product and service markets, including financial services (for instance, regulatory issues, mutual recognition agreements, distribution);
- business facilitation, such as the creation of an open environment for foreign investment (in particular for SMEs), electronic commerce and taxation.

In addition to these two elements, and reflecting the significance of deregulation in EU-Japan's bilateral relations, the Commission proposes to strengthen the existing deregulation dialogue through the establishment of an annual Ministerial review to (1)

assess progress over the previous year in both Japan and the EU, (2) monitor implementation of measures already adopted, and (3) set out an agenda of new measures. Furthermore, while deregulation needs to take place across all sectors of the Japanese economy, a focused list of priorities should be established to complement the full list of EU proposals for Japan.

4.2.5 Results

While the number of market access barriers in Japan remains high, significant progress has been made since 1995 in improving business opportunities for EU companies in Japan. The success of our efforts is reflected in a reduction in the number of high-profile trade disputes. At the same time, a very wide range of generic regulatory and market access barriers remain. The deregulation dialogue is increasingly the focus of the EU's efforts to improve opportunities for European companies.

Japan has taken up a number of regulatory reform measures specifically proposed by the EU in the fields of telecommunications, automobiles, financial services, construction, pharmaceuticals, cosmetics, distribution and employment agencies among others.

Progress has also been made towards concluding an EU-Japan Mutual Recognition Agreement (MRA) on testing and certification, the first of its type for Japan. It has been agreed that the initial phase of the agreement will cover 5 sectors³ which represent around 30% of exports of industrial products for both Japan and the EU. The Commission's aim is to sign the MRA at the next EU-Japan Summit providing the remaining technical obstacles can be overcome and to agree on broadening its scope in the future.

Significant improvements in access for European industry to the Japanese market for alcoholic spirits resulted from a case the EU brought against Japan in the World Trade Organisation (WTO). The WTO ruled that the Japanese tax system was discriminatory in that taxes on imported alcoholic spirits tended to be far higher than for their domestic counterparts. The Commission then reached a settlement with Japan under which Japan cut taxes on whisky and brandy by 44 % in 1997 and a further 30% in 1998. Further tax changes are planned, along with a number of tariff concessions.

Further success stories, including in the fields of fish, cars, sea transport services, medical devices, satellites, financial services and silk, are described in annex B.

4.2.6 Supporting EU firms in Japan

The Commission's 'Gateway to Japan' export promotion campaigns have proved to be successful in helping EU firms notably SMEs to break into the Japanese market. Under the second campaign, launched in 1997, direct extra export sales in excess of €232 million have been recorded so far, creating new jobs in 36% of the companies concerned.

The flagship Executive Training Programme (ETP), which is now in its 20th year of operation, has enabled more than 700 young European executives to gain in-depth knowledge and understanding of the Japanese business environment through language

³ . The 5 sectors to be included in the initial phase of the MRA are telecommunications terminal equipment, electromagnetic compatibility, electrical safety, good manufacturing practices (pharmaceuticals), and good laboratory practices (chemicals).

training, seminars and work experience. It is recognised as a prestigious management development programme and many ETP graduates remain in Japan and develop the businesses of EU-companies there.

The large number of applications received each year show that there still is a high demand for these programmes. Despite this widely acknowledged success, both programmes were suspended in early 1999 due to lack of agreement on the legal basis for a regulation to support these activities. The political agreement reached at the General Affairs Council in February, along with the subsequent opinion from the European Parliament in April, will ensure the programmes will be resumed once the Council has adopted the regulation formally and sufficient funds have been allocated to the Japan budget line.

The EU-Japan Centre for Industrial Co-operation (see 5.1.2) also supports a number of programmes of benefit to EU industry and SMEs.

4.2.7 Market penetration in Europe

The EU is committed to keeping its market open in accordance with the ASEM "trade pledge". In 1998, the EU's trade deficit with Japan increased more in absolute and percentage terms than that of any other major developed economy. The main market access issues for Japan in the EU are described below.

Since 1991, MITI has monitored the export of Japanese cars and light vehicles to the EU in accordance with the arrangement concluded with the EU in that year ("Elements of Consensus") and notified to the GATT. This arrangement has enabled European vehicle manufacturers to restructure their activities and enhance their competitiveness pending the full opening of the EU market in 2000. The arrangement has achieved its aims and has been implemented correctly by the Japanese authorities. It will therefore expire, as scheduled, at the end of 1999, and will not be renewed.

As part of the 2-way EU-Japan deregulation dialogue, Japan has submitted five lists of proposals to the EU. Progress has been made on a number of issues, including safety standards and import authorisations.

4.2.8 Commercial defence instruments

There are seven antidumping measures currently in force against Japan, including on certain television camera systems and electronic weighing scales. The Commission will continue to apply where appropriate trade defence instruments, including anti-dumping, in full conformity with its own legislation and the relevant WTO Agreements.

5. CO-OPERATION ACTIVITIES

The EU's co-operation activities with Japan have developed since 1995 along three main axes:

- Promotion of horizontal and sectoral co-operative activities
- Raising the visibility of EU-Japan relations
- Promotion of initiatives aiming to address the "knowledge imbalance"

5.1 Promotion of co-operative activities

5.1.1. New areas of co-operation

Since the 1995 Communication on Japan, which emphasised developing co-operation as the third pillar of EU-Japan relations, the range of EU-Japan co-operation activities has become more diversified. New dialogues have been established in the fields of humanitarian assistance, research and development in information technology and multimedia networks, global navigation satellite systems, education, legal dialogue, electronic commerce, fisheries, inter-administration exchanges and contacts between policy planners and analysts. A succession of efforts to promote co-operation have also been made in the field of customs co-operation and mutual administrative assistance, but these have not succeeded because of Japan's desire for one agreement covering competencies attributable in part to Member States whilst the EU has wanted separate agreements.

At the EU-Japan Ministerial Meeting in October 1998, a first political discussion was held on third pillar issues such as the fight against organised crime and drugs, cybercrime, trafficking of women, and the sexual exploitation of children. It is being followed up through discussions and co-operation at a working level.

5.1.2 Strengthening EU-Japan co-operation in existing areas.

Longer standing sectoral co-operation has been developed mainly through regular high-level dialogues, notably in the fields of industrial policy and co-operation, competition policy, telecommunications, macroeconomic issues, financial services, and transport. Some particularly promising areas in which EU-Japan co-operation can be further strengthened include:

- Development assistance for third countries, where it is important for leading donors such as the EU and Japan to undertake concrete co-operation projects on the ground for the efficient and effective implementation of assistance to partner countries.
- Social affairs, where there are plans from both sides to upgrade the existing dialogue to a level commensurate with the social challenges confronting both sides in fields such as employment security and flexibility, job creation and an ageing population.
- Environment and sustainable development, where the annual high level consultations have spawned a number of areas of dialogue, notably a continuing exchange of information on all aspects of climate change in the wake of the Kyoto Protocol negotiations. Other areas of discussion include emissions from cars, chemicals, biological diversity, waste management and recycling policies. These and other areas are set to burgeon as the environment maintains political importance both bilaterally and multilaterally.
- International fisheries policy, in particular tuna issues, where Japan and the European Community have decided to strengthen their co-operation in the framework of international organisations and relevant regional fisheries organisations

- Industrial policy, where the existing well-established dialogue has created working groups in key areas (biotechnology, standardisation and quality, information and electronic commerce) which could pave the way to common EU/Japan positions in the fields concerned.
- Industrial co-operation, notably through the EU-Japan Centre for Industrial Co-operation which is jointly managed and financed by MITI and the Directorate General for Industry. The Centre which was created in 1987 and opened its Brussels office in 1996, promotes industrial co-operation between the two regions through management training programmes (about 700 EU managers have already participated), traineeships for EU and Japanese students (over 50 students have taken part in Vulcanus programmes since 1996) and research programmes in the area of alternative energies (over 100 EU researchers participated). The Centre also provides business information to the public and organises seminars and conferences for the benefit of EU and Japanese industry. Sectoral industrial co-operation with Japan has also been pursued, for example through the JAMA-CLEPA conferences, designed to bring together Japanese car makers and European parts producers.
- Science and Technology, where explanatory talks aimed at analysing the mutual benefits of a possible Science and Technology Agreement could be launched. Such an agreement could facilitate the initiation of joint projects. Following the EU-US Agreement in this area, an upgrading of our relations with Japan to a similar status of partnership is worthy of close examination.
- Competition policy, where in light of the growing business interactions between the EU and Japan in the field of competition, and contacts between the Commission and the JFTC, further steps should be taken to evaluate the possible benefit of an agreement on the mutual exchange of information and positive comity in the field of competition policy.
- Consumer policy and consumer health protection, where inter alia a dialogue is being established between European and Japanese consumer associations, which could take up issues such as food safety, including the precautionary principle, hormones and genetically modified organisms (GMOs).

In addition to these areas, where there are good prospects for achieving agreements with Japan which would strengthen the foundation of EU-Japan relations, it is important to highlight the field of nuclear energy where, further to thorough preparatory work carried out between the Council and the Commission as well as detailed information on technical questions exchanged between Commission services and Japanese experts, negotiations between Euratom and Japan on an agreement on the peaceful uses of nuclear energy are about to begin.

To better focus EU-Japan efforts to develop co-operation in the future, the Commission proposes that the annual EU-Japan Summit develops a programme of co-operation initiatives to yield tangible results during the year to come. The objective should be to achieve concrete results by the time of each EU-Japan Summit meeting.

5.2 Raising the visibility of EU-Japan relations

Raising the visibility of EU-Japan co-operation activities would help to expand the level of confidence between the two partners, and hence promote further interaction. Steps taken in this direction since 1995 include:

- In 1997, an EU-Japan Co-operation Week took place in Japan. There were two main pillars to this. First, a jointly organised Conference on Co-operation in the fields of Education, Science and Technology. Second, an EU-Japan Symposium, jointly organised with Member States, and focusing on political and economic co-operation. In addition, a high-level seminar to explain economic and monetary union and the launch of the euro was held in Tokyo in November 1998. This will be followed by successor events this year.
- The production of a detailed overview document taking stock of existing co-operative activities, jointly adopted by Japan and the EU in 1998 and to be regularly updated. This document places EU-Japan co-operation within a comprehensive framework and facilitates the assessment of progress from both a qualitative and quantitative perspective.
- A project, in the form of a feasibility study, looking at the possibility of establishing a platform in Japan to help disseminate information on Europe ("Institute for Europe") and, to improve the understanding in Japan of the European Union and the fundamental changes it is currently undergoing.

Further actions need to be envisaged in this area. In conjunction with Member States, the Commission will examine the feasibility of holding a second EU-Japan co-operation week, once funding has been secured for the Japan budget line.

5.3 Promotion of initiatives aiming to address the "knowledge imbalance"

Europeans tend to be less aware of cultural, economic and political developments in Japan than their Japanese counterparts are about developments in Europe. The Commission has therefore been actively supporting initiatives aimed at redressing this "knowledge imbalance". Today EU-Japan co-operation needs greater involvement of the public at large to develop further, from the "bottom up", networks involving industry, universities, business and academics with the goal of turning dialogue into more joint initiatives and actions.

The Commission also shares the European Parliament's desire to boost people to people and youth exchanges beyond the current successful ETP programme.

6. CONCLUSIONS

As has been illustrated in this paper, EU-Japan relations have developed gradually but generally successfully within the scope of the 1991 Joint Declaration and the Council's conclusions on Japan in 1995. The broad themes of the Declaration have also been developed in the successive press conclusions issued at annual Summits.

There is no evidence to suggest that the Declaration is inhibiting the substantive development of EU-Japan relations. At the same time it is clear that relations have not attained their full potential. To create a more effective relationship with Japan and to

elevate it to a higher level, what is needed above all is a clear political commitment to develop a real partnership. In this respect, it would be particularly useful for the EU side to receive clearer proposals and ideas from Japan on how it would like to further promote EU-Japan relations.

For its part, the Commission proposes the adoption at each annual EU-Japan Summit of an agenda of priority actions for EU-Japan relations for the year ahead, covering economic, political and co-operation activities. The Commission's ideas for the next summit for an agenda of action for the coming twelve months are as follows:

Political dialogue

- Reinforcement of EU-Japan political dialogue on:
 - North Korea;
 - China's evolving political, economic and security role in the region;
 - Evolution of security structures in the region;
 - The impact of unilateral and extraterritorial policies on Asia.
- Identification of a limited number of practical and visible projects for joint collaboration and initiatives in the political field, in areas such as human rights and non-proliferation.

Economic and trade relations

- On multilateral trade issues, to intensify the dialogue on WTO issues, notably through the establishment of an annual Ministerial meeting on the WTO Millennium Round. The Commission also proposes to agree a joint programme of work to (1) intensify dialogue with other WTO members with a view to building a consensus on future WTO negotiations and (2) develop active participation of developing countries, notably of Asian partners in ASEM.
- On bilateral trade and investment relations, to work closely with Member States and European industry in reinforcing the co-operative approach to resolving market access issues in Japan through:
 - Working with Japan to deepen the two-way deregulation dialogue, notably through the establishment of an annual Ministerial review to (1) assess progress over the previous year in both Japan and the EU, (2) monitor implementation of measures already adopted, and (3) set out an agenda of new measures. Furthermore, while deregulation needs to take place across all sectors of the Japanese economy, the Commission proposes to draw up a focused list of priorities for the deregulation dialogue with Japan.
 - Concluding and implementing an EU-Japan MRA and broadening its sectoral coverage.

- Reinvigorating and reorganising the EU-Japan business dialogue and encouraging high value business input on trade and investment issues into the EU-Japan policy process.
- The Commission proposes that the EU intensifies its dialogue with Japan in appropriate fora on economic matters, notably with regard to (1) international monetary developments given the launch of the euro, (2) the economic situation in Japan and the EU and (3) the Asian Financial Crisis.

Co-operation activities

- For co-operation activities, the Commission proposes that the annual EU-Japan Summit develops a programme of co-operation initiatives which will yield tangible results during the year to come. The next Summit should give particular impulse to achieving an agreement on the peaceful uses of nuclear energy.

Some outstanding market access issues

Distribution

The complexity and inefficiency of distribution systems in Japan is an impediment to both domestic and foreign business throughout the Japanese economy. For consumers it reduces the variety of products available and pushes up prices.

With regard to large stores, progress has been made with the introduction of a new legal scheme, the "Large Scale Retail Store Location Law". However, the Commission remains concerned that this liberalisation at a national level could be frustrated by excessive regulation at a local level and about the transition period between the old and new laws.

As is the case for products, there are constraints in the distribution of services, for example in the financial and transport sectors. However, some positive steps have been taken, such as the introduction of direct marketing of motor vehicle insurance.

Competition policy

Effective competition policy is the necessary complement to Japan's ongoing deregulation process. Without it, government regulations may simply be replaced by private sector practices which hinder competitive forces and limit market access.

In Japan, the Commission would like to see:

- More effective enforcement of the Japan's Anti-Monopoly Act, notably through a more vigorous pursuit of violations;
- Further suppression of exemptions and exceptions under competition law;
- More effective sanctions and penalties, with the levels of administrative surcharges and criminal penalties being considerably increased and fully applied;
- Further strengthening of powers and operational capacities of the Japanese competition authorities (the Japan Fair Trade Commission).

Telecommunications

Even though improvements have been carried out recently by the Japanese authorities, many problems remain to be addressed in order to secure a more effective market access in the field of telecommunications in Japan. Obstacles of regulatory nature (high rates of interconnection to NTT networks, difficulty to access to rights of way, unclear conditions governing universal service provisions) have a negative impact on competition and prejudice both consumers and service suppliers.

Insurance

In Japan's insurance sector, significant liberalisation has taken place. However, there remains considerable scope for further modernisation. In particular, Japan needs to encourage competition in the sector. The Ministry of Finance should abolish individual product and rate approvals and replace them with supervision of solvency margins and capital requirements of insurance companies.

Foreign lawyers

The opportunities for foreign lawyers to practice in Japan are limited due to a restrictive regulatory regime. Despite some improvements since 1995, the current rules still prohibit Japanese lawyers from being in true partnership with licensed foreign lawyers. While this is a clear problem for European law firms, it also severely restricts the opportunities for young Japanese lawyers to gain experience of supplying international legal services in what is an increasingly global market place.

Transport

With regard to air transport, the demand for additional flight services to and from Tokyo's Narita airport has grown over recent years. However, slot allocation procedures at the airport are not transparent and do not conform to international (IATA) rules. This has been detrimental to the interests of European airlines, who have been discriminated against vis-à-vis their US counterparts. The Commission has had in-depth discussions on this issue with the Ministry of Transport and Japan's Deregulation Committee, with a view to finding a mutually satisfactory solution.

As for the transport of dangerous goods, most tank containers admitted into Japan to carry such products are subject to a physical inspection by Japanese authorities even when they have been constructed and certified to international standards. This additional inspection places an unjustified and unnecessary financial burden on international trade and should be abolished.

Phytosanitary and sanitary issues

With regard to fresh fruit and vegetables, a basic problem relates to the Japanese approval procedures for imports of new varieties and types. These procedures tend to be very long (2-3 years), costly and lacking in transparency. Often market access barriers are not only due to the regulations themselves but to the large measure of administrative discretion with which they are implemented. For example, it took France over 10 years to obtain authorisation to import apples to Japan, and then this was only granted for one single variety. Also, in the plant health and veterinary fields Japan still does not apply regionalisation within the Single Market.

Each Member State must therefore negotiate bilaterally and pass through the entire lengthy approval procedure from the very beginning for each new variety or type of fruit or vegetables which it wishes to export to Japan.

As is the case for fresh fruit and vegetables, Japan does not recognise that a single market for meat products exists in the EU. Furthermore, procedures for the upgrade of national disease status are unclear, lengthy and costly.

Starch

Japan has very high out-of-quota tariff levels for native starches, but manages its tariff quota in such a way that there is always a significant shortfall in the quantity actually imported.

Some market access success storiesCars

Deregulation in the area of cars has reduced costs and given Japanese consumers a wider choice. Japanese and European car manufacturers have responded to the reforms by releasing a wider, more up-to-date range of models, without a corresponding rise in prices. Furthermore, Japan's accession to the revised 1958 UN-ECE Agreement lays the basis for a broad based international harmonisation of standards in the years ahead. At the same time, there are still a substantial number of regulatory problems to be addressed, such as unique noise regulations and issues regarding vehicle certification.

Fish

With the prospect of action within the WTO looming, Japan agreed to implement an action programme for improving the Japanese import quota management system through negotiations to secure better market access for European fish products to the Japanese market. Under this programme, EU-Japan consultations are being held on an annual basis to monitor the implementation of the programme and eliminate gradually quantitative restrictions on fisheries products thereby promoting increased EU exports to Japan.

Port Practices

Long-standing pressure from the Commission to improve access to Japanese ports has focused on the deregulation of stevedore licensing and price controls and on the reform of the "prior consultation system". Japan has announced plans for the deregulation of the licensing procedures by the year 2000. Plans that were presented in November 1998 contain some positive elements, notably proposals to lift restrictions for newcomers to enter the stevedoring market, and to replace the current licensing system for stevedoring firms by a registration system. In addition firms will be able to set fees more freely and will no longer have to seek advance approval, as a notification to the authorities will be sufficient. The Commission will monitor the process closely, in particular with regard to its practical results. With regard to further changes to the prior consultation system, however, progress has been held up by the non-conclusion of new labour-management agreements.

Medical devices and pharmaceuticals

Following agreement at the EU-Japan Summit in June 1997, from 1 September 1997 Japan has accepted the results of quality testing of European medical devices (good manufacturing practices-imports or GMPi). This has significantly reduced expensive and time-consuming re-inspections in Japan for EU exports.

With regard to pharmaceuticals, Japan has undertaken to reduce the time for handling new drug applications to conform to international norms. While further progress is still needed, the measures, when implemented, will save time and costs for European business.

Sound recordings

Japanese authorities have accepted, after WTO consultations with the EC, to grant a 50 year “retroactive” protection on sound recordings (records, tapes,...) instead of only two and a half decades. This is very significant since Europe has been very successful in the last fifty years in the production of music with a popular world-wide appeal which can lead to significant royalties.

Financial Services

EU and Japanese co-ordination was crucial in reaching the WTO Agreement on Financial Services in 1997. The EU and Japan now have a common interest in promoting its rapid entry into force.

In the securities market, in the face of difficulties resulting from the problems in the financial sector, Japan considered the establishment of an Investor Protection Fund by 1 December 1998. The concept of the fund was criticised strongly by the European security firms in that they were concerned about the possible entry of bankrupt firms into the fund and the impact that this could have on their future liabilities. The Commission supported European firms in their request for the establishment of a second fund. The Japanese Ministry of Finance approved such a fund on 1 December 1998.

Satellites

The European Communities withdrew in 1997 its complaints in respect of a procurement tender published by the Ministry of Transport of Japan to purchase a multi-functional satellite for Air Traffic Management, following a decision to co-operate in the field of satellite-based navigation systems. This entails improved positioning and navigation capabilities with a view to enhanced security in the area of air, sea, road and rail transport, and brings potentially important economic benefits to EU industry.

Monitoring of US-Japan agreements

Since the agreement reached at the EU-Japan Ministerial meeting of November 1994, the Commission has actively monitored US-Japan Framework Agreements. Through participating in the US-Japan meetings themselves (in the case of cars and car parts) or subsequent bilateral meetings with the Japanese administration (in sectors including medical equipment, flat glass and paper/paperboard), the Commission has been able to help ensure that EU interests are protected and that EU firms are not suffering discriminatory treatment.

Semiconductors

In the context of the Information Technologies Agreement, European industry now participates in the World Semiconductor Forum. This has enabled it to broaden its industrial co-operation activities with Japan to include those which had been exclusively between the United States and Japan.

Silk

The Japanese authorities maintained for a long period a complicated system of import licensing for silk yarn which resulted in a de facto restriction on trade. This adversely affected the European silk industry in its exports to Japan. A solution has now been found to resolve the issue whereby the Japanese authorities have introduced, starting from 1 November 1997, a system of automatic licensing for imports of silk yarn originating in the Community.

Construction

In the field of construction, the Commission welcomes the move towards performance standards for building and construction materials. This is in line with international practices and should increase opportunities for European firms in Japan.

Statistical annex

Population and GDP (1998)

		World	EU	Japan	US
Population	Million inhabitants	5,901	375	126	270
	% world	100.0	6.4	2.1	4.6
GDP	billion ecu	26,261	7,474	3,669	7,518
	% world	100.0	28.5	14.0	28.6
GDP per cap	Thousand ecu	4.5	19.9	29.1	27.8

Source: World population WFA, World GDP IMF-World Economic Outlook,
Country values: Broad Economic Policy Guidelines, European Commission DG II

EU trade with Japan (1990-1998, billion ECU)

Year	Trade with Japan			
	Exports	Imports	Balance	
			Value	%change
1990	22.7	46.0	23.3	-
1991	22.2	51.8	29.6	27.0
1992	20.6	51.5	30.9	4.4
1993	22.8	47.7	24.9	-19.4
1994	26.6	48.4	21.8	-12.4
1995	32.9	54.3	21.4	-1.8
1996	35.8	52.6	16.8	-21.5
1997	36.0	59.8	23.8	41.7
1998	31.1	65.2	34.1	43.3

Source: Eurostat COMEXT. Provisional figures.

Japanese current account balance as % of GDP (1993-2000)

Year	1993	1994	1995	1996	1997	1998	1999*	2000*
Current account as % GDP	3.1%	2.8%	2.2%	1.4%	2.3%	3.3%	3.5%	3.6%

* = forecast. Source: European Commission

EU Exports, 1998

	Value (Billion ECU)	% of total
Total exports	716.7	100.0
Exports to Japan	31.1	4.3
Exports to USA	158.8	22.2

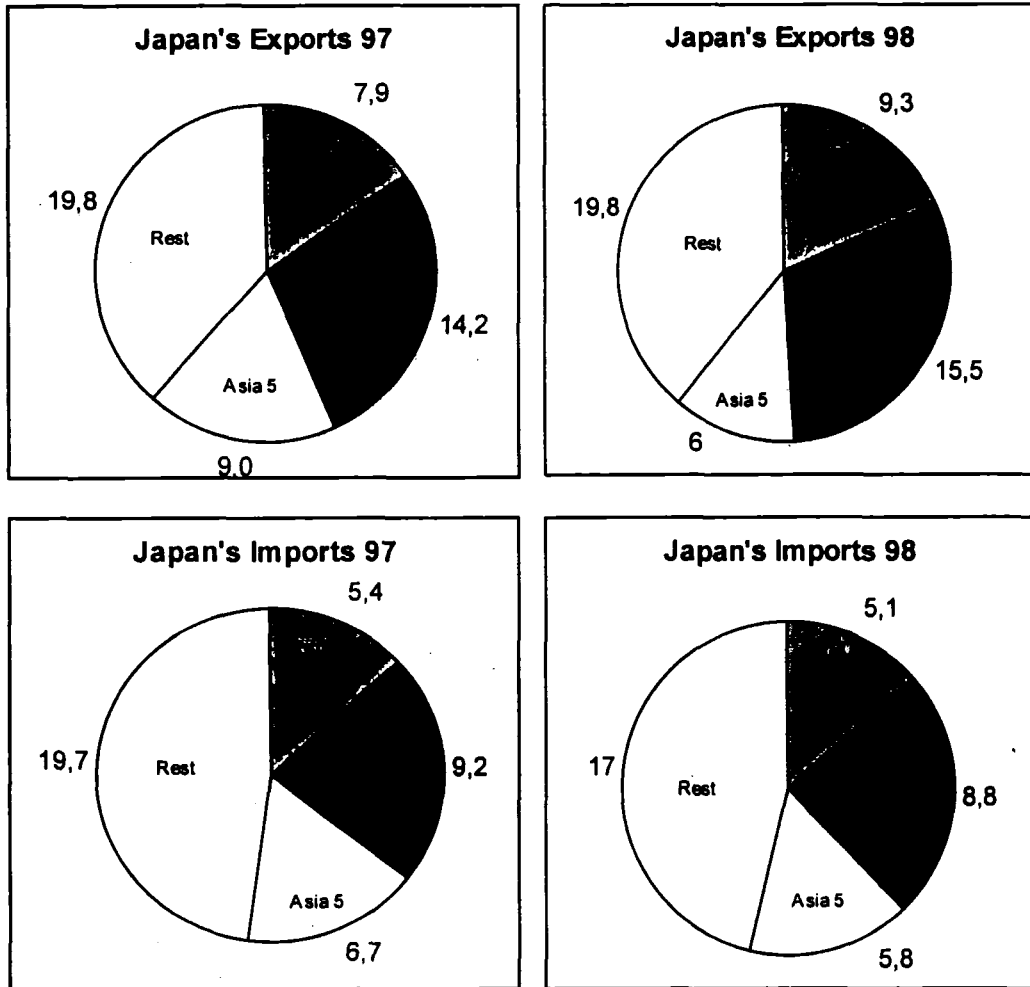
Source: Eurostat COMEXT. Provisional figures.

EU Imports, 1998

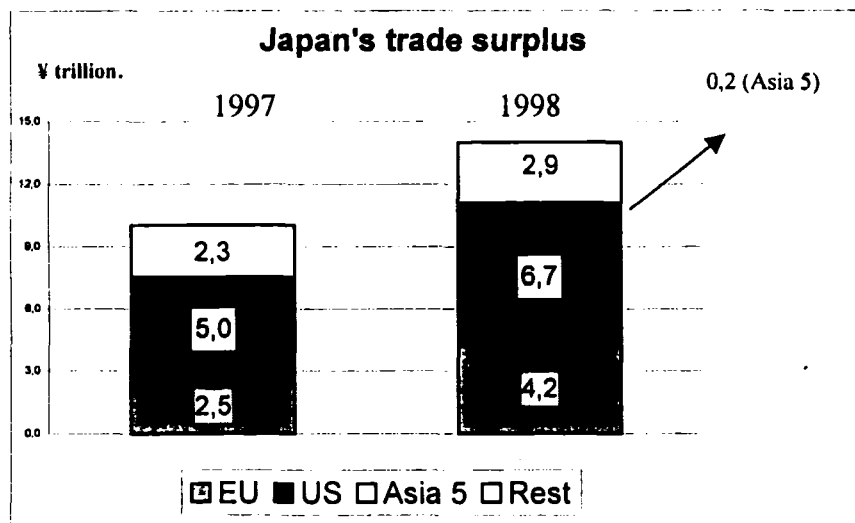
	Value (Billion ECU)	% of total
Total imports	702.1	100.0
Imports from Japan	65.2	9.3
Imports from USA	150.2	21.4

Source: Eurostat COMEXT. Provisional figures.

Japan's trade flows 1997/1998 (all figures expressed in ¥ trillion).



Source: Japan's Ministry of Finance. Asia 5 = Korea, Malaysia, Philippines, Thailand, Indonesia.



Source: Japan's Ministry of Finance.
N.B. Trade surplus with the rest of the world in 1997 less than 0.1 ¥ trillion.

Foreign direct investment (¥ billion, stock, end of 1997)

Japanese direct investment abroad 35,334
 Foreign direct investment in Japan 3,519

Japanese direct investment in the EU 6,839
 EU direct investment in Japan 967

Source : Japan's Ministry of Finance

Japanese GDP growth (1993-2000)

Year	1993	1994	1995	1996	1997	1998	1999*	2000*
GDP growth	0.3%	0.6%	1.5%	5.1%	1.4%	-2.9%	-1.3%	0.5%

* = forecast. Source: European Commission

Forecasts for Japan's economy

	1998		1999	2000
	At current prices (¥ trillion)	As % of GDP	Annual data* (% change)	Annual data* (% change)
Private consumption	304.4	61.5	-0.7	-0.4
Government consumption	50.0	10.1	2.5	2.0
Gross fixed capital formation	129.7	26.2	-5.0	0.6
Stockbuilding (as % of GDP)	0.3	0.1	0.2	0.2
Domestic demand	485.4	98.0	-1.9	0.1
Trade in goods & services				
Total exports	55.3	11.1	0.9	5.3
Total imports	45.5	9.2	-3.1	2.9
GDP at market prices	495.2	100.0	-1.3	0.5

* Percentage change over preceding period at annual rates at constant 1990 prices

Source: European Commission