



Japan - EU Trade Relations: What can Serbia learn from this partnership?

Conference report

The International and Security Affairs Centre (ISAC), in cooperation with the Embassy of Japan in Serbia, organized the conference “Japan-EU trade relations: What can Serbia learn from this partnership”, held on February 28, 2019, at the Hotel Radisson Collection in Belgrade. The main theme of the conference was the new European Partnership Agreement (EPA) between the European Union (EU) and Japan and its effects on the EU, Japan and EU candidate states alike. This report includes the content of the keynote speeches, presentations by speakers and discussions held in three panels, whose highlights are divided by topic. You can also find the key conference conclusions on ISAC’s website (www.isac-fund.org), as well as the recordings of the conference which was broadcast live via ISAC’s facebook page (www.facebook.com/ISACfund). ISAC bears sole responsible for the content of this report.

The conference was opened by Milan Pajevic, Chairman of the ISAC Advisory Board, H. E. Akira Kono, Ambassador of Japan to the EU, Mateja Norcic-Stamcar, Deputy Head of Mission of the EU Delegation to Serbia, and Dr. Tanja Miscevic, Head of the Negotiating Team for the Accession of the Republic of Serbia to the EU.

The keynote speakers recalled historic ties and cooperation between Japan and the EU, adding that the EPA had not been created by chance, but was rather a natural continuation of cooperation between the two entities. The ratification of the EPA (February 1, 2019) created an economic space based on the principles of freedom and rule of law. This agreement not only strengthens Japan-EU economic ties, but also solidifies their bilateral relations with a view to creating a joint global agenda towards defending multilateralism and cooperation based on generally accepted rules. Therefore, the nature of the EPA is not only economic, but also political, which shows that Japan and the EU are united around common values, such as democracy, rule of law and human rights. As both parties to the agreement are facing a number of challenges, such as protectionism in particular, there is a strong interest for them to act together. It was pointed out that the EPA, currently being the world’s most advanced and most innovative free trade agreement, should serve as a model of future agreements between other entities.

The EPA is very important for Serbia given its pro-European path and its main foreign policy goal - to join the EU. The current negotiating process is nothing else but the process of Serbia's attaining European standards in various areas, especially those that will lay the basis for economic exchange, and solidifying cooperation with countries outside the EU. In this context, the fact that the EPA was concluded is of great importance for Serbia both in terms of its current indirect effects and in terms of its future effects once Serbia has become a part of this agreement, which will happen automatically upon its entry into the EU.

Panel 1: Japan-EU partnership and global economic trends

The panellists were Dr. Shujiro Urata, Professor at Graduate School of Asia-Pacific Studies, University of Waseda, Dr. Predrag Bjelic, Professor at the University of Belgrade Faculty of Economics, and Tobias Gehrke, Research Fellow at Egmont - the Royal Institute for International Affairs.

All participants in this panel agreed that successful implementation of the EPA would enhance global economy. This agreement, which is the result of joint EU-Japanese efforts, belongs to a new generation of trade agreements because it also contains sections on corporate governance, climate change and regulatory cooperation. The EPA covers trade worth over 13 billion euros and, according to some estimates, it will have an impact on the creation of 40,000 jobs in certain sectors that will additionally boost trade.

There are several trends which significantly impact global trade. The most important one of them is the global rise of Asia. Japan is the third strongest global economy, while China's economy, which has been growing for decades now, is ranked the world's second largest economy. Major growth has also been registered in India and the so-called 'Asian Tigers'. Another significant trend is the attitude of the United States that has started to call multilateralism into question by pushing its 'America first' policy. Some symptoms of this include the US withdrawal from the Trans-Pacific Trade Partnership (TTP) Agreement with Asian countries and worsening of relations with the EU. Yet another trend is instability within the EU itself, ranging from political rifts to some member states' acts of undermining some of the essential values that the EU rests upon. The main challenge in the EU right now is a potential UK withdrawal from the EU, i.e. Brexit. Furthermore, Brexit is a challenge to the implementation of the EPA, because it will significantly reduce the field for services to Japanese companies.

Despite all the challenges, Japan and the EU are seeking, by means of the EPA, to offer and provide responses to global challenges to trade.

Global trade and the EPA

Protectionist policy measures imposed by the United States, as well as by other countries, are highly debatable. The international trade system had been built gradually for more than half a century, based on rules accepted by all parties involved. However, the situation changed in the last decade. The United States had previously insisted on free economic exchange and a rules-based system of global trade. However, the Trump Administration now perceives tariffs as a powerful way to achieve its own national interests. On the other hand, unilaterally imposed tariffs are contrary to the rules of the World Trade Organization (WTO).

However, global circumstances have changed significantly over the past 40 years in terms of the structure of trade, particularly with respect to industrial products. The world economy today is

based on global economic chains and trade in intermediate goods that most economies, including the US, depend upon. In other words, frequent restrictions of imports may affect domestic companies whose final products depend on import of intermediate goods from other countries. Thus, tariffs affect national economic development as well.

A major question is what will happen with the WTO, an important forum for settling the most important trade related issues, which is obviously in need of reform. Every time there is a blockade within the WTO, some bilateral trade agreements, such as the EPA, are concluded as a result. The WTO has created rules that allow regional free trade agreements, provided that the core values underpinning this international organization are respected. Therefore, the EPA was emphasized as a shining example of fight against protectionism and the “light at the end of the tunnel”.

It was stressed that a future WTO reform should particularly focus on the issue of global inequalities among people. This very issue is often listed as a consequence of international free trade. During the process of restructuring of the global trade system all these circumstances must be taken into account. A reformed WTO can only be created on the basis of agreement among key trade actors in the world today - the EU, Japan, China and the United States.

Japan's position

Japan has been faced with a low economic growth for years now, which is also a typical feature of a developed economy. The demographic situation in Japan leaves much to be desired as its population is declining. If this trend continues, Japan's population will fall below 100 million by 2050. In order to give an impetus to economic growth, Japan needs a rise in productivity, an open market and domestic policy reform. To that effect, Japan's interest is to promote the global market and global trade due to the shrinking of its own market, which is why it seeks to promote international trade partnerships and investments. Therefore, Japan is highly committed when it comes to future agreements.

The challenges that Japan is faced with in the global economy are the so-called 'ABCs': A) 'America first'; B) Brexit or Brussels; and C) China. As for the first challenge, 'America first', Japan and the EU should fight such an approach to global trade. Trade related issues should remain a separate area and they must not be linked with other issues that do not refer to trade. However, Japan remains flexible and open to new negotiations with the United States, particularly over the latter's rejoining the TTP. When it comes to Brexit, Japan does not have much influence on the issue even though Brexit will certainly destabilize the EU and shrink the market for Japanese goods and services. With respect to China, it is important for Japan that China should stay a 'peaceful' country with economic growth and that China's participation in global trade should be based on compliance with all international rules, especially those on protection of intellectual property rights. Still, there are some concerns, particularly in view of the need for certain structural changes. It would be important for Japan to establish contacts and exchange with people from academic circles in China who favour the opening of the market.

The EPA and the EU

The EU is committed to liberalism and multilateralism, while being against a closed and protectionist global economic system. EU negotiations with New Zealand, Vietnam, Mexico and other countries on new agreements modelled on the EPA with Japan can be expected.

As far as the EU is concerned, the EPA is a geopolitical and geoeconomic agreement. China's economic strengthening is also a security challenge for the EU. On the other hand, a trade conflict between the United States and China puts both Japan and the EU in an awkward position of having to choose their respective stance towards this conflict. Hence, this is a comprehensive challenge that requires major changes, as some countries are strengthening economic nationalism and utilizing various economic mechanisms to protect their own interests. Furthermore, both China and the United States are pushing their respective visions of the future global system. Thus, the EPA should also be perceived as an international policy instrument which is trying to shape the international scene and which is based on foreign policy interests of both the EU and Japan.

The WTO is essential for both Japan and the EU, as it guarantees the survival of free trade, so both sides are ready to exert efforts to preserve it. Given such a large number of challenges that global trade is faced with, there is an obvious need for putting in place a new set of rules in order to deal with them. Therefore, the current WTO system is in danger, running a real risk of becoming dysfunctional. There is a plethora of new trade related issues that are not regulated or harmonized within the WTO. To that effect, the EPA is a step forward as it is related to the implementation of key issues which will require cooperation in the future. Hence, the EPA may also serve as a platform for joint creation of new norms and rules.

Panel 2 - Japan-EU economic partnership agreement and the importance for EU candidate states

The panellists for this panel were H.E. Junichi Maruyama, Ambassador of Japan to the Republic of Serbia, Marco Chirullo, Acting Head of Unit of DG Trade, European Commission, Tatjana Dinkić, Head of the working group for Chapter 30 within Serbia's Accession Negotiating Team to the EU, and Dr. Aleksandar Milošević, Professor at the University of Belgrade, Faculty of Political Sciences. The panel was moderated by Dr. Vladimir Medjak, Vice-President of the European Movement in Serbia.

What are the benefits of the EPA for the EU and Japan?

Launched in 2013, the EU-Japan talks on the EPA took a long time to finalize. Japan is a stable democratic country and an important market for the EU. From the Brussels' perspective, the EPA is an initial step towards enhanced European cooperation with Asian countries. So far, the EU has concluded agreements with Singapore and Japan, while talks continue with other countries, which will contribute to EU's greater economic exchange with those countries.

Now that the EPA has entered into force, the Japan-EU trade will be more competitive. Trade liberalization will boost exchange as high tariffs and export and import quotas that had previously been in force were lifted on 1 February 2019. An open market gives ample opportunities to both the EU and Japan. There will be a phased liberalization of trade, which will cover all groups of products. For instance, the tariffs on footwear, which used to be 31%, now amount to 21.5% and will be reduced even further. For some other products, such as hard cheeses, the tariffs will remain in force for the next 15 years. There is a transition period for some products, e.g. chemical products, where the tariffs will remain at 3.5%. The Japanese market used to be closed to alcoholic beverages and pork, for instance, and these were the areas where a system of full

protection was in place, but now the Japanese market will be open to products from the EU. Manufacture in numerous sectors of industry, such as cosmetics, electronics, pharmaceuticals and medicine, is based on the same standards (ISO standards), which will help increase trade.

During the negotiations and thereafter, the EU has had excellent cooperation with Japan. Mutual requirements were respected and everything that the two parties had agreed upon was implemented very quickly.

Investments and protective measures are not covered by the EPA and the signing of an additional agreement is pending. Nevertheless, the EPA provides for some opportunities in that regard, too. For instance, Japanese business people may temporarily move to the EU for business reasons. There is a number of Japanese investments that had earlier come to Europe, and some of these companies are doing great, like Toyota or Mitsubishi. One step which is yet to be taken is harmonization of goods quality standards, as well as harmonization of regulations.

The EPA and EU candidate states

There are three types of EPA effects on EU candidate states: indirect, direct (but not instantaneous) and investment opportunities.

The indirect effect of the EPA is instantaneous for all European countries in general, regardless of whether they are EU members or not. Economic ties among European countries are strong, with a large volume of trade, and the same goes for Serbia, which mostly exports its goods to neighbouring countries and EU member states. As EU exports to Japan are likely to increase as a result of the EPA, which will in turn stimulate greater production, the EU is also likely to import more raw materials and intermediate goods from other partner countries. More Japanese business people are also likely to come to Europe, including Serbia, which may have a positive impact on future growth of Japanese investments in Serbia and other EU candidate states.

Once they join the EU, all candidate states will feel the direct impact of the EPA, i.e. they will be able to export their goods to Japan in line with EPA provisions. But, the candidate states will feel the impact of the EPA in the accession period as well, because they will have to align with the standards promoted by the EPA, which will, in turn, make them better prepared to participate in direct trade with Japan. They will also feel other effects in terms of reduced tariffs and simplified procedures.

As noted previously, with respect to investments, the agreement on investment protection remains to be concluded. It is highly important that Japanese investors should enjoy the same level of protection in candidate states as the one in the EU. This will definitely happen once Serbia and other countries become part of the EU, but as one should always try to be forward-looking, perhaps some steps in that direction may be taken even now.

Therefore, both current and potential EU candidate states are likely to feel the effects of the EPA, primarily in terms of a potential increase in investments by Japanese companies, since these states are part of a wider EU system. Should Japan invest in candidate states, this will stimulate and strengthen the reform process and thus contribute to a successful closing of negotiations with the EU.

The EPA effects on Serbia

Serbia can only benefit from the market liberalization and access to the Japanese market. Candidate states can already benefit from the EPA in terms of non-tariff measures and harmonization of global standards. Serbia has sent a clear signal to the EU that it favours multilateralism, liberalism and measures provided by the world trade system. Since Serbia is a small country, it is less likely to achieve sufficient productivity and competitiveness of its market without free trade.

Chapter 30 – ‘External Relations’ is one of the negotiating chapters that Serbia has opened with the EU. What remains to be done is, first of all, for Serbia to join the WTO and pass an action plan voicing its readiness to act in line with the *acquis communautaire* in trade relations. Serbia has a number of free trade agreements with other EU candidate states and potential candidate states through its membership of CEFTA. Moreover, Serbia has free trade agreements with several important third countries, like the Russian Federation, Turkey and EFTA countries. In other words, 86% of Serbia’s trade is covered by free trade agreements.

Furthermore, CEFTA provides for a possibility of joint manufacture of goods based on the cumulative principle. Therefore, Serbia should not be perceived individually, but as a part of a broader network of agreements and as being inextricably linked to the EU.

With the above benefits and its geographical location in the centre of the region, Serbia can be interesting for Japanese companies, in terms of exports to both the EU and other countries. Serbia’s geographical proximity to the EU would facilitate transport and distribution of Japanese products.

Serbia’s exports to the EU mostly include electronic equipment and cars, which are the very same products as those that Japan exports to the EU. This can additionally motivate Japanese companies to invest in Serbia because the base for manufacturing the same products already exists there. On the other hand, even after the signing of the EPA, Serbia has opportunities to export these products to the EU much more easily than Japan, and so Japan could be interested in investing in Serbia for that reason as well. The current exports to Japan currently amount to about 70 million US dollars, of which exports in cigarettes account for 80%.

To Japan and other foreign investors it is important that Serbia should join the WTO, regardless of all the challenges this organization was previously faced with. There is a lack of general understanding in Serbia as to how important membership in international organizations really is for small countries. Such membership can better protect a country’s own interests thanks to clearly defined rules of the game. Positive examples of Moldova and Macedonia, which have drastically increased their respective trade upon joining the WTO, practically speak in favour of membership in this organization. It is important for investors that Serbia joins the WTO because membership will open new markets to the Serbian economy. Moreover, the WTO has an efficient dispute resolution mechanism (unavailable within CEFTA), which the Serbian economy badly needs due to continuous trade disagreements primarily with neighbouring countries. Finally, the membership of the WTO enables accession to the EU. Negotiations with the WTO stopped in 2013 and Serbia is one of the few countries that are not WTO members (other European non-WTO members include Bosnia and Herzegovina, Belarus and Azerbaijan). Accession to the WTO will require changes of regulations governing trade in GMO products and completing open bilateral negotiations.

Panel 3: Serbia's EU integration and the case for closer economic cooperation with Japan

The panellists were Andrew Fraser, Senior Adviser to Mitsubishi Corporation and Managing Board member of Mitsubishi Corporation International, Goran Pekez, President of Japan Business Alliance Serbia and Corporate Manager of Japan Tobacco International in Serbia, Ana Tozzi, Executive Director of Foreign Investors Council in Serbia, and Mihajlo Gajić, Program Director of LIBEK Economic Research Department. The panel was moderated by Biljana Stjepanović, Editor of "Nova Ekonomija" magazine.

Necessary reforms in Serbia in order to attract foreign investments

For foreign direct investments of better quality, Serbia should become a functional economy, able to withstand pressure. This will primarily require macroeconomic stability, strengthening rule of law, smaller state influence on the economy, reducing bureaucracy, fight against corruption, reducing corruption and, of course, investment in education and science. What is particularly important in that context is not only Serbia's accession to the EU, but also the accession process itself because, if properly implemented, it can help the country learn important lessons on how to improve the competitiveness of its economy. It is important for Serbia to learn from good and bad practice examples of other countries. Successful completion of this process requires great expertise and technical support.

It is important to outline that sixty percent of investments in Serbia come from existing investors. Thus, foreign investors who are already present in Serbia are the best ambassadors of Serbia and foreign companies are the engines of development of the Serbian market. Foreign investors in general are interested in investing in the society in which they operate, but their interest is not enough and Serbia should commit serious internal reform and decisiveness in the pro-EU foreign policy course.

Furthermore, it is of particular importance for Serbia to liberalize its market and become a part of global manufacturing chains, which is currently not the case. This would open up more room for cooperation with companies from Japan and other countries. Without its presence in the global manufacturing chains, Serbia will continue to linger on the margins of economic development.

Each year, the Foreign Investors Council publishes its White Paper report. On average, an improvement of 35% is reported each year, of which full progress accounts for only 5%. Some areas covered by the White Paper that are deemed of interest for foreign investors include the following:

1. Digitalization. Progress has been made in this domain, especially after the enactment of the 2016 Law governing digitalization, but subsequent by-laws that would enable full implementation of the law are lagging behind;
2. Tax system. The problems here include consistency, treatment of companies, and accounting standards which are not aligned with those of the EU;
3. Employment regulations. The Council advocates changes of wage calculation forms, i.e. simplification thereof;
4. Agriculture. There is a lack of recognition of EU certificates in this domain.

Foreign investors should not be viewed as 'predators' because there are investors who are truly interested in long-term investments and who do not come to invest in Serbia because of subsidies.

Without this kind of reforms, Serbia might only remain attractive to some foreign investors who come because of an opportunity to address challenges in a non-institutional manner or because of high subsidies that currently amount to 2.7%. Subsidies may serve as an instrument for attracting investors, but what is far more important is the rule of law, and primarily judicial reform.

On Japanese investments

There are a lot of Japanese investments in the EU and its member states are interested in attracting more investors from Japan. One of the reasons for this interest in Japanese investments is the way Japanese investors treat employees and rights of employees. When making their investments, Japanese investors are interested in long-term business operations. Their work is based upon the principle of cohesive partnership that the *kaizen* philosophy personifies. Figuratively speaking, this concept means 'work for common benefit'. Thus, Japanese investments are focused on long-term integration into the community and on generating productivity and added value for the benefit of everyone involved: the investor, employees and the host country alike. In that regard, more investments coming from Japan would mean a long term gain for Serbia.

There are currently 32 Japanese companies operating in Serbia, which indicates a growing interest in this particular market. Many Japanese companies choose Serbia as their management seat for the Balkans, as part of wider Japanese business groups.

But as mentioned above, political and macroeconomic stability is essential. New Japanese investments need prerequisites such as clear political stability, foreign policy orientation towards the West, i.e. in Serbia's case, foreign policy orientation towards the EU, strengthening of the rule of law and embracing of the European business standards. This would imply having in place the same regulations as the EU and recognizing EU standards and certificates.

In addition, the link between the EU accession and environmental protection was stressed, and Japan is a world leader in environmental protection standards. By focussing on environment protection and standards, Serbia could potentially attract investment which would in the same time be market attractive and be an interesting asset for the EU market as a whole.

As for other investments, it is always useful for a country to review its current economic activities and industrial sectors and try to attract new investments on that basis.

For instance, the IT sector is currently booming in Serbia and this is a potential that the country should tap into in order to attract new investments. The so-called Fourth Industrial Revolution does not require major investment in infrastructure, so Serbia can easily catch up with developed countries in this domain. Booming of the IT and further digitalization could increase Serbia's attractiveness for Japan.