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EU-Japan Business Dialogue Roundtable June 4, 2007

FACING NEW GLOBAL REALITIES TOGETHER: Competitive challenges from emerging countries *and* Strengthening EU-Japan economic co-operation

Ladies and Gentlemen,

In March this year, the European Union celebrated the fiftieth anniversary of the signing of the Treaties of Rome, which laid the foundations for the Europe we see today. One of the salient features of that Europe is its ever-increasing openness to trade and investment. This has been a major catalyst to growth in the EU and a powerful stimulus to competition, innovation, productivity and job creation. Today, perhaps more than ever in the past, we are both reaping the rewards of that openness and facing its most testing challenges. The US, Europe and Japan are no longer the only forces driving the global economy. Increasingly, a number of emerging countries are taking the stage as economic powers, and we need to find ways of turning their newfound competitiveness to mutual advantage.

Who are these emerging countries?

You are no strangers to the story of the spectacular rise of China, as well as India, and to some degree Brazil, Russia and the ASEAN bloc. Together, emerging countries now represent more than 15% of global trade flows.¹ Since 1980, China has enjoyed annual average growth of 9%.² Recent GDP growth for India has been almost as impressive, running at over 8% in 2005. While of course this growth is from what was, originally, a very low base, it seems to be firmly established and shows no signs of petering out – China's GDP is predicted to grow on average 6.6% every year between 2005 and 2025,

¹ Commission Staff Working Document SEC(2006)1230 – Annex to the Communication “Global Europe: Competing in the World”

² Commission Working Document COM(2006)632 accompanying a policy paper on EU-China trade and investment: Competition and Partnership



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with India managing 5.5%³.

Both China and India are doing much to stimulate their economic growth. China operates considerable incentives for FDI and attracted 13% of world FDI inflows in the period 2002-4. By 2005, foreign invested companies accounted for more than half of total Chinese exports.⁴ The benefits are spreading throughout the population – over recent years, per capita income in China has doubled, then doubled again, and then again to reach a fifth of the current EU level in purchasing power parity.⁵ A large middle class, with rising economic power, is rapidly emerging. India's middle class is also expanding and may now number between 200 and 300 million people. We already recognise that these countries are major players on the economic stage. And with their massive populations, they represent not only huge talent pools of often highly educated staff, but also huge markets of tremendous interest to companies both domestic and foreign.

Let's briefly take a closer look at trade between the EU and China and India

The European Commission describes China as, and I quote: “the single most important challenge for EU trade policy”.⁶ Europe accounted for more than 19% of total Chinese exports in 2005, importing everything from manufactured goods, machinery and mechanical appliances, to electrical equipment and textiles⁷. In the same year, China ranked as Europe's fourth largest export market, taking not only European machinery and mechanical appliances, vehicles, and chemicals⁸, but also services, with the EU capitalizing on its strengths in the financial, construction, distribution and educational services sectors. This just goes to show that EU-China trade is not all a low-cost game – the strongest performing European exporters to China have some of the highest labour costs in Europe.

³ Commission Communication COM(2006)567 – “Global Europe: Competing in the World”

⁴ Commission Working Document COM(2006)632 accompanying a policy paper on EU-China trade and investment: Competition and Partnership

⁵ Commission Communication COM(2006)567 – “Global Europe: Competing in the World”

⁶ Commission Working Document COM(2006)632 accompanying a policy paper on EU-China trade and investment: Competition and Partnership

⁷ Source: DG Trade / Eurostat 15 September 2006

⁸ idem



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Trade between the EU and India is less spectacular, but still significant and growing. Exports from India to Europe grew by more than 32% in 2005 and accounted for 22% of India's total exports that year. Europe's exports to India grew by 24% in the same period⁹. Europe was both India's largest export and largest import partner.

Of course, European companies are facing unprecedented competition not only from China and India, but also from Brazil in agricultural trade, from Russia in resource and heavy industry trade, and from many others. The challenge is particularly serious in manufacturing sectors, where the cost of labour is crucial. But it is not limited to processed goods with limited added value – Chinese companies, for example, are making significant gains in high technology product markets and are actively developing their R&D capacity. This increases the pressure on European firms to remain at the forefront of developing high-quality products and services – if not, we will increasingly experience the export of not only low cost manufacturing jobs, but also higher value-added jobs to China.

But it is not all bad news. The EU has already benefited enormously from the growth of the emerging countries and stands to benefit further from the growing market for advanced technology, high value goods and complex services. Investments abroad have allowed EU firms to remain competitive by gaining access to lower-cost inputs and, in some cases, have allowed them to maintain higher-end activities, such as R&D, design and marketing, within Europe.

How does this compare with the situation for companies in Japan?

According to a JETRO press release in March¹⁰, Japan's trade with China rose 11.5% year-on-year in 2006. While the US remained Japan's largest trade partner, accounting for 17.4% of Japan's total trade, China was close on its heels, at 17.2%, and is expected to overtake the US in 2007. Japan's exports to China rose more than 15% year-on-year, nearly doubling the 2005 figure, driven by strong growth in product markets such as electronic parts, automobiles and auto parts and materials. Japan's imports from China grew by the much lower rate of 8.5% year-on-year. Why is this?

⁹ Source: DG Trade/Eurostat 15 September 2006

¹⁰ Japan External Trade Organization, 8 March 2007



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It seems that, while China is stoking competitive pressure worldwide, Japan has, for some years now, been quite successfully engineering its economy to be complementary to, rather than in competition with, China. It has used China's strengths as a catalyst to purge its own weaknesses, shifting low value, bulk manufacturing work out of Japan to be replaced with higher value-added innovation-driven and specialist activities, more compatible with high domestic cost structures. It has also chosen to shield specific areas of its home market – notably in the agricultural sector – from direct lower cost competition. However, it seems likely that Japan will in future further capitalize on China's competitive strengths by bringing the benefits of lower costs and higher productivity to its entire economy.

So what kind of policy response is business looking for?

We have seen how, in recent years, rapid growth in China and India has diverted interest away from the EU–Japan relationship. There is even a feeling on the European side that Japan is becoming insignificant because of the growth of its neighbour.

There is a tendency to believe that we have to focus on either Japan or China.

This is fundamentally wrong. If we are to integrate rapid growing newcomers into the global economy and take full advantage of what they bring to the table, then developed economies like the EU and Japan need to work closely together. Persuading China to meet its WTO commitments and to improve market access for foreign companies requires *solidarity* and *energy* on behalf of other WTO members. It is essential that the EU and Japan cooperate in this.

Let's be clear – any attempt at protectionism is not a long-term answer to the challenges we face. We can better promote our own economic interests by actively pursuing the further opening of markets worldwide and ensuring that international rules are applied fairly and transparently. Taking the case of China, while WTO accession has led to significant falls, a number of tariff and non-tariff barriers remain in place in industries important to both EU and Japanese exports, and there are continuing restrictions on investment in manufacturing and in services. Non-tariff barriers are in some ways depressingly familiar – including product certification, labeling standards, import



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approval requirements and customs clearance delays. Chinese national standards often differ significantly from international standards. Unreasonable sanitary and health requirements are a particular problem in the perishable goods sector. Many procurement markets remain closed to foreign business and we are witnessing in some industries the emergence of what seem to be “local content” requirements that discriminate against foreign suppliers. And everyone suffers from the fact that the application of laws is often not uniform. The Intellectual Property regime remains weak, with consistent, effective implementation and enforcement still notable by their absence.

Equally, we must of course ensure that our own house is in order. As the Commission has said in its policy paper on trade with China: “Europe cannot call for openness from China from behind walls of its own”. This is just as true for Japan, given its position as a “trading super power”. Our prosperity is now intrinsically linked to that of other regions of the world, and any obstacle to global supply chains can damage us. Frankly speaking, the list of problems facing foreign companies on the Chinese market is not so different from the problems European companies faced in Japan twenty years ago. We are happy to have seen substantial progress since then but, to be honest, we still face problems in the very same areas to this day. Japan should not be complacent about this.

In fact, I believe there is much that Japan and Europe could do *together* to help each other not just meet but thrive on the competitive challenge from emerging economies. I believe we could use this challenge to identify ways to strengthen our own relationship that will enhance our capacity as leaders in global trade.

We have, over the years, built immensely strong economic ties. Japan accounts for more than 5% of all EU trade and ranks as Europe’s fifth largest trading partner. Europe in turn accounts for more than 13% of Japan’s foreign trade and is its third largest trading partner.¹¹ We both need to find ways to link our own external and internal policies to foster our competitiveness. We both need to succeed as providers of top quality goods and services in the world economy. We both need a reliable platform of fair and consistent rules and standards to achieve this.

¹¹ Source: DG Trade / Eurostat 15 September 2006



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Why not look at ways that we can do this together?

We in the EBC believe that it is time for the EU and Japan to deepen mutual trade and investment relations. We recognise the progress that has been made through the various existing dialogues on trade and regulatory reform, as well as other measures in the 10-year Action Plan for EU-Japan Cooperation.

But significant issues, some of which were identified in the report and presentations made yesterday by Working Party 1, still persist, in areas that the WTO does not currently address, such as rules on investment, regulation, competition and public procurement, as well as mutual recognition and standardisation.

We do not believe that the solution is a traditional type of FTA, that focuses primarily on tariff barriers. But we do realise that in the current global environment that I am describing, we can no longer afford to tolerate non-tariff barriers.

Given the challenges of the global economic landscape, the strength of bilateral relations, the importance of our mutual trade and our shared interest in fostering competitiveness, we believe that the time is right for further, faster economic integration. We believe that now is the time to initiate cooperation on the development of a formal Economic Integration Agreement (EIA) that builds on and complements WTO rules. This would accelerate the reduction of non-tariff barriers and could provide the impetus for a step change in EU-Japan trade and investment. It could allow us to lead in the development of rules and standards, for use not only at home, but in markets beyond our own borders.

The greater the consistency in rules and standards, the better for business. But only, of course, if the rules and standards are the right ones: active business involvement in the formulation of an Economic Integration Agreement will be essential – we alone have the experience to say what works, what hurts, and what the priorities must be.

Of course, this is not a new idea. Japan already has several Trade Agreements, with Singapore and Malaysia for example, and is in discussions about more. Meanwhile, the EU is contemplating agreements with countries whose market potential it sees as of particular interest, such as India, Korea and the ASEAN countries. We can only stress



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the point made by our colleagues in BusinessEurope in a strategy paper last December, that far greater additional trade volumes can be expected from agreements between large trading partners at a similar level of development than from partners at different levels¹². I believe this would be the case with an agreement between Europe and Japan. Accordingly, we urge the Japanese Government and the European Commission to start preliminary talks on establishing an EU-Japan Economic Integration Agreement

To conclude

Ladies and Gentlemen, the emergence of new countries as economic powers is creating opportunities for growth and development not only in those countries, but also throughout Europe, and in Japan. Rather than being powerless to prevent our own decline, we must become dynamic architects of our future success. We have the wonderful opportunity of discovering new markets, developing new approaches to production, and reinventing our competitiveness. And we do not have to tackle this alone: by working closely together, we can boost our strengths, combat our weaknesses, and help define the way the world does business. I invite you, ladies and gentlemen, to approach this new economic order not as a race to the bottom, but a race to the top.

Thank you for listening.

¹² UNICE Strategy on an EU approach to Free Trade Agreements, 7 December 2006