

**CHARLES UNIVERSITY**

**FACULTY OF SOCIAL SCIENCES**

Institute of Political Studies

Department of International Relations

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**Martin Egreši**

**CHARLES UNIVERSITY**

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**Abenomics and its Influence on the Business Relations of  
the European Union and Japan**

Master's thesis

Author: Martin Egreši

Study programme: International Relations

Supervisor: Dr. rer. pol. Michal Parížek, M.Sc., Ph.D.

Year of the defence: 2021

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1. I hereby declare that I have compiled this thesis using the listed literature and resources only.
2. I hereby declare that my thesis has not been used to gain any other academic title.
3. I fully agree to my work being used for study and scientific purposes.

Prague 2021

Martin Egreši

## References

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## **Abstract**

Trade relations between Japan and the European Union have undergone dynamic development since the end of World War II, which has not provided the desired results for many decades. Most of the negotiations that took place during the 60 years after the war failed on the demands and conditions of both parties, from which they did not want to withdraw. It was in the case of Japan that there was always a problem in the protection policy of the domestic market, the reduced competitiveness of foreign companies and the protection of domestic products through high tariffs, which always prevented the realization of mutual trade. In 2012, after the new LDP government took office, Japan's position changed, and Prime Minister Shinzo Abe began negotiations with the European Union on new trade cooperation. These negotiations were part of Abe's plan to rebuild the Japanese economy, which was in recession after a poor economic strategy in the 1980s and global financial crises followed by the Fukushima nuclear disaster in 2011. In response, Abe introduced the so-called three arrows - a set of domestic and foreign economic measures to kick-start the Japanese economy. Negotiations with the EU then took place together with other countries, however, these trade meetings were among the most important in terms of world trade, given the common trade history and the possibility of economic growth on both sides. The Economic Partnership Agreement (EPA) then entered into force in 2019 and, in addition to the largest free trade area, presented an ambitious plan to improve mutual trade, which includes, among other things, complete reduction of tariffs or easier investment opportunities.

## **Abstrakt**

Obchodní vztahy mezi Japonskem a Evropskou Unií prošly od konce druhé světové války dynamickým vývojem, který po dlouhá desetiletí nepřinesly žádané výsledky. Většina jednání, která se během 60 let po válce uskutečnila, ztroskotala na požadavcích a podmínkách obou stran, ze kterých nechtěly ustoupit. Právě v případě Japonska zde vždy působil problém v ochranářské politice domácího trhu, snížené konkurenceschopnosti zahraničních firem a ochrana domácích produktů skrze vysoká cla, která vždy bránila v dosažení potenciálu, který vzájemný obchod nabízel. V roce 2012 po nástupu nové vlády strany LDP se japonský postoj změnil a premiér Šinzó Abe započal vyjednávání s Evropskou Unií ohledně nové obchodní

spolupráce. Tato jednání byla součástí Abeho plánu na obnovu japonské ekonomiky, která se nacházela v recesi po špatné ekonomické strategii v 80. letech a světových finančních krizích následovaných jadernou katastrofou ve Fukušimě v roce 2011. Jako odpověď představil Abe tzv. tři šipky – soubor domácích a zahraničních ekonomických opatření s cílem nastartovat japonskou ekonomiku. Jednání s EU pak probíhala společně s dalšími zeměmi, nicméně tato obchodní setkání se řadila vzhledem ke společné obchodní historii a možnosti ekonomického růstu na obou stranách mezi ta nejdůležitější i z pohledu světového obchodu. Dohoda o hospodářském partnerství (EPA) pak vstoupila v platnost v roce 2019 a kromě největší zóny volného obchodu představila ambiciózní plán na zlepšení vzájemného obchodu, který mj. zahrnuje postupné zrušení cel nebo lehčí možnost investic.

## **Keywords**

Abenomics, Japan, European Union, Trade, EPA

## **Klíčová slova**

Abenomika, Japonsko, Evropská Unie, Obchod, EPA

## **Název práce**

Abenomika a její vliv na obchodní vztahy mezi Evropskou Unií a Japonskem

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## Introduction

Abenomics is a term abbreviated in Japan for Prime Minister Abe's economic reforms, introduced in 2012. These reforms represented an ambitious plan to restart the Japanese economy through the application of three arrows, or three strategic plans intervening in domestic and foreign policy. After losing World War II, Japan found itself in a critical situation in all areas - material, political and economic. Under American administration, it started the recovery of the economy and the processes of modernization and catching up with developed countries. However, the Japanese economy proved to be resilient to all challenges, and in the late 1960s it became one of the world's most powerful economies, whose growth was not threatened by the global energy crisis of the 1970s. However, the upward trend failed due to a poor domestic economic strategy, when Japan's specific bubble economy burst and Japan entered an economic recession, exacerbated by global financial crises and the Fukushima nuclear accident.

Following the introduction of Prime Minister Abe as the head of the ruling LDP party, an ambitious plan to restore a stagnant economy was presented, which was targeted by many critics as utopian. Domestic reforms were part of the first two arrows, while foreign policy was in the third. Domestic reforms focused on macroeconomic factors and growth strategy and were to be the basis for Japan's further economic success. The third arrow should follow and was to be implemented through closer trade cooperation with other regions of the world, which eventually led to the two most commercially large projects - the Trans-Pacific Partnership (TPP) and the Economic Partnership Agreement (EPA). It was foreign economic cooperation that often-encountered obstacles, especially on the part of Japan, which applies government protection of the market against foreign competition through difficult conditions of market entry, high tariffs on imports and the promotion of its own production. This was not a different case with the cooperation with the European Union or with the institutions that preceded it.

It is relations with European countries that have undergone major changes since the end of the war. After the war, both regions struggled with the recovery of not only their economies, so relations did not begin to develop fully until the 1970s. However, these obstacles blocked negotiations in this case as well, and mutual relations essentially stagnated until the collapse of the Soviet Union and the enlargement of the EU that included the new states of Central and Eastern Europe. And although mutual investment improved at the beginning of the millennium



and exports to both countries were at the top of the list of all countries, the potential for development was still considerable. The world's third strongest economy and its market and products are attractive to the EU, as is lucrative large EU market with growth potential in the form of access for new countries in Eastern Europe for Japan.

The potential of mutual trade was also realized by Prime Minister Abe, who started negotiations with EU representatives on economic cooperation in parallel with other regions. The talks were accompanied by debates on, among other things, tariff reductions on both sides, as well as ensuring fair market entry conditions for foreign entities - two sectors that Japan has defended hard for decades but now had to be prepared to free itself from its protectionism in order to starting the economy after years of recession. During the negotiations, the effectiveness of domestic reforms was also monitored in Japan, which did not work as expected in certain areas. The agreement then entered into force in 2019 and its first effects can be observed after only two years.

## **Methodology and thesis layout**

The diploma thesis deals with various types of primary and secondary sources, which are subjected to analysis, from which, based on selected data, Prime Minister Abe's economic plan, its connection with trade relations with the EU and mutual trade relations will be examined. The approach is in the form of a case study.

The thesis is divided into 4 chapters, which are continuously followed by subchapters. The first chapter deals with the development of the Japanese economy after World War II until 2012. It describes the challenges faced by the economy after the war and the whole chapter represents an important entry into the problems facing the Japanese economy over the past decades, justifying Shinzo Abe's success in elections in 2012 and his possibility of implementing economic reforms. The second chapter presents Abe's reforms - Abenomics through the main three arrows, which the subchapters present in more detail. It will also introduce some of the results of Abenomics in domestic politics a few years after the introduction of reforms, but also criticism from economists, as some sectors in Japan did not share Abe's positive ideas. The third chapter discusses the development of common trade relations between the EU and Japan, emphasizing the difficulties that the negotiations brought and the factors that had to be removed in the future in order to achieve better results. The fourth chapter deals with mutual trade with the EU after 2012. It also mentions the TPP agreement, which could compete with the EPA, but its failure has increased the importance of the EPA. Here is a more detailed presentation of

the motivation of both actors to enter into an agreement, the controversial points of the agreement, which relate to the third chapter, and the presentation of business results over the past two years.

## **Thesis goal and hypothesis**

The aim of this thesis is to determine the impact of Abenomics on mutual trade relations between the EU and Japan after 2012. Through the introduction of the Japanese economy and mutual relations before the new government in 2012, the aim is to analyse the development of relations in connection with Japan's new economic strategy and to present the results of mutual trade, especially in the last two years in which EPA is effective. The thesis should present the state of mutual trade relations and their transformation at a time when the results of the last two years will be adopted on the basis of the EPA agreement, which covers the largest free trade area in the world, and which is the result of Abenomics. This topic was chosen due to the complex history of mutual trade relations and the economic potential that these relations hide and which is already being fulfilled to some extent through EPA. The implement of Abenomics here has been a driving factor with which relations have shifted the most in recent decades.

In this work we will follow two hypotheses –

- 1, Trade agreements with foreign regions were created in response to a stagnant economy in the event of the failure of domestic reforms, and their process was therefore accelerated.
- 2, The deepening of mutual relations with foreign partners occurred as another tool to support the domestic economy implemented according to plan, despite the possible failure of domestic reforms.

## **Time period of work**

The diploma thesis deals with the period after the Second World War in the case of Japan and Europe. This period was chosen due to the recovery of the economy and mutual relations in general and a greater volume of cooperation than in the pre-war period. Attention is then focused on the period after 2012, as a new government coalition is taking office this year, which leads to the greatest dynamism in mutual history in the entire history of mutual communication.

## **Literature review**

The thesis works with primary and secondary sources. Official reports from the European Commission and the Ministry of Foreign Affairs of Japan are used as primary sources on trade data. Graphs are taken from the static website, which provide a better overview of the development of the Japanese economy and mutual imports and exports. Academic publications will be used to present Abenomics and the development of mutual relations. However, due to the pandemic situation during the years 2020 and 2021, which brought with it the closure of libraries, the work is mostly based on Internet resources, especially on academic articles on these topics. Articles on news websites are then used for additional information. Compared to the thesis, the literature is changed due to a more detailed definition of the work and finding the sources used in this work as more adequate than the sources mentioned in the thesis. Also, there is no longer a chapter on the "negotiation process" as I found appropriate to pay more attention to problematic sectors and motivations of both parties, which follow the historical development of trade relations, and which can then be observed in examining the results of EPA.

The sources listed in the thesis are according to the citation form ČSN ISO 690.

# 1 Development of Japanese economy between 1945-2012

## 1.1 Introduction to Japanese economy

The Japanese economy was decimated after the end of World War II. The costs associated with waging war on several fronts and subsequent carpet raids, which damaged or destroyed industrial centres, left the local economy in ruins. The economic recovery plan began almost immediately after the administration was handed over to the United States, but it took less than a decade for the Japanese economy to reach pre-war levels of production. However, in the mid-1950s, economic growth began, along with massive industrialization that lasted less than twenty years until 1973, making Japan the world's second strongest economy.<sup>1</sup>

Between 1950 and 1973, economic growth averaged around 10 % and doubled every seven years. Although economic growth slowed during the 1970s, it still remained at a higher level than in other developed countries. At the end of this decade and for the vast majority of the 1980s, annual economic growth remained above 4 % and even increased slightly at the turn of the decade. However, growth has stalled since 1993 and stagnated for two decades before Prime Minister Abe's government came up with a new plan to kick-start the economy.<sup>2</sup>

## 1.2 Japanese economy after 1945

The Japanese economy after World War II can be called a process of catching up with other world industrialized economies. Efforts to catch up economically with European states and the United States began shortly after the signing of the peace in 1945 and continued until the late 1960s. Achieving this process to a successful goal was set not only by the then government, but it was also part of the strategy of corporations, companies and other private entities. With a view to early success, the government coordinated a common economic approach that also often restricted competition.<sup>3</sup>

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<sup>1</sup> KIMURA, Fukunari. Japan's model of economic development: Relevant and nonrelevant elements of developing economies. *UNU-WIDER* [online]. 2009, No. 2009/22 [Accessed 4.3.2021]. p. 1. ISSN: 1810-2611. Available from: <https://www.econstor.eu/bitstream/10419/45138/1/601794184.pdf>.

<sup>2</sup> ITO, Takatoshi and HOSHI, Takeo. *The Japanese Economy*. Cambridge: The MIT Press, 2020. p. 41. ISBN: 9780262357180.

<sup>3</sup> OTSUBO, T. Shigeru. Post-war Development of the Japanese Economy [online presentation]. Nagoya University, April 2007 [Accessed 6.3.2021]. p. 5. Available from: [http://www.gsid.nagoya-u.ac.jp/sotsubo/Postwar\\_Development\\_of\\_the\\_Japanese%20Economy\(Otsubo\\_NagoyaU\).pdf](http://www.gsid.nagoya-u.ac.jp/sotsubo/Postwar_Development_of_the_Japanese%20Economy(Otsubo_NagoyaU).pdf).

Monetary policy was reformed to provide finance to strategic sectors for economic growth, and although the domestic market was strongly protected in the early stages of post-war development, the threat of global competition was a sufficient reason for productivity growth due to potential exports to foreign markets. On the other hand, the development of non-tradable sectors lacking prospective investment lagged behind.<sup>4</sup>

A significant macroeconomic obstacle was also the lack of savings, to which the government responded by creating a system for direct channelling of funds to key industries to accelerate economic development. At the microeconomic level, a market system was created, which was based on building long-lasting relationships between economic agents, such as a long-term employment system or a main bank system. These relations, together with active public policy, played an important role in the post-war period.<sup>5</sup>

Due to unfavourable foreign conditions, the Japanese government paid full attention to macroeconomic stability as a basic precondition for economic development. After the war, hyperinflation occurred in Japan, caused, among other things, by the loss of control over monetary discipline, the reduction of share capital or the demilitarization of industries. The Japanese government, together with the occupation administration, responded to this unfavourable situation by introducing Dodge's<sup>6</sup> plan for stabilizing the economy in 1949, which consisted, for example, in achieving a balanced state budget or unifying exchange rates. After gaining independence in 1951, the Japanese government continued to develop its economy through its own fiscal and monetary policies.<sup>7</sup>

The factors of post-war success were partly specific to Japan and partly identical to other countries. For example, it shared the advantage of being able to mobilize a significant workforce from low-productivity sectors such as agriculture to higher-productivity sectors such as industry and modern services. This workforce then combined with the advantage for Japan of being inspired by modern technologies already used by other countries, such as the United States, the United Kingdom and Germany. Another advantage was the provision of mass production of

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<sup>4</sup> OTSUBO, T. Shigeru. Post-war Development..., p. 2.

<sup>5</sup> OTSUBO, T. Shigeru. p.5.

<sup>6</sup> Chairman of Detroit's bank, Joseph Dodge, introduced financial plan to help Japanese economy in March 1949.

<sup>7</sup> KIMURA, Fukunari. Japan's model..., p. 3.

goods and services in the 1950s in order to take full advantage of economies of scale, to which, in addition, significantly contributed the demand from the US during the Korean War.<sup>8</sup>

Regarding the factors specific to Japan, we can mention the relatively high human capital due to the company's traditional investment in education and training, which in 1973 even corresponded to the length of the 15-64 age education process in most developed countries. An integral part of the workforce in Japan is the still known system of lifelong employment, which is applied in large and medium-sized companies. This system provided companies with a long-term workforce and employees with the security of a promising job, although on the other hand it also led to dualism in the labour market. This dualism arose among large companies with higher productivity and salaries against smaller firms that could not afford similar productivity or salaries. However, both parties eventually interconnected in the labour market through the dependence of larger companies on subcontracting goods from smaller ones.<sup>9</sup>

Although Japan's economic growth in the second half of the 20th century is often referred to as an economic miracle, Japan's situation was not very special from today's perspective. The development of the Japanese economy can be compared with the usual economic development in other countries, where, as in Japan, it relies on several internal and external economic factors. Internal factors include macroeconomic stability, economic infrastructure, or human capital. However, external economic factors have differed compared to today. The rate of globalization in the 1950s was far from the current level, and foreign direct investment or financial assistance from other countries could also not be relied upon, as each country's strategy was development with minimal reliance on foreign aid.<sup>10</sup>

### 1.3 Japanese economy after 1970

However, as the catching-up process ended, the energy crisis in the 1970s followed and the Japanese economy gradually transformed. In the 1980s, limited investment opportunities in the domestic market, together with a loose monetary policy and a rapid appreciation of the yen, propelled investment in the securities and real estate markets, creating a financial bubble. After

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<sup>8</sup> VITTORIO, Valli. Growth and crisis in the Japanese economy. *Department of Economics and Statistics Cognetti de Martiis* [online]. July, 2012 [Accessed 5.3.2021]. p. 4-5. ISSN: 2039-4004. Available from: [https://www.researchgate.net/publication/254455835\\_Growth\\_and\\_crisis\\_in\\_the\\_Japanese\\_economy](https://www.researchgate.net/publication/254455835_Growth_and_crisis_in_the_Japanese_economy).

<sup>9</sup> Ibid.

<sup>10</sup> KIMURA, Fukunari. p.1.

its rupture in the early 1990s, there was a period of the so-called lost decade<sup>11</sup> when the Japanese economy was coping with the growing needs of basic structural reforms.<sup>12</sup>

Following the achievement of the post-war goal of a balanced and competitive economy along the lines of the West in the early 1970s, a gradual change in the domestic market was expected in the form of abandoning collective corporate governance in cooperation with the government and moving towards greater autonomy and competition. However, the common business approach and government intervention remained largely in the 1980s, and together with the lack of investment opportunities and speculation in real estate markets, a "bubble" economy emerged, to which macroeconomic reforms dealing with the rapid growth of the yen in the mid-1980s. The bubble then burst in the face of restrictive monetary policy, first in the stock market in 1990, and then in the real estate market in 1991.<sup>13</sup>

The two-year energy crises of 1973 and 1979 contributed to a sharp decline in the average GDP growth rate from 9.1 % before 1973 to 3.7 % over the next two decades. Looking ahead, the demographic development was not favourable either, when the rate of population growth began to decline and fell to 0.3 % within 15 years until 1991, with the prospect of further deterioration. Nevertheless, Japan maintained a faster growth rate than the United States or Western Europe and narrowed the gap with the United States. This was helped, among other things, by a higher education of the workforce and a gradual focus on developing one's own technologies and forgiving them from "copying" technologies from other countries. Japan has even become the largest exporter of these commodities in the world in certain industries, such as electronics or cars.<sup>14</sup>

The relationship between the financial economy and the real economy, specifically the role of capital gains, also has a role to play in slowing down exceptionally rapid economic growth in the 1970s and stopping it altogether in the 1990s. In Japan, land and stock prices rose after the war, and then their prices rose every year. In the 1980s they even swung over the prices of most developed countries. This gradual "inflation" of the bubble was influenced primarily by the "vicious circle" mechanism.<sup>15</sup>

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<sup>11</sup> Period of economic stagnation in Japan between 1991-2001 caused by a collapse of price bubble.

<sup>12</sup> OTSUBO, T. Shigeru. p. 2.

<sup>13</sup> Ibid. p. 5.

<sup>14</sup> VITTORIO, Valli. Growth and Crisis..., p. 10.

<sup>15</sup> VITTORIO, Valli. p. 11.

This mechanism consisted of a steeply rising land price in response to strong economic growth and increased population density in metropolitan areas such as Tokyo, Kyoto, or Osaka. Related to this was the problem of poor organization of spatial planning and development policy. This situation then strengthened the value of the real assets of larger and smaller companies, which could then use these lands as collateral for banks in exchange for other generous loans. The lack of floating funds on the stock exchange and the growing demand for shares from investors have also caused stock market prices to rise above current rates. In addition, the shares themselves could be used as a guarantee for the profit of the loan. High lending has allowed companies with the prospect of rapid GDP growth and global demand to make significant investments. Increased GDP growth related to rapid investment growth brought profits, increased the value of real estate assets and shares, which in turn served banks in continued financing, increased investment and the whole process created a vicious circle.<sup>16</sup>

The two energy crises of the 1970s only weakened this mechanism, not stopped it. The weakening took the form of declining GDP growth, which was also linked to Japan's dependence on energy imports and a change in environmental policy, which needed to undergo costly reform following the events of water or air pollution. With the gradual decline of economic growth, the growth mechanism collapsed at the end of the 1980s, under the influence of the liberalization of capital movements and the bursting of the structural economic bubble.<sup>17</sup>

## 1.4 Japanese economy after 1990

After 1990, the Japanese economy faced the aftermath of a bursting bubble. Over-investment and employment have accumulated to such an extent during the "bubble" economy that, after the bubble burst, a significant surplus of workers remained, and the number of outstanding loans increased. This situation then led to long-term stagnation, persistent deflation, and the financial crisis despite a massive expansion of government spending, which in turn led to an increase in public debt. Under these conditions, it was clear to the government that only comprehensive strategies and bold structural reforms were a necessary way out of the economic recession.<sup>18</sup>

As a result of the collapse of the bubble, the assumption of economic development has also changed. From the positive outlook for GDP growth, he turned to expectations of a capital

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<sup>16</sup> Ibid. p. 11-12.

<sup>17</sup> Ibid. p. 12.

<sup>18</sup> OTSUBO, T. Shigeru. p. 5.



loss on both assets and shares. In response to the projected capital loss, the Japanese monetary authorities raised interest rates in 1990-91, exacerbating the crisis on both the stock market and the real estate market. Banks were forced to drastically reduce credit lines, which ultimately led to the collapse of companies' investments. The crisis originally affected only finance, but by 1993 it had spread to the real economy. Due to the close link between banks and industry, which was the basis of the Japanese banking model, this only deepened the critical situation of the banking and insurance company. The financial sector, which was the driving force behind the growth model until the end of the 1980s, thus fell apart, despite state intervention to rescue the most important financial intermediaries.<sup>19</sup>

The situation in Japan was not helped by the financial crisis in the world either. The two most serious crises that delayed the recovery of Japanese industry were the financial crisis in Southeast Asia in 1997-98 and the global financial crisis in 2007-11. Even due to both crises, Japan's economic performance from 1992 to 2011 was one of the worst in the industrialized world, and the country lagged far behind its main competitors. As a result of the crisis, larger companies began to move away from the system of lifelong employment that prevailed until the late 1980s. Nationwide, less investment has been made in increasing production capacity and research, two key areas that have served as the basis for Japan's growth model. The unemployment rate has been gradually increasing and in 2011 even exceeded the 5% level, which is an unusually high value by the Japanese standard.<sup>20</sup>

Between 1990 and 2011, annual GDP growth declined by 0.7 %, and compared with the situation in the United States, GDP in Japan fell from 85 % in the early 1990s to 72 % in 2010. Despite this decline, Japan continued to grow in 2012. Before the arrival of the new government, Shinzo Abe held the third position of the strongest economy in the world and the second in terms of technological level.<sup>21</sup>

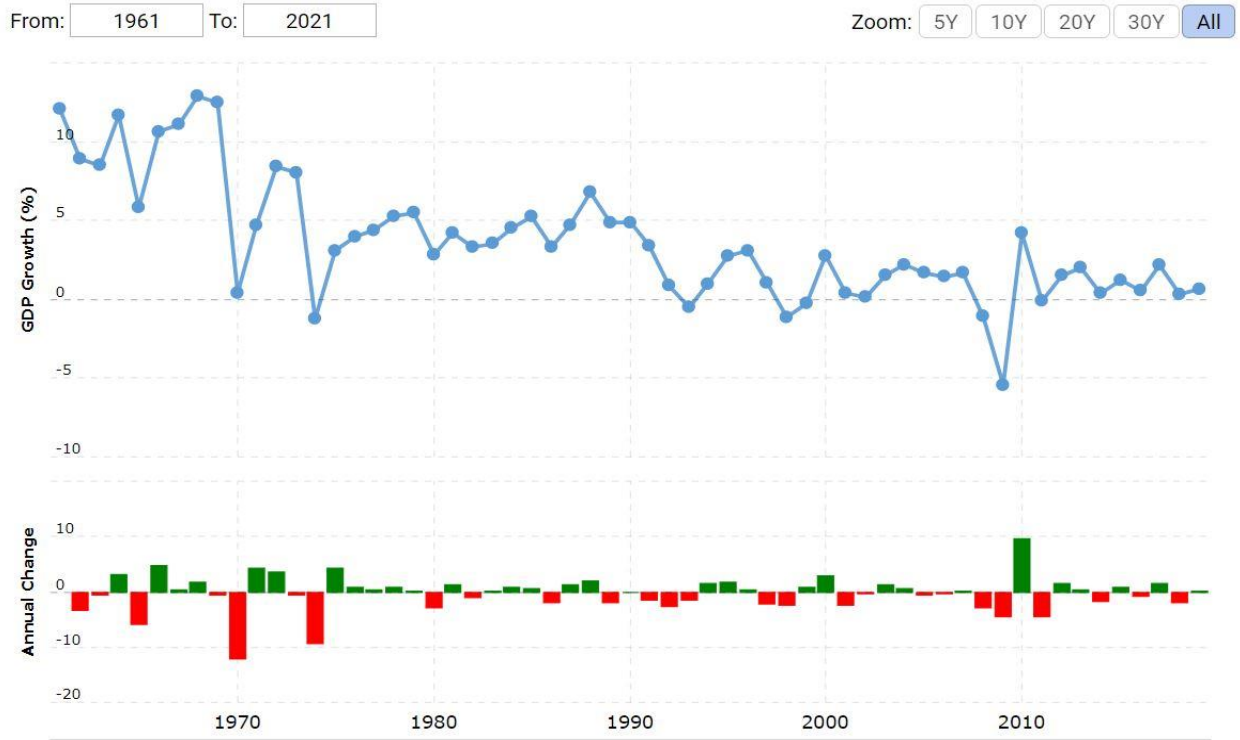
Below is a table of percentage GDP growth in Japan from 1961 to 2012. After significant GDP growth during the 1960s, a double significant decline of 10 % and subsequent growth stability of around 5 % can be observed until the 1990s, when growth gradually slowed down and in 2009 it even saw a sharp decline to negative values.

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<sup>19</sup> VITTORIO, Valli. p. 15.

<sup>20</sup> Ibid. p. 11.

<sup>21</sup> VITTORIO, Valli. Growth and Crisis..., p. 2.



Source: Macrotrends.com

## 2 Abenomics and three arrows

### 2.1 Introduction to Abenomics

The unfavourable economic development left Japan during the next elections in 2012 in an unfavourable situation of low growth, slight deflation, and unprecedented public sector debt. Both domestic and foreign observers perceived Japan as a country inevitably in decline and estimated a potential solution to the crisis to be difficult to implement given the massive bureaucratic system of politics. Fortunately, these catastrophic assumptions proved to be exaggerated, because despite all the negatives, the economy also showed its strengths:

- 1) GDP per capita, and especially productivity, grew again at a similar pace as other advanced economies.
- 2) Despite the aftermath of the devastating earthquake and subsequent tsunami in March 2011, the Japanese economy was able to recover relatively quickly and show its resilience. And although all nuclear power plants shut down at the time, shutting

down a quarter of the country's power and disrupting production in parts of Japan, economic growth still exceeded 4 % in the first quarter of 2012.

- 3) In the last 15 years, despite the efforts of many reforms, it has been possible to restore economic activity at least partially and thus create an optimistic impulse for the coming years.

In any case, Japan faced enormous challenges. Persistent deflation, an aging population and a shrinking workforce, or even rapidly rising public debt, were problems that needed to be addressed through a change of approach.<sup>22</sup>

The new-new Prime Minister Shinzo Abe decided to face these challenges, winning the elections with his Liberal Democratic Party (LDP) in December 2012 and becoming Japan's prime minister for the second time.<sup>23</sup> Following his election, Abe presented his extensive plan for economic recovery, which consisted of the so-called "three arrows" and which was given the now commonly used nickname - Abenomics. The Abenomics plan simply consisted of three pillars that are interconnected and work together, in contrast to previous reforms, where the individual pillars worked independently and therefore did not meet expectations.<sup>24</sup>

The main idea of Abe's plan was to break free from deflation by easing the currency and lowering the real interest rate, which would also stabilize investment. Structural reforms would thus ensure higher growth in the long run, which would improve debt dynamics. The elaboration of a medium-term fiscal plan would make it possible to control the pace of adjustments by reducing the risk of a sharp rise in government bond rates. All three arrows were to be the key to the successful implementation of the plan, which was also intended to reduce the risks for the future of the fiscal crisis. The failure of the reforms would mean a recurring fall into the deflationary gap and a loss of confidence in Japan's public finances, but the Japanese government considered this risk a better choice than continuing with the previous model.<sup>25</sup>

## 2.2 First arrow – Monetary policy

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<sup>22</sup> BOTMAN, Dennis, DANNINGER, Stephan and SCHIFF, Jerald. Chapter 1. Abenomics: From the Lost Decade to the Three Arrows. In: *Can Abenomics Succeed? : Overcoming the Legacy of Japan's Lost Decades*. USA: International Monetary Fund, 2015. ISBN: 9781498324687. Available from: <https://www.elibrary.imf.org/view/IMF071/21547-9781498324687/21547-9781498324687/ch01.xml>.

<sup>23</sup> For the first time he acted as a prime minister between 2006-2007.

<sup>24</sup> FUKUDA, Shinichi. Abenomics: Why was it so successful in changing market expectations? *Journal of the Japanese and International Economies* [online]. 2015, vol. 37, p. 2 [Accessed 13.3.2021]. ISSN: 1095-8681. Available from: <http://www.cirje.e.u-tokyo.ac.jp/research/dp/2015/2015cf969.pdf>.

<sup>25</sup> BOTMAN, Dennis, DANNINGER, Stephan and SCHIFF, Jerald. Chapter 1. Abenomics...

In January 2013, at the instigation of Prime Minister Abe, who threatened the Bank to lose independence, the Bank of Japan launched the first of three arrows focused on monetary policy, more specifically on quantitative and qualitative easing to achieve stable inflation of 2 %, the highest value since 1991. In addition, in April, the bank's new director, Haruhiko Kuroda, promised to reach the target within two years. The volume of asset purchases already foreshadowed a departure from the previous incremental model, and this departure was only underlined by the agreement signed between the Japanese government and the Bank of Japan shortly after the new government took office, which also doubled the monetary base. The agreement further explains the effectiveness of monetary policy in achieving expected economic growth depends on well-defined complementary fiscal and structural reforms.<sup>26</sup>

It was expected that four interconnected ways would be needed for monetary policy to be reflected in prices and the real economy. First, quantitative and qualitative easing would maintain long-term real interest rates, which would automatically increase domestic demand and reduce the output gap. Second, in order to balance the portfolio (including high domestic and foreign loans), the Bank of Japan must purchase a significant amount of Japanese government bonds. Furthermore, improving communication and increasing real inflation would lead to higher inflation expectations. And finally, a temporary depreciation of the yen could help increase inflation.<sup>27</sup>

At the same time, changes in monetary policy were linked to economic developments abroad. The improvement in the global outlook and the reversal of significant safe flows back to Japan was compounded by the depreciation of the yen, which fell by 24 % in May 2013 after a six-month depreciation and contributed to an early rise in inflation and expectations. However, this support for inflation soon disappeared and other mechanisms had to become even more functional. Although this strategy has led to progress towards 2 % inflation, it has only reached half of the expectations.<sup>28</sup>

## 2.3 Second arrow – Fiscal policy

The Japanese government urgently needed a plan to reverse the long-term upward trend in government debt. Net public debt in 2012 was 134 % and gross debt rose to 240 %. Both of

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<sup>26</sup> HAUSMAN, Joshua K. and WIELAND, Johannes F. Abenomics: Preliminary Analysis and Outlook. *Brooking Papers on Economic Activity* [online]. 2014, 1-63 [Accessed 10.3.2021]. ISSN: 0007-2303. Available from: <https://www.jstor.org/stable/23936270>.

<sup>27</sup> BOTMAN, Dennis, DANNINGER, Stephan and SCHIFF, Jerald. Chapter 1.

<sup>28</sup> BOTMAN, Dennis, DANNINGER, Stephan and SCHIFF, Jerald. Chapter 1.

these enormous values have placed Japan at the forefront of the world's advanced economies. Until 2013, the increase in debt was able to be financed almost without problems thanks to domestic investors who bought government bonds. In this regard, however, the government feared a change in the attitude of investors, who could lose confidence in bonds and their re-benefit would be extremely costly. And given long-term trends such as declining populations or declining household savings, the government considered its concerns significant. Fiscal policy adjustment was thus necessary, considering the situation in Europe, where the euro area debt crisis was being addressed, and it turned out that a mere adjustment of fiscal policy without economic growth would not work.<sup>29</sup>

Abenomics came up with a proposal for a medium-term fiscal plan that was to be sufficiently detailed to maintain investor confidence and prevent a sharp rise in government bond yields that could jeopardize the entire plan. However, maintaining confidence in the fiscal plan required concrete early steps to be taken, as experiences with long-term deficits and debt growth have been to the detriment of the government. Thus, a package of measures was presented, including increased revenues and expenditure control - in particular rising social welfare expenditure, which was ultimately intended to reduce the deficit and improve the incentive to invest.<sup>30</sup>

The first year since the introduction of Abenomics was more marked by stimulus and adjustment of the economy. After a series of stimulus measures of around 1.5 % of GDP, which became operational by April 2014, the government decided to increase the excise tax from 5 % to 8 %, which was the first step in resolving the national debt. However, the tax increase did not bring the expected economic growth, so the government postponed the tax increase again to 10 % in 2017. After two years, Japan was close to reducing public debt and projected growth, but only by modest steps, which were not supported by the postponement of tax increase.<sup>31</sup>

## 2.4 Third arrow – Growth strategy

As mentioned at the beginning of the chapter, all arrows must be intertwined and without each other they would not work. Therefore, the success of Abenomics cannot be relied upon solely on fiscal and monetary policy stimulus. At the same time, it is necessary to focus on increasing potential growth from the current low level of around half a percent to the ideal 2 %

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<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> HAUSMAN, Joshua K. and WIELAND, Johannes F. Abenomics..., p. 2-3.

per year. The necessary transformation will be difficult, but not unprecedented. A lasting abandonment of mild deflation would lead Japan on the right path, but a few comprehensive structural reforms are needed as part of the new growth strategy. Many growth strategies have been introduced over the last decade, although their real impact on the economy is negligible. The reason is not to include the most fundamental obstacles to growth in the plan, because they are also the most difficult to solve, both politically and economically. However, after the introduction of Abenomics, there was hope for a change, which intensified after the launch of the first two arrows, which were closely related to growth. This time, the situation benefited from the fact that the victorious Liberal Democratic Party won a majority in both chambers of parliament, so the enforcement of the new plan was not hindered, as well as the increasing public popularity of Prime Minister Abe.<sup>32</sup>

The Growth Strategy is a mechanism that addresses the demographic decline in labour growth and responds to it by seeking to increase labour participation among women, senior citizens and also takes into account the participation of foreign workers. However, labour market reform has had to be a necessary priority, as Japan, for example, have a fairly high percentage of non-employed women who either take care of their own households or are prevented from returning to work after childbirth. In the domestic market, several policies would transform a stable financial sector as a driving force for growth. Lower tax rates and better corporate governance would help reduce high corporate savings. In addition to focusing on the domestic market, it was planned to participate in economic agreements and partnerships with other countries and to integrate more deeply into the fast-growing Asian markets. Since the agreements, Japan has hoped, among other things, to increase foreign direct and outgoing investment and stimulate deregulation in agriculture and the service sector.<sup>33</sup>

## 2.5 Growth financing

Finance is not part of the three arrows of the Abenomics, but it plays a crucial role in each of them. As the new economic plan envisaged taking risky steps, it was necessary to focus on a more proactive financial sector in the search for credit opportunities. The Japanese financial sector was able to do more to support growth. Start-up finance has lagged other advanced economies, while less dynamic small businesses are artificially maintained through loan guarantees. It was the new monetary policy framework that was able to give the financial

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<sup>32</sup> BOTMAN, Dennis, DANNINGER, Stephan and SCHIFF, Jerald. Chapter 1.

<sup>33</sup> BOTMAN, Dennis, DANNINGER, Stephan and SCHIFF, Jerald. Chapter 1.

sector more room to support growth. Bank of Japan purchases accounted for approximately 70 % of newly issued government bonds when they began their release in 2013, further enhanced by the expansion of the program in October 2014. As government bonds declined, banks were able to focus more on domestic or foreign opportunities. Domestic loans recorded a turnaround and, after years of decline, rose by 3 % for all types of businesses. Large banks focused on expanding into foreign markets, especially Asian ones, as foreign profits accounted for up to a third of total profits.<sup>34</sup>

On the other hand, not all financial institutions have chosen to change their approach. Some regional banks and insurance companies maintained a steady demand for government bonds, while other banks hold large reserves at the Bank of Japan. In addition, the credit support system weakened banks' credit risk assessments for small and medium-sized enterprises, and reduced venture capital for start-ups, which dampened the natural process of economic dynamism. In this case, it was necessary to get rid of loan guarantees and find more targeted support for businesses, including asset-based loans.<sup>35</sup>

## 2.6 Critique of Abenomics

However, in the ranks of the opposition, they are critical of Abe's ambitious economic plans. The opposition and some economists fear the great risks of Abenomics. While some do not see real economic improvements in the plan, possible hyperinflation due to monetary easing is of greater concern. The International Monetary Fund has also indirectly added to the criticism, warning against the unsustainability of Japan's sovereign debt, which has long been attacking values well above 200 % of HPD. Economists from the Bank of Japan's board of directors also viewed negatively at negative interest rates, a relatively new and untested system capable of damaging the banking system. Critics feared that negative rates would not encourage public spending, but the accumulation of cash and thus increase deflationary pressures. However, the measure was approved by a narrow majority 5 to 4 at the Bank of Japan.<sup>36</sup>

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<sup>34</sup> Ibid.

<sup>35</sup> BOTMAN, Dennis, DANNINGER, Stephan and SCHIFF, Jerald. Chapter 1.

<sup>36</sup> XU Beina and BRIDE Mc James. Abenomics and the Japanese Economy. In: *Cfr.org* [online]. New York: The Council on Foreign Relations, 2018 [Accessed 15.3.2021]. Available from: <https://www.cfr.org/backgrounder/abenomics-and-japanese-economy>.

## 2.7 Results of Abenomics

In 2015, 2 years after the launch of Abenomics, the greatest effect was seen in the financial markets. The markets were also helped by the Bank of Japan's expansion of qualitative and quantitative easing programs, which purposefully increased the annual growth of the monetary base from 60 to 80 billion-yen, accounting for 16 % of GDP. In 2014, the growth plan was most dramatically reflected in financial developments, more precisely in many yen and in the share price. It was only weakened from 79\$ in 2012, to 102\$ in March 2014, and continued to weaken in 2015 to 123\$ in August 2015. This year was only the weakest since 1982. Market prices continued to rise rapidly. The Tokyo Stock Price Index (TOPIX) rose by 62 % over two years and continued to grow by 36 % in 2015.<sup>37</sup>

Not all the failures that were criticised as the Prime Minister's fault after 3 years of the functional Abenomics were, in fact, so bad. Unemployment remained at 3.6% at the beginning of 2015, which was the second-best result in the last 16 years. The sales tax was increased from 5 % to 8 %, which resulted in a weaker effect than predicted by financial institutions in Japan and abroad. Inflation remained at 1 % after one year of Abenomics, and although this value did not increase significantly in the following years and decreased during the pandemic, keeping this value for several years can be considered a success, because it is the first time in the 21st century, when inflation is maintained above 1 % for a long time. Unfortunately, even if we omit the Covid pandemic, the inflation rate of 2+ % is key to reducing the state debt, which, according to the development, would not have been possible even without the intervention of anti-pandemic measures in the economy. Similarly, wages increased the highest in the last 6 years, although in the second government period since 2017, the trend stopped.<sup>38</sup>

In 2017, after 4 years of economic reforms, the effect continued to be most visible in the macroeconomic area. The improving economic situation and the aging of the population have opened up new jobs on the market, which have been filled year-on-year. In 2012, unemployment reached 4.5 %, but the value decreased every year thanks to the formation of

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<sup>37</sup> HAUSMAN, Joshua K. and WIELAND, Johannes F. Overcoming the Lost Decades? Abenomics after Three Years. *Brooking Papers on Economic Activity* [online]. 2015, p. 387-389 [Accessed 10.3.2021]. ISSN: 0007-2303. Available from: <http://www.jstor.com/stable/43752179>.

<sup>38</sup> BIRD, Mike. The West Can Only Dream Of Japan's Level Of „Failure“. In: *Businessinsider.com* [online]. New York: Business Insider, 2014 [Accessed 25.4.2021]. Available from: <https://www.businessinsider.com/shinzo-abe-is-right-abenomics-has-not-failed-and-he-deserves-credit-2014-11>.



600 000 new workplaces. Unemployment fell to 3.1 % by 2017<sup>39</sup>, and although the decline slowed, in 2019 it reached only 2.2 %, the lowest level since 1992.<sup>40</sup> In 2020, the value rose to 3.1 % due to pandemic measures, which is the highest value in the last 3 years. In 2021, a further slight deterioration can be expected, the extent of which will depend on the amount of economic aid to companies affected by possible government regulations.<sup>41</sup>

In December 2017, the inflation rate was around 1 %, which is still half of the promised 2 % value. GDP growth, on the other hand, increased by 0.5 % for the second year in a row, with GDP growing every quarter, the longest period in thirty years. Unlike GDP, however, wage growth and public spending lag behind, where both fell by 0.2 % and 0.1 %, respectively. In addition to inflation, the failed wage growth is the main point of failure and criticism, where wages have fallen by an average of 9 % over the last 20 years. Therefore, the growth of salaries for the future was chosen by Abe as one of the main points of domestic policy in the elections in 2017, where the LDP managed to win again. The plan included a 3 % wage increase from 2018, but many companies did not accept it due to higher production costs and possible losses. In this respect, there is again the Covid-19 pandemic, due to which the improvement of the situation in the forecasts will not improve even in 2021.<sup>42</sup>

However, the main goal of Abenomics, and especially its monetary arrows, was to reduce 15 years of deflation. And after three years of operation, positive results could be seen, although the Bank of Japan did not deliver on its promise to achieve 2 % inflation within two years. The consumer price index increased by only 0.2 % during the period 2014-2015, while the Index (CPI) excluding food and energy increased by 0.6 %. However, despite the Bank of Japan's plan, even the 2014 surveys on expected market inflation developments were less optimistic, as none of them even approached 2% growth.<sup>43</sup>

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<sup>39</sup> GRABOWIECKI, Jerzy and DABROWSKI, Mariusz. Abenomics and Its Impact on The Economy of Japan. *Optimum Studia Ekonomiczne* [online]. 2017, 5(89), p. 29 [Accessed 15.3.2021]. ISSN: 1506-7637. Available from: [https://www.researchgate.net/publication/324097508\\_Abenomics\\_and\\_Its\\_Impact\\_on\\_The\\_Economy\\_of\\_Japan](https://www.researchgate.net/publication/324097508_Abenomics_and_Its_Impact_on_The_Economy_of_Japan).

<sup>40</sup> KANEKO, Kaori and LEUSSINK, Daniel. Scorecard of Japan's 'Abenomics' stimulus policies. In: *Reuters.com* [online]. November 2019 [Accessed 13.3.2021]. Available from: <https://www.reuters.com/article/us-japan-abe-economy-graphic-idUSKBN1XP05L>.

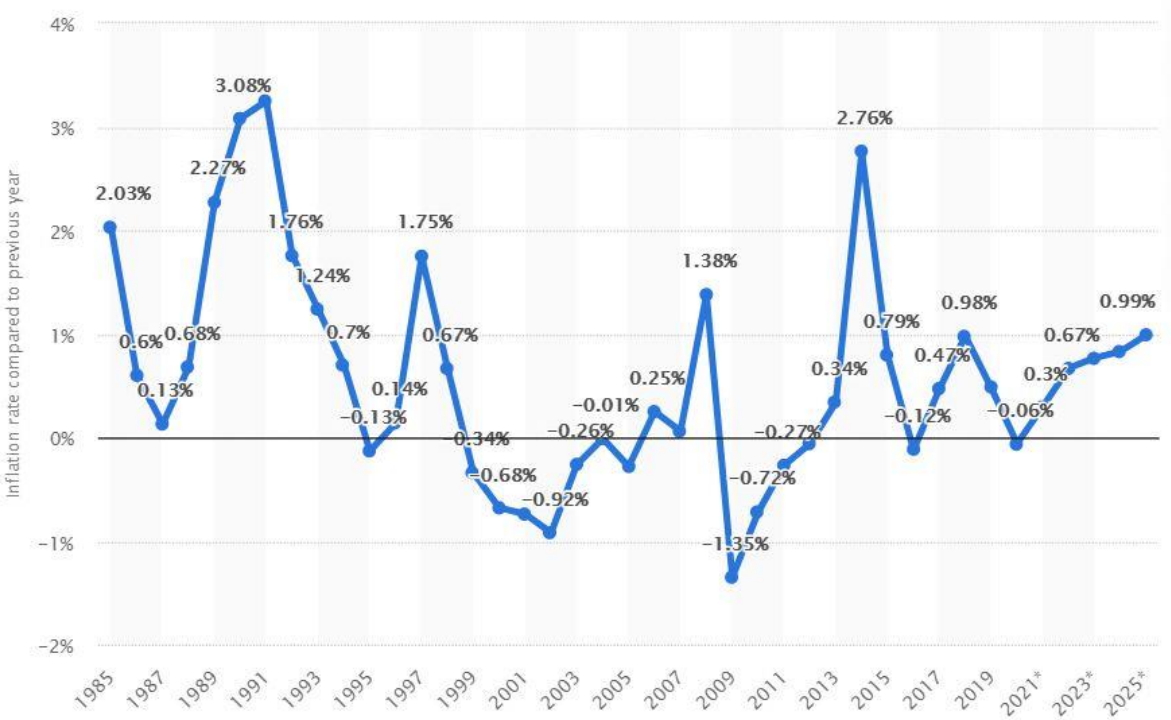
<sup>41</sup> *Global Times* [online]. Japan's unemployment rate hits 3-year high in October. Beijing, 2020 [Accessed 13.3.2021]. Available from: <https://www.globaltimes.cn/content/1208579.shtml>.

<sup>42</sup> XU Beina and BRIDE Mc James. Abenomics and...

<sup>43</sup> HAUSMAN, Joshua K. and WIELAND, Johannes F. Overcoming..., p.390.

The second arrow of fiscal stimulus was considered a relative success shortly after its launch. The stimulus helped ensure that the GDP gap narrowed to reverse the unfavourable development of deflation. Due to the economic recovery since the Abe government took office, taxes were raised in April 2014, despite the expected negative effects on inflation and economic growth. In the future, the risk associated with the transition from fiscal expenditures to fiscal consolidation arose. Japanese economists have pointed out that a possible halt to the transition to fiscal consolidation could lead to a catastrophe in the nation's financial balance.<sup>44</sup>

In the chart below we can see the average value of Japan's inflation compared to previous years. In 2014, the highest increase can be recorded in the last 23 years, which is also related to the increase in the tax rate from 5 to 8 %, as mentioned in the description of the second arrow. Although the value has fallen again in the following years and stable 2% inflation is not reaching, an improvement can be seen compared to the previous decade. The outlook for the future is realistically at the level of previous years, but it is not yet possible to predict with certainty how the development will continue, given the pandemic<sup>45</sup>situation not only in Japan.



Source: Statista.com

<sup>44</sup> TAKATOSHI, Ito. Abenomics: Early Success and Prospects. *Japan Spotlight* [online]. 2013, 4-7 [Accessed 11.3.2021]. ISSN: 1348-9216. Available from: [https://www.jef.or.jp/journal/pdf/191st\\_cover1-01.pdf](https://www.jef.or.jp/journal/pdf/191st_cover1-01.pdf).

<sup>45</sup> Coronavirus pandemic that started in Japan in January 2020, followed by restrictions affecting economy.

Together with the first arrow, the government's achievements are helping to increase public support and thus occupy more seats in the upper house, which is critical to economic reforms and where the Japanese Democratic Party had a majority after the 2009 elections. In 2013, however, the LDP, in a coalition with Komeito, won this majority after the election, securing 135 seats out of 242 and thus confirming public support for the government's economic strategy.<sup>46</sup> After the winning parliamentary elections in 2017, Abe's LDP was again dominated by the Senate in 2019, but without the dominance of previous years. However, this was not only related to the economic situation, but also based on domestic and foreign policy.<sup>47</sup>

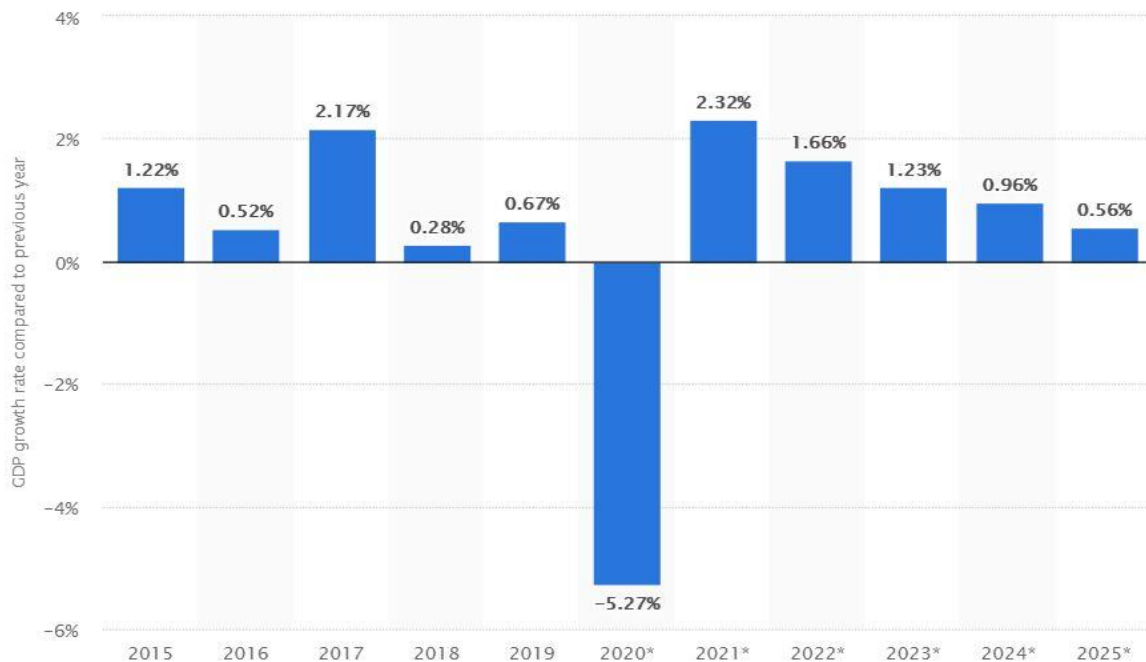
However, the third arrow focusing on overall growth lags behind the first two. Real GDP grew by 2.3 % during 2012 and 2013, and as it grew more than during the two decades of the boom in the 1970s and 1980s, the outlook for the coming years was optimistic. However, this optimism disappeared the following year, as overall growth in 2014 was negative. In 2015, on the other hand, the situation improved slightly, and GDP grew by 2.2 % compared to the previous year.<sup>48</sup> The graph below shows a slight increase in GDP in the following years, except for 2017, when growth increased by more than 2 % compared to the previous year. In 2020, however, growth fell by more than 5 % despite optimistic prospects due to economic measures because of the coronavirus pandemic. The expected growth in the coming years must therefore be taken with a grain of salt because it is uncertain whether Japan will have to resort again to strict anti-epidemic measures that will significantly affect the economy.

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<sup>46</sup> *Nippon: Your Doorway to Japan* [online]. Tokyo: The Nippon Communications Foundation, ©2015 [Accessed 12.3.2021]. Available from: <https://www.nippon.com/en/features/h00035/>.

<sup>47</sup> WAKATSUKI, Yoko, GRIFFITHS, James and YEUNG, Jessie. Shinzo Abe declares victory in Japan election but fails to win super majority. In: *CNN.com* [online]. 22.7.2019 [Accessed 12.3.2021]. Available from: <https://edition.cnn.com/2019/07/22/asia/japan-election-result-intl-hnk/index.html>.

<sup>48</sup> HAUSMAN, Joshua K. and WIELAND, Johannes F. *Overcoming...*, p.397.



Source: Statista.com

Abenomics is based on two opposing economic trends. Monetary policy and fiscal policy are inspired by Keynes stimulation of demand<sup>49</sup>, whereas growth strategy proceeds from supply economics. Basically, Abenomics aims at two goals – short-term stimulation of economy and long-term strategy plan of development, which includes industry and agriculture modernization, extension of export or the liberalization of labour market. This strategy may also contribute in reconstruction of outdated but still prevailing socio-economic model of Japan. According to macroeconomic indicators, the effects of Abenomics on Japanese economy may be evaluated as rather positive. The reforms managed to lower the unemployment level and rise the inflation, even though the promised stable value of inflation was not achieved. On the other hand, one thing Abenomics does not include is demographic change. As the population grows old and ratio of childbirth is decreasing, the development of Japanese market, which will be more dependent on the young labour force, is in danger. This trend needs to change as quickly as possible to make any economic plan work in the future.<sup>50</sup>

<sup>49</sup> Macroeconomic theory developed by economist John Maynard Keynes about total spending and its effects on employment and inflation.

<sup>50</sup> GRABOWIECKI, Jerzy and DABROWSKI, Mariusz. Abenomics and..., p. 33-34.

## 3 Trade relations between Japan and Europe

### 3.1 Trade relations between 1950-1989

Trade relations between Europe and Japan began to deepen only in the 1970s. In the previous post-war period, Japan focused mainly on rebuilding its own devastated economy and by the 1970s had changed the focus of industry from agricultural to automotive and electrical engineering. After the war, Europe also focused on reconstruction, where the shift was more complex and included institutional changes in the form of European institutions.<sup>51</sup> In the 1950s, there were still extensive trade restrictions between the two partners, where, for example, tariffs reached 20 to 30 %. Although the theory of mutual trade was partly aided by the Treaty of Rome<sup>52</sup> and the first rounds of GATT negotiations, to which Japan joined in 1955, trade relations remained relatively cold due to an amendment to the treaty where European members demanded retention of their existing guarantees. This was perceived as discrimination by Japanese side. This feeling was further intensified by the approach of the Council of Europe, which in 1962 decided to keep all its guarantees in any other treaties concluded between Japan and the Member States.<sup>53</sup>

The European Commission's proposal to negotiate a new joint trade agreement, which was to replace all the existing ones with a focus on two main points - liberalization and cooperation, brought hope of improving relations. The Commission offered Japan full liberalization in exchange for appropriate concessions on Japan's protection policy and the creation of a mechanism to review and remove non-tariff barriers. However, even this initially promising act ended in failure in 1972. The Commission insisted on the inclusion of a safeguard clause - the introduction of a restrictive policy, which was an insurmountable barrier for the Japanese Government, still bearing in mind similar conditions during the GATT rounds.<sup>54</sup> However, the Commission did not want to back down on this matter, as concerns about imports of goods in sectors that were declining or not yet sufficiently developed in Europe prevailed in

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<sup>51</sup> PAPE, Wolfgang and ZANDER, Christine. FDI and Market Access Issues in Japan for EU-SMES. In: *In Search for Growth: Towards a New Role for SMEs in EU-Japan Relations* [online]. Brussels: EU-Japan Centre for Industrial Cooperation, 2012 [Accessed 24.4.2021]. 142 p. Available from: <https://www.eu-japan.eu/sites/eu-japan.eu/files/In%20Search%20for%20Growth%20-%20Towards%20a%20New%20Role%20for%20SMEs%20in%20EU-Japan%20Relations.pdf>.

<sup>52</sup> Founding treaty of European Communities (EC) signed in 1957.

<sup>53</sup> KECK, Jörn, VANOVERBEKE, Dimitri and WALDENBERGER, Franz. *EU-Japan Relations, 1970-2012: From Confrontation to Global Partnership*. London: Routledge, 2013. 374 p. ISBN: 978-0415658720.

<sup>54</sup> CIHELKOVÁ, Eva. *Vnější ekonomické vztahy Evropské Unie*. Praha: C. H. Beck, 2003. 709 p. ISBN: 80-7179-804-5.

most Member States and thus called on Japan to open its market to foreign competition as a sign of modern industrialized country.<sup>55</sup>

As the European Economic Community was enlarged in 1973 and included new members - Ireland, Denmark and the United Kingdom, the question of the abolition of tariffs between Member States was resolved. After this step, attention turned to foreign issues, including trade relations with Japan. The following year, a permanent delegation was set up in Tokyo for new rounds of negotiations. The Japanese side, on the other hand, used the embassy in Brussels for its negotiations in Europe, which was then replaced in 1979 by its own permanent delegation.<sup>56</sup> However, the appointment of delegations did not prevent the fact that mutual trade collapsed and the trade deficit widened in the 1970s, which was not helped neither by the oil crises of 1973 and 1979, nor by problems with shipbuilding and the steel industry in 1976-1977.<sup>57</sup>

After the election of Japanese Prime Minister Nakasone Yasuhiro in 1982, who expressed a willingness to develop relatively stagnant trade relations with the United States and Europe, the rounds of trade negotiations began to resume. During his tenure until 1987, Nakasone met repeatedly with Commission presidents Gaston Thorn and Jacques Delors. However, at first, in addition to a slight moderation of exports, the meetings only brought an agreement to establish official meetings from 1985.<sup>58</sup> Through these meetings, the Commission wanted to engage Japan in the world economy and deepen bilateral relations, including agreeing to remove barriers to the entry of European goods into the Japanese market, while overseeing Japanese exports of goods to the European market. It was on the example of Japan that the EEC realized the weak protection of its market through the application of strict import regulations, which the Japanese managed to circumvent to some extent.<sup>59</sup> However, the meeting brought results, as during 1985-87 mutual trade increased the most in the last decade, when exports of goods to EC member states increased by 5 % and imports by 8.7 %.<sup>60</sup>

### 3.2 Trade relations since 1990

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<sup>55</sup> KECK, Jörn, VANOVERBEKE, Dimitri and WALDENBERGER, Franz. *EU-Japan Relations...*, p. 28-29.

<sup>56</sup> *Ibid.* p. 29-30.

<sup>57</sup> PAPE, Wolfgang and ZANDER, Christine. *FDI and Market Access Issues...*, p. 13-14.

<sup>58</sup> KECK, Jörn, VANOVERBEKE, Dimitri and WALDENBERGER, Franz. *EU-Japan Relations...*, p. 74-75.

<sup>59</sup> CIHELKOVÁ, Eva. *Vnější ekonomické vztahy Evropské Unie.* p. 223.

<sup>60</sup> KECK, Jörn, VANOVERBEKE, Dimitri and WALDENBERGER, Franz. *EU-Japan Relations...*, p. 79.

Relationships changed dramatically only during the 1990s. Following the collapse of the Soviet Union and the end of the Cold War, the European Community wanted to strengthen its position in the world. At the same time, the Japanese side spoke positively about the future cooperation through a document sent to the Commission in 1990 by Deputy Foreign Minister Owada Hisashi, who proposed concrete steps to improve the trade mechanism. The Japanese government decided to take this step both because of the growing potential of the European market and because of its transatlantic partnership with the USA and its efforts to respond similarly. The 1990 agreement then became the basis for common economic relations, which continue to this day in an expanded form, through the economic partnership agreement (EPA).<sup>61</sup>

The business and investment situation in Japan had always been more difficult for foreign entities. The complex and costly distribution system has become counterproductive and has become an obstacle to the potential of the Japanese economy in a globalized world. However, this situation is still hard to overcome, given the long tradition of strong domestic consumption, government protectionism and functional cross-shareholding, which have helped maintain a domestic trading system based on protecting Japanese companies from foreign competition for a long time. According to the European Union (EU), this over-regulation of the market was thus a major obstacle to the development of trade relations not only between the Union, but also with other Asian countries or the USA. Among other things, the EU openly asked the Japanese government in 2006 to reduce unnecessary regulations that harmed trade relations, for example by abolishing capital gains taxes on foreign companies through mergers and acquisitions.<sup>62</sup>

Although regulations have not eased in the coming years, mutual investment between 2002-2006 averaged \$ 5.5 billion per year.<sup>63</sup> The mutual meeting of the two parties in Tokyo in 2002, which became a milestone for the development of mutual relations in the new millennium, played a part in this. A strategic partnership agreement was reached here, covering not only the trade union but also security or climate issues. This agreement became the basis for further negotiations in the coming years, which then brought adjustments, for example in

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<sup>61</sup> Ibid. p. 110-115.

<sup>62</sup> BERKOFKY, Axel. *The EU and Japan: a partnership in the making* [online]. Brussels: European Policy Centre, 2007 [Accessed 18.4.2021]. ISSN: 1782-494X. Available from: <https://www.files.ethz.ch/isn/30653/EPC%20Issue%20Paper%20No%2052.pdf>.

<sup>63</sup> Ibid

the strategic cooperation in Asia in 2006 or in the agreement on reducing greenhouse gas emissions in 2007.<sup>64</sup>

The enlargement of the EU in 2004 to include new member states from Central and Eastern Europe also helped the Japanese side to invest and expand into the European market. The Japanese saw the opportunity not only in a larger market, but also in low labour costs and low corporate taxes. After only a few years, Japanese companies have praised this expansion by facilitating Japanese investment and trade with Member States through a single and codified set of trade rules, laws and standards. EU Member States, in turn, benefited from job creation. Investments and the number of companies grew the most in two countries, Poland and the Czech Republic.<sup>65</sup>

Trade relations between the EU and Japan remained strong in the first decade of the new millennium, with total bilateral trade reaching around € 116 billion in 2004. Although below the Union's trade with China (the EU's second largest trading partner in 2006, with bilateral trade reaching more than € 200 billion), Japan's trade deficit of € 30.5 billion is significantly lower than the EU's trade deficit with China, which amounted to 106 billion euros in 2006. With a share of 4.1 % of EU exports in 2005, Japan was the fifth largest export market for the EU. After the USA, Switzerland, Russia and China, 7.36 % of agricultural exports, 5.46 % of its textiles and 5.39 % of its chemicals were exported from the EU. Japan was also the fourth largest source of imports to the EU, after the US, China and Russia, covering 6.2 % of the EU import market.<sup>66</sup>

In 2011, after the earthquake and accident of the Fukushima nuclear power plant, another summit took place in Tokyo, hosted by Prime Minister Naoto Kan. This meeting also took the form of expressing thanks to the EU for helping Japan deal with the consequences of the damage and helping the local population in the accident area. That is why the summit and the whole of 2011 became a turning point in several areas. In addition to the need to recover from the strongest earthquake in the history of Japan, there has also been the greatest strengthening of mutual relations since the beginning of bilateral cooperation. For the first time, a proposal was made for an economic cooperation and new free trade agreement (EPA), which began to be negotiated two years later and which, after its ratification in 2019, secures the

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<sup>64</sup> WATANABE, Hirotaka. Japan-Europe Relations at the Multilateral Level. In: *Japan's Diplomacy Series* [online]. Tokyo: The Japan Institute of International Affairs, 2013 [Accessed 26.4.2021]. 201-218 p. Available from: [http://www2.jiia.or.jp/en/pdf/digital\\_library/japan\\_s\\_diplomacy/160330\\_Hirotaka\\_Watanabe.pdf](http://www2.jiia.or.jp/en/pdf/digital_library/japan_s_diplomacy/160330_Hirotaka_Watanabe.pdf).

<sup>65</sup> BERKOFSKY, Axel. *The EU and Japan...*, p. 22.

<sup>66</sup> *Ibid.* p. 21.



largest free trade area in the world. In addition to the agreement, several other negotiations took place for the rest of the year on nuclear energy, climate protection or trade in goods and services.<sup>67</sup>

We will look at the EPA itself, it's the course of the negotiations between 2012-2019 and its results in the next chapter. We will also examine the trade between EU-Japan during this period and the motivation of both actors, focusing on the Japanese side in relation to the prime minister's Shinzo Abe's government and the state of the Japanese economy.

## **4 Abenomics and mutual trade after 2012**

### **4.1 TPP and EPA**

#### **4.1.1 The background of TPP**

By presenting his economic plan, Prime Minister Abe wanted to kick-start a stagnant economy that was still marked by the devastating tsunami of 2011 and the financial crisis in previous years. In addition to the strategy focused on domestic economic factors, the third arrow also included foreign ones, for example in the form of new international agreements. Abenomics' growth strategy thus counted on two pillars - international economic partnership agreements and domestic reforms limiting protectionism and increasing competitiveness. The Japanese economy is largely dependent on trade and investment, thus ensuring easier access for international companies to the Japanese market through agreements on free trade zones with other countries have become a priority issue in the issue of foreign economic strategy.<sup>68</sup>

The two largest agreements in terms of scope and content are the Trans-Pacific Partnership (TPP) and the Economic Partnership agreement (EPA). The TPP was established to reduce trade barriers and deepen trade between members in 2005, when Chile, Brunei, Singapore, and New Zealand signed the partnership agreement. However, the agreement gained a new dimension only after the US joined the negotiations in 2008, which was followed by other countries in the Pacific, including Japan, in 2013. After talks with US President Barack Obama, Prime Minister Abe was given access to the negotiating table. With its entry, the

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<sup>67</sup> WATANABE, Hirotaka. *Japan-Europe Relations...*, p. 7.

<sup>68</sup> EU and Japan accelerate FTA in bid to conclude it by end of year. In: *Asiahouse.org* [online]. London: Asia House, 2015 [Accessed 20.6.2021]. Available from: <https://asiahouse.org/news-and-views/eu-japan-accelerate-fta-bid-conclude-end-year/>.

Japanese side offered a reduction in tariffs on domestic agricultural products, which were a sensitive political topic in Japan and at the same time helped economically weaker countries with the process of negotiating the terms of the agreement. In 2015, all 12 participating countries agreed on the final text of the Partnership Agreement and signed it in Auckland on 4 February 2016.<sup>69</sup>

The US withdrawal from the agreement at the instigation of US President Donald Trump in January 2017 was a big loss, but also a challenge for the remaining members. Japan's role in the negotiations was important in the original agreement and took the initiative this time when a meeting of the remaining members agreed on the future of the agreement in Hanoi in May 2017. In January 2018, they reached an agreement and amended the agreement without US participation. On December 30, 2018, they presented a comprehensive and progressive agreement for trans-pacific partnership, also known as the TPP11 Agreement, which entered into force on that day.<sup>70</sup>

The main debate over the TPP has been in Japan over the abolition of tariffs on agricultural products. It was agriculture that the Japanese part of the agreement dealt with to a greater extent and also aroused a great response, especially among farmers, who organized demonstrations of several thousand people. The biggest concern was the import of cheap food from abroad and the threat to local production, after which the protesters demanded the protection of local farmers from foreign competition. After increasing pressure, the ruling LDP promised farmers fair conditions and assurances that the agreement was economically advantageous for all parties. However, the LDP itself was not united on this issue, where some deputies opposed the negotiated terms, but the majority ultimately voted in favour of the agreement.<sup>71</sup>

#### 4.1.2 The background of EPA

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<sup>69</sup> SHINODA, Tomohito. *Two-level game analysis of Japan in the TPP negotiations* [online]. Asian Journal of Comparative Politics, 2019 [Accessed 20.6.2021]. ISSN: 2057-8911. Available from: <https://journals.sagepub.com/doi/abs/10.1177/2057891119865025?journalCode=acpa&>.

<sup>70</sup> Trans-Pacific Partnership (TPP) Agreement Negotiations. In: *mofa.go.jp* [online]. Tokyo: Ministry of Foreign Affairs of Japan, 2021 [Accessed 20.6.2021]. Available from: <https://www.mofa.go.jp/files/000420486.pdf>.

<sup>71</sup> Rally staged in Tokyo to protest Japan's entry into TPP talks. In: *Japantimes.co.jp* [online]. Tokyo: The Japan Times, 2013 [Accessed 22.6.2021]. Available from: <https://www.japantimes.co.jp/news/2013/03/13/national/rally-staged-in-tokyo-to-protest-japans-entry-into-tpp-talks/>.

The EU-Japan Economic Partnership Agreement is the largest bilateral agreement between the EU and Japan, creating the world's largest free trade area and accounting for 30% of world GDP. The agreement contains a commitment not only to trade, but also to services and mutual investment. It also includes, among other things, the protection of European products in Japan and vice versa, lower prices and a greater supply of goods to consumers, or the possibility of smaller businesses entering and equalizing conditions in the new market.<sup>72</sup>

The first rounds of negotiations began in April 2013. In 2012, the European Council gave a mandate to the European Commission to start negotiations with Japan. Also, in the same year, the Japanese side agreed to negotiate in accordance with the strategy of the third arrow of Abenomics. After 18 rounds of negotiations, an agreement was reached on both sides on 6 July 2017 and the final form was approved at the end of this year.<sup>73</sup> The EU then had to follow a more complex legislative approval process, as the agreement includes more provisions falling within the exclusive competence of the EU. The Commission therefore submitted a draft contract to the Council in the spring of 2018, and the Council subsequently sent the agreement to the European Parliament for signature on 6 July 2018, one year after the agreement was reached. During July, the treaty was signed at a joint summit in Tokyo and ratification took place in December 2018 with a vote of 474 for and 152 against. At the same time, the agreement was ratified in Japan, where it was approved by both houses of parliament. At the beginning of February 2019, the EPA officially entered into force.<sup>74</sup>

Upon entry into force, the agreement itself abolished almost all tariffs for EU-based companies and provided for a gradual increase in liberalization to 99 % at the end of the trial period. At the same time, around 85 % of agricultural products exported from the EU can enter the Japanese market duty free. Furthermore, a number of regulatory barriers are removed, ensuring the protection and fairness of the conditions of companies' entry into the Japanese market (a point at which negotiations have often failed in the past), including the possibility of entering the car market. On the other hand, the EU is also committed to giving access to

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<sup>72</sup> CHOWDHRY, Sonali, SAPIR, André and TERZI, Alessio. *The EU-Japan Economic Partnership Agreement* [online]. Brussel: European Parliament, 2018 [Accessed 17.6.2021]. ISBN: 978-92-846-3880-2. Available from: <https://op.europa.eu/en/publication-detail/-/publication/82ec386c-c5ed-11e8-9424-01aa75ed71a1/language-en>.

<sup>73</sup> Ibid. p. 7.

<sup>74</sup> PEREIRA, Silva Pedro. EU-Japan Economic Partnership Agreement (EPA). In: *Europarl.europa.eu* [online]. Brussels: European Parliament, 2019 [Accessed 28.6.2021]. Available from: <https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-eu-japan-epa>.

Japanese companies, including car companies. Finally, there is also the topic of public services and procurement, where the agreement guarantees non-discriminatory access to government contracts together with their award.<sup>75</sup>

#### 4.1.3 Motivation of the EU

The most important reasons for the agreement are generally the decline in Japan's share of exports of goods to the EU, as well as the decline in imports of Japanese goods to the EU - in both cases the share fell by more than half between 1990 and 2017, when this year it was around 3-4 %. A strategic approach also played a role on both sides. The large and expanding EU market has always been attractive to the Japanese side, and on the other hand, the EU has neglected the region due to the higher protectionism of the Japanese market. However, the prospect of investing in the country's third strongest economy and easing restrictions on entering this market changed the EU's approach, which was also included in the Trade for All strategy in 2015.<sup>76</sup>

The geopolitical importance and scope of a possible agreement from the EU's point of view also played a role here, when the negotiations of transatlantic trade and investment partnership failed in 2017, culminating in a US tariff cut of 25 % in June 2018 on steel and 10 % on aluminium products. It was in the TTIP agreement that there was the potential to create the largest free trade area, but none of the rounds of negotiations brought a majority agreement on the points under discussion.<sup>77</sup>

#### 4.1.4 Motivation of Japan

Japan's economic situation was the primary reason why the Japanese government negotiated an agreement. As mentioned in previous chapters, after World War II, Japan not only recovered but also grew economically to the forefront of the world's strongest economies in 1990. This was achieved, among other things, in US cooperation with the ruling LDP, which then launched the economy. Although the economy remained at the forefront of the world in later years, other Asian countries, led by China, began to experience the same boom as Japan once did, and the economy gradually turned into stagnation, which was not helped by the ensuing financial or natural crises. The LDP, led by Abe, set the restart of the economy again

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<sup>75</sup> PEREIRA, Silva Pedro. EU-Japan Economic...

<sup>76</sup> CHOWDHRY, Sonali, SAPIR, André and TERZI, Alessio. The EU-Japan..., p. 7.

<sup>77</sup> Ibid.

and, as in the past, the success of the domestic economy was also tied to the foreign one. In addition, LDP, in cooperation with Komeito,<sup>78</sup> was in an advantageous position to carry out its ambitious plans. As a liberal-oriented party which was behind the economic boom in the past, it had experience in starting the economy. However, to its election victory in 2012 contributed not only this experience and the weak left-wing opposition but also the deepening of the crisis under the three-year rule of the Democratic Party of Japan in 2009-2012.<sup>79</sup>

The EU offered itself as a suitable partner for cooperation not only thanks to the logical perspective of one of the world's largest markets, but also from the point of view of the Japanese government. In its strategic plan for the coming years, presented after its inception, they see the EU as a strong community whose members share democratic values and respect for human rights, influence international affairs and promote a market economy. The EU is seen as an economic and security partner to whom Japan has helped to democratize the Baltics and Eastern Europe, and with whom relations need to be strengthened.<sup>80</sup>

## 4.2 The content of the agreement

The EPA between Japan and the EU is an exemplary agreement in the 21st century and goes far beyond the ordinary free trade agreement. Most of the content concerns the liberalization of trade between the two economies, mainly through the reduction of tariffs on certain products, which can now be adjusted to the needs outside the WTO rules under which trade took place before the current agreement. At the same time, however, the agreement also allows some politically sensitive goods to be kept at the same level in terms of tariffs.<sup>81</sup>

### 4.2.1 Tariffs

It is the elimination of tariffs that is essential here from a historical point of view as well, as this is the largest tariff reduction in the history of the FTA. Industrial products should eventually achieve a 100 % reduction in tariffs on both sides and for other products it is 95 %.

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<sup>78</sup> Political party with significant support of religious movement Soka Gakkai, promoting peace and harmony.

<sup>79</sup> PRADO, de César. *Prospects for the EU-Japan Strategic Partnership* [online]. Tokyo: EU-Japan Centre for Industrial Cooperation, 2014 [Accessed 28.6.2021]. p. 39-40. Available from: <https://www.eu-japan.eu/sites/default/files/publications/docs/eujpstrategicpartnership.pdf>.

<sup>80</sup> Ibid. p. 11-12.

<sup>81</sup> The EU-Japan Agreement Explained. In: *Ec.europa.eu* [online]. Brussels: European Commission, 2018 [Accessed 13.6.2021]. Available from: <https://ec.europa.eu/trade/policy/in-focus/eu-japan-economic-partnership-agreement/agreement-explained/>.

<sup>82</sup> The majority of goods protected by customs duties in 2017 (year before the final agreement) are below 10%, the remaining products then reach either 35 % or, on the other hand, extreme values, which for specific products (especially agricultural) fall well above 100 %. In Japan there is a big difference between the agricultural and manufacturing industries - while tariffs on agricultural products are generally high, in the case of, for example, mechanical engineering, they reach around 7 % and in the case of electronics 8 %. However, the EU has similar lower values, from which it can be concluded that non-tariff measures are also a major obstacle to mutual trade.<sup>83</sup>

#### 4.2.2 Investments and public procurement

The importance of trade in goods cannot be denied, but so is the ability to invest and award public contracts. The EU is the largest provider of FDI in Japan and at the same time Japan is the largest investor in the EU market, providing jobs for more than half a million people. EPA guarantees the continuation of a wider range of investments on both sides, including SME investments. Important progress has also been made in the services sector, where the parties have committed themselves to facilitating the movement of individuals, including investors and workers in need of relocation due to, for example, the relocation of their employer. The Japanese side sees this step as a tool for improving the FDI situation in the EU.<sup>84</sup>

However, the provision of services is generally subject to restrictions and delays in Japan. The governments of the individual prefectures have their own rules, which often lead to discrimination against foreign companies. Attractive sectors such as financial services and telecommunications thus face the arrival of competition through the agreement, and a greater variety of services, but so far access options are relatively limited for investors. The same applies to automotive sector, where investments on Japanese market could have positive impact for subcontractors in the Europe but higher competition from Japanese companies could also pose a threat for them.<sup>85</sup>

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<sup>82</sup> KODAMA, Kazuo. *The Japan-EU EPA from Japan's perspective* [online]. Brussels: EPA Seminar, 2018 [Accessed 11.6.2021]. Available from: <https://www.eu.emb-japan.go.jp/files/000405861.pdf>.

<sup>83</sup> The Japan's Tariff Schedule as of April 2017. In: *Customs.go.jp* [online]. Tokyo: Japan Customs, 2017 [Accessed 13.6.2021]. Available from: [https://www.customs.go.jp/english/tariff/2017\\_4/index.htm](https://www.customs.go.jp/english/tariff/2017_4/index.htm).

<sup>84</sup> KODAMA, Kazuo. *The Japan-EU...*

<sup>85</sup> WNUKOWSKI, Damian. EU-Japan Free Trade Agreement: Opportunities and Challenges for Businesses in the CEE. *Bulletin* [online]. March 2015, 29(761) [Accessed 16.6.2021]. Available from: [https://www.pism.pl/files/?id\\_plik=19375](https://www.pism.pl/files/?id_plik=19375).

The total public procurement market in Japan is around 20 % of GDP. Procurement is governed by the 1996 Government Procurement Agreement (GPA). However, access to contracts under this agreement is problematic on the part of Japan, as the way in which public contracts are awarded differs from Europe, is less transparent and, in addition, exceeds the total volume of GPA procurement.<sup>86</sup> It is precisely the lack of transparency and the non-competitive environment that have been blamed on Japan as a major problem for the development of trade, especially by European railway companies, which have long been interested in entering the broad Japanese market. The interest of the companies far exceeds the offer, as only 2 % of the Japanese railway market is accessible to foreign entities. However, this restriction disappears by the contract, although foreign companies still must comply with the rules for operating in the Japanese market.<sup>87</sup>

### 4.2.3 Non-tariff measures

Non-tariff measures were introduced as regulation of a specific sector on the domestic market, they include all non-tariff measures affecting the cost of trade. These measures are generally considered to be a major obstacle to trade between Japan and the EU. Non-tariff measures affect several sectors of the Japanese market, some of which are even completely closed to exports from abroad. This applies in particular to agricultural products and means of transport. Even in this case, European companies were interested in eliminating them. These include manufacturers in the food and healthcare industries. However, the problems also figure on the opposite side. The Japanese side points to the different approaches of both partners to regulatory systems, for example for the labelling of medical devices or the certification of industrial products.<sup>88</sup>

## 4.3 Japanese economy – sensitive sectors

### 4.3.1 Agricultural industry

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<sup>86</sup> GARNIZOVA, Elitsa et al. *Trade Sustainability Impact Assessment of the Free Trade Agreement between the European Union and Japan* [online]. Brussels: European Commission, 2016 [Accessed 29.6.2021]. p. 53-54. Available from: [https://trade.ec.europa.eu/doclib/docs/2016/may/tradoc\\_154522.pdf](https://trade.ec.europa.eu/doclib/docs/2016/may/tradoc_154522.pdf).

<sup>87</sup> ARMANOVICA, Marika. *Trade and economic relations with Japan: assessing the hurdles to the FTA* [online]. Brussels: European Union, 2012 [Accessed 29.6.2021]. Available from: [https://www.europarl.europa.eu/RegData/etudes/briefing\\_note/join/2012/491428/EXPO-INTA\\_SP\(2012\)491428\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/briefing_note/join/2012/491428/EXPO-INTA_SP(2012)491428_EN.pdf).

<sup>88</sup> WNUKOWSKI, Damian. EU-Japan Free Trade...

The most politically sensitive topic among the Japanese nation and one of the most controversial sectors in foreign trade is clearly Japanese agriculture. However, despite the emphasis on domestic products, Japan is forced to import more than half of basic foodstuffs, and the situation does not improve in the future, due to the modernization of society, the outflow of population from rural areas or the mostly mountainous environment of Japan. The overall food self-sufficiency ratio is about 64 % and its still declining. Rice makes up a quarter of all production and is the main commodity of agriculture. Other products with high daily usage is wheat, vegetables and meat – all is part of everyday eating habits. As written in the previous chapter, customs duties on agricultural products vary considerably. While part of the production is completely duty-free, for others the duties amount to way over 100 %. But agriculture would not be working without government support, which subsidizes it through direct payments, and Abe's government is now also focusing on supporting exports as part of a revitalization strategy.<sup>89</sup>

Like rice, meat is very popular, especially beef and pork. In 2020, Japan was again the third largest importer of beef in the world covering around 9 % of world imports. It is a position which is held by Japan for many years and thus represents a lucrative market for European exporters.<sup>90</sup> The pork market is much more lucrative for European exporters, where European companies account for almost quarter of total pork imports. Here again, however, there is Japanese protectionism, which protects domestic producers through tariffs and other barriers against cheap imports, where beef is under 39 % tariffs and pork under approximately 9 %. Nevertheless, they should phase out between 5-15 years.<sup>91</sup>

### 4.3.2 Automotive industry

Cooperation on the automotive industry is crucial for both countries. Japan exports the largest number of cars to the EU, and although exports from the EU account for about 10 % of

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<sup>89</sup> FOURNEL, William. *Market opportunities for EU agribusinesses in the context of the EU-Japan EPA* [online]. Tokyo: Eu-Japan Centre for Industrial Cooperation, 2017 [Accessed 30.6.2021]. Available from: <https://www.eu-japan.eu/sites/default/files/publications/docs/2017-10-market-opportunities-eu-agribusinesses-fournel-min.pdf>.

<sup>90</sup> COOK, Rob. World Beef Imports: Ranking of Countries. In: *Beefmarketcentral.com* [online]. July 2021 [Accessed 30.6.2021]. Available from: <https://beefmarketcentral.com/story-world-beef-imports-ranking-countries-146-106900>.

<sup>91</sup> EPA and Meats. In: *Eubusinessinjapan.eu* [online]. Brussels: EU-Japan Centre for Industrial Cooperation, 2020 [Accessed 30.6.2021]. Available from <https://www.eubusinessinjapan.eu/issues/economic-partnership-agreement/epa-meats>.



total exports (12.5-billion-euro), European carmakers export counts to over 8-billion-euro worth of cars and trucks exported to the market in Japan. Cars are also the second most imported and exported products between EU and Japan.<sup>92</sup> Nevertheless, these companies did not hide their concerns about the Japanese protective hand over their market and possible continued discrimination before signing the agreement, while the European market will be more open to Asian companies.<sup>93</sup>

### 4.3.3 Life sciences

A less controversial, but nevertheless important topic for mutual business relations is also medical needs. For years, Japan has been among the largest pharmaceutical markets in the world, averaging 100 billion dollars a year. The market is thus lucrative in terms of performance and potential growth with possible increase of GDP by 0.5 % by 2030. However, trade is traditionally opposed by tariffs that are imposed on medical supplies together with a reference price. Pharmaceutical sector operates without tariffs but faces the requirement of duplicate testing and some medical applications need to undergo authorisation before entering market.<sup>94</sup>

## 4.4 EPA Results

### 4.4.1 Trade results with EU

In February 2020, a year after the agreement entered into force, the first results were already observable. During the first 10 months, total exports of goods to Japan increased by 6.6 % compared to 2019, and at the same time it was the largest growth in the last three years, when the value was around 4.7 %. Exports of Japanese products to the EU also recorded almost the same numbers, where the increase was 6.3 %. Some sectors also saw a significant increase in exports during the year compared to previous years, namely dairy and meat products with a 12% and 10% increase, electronic components with a 16 % increase and leather products, which

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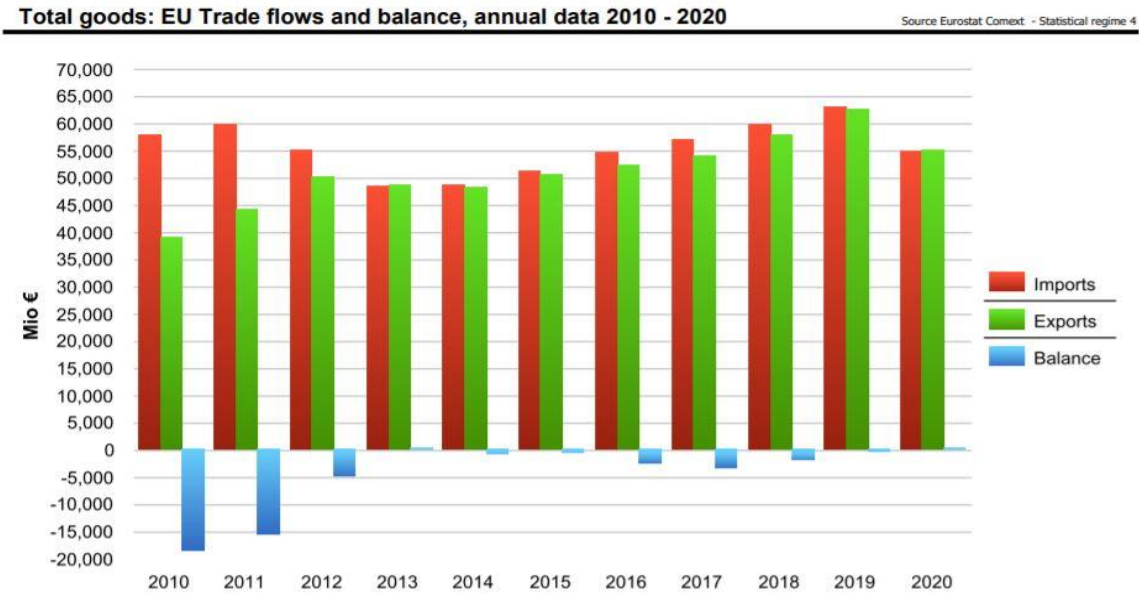
<sup>92</sup> EU-Japan free trade agreement within reach. In: *Europarl.europa.eu* [online]. Brussels: European Parliament, 2017 [Accessed 2.6.2021]. Available from: [https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/608648/EPRS\\_BRI\(2017\)608648\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/608648/EPRS_BRI(2017)608648_EN.pdf).

<sup>93</sup> Obchodní dohoda mezi EU a Japonskem přiděluje vrásky automobilovému průmyslu. In: *Euractiv.cz* [online]. Praha: EU-Media s.r.o, 2013 [Accessed 4.6.2021]. Available from: <https://euractiv.cz/section/obchod-a-export/news/obchodni-dohoda-o-mezi-eu-a-japonskem-pridelava-vrasky-automobilovemu-prumyslu-010724/>.

<sup>94</sup> Directorate-General for Trade. *Trade and economic relations with Japan: assessing the hurdles to the FTA* [online]. Brussels: European Commission, 2016 [Accessed 4.6.2021]. p. 6. Available from: [http://trade.ec.europa.eu/doclib/docs/2016/may/tradoc\\_154523.pdf](http://trade.ec.europa.eu/doclib/docs/2016/may/tradoc_154523.pdf).

increased by 14 %. Other sectors do not have such a significant increase, although the situation is expected to improve every year through tariff reductions, as after the full implementation of the agreement, mutual trade is expected to increase by 36 billion euros.<sup>95</sup>

In the chart below we can see the mutual balance of trade in the period 2010-2020, which includes the total import and export of goods in the order of millions of euros. Following the beginning of the LDP government in 2012, a balance can be observed between imports and exports and their increasing values after the start of EPA negotiations. In 2019, when the agreement entered into force, the highest increase was recorded for the graph period, which can be attributed to the already reduced tariffs on most products. Although forecasts for the coming years promised further growth, the Covid-19 pandemic also affected mutual trade and negatively affected imports and exports of goods. From spring to autumn 2020, total exports of goods fell to 3.8 billion euros and imports to 3.9 billion euros. However, the declining trend stopped during September and has been rising again since then. In December 2020, both imports and exports reached 5 billion euros and continued to rise.<sup>96</sup>



Source: Webgate.ec.europa.eu

<sup>95</sup> Trade: First year of the EU-Japan Economic Partnership Agreement shows growth in EU exports. In: *Ec.europa.eu* [online]. Brussels: European Commission, 2020 [Accessed 20.6.2021]. Available from: [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_20\\_161](https://ec.europa.eu/commission/presscorner/detail/en/IP_20_161).

<sup>96</sup> Japan-EU – international trade in goods statistics. In: *Ec.europa.eu* [online]. Luxembourg: Eurostat, 2021 [Accessed 15.6.2021]. Available from: [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Japan-EU\\_%E2%80%93\\_international\\_trade\\_in\\_goods\\_statistics#Recent\\_developments.2C\\_impact\\_of\\_COVID-19](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Japan-EU_%E2%80%93_international_trade_in_goods_statistics#Recent_developments.2C_impact_of_COVID-19).

In February 2021, two years have passed since the EPA was in operation, and this anniversary was celebrated more by EPA Commission President Valdis Dombrovskis and Japanese Foreign Minister Toshimitsu Motegi on an agreement to improve the treaty - each party will protect an additional 28 geographical indications - agri-food products from imitation. Trade in cars and wine, key sectors, should also be facilitated by the end of the year as a tool for recovery from the Covid-19 pandemic. Facilitation will take the form of simplifying car exports from Japan to the EU and vice versa, as the list of safety requirements that will not require double approval will be expanded. In practice, this means that if Japan issues certification for a car heading to the EU, the European side will no longer examine the conditions of certification, and the opposite is true. At the same time, in line with the agreement, Japan has brought its wine standards closer to the EU and allowed several EU oenological practices on its territory. With this step, more wine products will be able to enter the Japanese market.<sup>97</sup>

The disputed agricultural products from Japan are covered by a relatively large part of the agreement. Although overall customs duties are reduced every year, the introduction of new duties or the retention of a certain level of existing ones is not completely ruled out in the agreement. Such a case may arise either by mutual agreement with the EU or after a duly justified situation has arisen and the latter has been informed. However, tariff limits are set for these cases. Let's look at the specific agricultural commodities we mentioned in the previous section - beef and pork, along with the important automotive industry.<sup>98</sup>

For both beef and pork, Japan can apply safeguard measures if the total volume of imports from the EU for these products exceeds the standard in metric tonnes per year, with a value of 43,500 metric tonnes in the first three years and then increasing every year. Similarly, there are other agricultural products, where, however, the set values differ for each product separately. Beef will also maintain tariffs of 38.5 % for the first three years, which should fall by 20 % within 15 years and be reduced by 1 % every year, except for a duty-free situation, provided that the conditions of total imports from the EU are met. In the case of pork products,

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<sup>97</sup> The EU and Japan trade deal celebrates second anniversary by further strengthening ties. In: [Ec.europa.eu](https://ec.europa.eu) [online]. Brussels: European Commission, 2021 [Accessed 20.6.2021]. Available from: [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_21\\_313](https://ec.europa.eu/commission/presscorner/detail/en/IP_21_313).

<sup>98</sup> Agreement between the European Union and Japan for an economic partnership. In: [Trade.ec.europa.eu](https://trade.ec.europa.eu) [online]. Brussels: European Commission, 2018 [Accessed 21.6.2021]. p. 197-198. Available from: [http://trade.ec.europa.eu/doclib/docs/2018/august/tradoc\\_157229.pdf#page=49](http://trade.ec.europa.eu/doclib/docs/2018/august/tradoc_157229.pdf#page=49).

customs duties vary, the highest reaching 20 %, which should fall to 2 % within ten years and disappear for the eleventh year.<sup>99</sup>

In the automotive industry, the tariff rate also differs, for example, according to engine capacity, vehicle types, vehicle power, etc. The basic rate is usually up to 20 % and is decreased by one percent after the first year, with a continuing trend lasting until the eighth or thirteenth year, when duties should disappear. An example is an engine with a capacity of more than 2800 cm<sup>3</sup> - here is the basic rate of 16 %, which decreases to 14.8 % after a year and then further decreases by 1.3 % for 12 years. Prior to the agreement, snow-specific vehicles had a rate of 5 %, now they are decreasing by 0.6 % until the seventh year. Unlike agriculture, the automotive industry does not specify the conditions under which duties could be renewed - the same is true of other sectors, so any changes in tariff reductions should only be possible with the agreement of both parties.<sup>100</sup>

From the available information on the development of mutual trade relations, it is possible to observe a clear contribution of EPA in the first year of operation of the agreement and possibilities for the future. Although Japan has secured the possibility of reintroducing customs duties, especially on protected agricultural products, their introduction is only necessary. As a result, duty-free trade will benefit both economies, especially in the coming years, when both economies will recover from the effects of the Covid-19 pandemic. Mutual trade reached balanced values in imports and exports during the EPA negotiations, and in 2019 it rose the most in 10 years. In addition to the goods market, another inflow of investment is expected, but this was also limited by the pandemic. The predictions of continued rising trade in 2020 were thus not fulfilled. However, the prospect for the coming years is favourable.

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<sup>99</sup> Ibid. p. 205-217.

<sup>100</sup> Ibid. p. 75-78.

## Conclusion

The aim of this work was to determine the influence of Abenomics on trade relations between Japan and the European Union. After the Second World War, mutual trade relations underwent a dynamic development, accompanied by disagreements over domestic economic measures on both sides, and above all, Japanese protectionism and caution against foreign influence played a major role. Both the Japanese and European economies underwent a major transformation after the war, during which many meetings took place with the aim of establishing closer economic cooperation, which, however, in the vast majority did not bring anything significant. Both sides took turns criticizing each other for the failure of the negotiations, and in a similar vein it can be said that the situation continued until 2012, when with the Prime Minister Abe took office and both sides agreed to begin negotiations on the most ambitious trade agreement not only in Japan but worldwide.

The Japanese economy was in a critical state after World War II. After the signing of the peace agreement, the process of catching up with the world's advanced economies began, which lasted more than 20 years. In the years following the war, the American government played a major role here, helping the Japanese government with its economic plan, and in the 1950s, during the Korean War, it created demand for goods and services on Japanese territory. After gaining independence in 1951, the Japanese government continued its own economic strategy with an emphasis on macroeconomic stability and high human capital. The post-war goal was met in the late 1960s, and Japan's growth rate was only slowed, not stopped, by two energy crises in the 1970s. In the 1980s, however, the financial bubble increased through rising land and stock prices, which then burst in the 1990s, causing a financial crisis and changing the assumption of economic development. The poor situation in Japan was not improved due to the two global financial crises, which caused Japan to lag behind its main competitors.

The crisis continued during the rise of the new Japanese government, a coalition of LDP and Komeito. The main goal of the new government and Prime Minister Shinzo Abe was to kick-start economic growth through a series of necessary measures. The main idea of this plan was to reduce deflation and stabilize investment even at the cost of a major economic downturn in the event of failure. The so-called three arrows - monetary policy, fiscal policy and growth strategy - should have helped with this plan. The aim of the arrows was, for example, to achieve stable inflation, increase taxes or encourage investment from abroad. During the analysis of the

results, several years after the downturn, the greatest progress was seen in the financial markets and in the macroeconomic area, although some promises, such as stable inflation of 2 %, were still not achieved.

Trade relations between the EU and Japan have never been easy in terms of its own protectionist policy, which is practiced mainly by Japan. Although trade relations improved and trade in goods increased in the 1990s, investment opportunities were limited on both sides. The regulation of the market by the Japanese government also meant a strict response from the EU, and investments never reached possible values, although both markets were always lucrative for the other side. Following the tragedy in Fukushima Prefecture in 2011, a joint summit in Tokyo brought a proposal for a joint agreement, which was taken over by a new government led by the LDP after its victory in 2012. In addition to domestic economic reforms, Prime Minister Abe also presented foreign plans that included closer cooperation with economic partners around the world. The lucrative European market and the need to at least partially abandon protectionist policies due to the need to restart the economy then led to an agreement about the largest free trade area in the world.

The EPA, which entered into force in February 2019, gradually eliminates tariffs on most products in both the EU and Japan over a limited period and adjusts the investment climate to a fairer and more competitive market. Already during the first year of the valid agreement, mutual exports increased by more than 6%, with some sectors reaching several times this value. In the last 10 years, this was the largest increase in imports and exports of goods. In Japan, the most protected commodities - agricultural products - have also seen an adjustment in the tariff rate, although the Japanese have pushed for the retention of certain exceptions, similar to the automotive industry.

Although positive developments can be observed over the past two years for mutual trade, a significant reduction and completely duty-free trade can only be expected in the future, as the agreement is set to gradually reduce tariffs and open trade over a period of over ten years. Although predictions are favourable for the future, the covid-19 pandemic affected trade and investment in 2020, and trade is recovering at a slower pace due to the ongoing situation. However, after the launch of Abenomics, the biggest shift in mutual economic relations in the last decades can be observed with certainty, especially through the successful EPA agreement. It is also possible to agree with the second hypothesis, namely that the acceleration of foreign agreements was not solely subject to the functioning of domestic reforms, which, although not providing the desired results in certain areas, did not lead to faster negotiations, as the Japanese

government led long debates about tariffs reduction of their protected goods and foreign agreements thus proceeded in accordance with the economic strategy.

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