

EU and Japan Trade Deal

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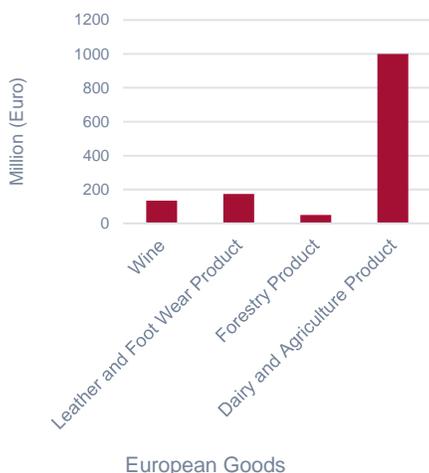
As the trade war between U.S and China continues to intensify, the EU and Japan have implemented a new trade deal known as the Economic Partnership Agreement (EPA) on February 1, 2019. Japan and the European Union has been negotiating on this free trade deal since 2013, which the trade deal reached a final agreement on July 2018. This new deal is a bridge for opening free trade between Japan and the European Union. The value of import and export between EU and Japan is worth approximately one-third of the world’s GDP, and EPA has a direct effect on nearly 635 million people, the population of both Japan and the European Union. While the removal of tariff could be concerning for the government as the cost of this deal is the foregone international tax revenue, EPA is aiming at increasing the export and import but also promoting fair competitions for the companies between the two parties that ultimately help to improve their economy. Beside the economic effect, the EPA is also viewed as a message to the nations across the world on revaluing the importance of using free trade rather than protectionism as a more effective method to increase one nation’s economic performance. These have been driving forces that enabled the negotiation started in 2013 to reach a final agreement.

Economic Partnership Agreement

In the Economic Partnership Agreement, Japan will be removing 97% tariffs on imported European goods. Meanwhile, the European Union will be removing 99% tariffs on imported Japanese goods. The missing 3% and 1% are due to some sensitive products that are illegal in the countries; for example, whale meat is illegal in the EU. The deal would benefit companies on both sides of the parties as shown in Figure 1 in a way that many European industries would be able to save hundreds million of euros with the removal of customs duties. Specifically, one of EU’s main exports to Japan is its dairy product and its agriculture product, and the removal of the tariffs means the companies save approximately one billion euros in total on custom duties. The deal will bring benefits to these European industries since it has removed custom duties of 40% on the beef product, of 40% on the cheese product, of 30% on the chocolate product, and of 15% on the wine.

On the other hand, Japan’s main export to the EU is their cars, which the 10% tariff on imported Japanese car will be slowly reduced and removed in the upcoming years. This new deal also has been given an unofficial name called “Cars for Cheese” because it opens up more business opportunities for the car industry in Japan and the dairy industry in the EU. Japan looks forward to this deal as they estimate that it will help increase its GDP by 1% and create 290 thousand jobs in the country. In addition, the effect of EPA took immediate effect in many Japanese supermarkets on February 1st where many of the European wine, chocolate, and cheese have dropped their price. Not only did the Japanese consumers benefited from a lower price on European goods, but the Japanese producer also benefited from EPA as they can sell their product in a larger market and set their price at a more competitive range in the EU. According to an interview from Hirobumi Shimazaki, owner of a soba factory, he talked about soba in France is four

Figure 1: Money Saved from Removal of Custom Duties



times its price compares to the same product sold in Japan. Now with EPA taking effect, they are able to decrease their pricing to attract more consumers. Overall, the EPA has enabled producers who are more efficient to produce at a greater quantity and correct the misallocation of resources in the market. Ultimately, this creates a win-win scenario for both producers and consumers in the EU and Japan.

Economic Effect of EPA

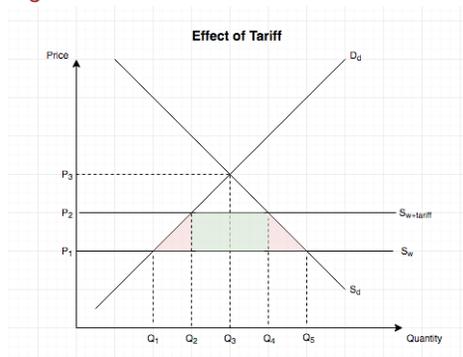
One of the concerning factors of EPA is the risk for government losing its source of revenue from the tariff as shaded by the green area in Figure 2. Both the EU and Japan have been running on a budget deficit for the past five years, where Japan's budget deficit has been around 4.5% of its GDP for both 2016 and 2017 and EU's budget deficit has been around -1.5% of its GDP in 2016 and -1% of its GDP in 2017. Removing tariff that worth approximately one billion euro would similarly mean that the government will lose a massive portion of its international tax revenue. However, Japan has proposed that the EPA will be able to create 290,000 new jobs in the nation, and there have been around 12000 Germany companies doing business in Japan and this figure may grow "by double-digit percentage" in the upcoming years according to the source, USA Today. The new companies and job opportunities could be an alternative method for the Japanese government to recover from their loss of revenue as fewer people will rely on unemployment benefits and more people will be paying tax. Furthermore, with the tariff removed, goods will be produced by more efficient producer resulting a larger quantity to be sold, Q4 to Q5, at a lower price, P2 to P1, as shown on Figure 2. There will be a welfare gain as shaded in the red area on the diagram, and both producer and consumer are better off with this new deal. However, the consequence is that the domestic firms in both parties will be in a more competitive environment, and this could be vital for small domestic firms as they will have to compete with firms from the foreign country that are producing at a larger economy of scale. While subsidization is a possible alternative solution for the government to help domestic firms, this solution is unrealistic due to a large amount of expense.

EPA allows both EU and Japanese firms to increase the potential economic activity with access to a larger market. With a larger quantity of goods demanded, the firms will be able to lower production cost due to larger economy of scale by specializing in producing specific goods. Thus, the unofficial name of this deal "Cars for Cheese" is also an indirect message that specialization could be a solution to avoid direct competition between both producer and consumer in Japan and the European Union. For Japan, this deal could potentially help increase their GDP, which the positive economic shock is beneficial for Japan's low growth economy in these recent years. Likewise, with Brexit happening in the EU, this new deal could help to form new businesses that stabilize the EU economy to an extent.

EPA's Message to the Globe

In the past, Japan has not been an active member on the topic of free trade. However, this attitude has changed as Japan become one of the driving forces to implement CPTPP11 (Comprehensive and Progressive Agreement for Trans-Pacific Partnership 11) after the US president, Donald Trump, turn against the TPP deal. According to the explanation of Japan's ambassador, Jun Yamazaki, on Japan's new approach, "Our country does not produce natural resources. Our strength is that we have people - a quite

Figure 2: Effect of Tariffs



well-educated population that is fairly diligent in doing things, and in order to utilise that asset, we do have to have interaction with the outside world, and that definitely means free trade, and creating a more liberalised investment climate." Likewise, the President of European Commission shares the same value on the importance of free trade, which he claimed that EPA is "a message to the world about the future of open and fair trade." The EPA is viewed as a message challenging the US's and China's idea on favoring protectionism. Also, the EPA affects the U.S since both EU and Japan are currently negotiating a possible trading partnership with the U.S. Since the EU beef is now cheaper as in February 1st, the lower price has attracted more consumer's attention and has negatively affect the U.S beef industry operating in Japan. In the same way, a lower price on Japanese car in the European Union will similarly make the U.S car industry less competitive. With these effects, the U.S will more likely to look for a trade agreement to help its domestic firms operating in the EU and Japan.

Besides promoting the idea of global free trade, EPA has also enabled fair competition for firms within the two regions. Prior to the implementation of EPA, Japan has been adapting to different international safety regulations and measures such as "Textile Labelling System" and "International of Quality Management Certification" to reduce the cost of EU importing by removing these technical barriers. The EPA has enabled the biggest transfer of data, which are information that could be used for commercial purposes. Safe transfer of data will not only help the foreign business to settle, but it will encourage foreign and local investors to invest.

With EPA, Japan has also agreed to the Paris Climate Agreement, which it is believed that EPA will make "positive contribution" to fight climate change. The deal serves like a role model because the EU has mentioned that they are seeking for their future trading partners to also agree to the Paris Climate Agreement. However, there have been alternative perspectives stating that this could be an unlikely scenario as domestic firms in the EU would not be willing to risk losing the opportunities to expand their market.

Conclusion

Opposing to the rising popularity of protectionism, Japan and the EU have implemented the EPA to encourage global free-trade. The free trade deal that involves 635 million people and covers nearly one-third of the world's GDP have clearly shown its positive outcomes and potential risk. EPA has helped unified Japan and the EU not simply in terms of exports and imports, but it has also made competition and investment between two regions more balanced. Despite the potential risk for the domestic firm losing its protection from the government regulation, this could be resolved if the firms continue on specialization in this new massive market. Furthermore, both the EU and Japan seek this deal to boost their GDP and to create jobs opportunities. The people have benefited from the lower price on foreign goods as it takes immediate effect on February 1st and new job opportunities in the countries. The deal negotiated since 2013 taking effect would adjust the misallocation of goods allowing the efficient producer to produce more quantity of goods and increasing the total consumption and output in both Japan and the European Union. Overall, the EU and Japan agree on this deal mainly to help to boost their economy and to promote more future trade agreements among other countries.

Sources: BBC, Financial Times, 文茜世界週報, USA Today, Trading Economics, European Commission

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