Contacts

For more information, please contact:

Eric Desomer
Partner
+ 32 497 59 63 91
edesomer@deloitte.com

Björn Willemsens
Director
+32 475 90 09 35
bwillemsens@deloitte.com

Deloitte.

EU – Japan Free Trade Agreement

Impact assessment for the automotive industry

Free trade where there is reciprocity

On 18 July the Commission adopted a recommendation for a Council Decision authorizing the opening of negotiations on a Free Trade Agreement (FTA) between the EU and Japan. Today, a globalized industry needs free trade, but only on a level playing field. In Europe, it is currently not the case. So would an FTA between Europe and Japan help the situation in Europe or make it worse?

The European Union is the second biggest producer of motor vehicles in the world. With 236 manufacturing sites spread over 18 countries and a total production of 17.7 million motor vehicles (15.7 million passenger cars), the industry provides 11.6 million jobs.

The economic crisis in the EU has caused sales volumes to drop in many Member States, resulting in 2012 being the worst year in car sales in more than a decade. In 2007 record sales resulted in over 18.2 million motor vehicles (15.5 million passenger cars) being registered in the European Union. This year, new motor vehicles sales are estimated to reach 14.4 million units whereas passenger cars are estimated to reach 12.3 million units. Experts predict that the region will experience slow growth as of 2014, recovering to record sales levels only by 2020.

Growing losses threaten the sustainability of the volume market manufacturers' businesses, while social constraints impede their ability to tackle structural overcapacity issues in the EU.

The proposed FTA would aim to remove customs duty, ranging from 10 % (for cars) to 22 % (for trucks), on vehicles made in Japan and imported into the EU. In return, Japan is expected to eliminate non-tariff barriers that prevent European auto manufacturers from penetrating the Japanese market.

Current difficulties notwithstanding, EU offers attractive pockets of growth, while Japan presents a shrinking and a traditionally "inward looking" market

For an importer, the market dynamics that are shaping the automotive landscape are far more attractive in the EU than in Japan.

In contrast, Japan is not a strategic market for EU OEMs for a number of reasons:

- Demographic decline entails a drop in overall market potential
- Trends (high tax driven) lead to a general loss of driving interest
- Current regulatory non-tariff barriers pose significant roadblocks to market entry and consolidation
- Preferential treatment offered to the mini ('Kei[1]') car segment (allowing Japanese OEMs to "lock in" more than one third of the total market)
- Last but not least, cultural barriers pose challenges

On balance, despite overcapacity in production facilities in both the EU and Japan, the EU provides significantly more opportunities for absorption of these capacities in the longer term, resulting in Japanese OEM's having more incentives to export to the EU than vice versa.

The FTA would benefit Japanese OEMs across the board. In contrast, a select set of premium car manufacturers in the EU stand to make marginal gains in Japan as a result of the FTA.

In addition, the elimination of the EU tariff would represent an average additional profit of €1,500 per vehicle imported from Japan. This financial windfall would significantly enhance the competitiveness of Japanese players in the EU. Combined with a likely depreciation of the Yen versus the Euro, this poses significant challenges to the growth and sustainability of the local auto industry in the EU.

Improved market access in Japan, often out of scope of any free trade negotiations, will remain an exercise in theory. Furthermore, an FTA will not address the issue of ever decreasing numbers of car buyers in Japan. All in all, only premium manufacturers from the EU stand to make limited gains from the FTA.

It is estimated that an FTA would result in 7,800 additional units exported from the EU to Japan, while 443,000 extra units could be exported from Japan to the EU.

In other words, the proposed FTA would only make the situation worse.

Given these arguments, the proposed EU-Japan FTA would be unbalanced. Every imported vehicle may potentially replace one produced in the EU. The impact on EU employment will therefore be significant, estimated at between 34,500 – 72,760 job losses in the sector[2].

The aftermath of an accumulation of unbalanced FTAs puts EU automakers under severe strain

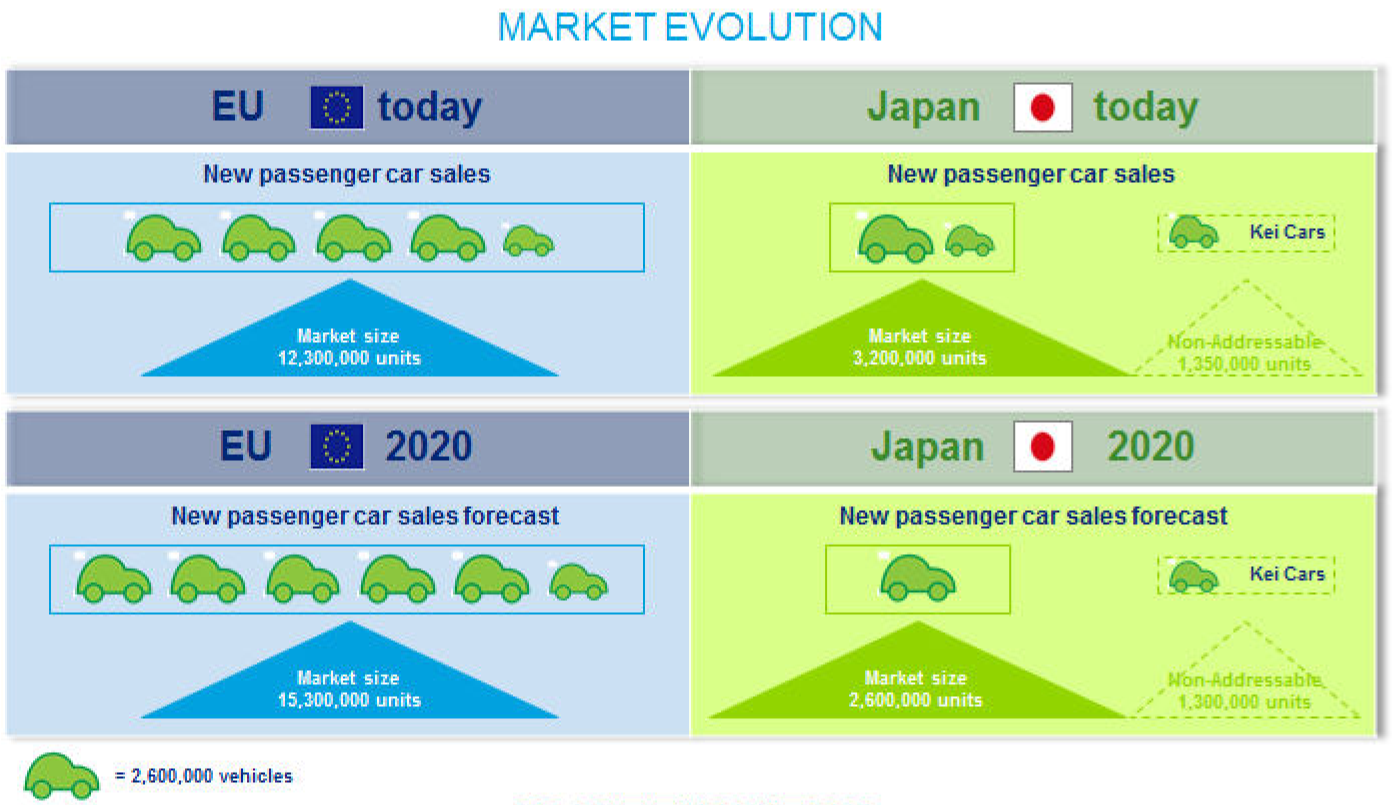
Today 17.6% of EU new motor vehicle sales are imports; in the long run this could rise to 23%. The global automotive market is growing, yet most of this growth is happening in emerging markets.

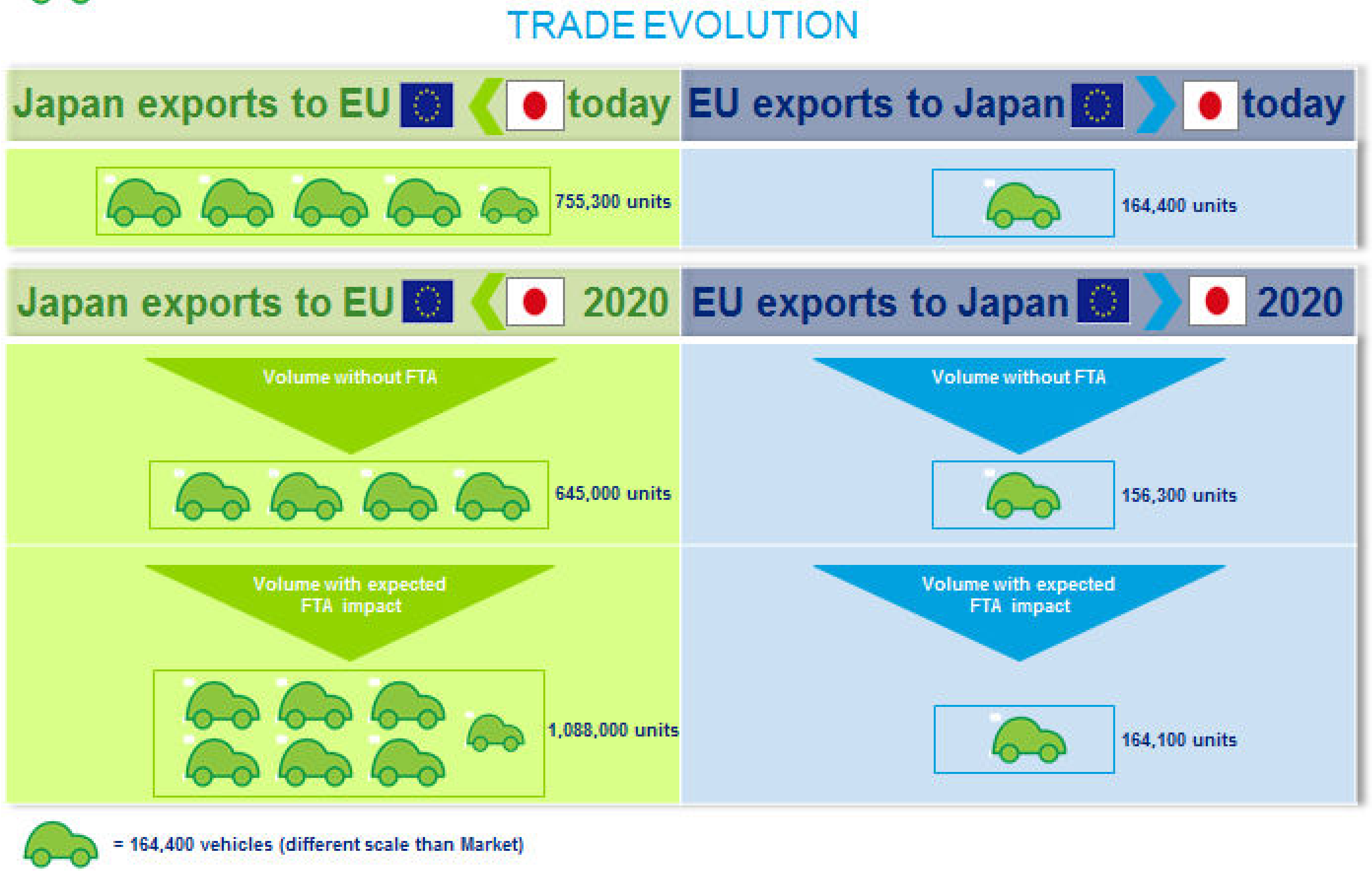
Existing trade barriers (import duties and non-tariff barriers), local market dynamics and governmental policy require overseas volume manufacturers to localize production to accelerate market penetration. Unbalanced FTAs with such economies may result in a further shift of production from the EU, consequently having a negative impact on the workforce of suppliers and OEMs.

A globalized industry needs free trade but on a level playing field

In a globalised automotive industry, free trade is important. FTAs should help iron out uneven trade flows.

In the case of the EU – Japan FTA, such an agreement will only widen the existing trade gap in the automotive sector. This, combined with the possible accumulation of asymmetrical FTAs with economies protective of their automotive sector, poses significant additional challenges to the health of the EU automotive industry, employment and the economic wellbeing in EU Member States.





[1] Kei car segment is composed by mini size vehicles; enjoying a preferential treatment in terms of tax, insurance, motorway tolls and parking registration. Its share in the Japanese market keeps increasing and represents today more than a third of the Japanese passenger car market. Only Japanese OEMs are producing this type of cars.

[2] The FTA impact results in additional Japanese imports of + 443k units, forming 2.7% of total EU production (2020 – own estimates). Assumption is that every incremental Japanese import is at the expense of EU production. Assuming 443k units = 6.900 direct jobs (in factory) and 27.600 indirect jobs, a share of 2.7% represents 34,500 jobs. This number can increase to 72,760 jobs for mainstream productivity plants. Ratio is in line with European OEM's employment versus production evolution.