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# EU-Japan FTA: Implications for U.S. Trade Policy

## Overview

In July 2018, the European Union (EU) and Japan signed a free trade agreement (FTA) after 18 rounds of talks since 2013. Following ratification in December, the agreement entered into force in February 2019. The EU and Japan account for about 40% of global trade and 30% of global GDP. Japanese and EU officials respectively touted the FTA as the “world’s largest, free, industrialized economic zone” and “most important bilateral trade agreement ever concluded by the EU.” EU Trade Commissioner Cecelia Malmström framed it in strategic terms as a “powerful signal” to the world “that Japan and the EU are partners” and stand together “to defend free and fair and sustainable trade in a climate where that is not taken for granted.”

The FTA talks concluded at a time of uncertainty for regional trade integration efforts. After abandoning Obama-era initiatives, the Trans-Pacific Partnership (TPP)—that included Japan—and U.S.-EU talks on a Transatlantic Trade and Investment Partnership (TTIP), the Trump Administration recently notified Congress of new separate trade negotiations with Japan and the EU (and the UK). The new talks, which some analysts see as partly motivated by EU-Japan cooperation, could begin in early 2019. As part of the backdrop, the EU and Japan have expressed concerns over recent U.S. tariffs imposed on their products and the perceived waning in U.S. support for the multilateral trading system. Japan also advanced the TPP-11 without U.S. participation, ratifying the deal in 2018.

As the EU-Japan FTA is implemented, the United States will be under increased stakeholders’ pressure to secure comparable access to these important markets. The EU collectively is the largest U.S. trade partner and Japan the fifth largest. The FTA eliminates tariffs on substantially all EU-Japan trade and nontariff barriers in key sectors. Terms include market opening for EU agricultural products, while Japan will gain advantages for its competitive auto sector. The FTA not only has implications commercially for the United States, but also for the U.S. role in shaping debates over trade rules in areas central to U.S. competitiveness.

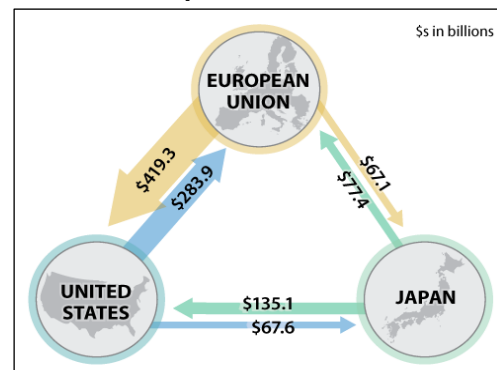
The FTA’s final terms were subject to some uncertainty. One concern was the pending withdrawal from the EU of the UK—a top destination for Japanese investment. The FTA applies to the UK while it remains an EU member, but a future UK-Japan deal would be contingent on outcomes of the Brexit negotiations. Unlike other EU FTAs, such as with Canada, the Japan deal faced few delays and political controversy during ratification. Because the deal sticks to provisions under the “exclusive competence” of the EU (e.g., by omitting certain investment issues), ratification by member states’ national or regional parliaments was not

required in addition to the European Parliament. These considerations could impact approaches in the U.S. trade talks.

## Trade and Investment Ties

Drivers of the EU-Japan FTA included mutual desires to revitalize trade ties and recapture market share, in particular given the progress of other major trade deals like TPP-11. In the past decade, EU and Japanese shares of each other’s trade have declined, in part reflecting the rise of China. Japan is the EU’s sixth largest trading partner; the EU is Japan’s third largest. Like the United States, the EU runs a goods trade deficit with Japan, but a surplus in services. The EU accounts for a quarter of Japan’s outward foreign direct investment (FDI), but Japan retains a small share of EU outward FDI. By contrast, the U.S. and EU are each other’s largest FDI source and destination, with cumulative FDI flows of over \$5 trillion. The U.S. is Japan’s largest country destination, accounting for a third of outward FDI.

**Figure 1. U.S., EU, Japan Trade in Goods, 2017**



**Source:** U.N. Comtrade accessed via International Trade Centre.

**Notes:** Trade figures reflect reporting country exports.

## Key Elements of the EU-Japan FTA

The FTA covers major areas of commercial engagement. Some issues prioritized in past U.S. FTAs are not covered, however. Several FTA commitments are sensitive issues for the U.S. bilaterally with the EU and Japan.

### Market Access

While EU and Japanese tariffs on average are relatively low, the elimination of tariffs on nearly all bilateral trade is expected to boost economic gains in key sectors. Japan will eliminate 97% of tariff lines on full implementation of the FTA (86% on entry into force); the EU will eliminate 99% of tariffs (96% on entry into force). Japan’s remaining tariffs for sensitive products, primarily in agriculture, will be reduced incrementally or be subject to tariff-rate quotas (TRQs). (Rice, seaweed, whale meat—banned in EU—are fully excluded.) Reduced nontariff barriers also aim to further market access (see below).

The EU expects large relative trade gains in agri-food products (see **text box**), textiles and clothing, machinery, footwear and leather products, among others, while Japan expects gains in industrial sectors, including autos, machinery, and chemicals. In particular, the EU will cut its 10% tariff on passenger vehicles within 7 years, while most auto parts tariffs are eliminated immediately. Tariffs on trucks, buses and tractors, and motorbikes are liberalized in stages.

#### Highlights: Japanese Agriculture Commitments

- **Beef:** 38.5% tariff reduced to 9% over 15 years;
- **Dairy (e.g., cheese):** hard cheeses tariffs up to 29.8% eliminated over 15 years; soft, fresh cheeses given duty-free TRQs that expand over time;
- **Pork:** 4.3% tariff eliminated and 482¥/kg specific duty reduced to 50¥/kg over 10 years;
- **Processed foods (e.g., pasta, chocolates):** Tariffs ranging up to 30% eliminated over 10 years;
- **Wine:** 15% tariff eliminated on entry into force.

FTA commitments also cover services, investment, and public procurement. **Services are liberalized** on a “negative list” basis (i.e., obligations apply to all sectors except those specified), with special attention to ensuring a level playing field in postal and courier services, financial services, and telecommunications. Other provisions aim to facilitate easier movement of company personnel between countries (known as “mode 4”). The FTA also ensures non-discriminatory **treatment for investments** and prohibits performance requirements—claimed by the EU as the most comprehensive list among FTAs to date. **Procurement access** goes beyond multilateral commitments, covering new municipalities and notably, Japan’s railway sector.

#### Standards and Regulatory Cooperation

Reducing nontariff barriers (NTBs)—e.g., divergent standards, technical requirements, and certification procedures—and regulatory cooperation were major EU-Japan priorities. The FTA has a separate chapter on regulatory cooperation, a first for the EU, which sets up a joint body. Several provisions promote greater transparency of regulations and mutual alignment with international standards—in particular for medical devices, textiles labeling, pharmaceuticals, and autos. For autos, Japan agreed to align its regulations with all standards of the United Nations Economic Commission for Europe (UNECE); as a result, motor vehicles will no longer need to be retested and certified upon export. A safeguard permits the snapback of tariffs if Japan reintroduces auto NTBs. Regarding agricultural products, sanitary and phytosanitary (SPS) provisions aim to simplify approval and import procedures and determine equivalence of measures.

#### Rules

EU-Japan FTA rules will affect key areas increasingly important to commercial ties. Observers question whether these approaches could set precedents for other FTAs. Selected features include:

- **Investment.** While provisions to promote FDI are included, investment protection and a related dispute mechanism are not, but are subject to ongoing talks. Japan’s FTA approach has been to maintain use of

investor-state dispute settlement (ISDS); the EU has pursued an alternative new investment court system, as per recent FTAs with Canada, Vietnam, and others.

- **Intellectual Property Rights.** The FTA reaffirms and expands on multilateral commitments, such as covering trade secrets. Enhanced protection is also ensured for geographical indications (GIs)—agricultural, food, and beverage products of specific geographic origin—a major EU priority. Japan recognized 205 GI-protected EU products; the EU recognized 56 Japanese products.
- **Digital Trade.** The FTA includes commitments not to impose duties on electronic transmissions or require disclosure of source code of software. Provisions on the cross-border flow of data are not included, however, unlike in Japan’s TPP-11, but both sides plan to review inclusion within 3 years. The EU and Japan reached a separate agreement in 2018 recognizing the adequacy of each other’s data protection standards to facilitate digital trade and complement the FTA.

Other rules cover state-owned enterprises (SOEs), corporate governance, small and medium-sized enterprises, and trade and sustainable development, including labor standards. For the first time in an FTA, both parties reaffirmed U.N. and Paris Agreement obligations related to climate change.

#### Potential Issues for Congress

The EU-Japan FTA could have several implications for congressional oversight of U.S. trade policy.

**Commercial Impact.** In the absence of a U.S. FTA with either major economy, certain U.S. industries could face competitive disadvantages or lost market share—e.g., those facing higher relative tariffs or regulatory hurdles—as the EU and Japan enjoy preferential access to each other’s markets. In particular, U.S. agriculture has expressed such concerns regarding Japan, the U.S. fourth largest export market. Per USDA analysis, certain market segments, such as pork, a top EU farm export, could face larger impacts.

**Objectives in Trade Negotiations.** EU-Japan FTA outcomes likely will influence negotiating priorities and debates about pending U.S. trade talks with both partners, the scope of which remains uncertain—for example, whether agriculture and auto sectors in the U.S.-EU case should be included or subject to staged talks. Differing approaches on politically-sensitive areas, such as autos and rules of origin, agriculture, NTBs and regulatory issues, digital trade, and currency are likely to be sticking points.

**Leadership in Global Trade Rules.** The EU-Japan FTA is the latest in an expanding EU FTA network, putting a growing share of global trade under EU FTA rules. For Japan, the deal was a strategic priority, after concerted leadership to finalize TPP-11. Observers question whether such FTAs will set precedents for future deals and will affect U.S. influence on the trading system. In particular, differing U.S.-EU approaches—e.g., on regulatory issues, standard setting, scope of IP protections, such as for GIs and pharmaceuticals, and data flows—may be consequential for shaping the direction of trade rules. At the same time, recent U.S.-EU-Japan efforts related to new subsidies and SOEs rules and plurilateral efforts on digital trade could be signs of other avenues for joint cooperation.

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