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U.S.-Japan Trade Agreement Negotiations

Overview

In April 2019, the United States and Japan held their first round of negotiations toward a new bilateral trade agreement. The Trump Administration is pursuing the talks with Japan under U.S. Trade Promotion Authority (TPA) procedures, potentially allowing for expedited legislative consideration of a concluded agreement. As the fourth-largest U.S. trade partner, Japan is a longstanding U.S. priority for trade negotiations, especially as recent Japanese trade agreements, including the EU-Japan FTA and the TPP-11 (the successor to the Trans-Pacific Partnership (TPP) following U.S. withdrawal), lower Japan's tariffs on imports from several countries, placing U.S. exporters at a disadvantage in the Japanese market. The two parties continue to negotiate on the precise scope of the talks, but both sides appear to prioritize quick results over a more comprehensive negotiation. Key issues are likely to include trade commitments on motor vehicles, agricultural goods, and services, as well as areas where the two nations have largely similar goals, such as digital trade. Currency commitments are a priority among some U.S. stakeholders, but Japan opposes including them in the trade talks.

On May 17, 2019, following an investigation by the U.S. Department of Commerce, President Trump proclaimed U.S. motor vehicle and parts imports, particularly from Japan and the EU, a threat to U.S. national security. This grants the President the authority to impose import restrictions under Section 232 of the Trade Expansion Act of 1962. The President directed the United States Trade Representative (USTR) to negotiate with Japan (and the EU) to address this threat and report back within 180 days. Japan strongly opposed U.S. Section 232 tariffs on imports of steel and aluminum in place since March 2018, but did not retaliate against the tariffs, in contrast with several other U.S. trade partners, including the EU and China. Given that motor vehicles are the top Japanese export to the United States, U.S. import restrictions on the sector would likely create a strong backlash from Japan. President Trump has stated he is using the threat of auto tariffs to influence broader U.S.-Japan trade negotiations, but it is unclear what auto outcomes the President seeks as part of the FTA talks.

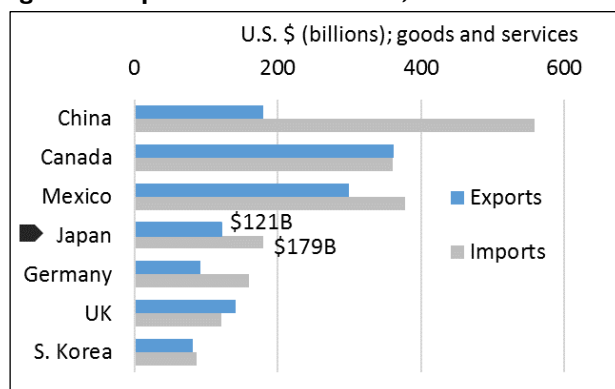
Bilateral Trade and Economic Relations

The world's third-largest economy, Japan is the fourth-largest U.S. trade partner, fourth-largest U.S. investment partner, and second-largest foreign holder of U.S. government debt. In 2018, U.S. exports to Japan totaled \$121.1 billion, with \$75.7 billion in goods and \$45.4 billion in services. U.S. imports totaled \$179.1 billion, with goods accounting for the bulk of imports (\$144.6 billion), most notably motor vehicles and parts (\$56.0 billion). The stock of U.S. foreign direct investment (FDI) in Japan was valued at \$129.1 billion in 2017, concentrated in finance and insurance (\$64.1 billion). Japanese FDI stock in the United

States totaled \$469.1 billion in 2017, with manufacturing accounting for the largest share (\$157.3 billion).

The size of the bilateral goods trade deficit, which at \$67.6 billion was the fourth-largest U.S. deficit in 2018, remains a source of tension, as does the idea that the imbalance stems in part from various nontariff barriers in the Japanese market. Such concerns arguably peaked in the 1980s and early 1990s, dissipating over the past two decades in the face of Japan's domestic economic challenges, major Japanese investment in the United States, Japan's increased economic openness, and a shift in U.S. focus to concerns over trade relations with China. The Trump Administration, however, has renewed U.S. focus on the trade deficit.

Figure 1. Top U.S. Trade Partners, 2018



Source: CRS with data from Bureau of Economic Analysis (BEA).

Scope and Timing of Negotiations

The potential scope of the trade talks remains unclear, in part due to differing characterizations by the two sides. Prime Minister Abe initially referred to the talks as goods-only negotiations, differing from other comprehensive Japanese FTAs. Meanwhile, U.S. negotiating objectives released in December 2018, as required by TPA, suggested a broad range of issues would be covered, including trade in goods, services, investment, intellectual property, state-owned enterprises, and digital trade. USTR indicated that it may pursue negotiations with Japan in stages, in consultation with Congress, which would represent a shift in approach from past U.S. FTAs, which typically involve one comprehensive negotiation.

U.S. exporters in key sectors such as automobiles, agriculture, and services have been challenged by multiple tariff and nontariff barriers for decades.
USTR, *USJTA Negotiating Objectives*, December 2018

Japan's FTAs with Other Major Markets

In 2018, Japan concluded and ratified two major FTAs, which exclude the United States and could have significant implications for U.S. stakeholders. The Japan-led

Comprehensive and Progressive Agreement for Trans-Pacific Partnership (or TPP-11), which took shape after the U.S. withdrawal from TPP, entered into force at the end of 2018. Meanwhile, the European Union (EU) and Japan, which together accounted for more than one-quarter of total U.S. trade in 2018, entered into an FTA in February 2019. U.S. exporters raise concerns that Japan's reduced tariffs on imports from TPP-11 and EU countries, particularly on agricultural products such as Japan's relatively high 38.5% beef tariff, threaten U.S. export competitiveness. New rules in the FTAs have also led to concerns that they may not reflect U.S. priorities. E-commerce provisions in the EU-Japan FTA, for example, do not cover the free flow of data, unlike the recently negotiated U.S.-Mexico-Canada Agreement (USMCA). Meanwhile, TPP-11 also suspended 22, largely U.S.-priority, provisions from the original TPP text, including some of relevance in Japan, such as prohibiting cross-subsidization of express delivery services by monopoly postal services (e.g., Japan Post).

Key Sectors and Potential Provisions

Agriculture

Opening Japan's highly protected agriculture market and reaching parity with exporters from Japan's FTA partners is a major priority for U.S. industry. In 2018, Japan was the fourth-largest U.S. agriculture market, with exports of \$12.9 billion. Japan's import sensitivities, however, may limit its concessions to those provided in TPP-11 (considered Japan's most ambitious commitments to date). Prime Minister Abe stated Japan plans to limit new agriculture market access to offers in existing FTAs.

Motor Vehicles

Motor vehicles have long been contentious in U.S.-Japan trade relations. Three major factors influence bilateral dynamics in the industry: (1) autos and parts are top U.S. imports from Japan (more than one-third of all goods imports); (2) despite being the third-largest world auto market, Japan imports few U.S.-made autos (\$2.4 billion in 2018), leading to a major bilateral U.S. deficit in the sector; and (3) major Japanese investment in U.S. production facilities (\$51.8 billion in 2017, or about one-third of Japan's FDI in U.S. manufacturing) supports nearly 350,000 direct and indirect U.S. jobs, per the Japan Automobile Manufacturers Association.

Japan has no auto tariffs, but U.S. industry argues that nontariff barriers, including discriminatory regulatory treatment, disadvantage U.S. sales. Japanese stakeholders counter that failure by U.S. industry to adjust to its market characteristics is to blame. TPP included commitments on nontariff issues, but arguably, the most significant provisions affecting auto trade were the 25- and 30-year phaseout periods for the 2.5% and 25% U.S. car and light truck tariffs, respectively. President Trump has repeatedly flagged the U.S. trade deficit in autos and noted that U.S. goals in the new talks include market access outcomes that will increase U.S. auto production and employment. Establishing auto rules of origin in the agreement may be a challenge given extensive U.S. supply chain links in North America and widespread Japanese sourcing in Asia.

Services

The United States has a bilateral services trade surplus, and Japan is a major market for U.S. service providers. For example, the Japanese insurance market is the second

largest in the world behind the U.S. market, accounting for nearly 30% of all U.S. foreign affiliate sales in the industry in 2016 (\$48.9 billion). Japan Post, the state-owned postal service, is among Japan's largest banks and insurers; it has moved toward privatization but remains majority-owned by the government. Historically, U.S. firms have found it difficult to enter segments of the Japanese market and argue that Japan confers preferential treatment on insurance and express delivery subsidiaries of Japan Post. Several TPP provisions were designed to level the playing field for services suppliers, and crafting similar rules in the new talks may be a negotiating priority for the United States.

Currency and Other Issues

Some U.S. stakeholders argue currency commitments should be a priority in the negotiations, as exchange rates have a significant effect on trade flows and the U.S. trade deficit. A weaker yen makes imports from Japan cheaper in the U.S. market while increasing the cost of U.S. exports. Although Japan has not intervened directly in foreign exchange markets since 2011, monetary stimulus under the "Abenomics" program has put significant downward pressure on the yen. Japan remains on the U.S. Department of the Treasury's currency monitoring list due to its large trade and current-account surpluses with the United States. USMCA includes the first-ever U.S. FTA commitments on exchange rates and could serve as a template in the Japan talks (TPP included a nonbinding declaration on currency). Japan opposes including currency provisions in the talks.

Digital Trade and Other Issues

On a number of trade issues, such as digital trade and state-owned enterprises, the two countries have largely similar goals. Commitments on these topics may also be included; USTR stated a need for "high standards in the area of digital trade" after the first round of negotiations.

Issues for Congress

Scope of Negotiations and TPA. The possibility that talks may proceed in stages raises questions regarding what areas will be prioritized and whether outcomes will meet congressional expectations or TPA requirements.

Trade Deficit. The Administration's focus on deficits, which presumably will center on autos, is likely to be a source of tension. Economists generally view trade deficits as driven by macroeconomic forces and less as an indicator of a trade relationship's "fairness."

U.S. Tariff Actions. President Trump's declaration under Section 232 that motor vehicle imports threaten U.S. national security and its emphasis on "American owned" production facilities is strongly opposed by Japanese auto firms, which have invested more than \$50 billion dollars in the United States supporting 170,000 U.S. jobs, according to data from the Bureau of Economic Analysis. It also raises questions over the definition of national security and congressional intent for the President's use of Section 232.

For more information, see CRS Report RL33436, *Japan-U.S. Relations: Issues for Congress*.

Cathleen D. Cimino-Isaacs, Analyst in International Trade and Finance

Brock R. Williams, Specialist in International Trade and Finance

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