Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

Updated October 3, 2019

U.S.-Japan Trade Agreement Negotiations

Overview

On September 25, 2019, President Trump and Prime Minister Abe announced they had finalized a limited bilateral trade agreement consisting of tariff cuts on agricultural and industrial goods and commitments on digital trade. The two sides stated their intent to begin negotiations on a more comprehensive deal after this initial agreement enters into force. Congress will likely not have a formal role in approving the "first stage" agreement, as the Trump Administration intends to use delegated tariff proclamation authorities in Trade Promotion Authority (TPA) legislation to enact the agreed-upon tariff changes, while the digital trade commitments are to take the form of an Executive Agreement. Japan's Diet, however, will have to ratify the agreement before it can enter into force. The Administration expects the agreement to take effect on January 1, 2020. As the fourth-largest U.S. trade partner, Japan is a priority for U.S. trade negotiations, especially as recent Japanese free trade agreements (FTAs), including with the European Union (EU) and the TPP-11 (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.

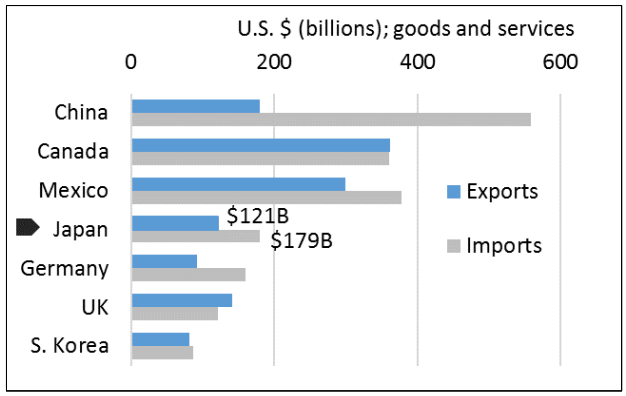
Notably, the limited agreement does not include trade commitments on motor vehicles, a long-standing area of bilateral tension. On May 17, 2019, following an investigation by the U.S. Department of Commerce under Section 232 of the Trade Expansion Act of 1962, President Trump proclaimed motor vehicle 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. 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. USTR Lighthizer stated that in light of the new agreement, the Administration has no intent, "at this point," to pursue additional Section 232 U.S. auto import restrictions. 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. Alleviating the auto tariff threat was a key objective of Japan in the recent 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 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 $125.5 billion in 2018, concentrated in finance and insurance. Japanese FDI stock in the United States totaled $484.4 billion in 2018, with manufacturing accounting for the largest share.

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 view by some observers that the imbalance stems in part from various nontariff barriers in the Japanese market. Such concerns arguably peaked in the 1980s and 1990s, dissipating over the past two decades in the face of Japan's domestic economic challenges, major Japanese investment in the United States, and a shift in U.S. focus to concerns over trade with China. The Trump Administration, however, has renewed focus on the trade deficit.

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



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

Japan's FTAs with Other Major Markets

In 2018, Japan 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 U.S. withdrawal from TPP, entered into force at the end of 2018. Meanwhile, the EU and Japan entered into an FTA in February 2019: these two trading partners accounted for nearly 30% of total U.S. trade in 2018. U.S. exporters raise concerns that Japan's reduced tariffs and nontariff barriers 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 proposed 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).

Scope of U.S.-Japan Negotiations

The Administration's decision to pursue negotiations with Japan in stages is a departure from past U.S. FTA practice, which typically involves one comprehensive negotiation. U.S. negotiating objectives released in December 2018, as required by TPA, suggested a broad range of issues would be covered in addition to tariffs and digital trade, including services, investment, intellectual property, and state-owned enterprises. The two countries aim to begin the second stage of talks within four months after entry into force of the initial agreement. U.S. businesses advocate for continued progress toward a more comprehensive deal with Japan, while other stakeholders question whether there will be sufficient political momentum in both countries to make progress in future talks. Several analysts also question the extent to which the limited agreement adheres to Article XXIV of the General Agreement on Tariffs and Trade (GATT) under the WTO that requires FTAs cover "substantially all trade," in particular given the exclusion of auto trade. Congress has historically taken issue with other countries' partial scope agreements, advocating for better adherence to Article XXIV, including in legislation. Though adherence to Article XXIV has rarely been challenged at the WTO, whether or not the U.S.-Japan deal violates the letter or spirit of this WTO requirement likely depends on the timeline and scope of next stage talks.

Initial Trade Agreement Provisions

The text of the initial agreement has not yet been released, but according to official statements, it covers agricultural and industrial goods market access and digital trade.

Market Access for 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. According to USTR, the agreement will lead to "substantial market access" for over $7 billion of U.S. agricultural exports through reduced or eliminated tariffs and U.S.-specific quotas, benefiting various products, including beef, pork, wheat, cheese, and wine. The agreement is also to include U.S. tariff reductions for certain niche products such as cut flowers, persimmons, and green tea, and modifications to the U.S. global tariff rate quota for beef. While U.S. industry generally supports the agreement, certain sectors including dairy and rice expressed concerns about the extent of new market access or the lack of attention to other key issues, such as geographical indications (GIs) and sanitary and phyto-sanitary standards (SPS), which are among the areas typically covered in comprehensive U.S. FTAs.

Market Access for Industrial Goods

USTR stated that the agreement includes U.S. tariff cuts on machine tools, fasteners, steam turbines, bicycles and parts, and musical instruments. U.S. auto tariffs are not included.

Rules on Digital Trade

On digital trade, an area in which the two countries have largely similar goals, USTR referred to the agreement as a "gold standard" that meets the rules set by the proposed USMCA. Key provisions include prohibition of localization barriers in the digital space and commitments on nondiscriminatory treatment and cross-border data flows.

Potential Provisions in Future Talks

Motor Vehicles

Autos and parts account for more than one-third of U.S. imports from Japan, and a reduction of U.S. 2.5% and 25% car and light truck tariffs, respectively, is likely to be a primary Japanese goal in next stage talks. Japan has no auto tariffs, but imports few U.S.-made autos ($2.4 billion in 2018). U.S. industry argues this stems from nontariff barriers, including discriminatory regulatory treatment, while Japan argues that U.S. producers' inability to cater to the Japanese market is to blame. President Trump has repeatedly flagged the U.S. autos trade deficit and noted that U.S. goals in trade talks include market access outcomes that will increase U.S. auto production and employment. While Japan buys few U.S. cars, Japanese FDI in U.S. production facilities ($51 billion in 2018) supports 170,000 U.S. jobs, according to the BEA.

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). 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, the state-owned postal service and one of Japan's largest banks and insurers. Several TPP provisions were designed to address such concerns, and crafting similar rules in future talks may be a negotiating priority for the United States.

Currency

Some U.S. stakeholders argue currency commitments should be a priority in the negotiations, as exchange rates have a significant effect on trade flows. A weaker yen makes imports from Japan cheaper in the U.S. market while increasing the cost of U.S. exports. Japan has not intervened directly in foreign exchange markets since 2011, but remains on the U.S. Department of the Treasury's currency monitoring list. USMCA includes the first-ever U.S. FTA commitments on exchange rates and could serve as a template in the Japan talks.

Issues for Congress

The Administration's decision to pursue a limited scope trade agreement with Japan in stages, while considering U.S. tariff actions under Section 232, raises a number of questions for Congress including:

- What areas should USTR prioritize in future talks?
- Do negotiated outcomes adhere to TPA requirements?
- What role should Congress play in limited agreements?
- Will a limited agreement make it easier or more difficult to address future bilateral trade liberalization?
- How do U.S. auto imports threaten national security?

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

Disclaimer