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U.S.-Japan Trade Agreement Negotiations

Overview

On October 7, 2019, after six months of formal negotiations, the United States and Japan signed two agreements intended to liberalize bilateral trade. The U.S.-Japan Trade Agreement (USJTA) provides for limited tariff reductions and quota expansions to improve market access. The U.S.-Japan Digital Trade Agreement covers rules on digital aspects of international commerce. The agreements, which took effect on January 1, 2020, without formal action by Congress, constitute what the Trump and Abe Administrations envision as "stage one" of a broader U.S.-Japan trade agreement, with future negotiations expected in coming months. The Administration used delegated tariff authorities in Trade Promotion Authority (TPA) to proclaim the USJTA provisions, while the digital trade agreement, which did not require changes to U.S. law, was treated as an Executive Agreement.

As the fourth-largest U.S. trade partner, Japan is a high 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.

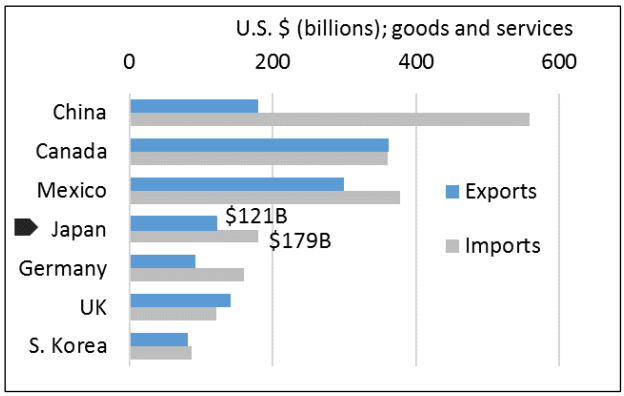
The USJTA does not include trade commitments on motor vehicles, a long-standing area of bilateral tension. In May 2019, following an investigation by the Department of Commerce under Section 232 of the Trade Expansion Act of 1962, President Trump proclaimed motor vehicle and parts imports, particularly from Japan and the EU, a threat to U.S. national security. Such action grants the President the authority to impose import restrictions, but some analysts question whether that authority has now expired. USJTA does not address potential Section 232 tariffs, but USTR Lighthizer stated that the Administration has no intent, "at this point," to pursue additional Section 232 restrictions on autos. Japan strongly opposed U.S. Section 232 tariffs on imports of steel and aluminum in place since March 2018, but did not retaliate, unlike other U.S. trade partners. Alleviating the auto tariff threat was a key objective of Japan in the trade 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 billion, with $76 billion in goods and $45 billion in services. U.S. imports totaled $179 billion, with goods accounting for the bulk of imports ($144 billion), most notably motor vehicles and parts ($56 billion). The stock of U.S. foreign direct investment (FDI) in Japan was valued at $125 billion in 2018, concentrated in finance and insurance. Japanese FDI stock in the United States totaled $484 billion in 2018, with manufacturing accounting for the largest share.

The size of the bilateral goods trade deficit, which at $68 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 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—Japan's tariff reductions in USJTA help alleviate such concerns. 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.

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 second stage talks as early as May 2020, but specific issues to be covered remain unclear. Several Members of Congress, U.S. businesses and stakeholders strongly advocate for a more comprehensive deal, while other stakeholders question whether there will be sufficient political momentum in both countries to make progress in future talks.

Analysts also question the extent to which the limited deal 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 autos. Congress has historically taken issue with other countries' partial scope agreements, advocating for better adherence to Article XXIV within 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 two agreements in the "stage one" deal cover some industrial goods and agricultural trade and cross-border digital trade. Neither includes a formal dispute settlement mechanism to enforce commitments.

U.S.-Japan Trade Agreement (USJTA)

The USJTA commitments cover about $14.4 billion ($7.2 billion each of U.S. imports and exports) or 5% of bilateral trade. The United States agreed to reduce or eliminate 241 tariffs on mostly industrial goods, including machine tools, fasteners, steam turbines, bicycles and parts, and musical instruments, and certain niche agricultural products, such as green tea. The U.S. will also expand its global tariff-rate quota for beef imports. Japan agreed to reduce or eliminate tariffs on about 600 agricultural tariff lines, such as beef, pork, and cheese, and expand preferential tariff-rate quotas for a limited number of U.S. products, such as wheat.

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 third-largest U.S. agriculture market, with exports of $12.9 billion. While U.S. industry generally supports the USJTA, certain sectors, including dairy and rice expressed concerns about the extent of new market access or lack of attention to other key issues, such as geographical indications (GIs) and sanitary and phytosanitary standards (SPS), which are areas typically covered in comprehensive U.S. FTAs.

U.S.-Japan Digital Trade Agreement

On digital trade, an area in which the two countries have similar goals, USTR sees the agreement as "comprehensive and high standard" in line with rules set by the USMCA. Provisions include non-discriminatory treatment, and commitments to prohibit or limit data localization barriers, restrictions on cross-border data flows, and transfer of source code or algorithms as conditions of market access.

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 (valued at $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 next stage of Japan talks.

Issues for Congress

The Administration's decision to pursue a trade agreement with Japan in stages and enact the limited "stage one" agreements without the approval of Congress, 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 the agreements compare with the TPP, and how has U.S. TPP withdrawal affected U.S. economic and strategic interests in Japan and the Asia-Pacific?
- How do U.S. auto imports threaten national security?

For more information, see CRS Report R46140, *"Stage One" U.S.-Japan Trade Agreements*.

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