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U.S.-Japan Trade Agreement Negotiations

Overview

Under Trade Promotion Authority (TPA) procedures, on October 16, 2018, the Trump Administration gave Congress its official 90-day advance notification of intent to enter into trade agreement negotiations with Japan. As the fourth-largest U.S. trade partner, Japan is a longstanding U.S. priority for trade negotiations, in particular following U.S. withdrawal from the proposed Trans-Pacific Partnership (TPP) in 2017, which included Japan. With initial TPA requirements met, official negotiations could start at any time. The precise scope of the negotiations remains somewhat uncertain but areas of focus likely include trade commitments on motor vehicles, agricultural goods, services, and potentially policies affecting exchange rates.

Japan's recent free trade agreements (FTAs) with major non-U.S. markets set new rules and lower tariffs for Japan's trading partners, disadvantaging U.S. exporters and further incentivizing U.S. interest in new talks. Japan had preferred a regional approach to trade negotiations, and urged the United States to reconsider its TPP withdrawal. Some suggest Japan became more willing to enter bilateral talks after President Trump in May 2018 launched a Section 232 investigation that could result in increased tariffs on Japanese autos and auto parts—Japan's top export to the United States and a major source of the U.S. trade deficit with Japan. Japan strongly opposed U.S. Section 232 tariffs on imports of steel and aluminum—deemed a threat to U.S. national security—in place since March 2018.

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 2017, U.S. exports to Japan totaled \$114.7 billion, with \$68.3 billion in goods and \$46.4 billion in services. U.S. imports totaled \$171.3 billion, with goods accounting for the bulk of imports (\$138.3 billion), most notably motor vehicles and parts (\$55.5 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 \$70.0 billion was the third-largest U.S. deficit in 2017, remains a source of tension, as does the idea that the imbalance stems in part from various non-tariff 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. Under the Trump Administration, bilateral tension over the trade deficit has returned to prominence in the relationship.

Figure 1. Top U.S. Trade Partners, 2017



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, within specific negotiating objectives released in December 2018—as required by TPA 30 days before talks can commence—the U.S. Trade Representative (USTR) suggested a broad range of issues will be covered, including trade in goods, services, investment, intellectual property, state-owned enterprises, and digital trade. USTR has indicated that it may pursue negotiations with Japan in stages, in consultation with Congress, which would represent a shift in approach from recent 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 non-tariff 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 although excluding the United States, 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. withdrew 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 2017, entered into an FTA in February 2019. U.S. exporters to Japan worry that a reduction in tariffs for TPP-11 and EU countries, particularly on agricultural products such as Japan's relatively high 38.5% beef tariff, will threaten the competitiveness of U.S. exports in the

Japanese market. 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) and TPP-11 that prohibit related restrictions. Meanwhile, TPP-11 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, such as the EU, Australia, and Canada (a member of TPP-11), is a major priority for U.S. industry in the proposed talks. In 2017, Japan was the fourth largest U.S. agriculture market, with exports of \$11.9 billion. Japan's import sensitivities in the sector, however, may limit its concessions to those provided in the TPP (considered Japan's most ambitious commitments to date). In announcing new talks, Abe said 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 the top U.S. import from Japan, accounting for more than one-third of all goods imports; (2) despite being the third-largest world auto market, Japan imports very few U.S.-made autos (\$2.3 billion in 2017) 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 facilities) supports nearly 350,000 direct and indirect U.S. jobs, as per the Japan Automobile Manufacturers Association.

Japan has no auto tariffs, but U.S. industry argues that non-tariff barriers, including inequitable regulatory treatment, have led to poor U.S. sales abroad. Japanese stakeholders counter that failure by U.S. industry to adjust to its market characteristics is to blame. TPP included commitments on non-tariff issues, but arguably the most significant provisions affecting auto trade were the 25- and 30-year phase-out 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 in the new talks, U.S. aims include market access outcomes that will increase U.S. production and employment in the sector. Establishing auto rules of origin in the agreement may be a challenge given extensive U.S. supply chains 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 United States, 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 and among Japan's largest banks and insurers, 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 provisions may be a negotiating priority for the United States in the new talks.

Currency

Some U.S. stakeholders argue that the Japanese government has at times made efforts to unfairly depress the value of the Japanese yen relative to the U.S. dollar to gain a trade advantage, contributing to 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. Treasury Department's currency monitoring list due to its large trade and current account surpluses with the United States. USMCA commitments, which could serve as a template for talks with Japan, includes the first ever chapter on exchange rate policies in a negotiated U.S. FTA, and it goes further than the non-binding declaration on currency in the proposed TPP.

Issues for Congress

Scope of Negotiations and TPA. The initial framing of the negotiations emphasized a focus on areas that produce "early achievements," while USTR's objectives suggest talks aim to cover a broad agenda. The possibility that talks may proceed in stages raises some questions for U.S. stakeholders regarding what areas will be prioritized and whether outcomes will meet congressional expectations or TPA requirements. The debate over pending ratification of USMCA may also influence U.S. approaches to Japan talks.

Trade Deficit. Among top USTR objectives related to trade in goods is to "improve the U.S. trade balance and reduce the trade deficit with Japan." The focus on deficits, which presumably will center on autos, is likely to be a source of tension; Japan and other countries generally view bilateral trade imbalances as just one aspect of trade relations and less an indicator of a relationship's "fairness."

Presidential Tariff Authorities. The March 2018 imposition of U.S. Section 232 tariffs on Japanese metals imports created new uncertainties in the bilateral relationship. Unlike other countries, Japan has not filed a dispute at the World Trade Organization (WTO), though it is considering retaliatory tariffs on U.S. products. While the Trump Administration indicated it would hold off on new tariffs against Japanese autos as new trade talks proceed, the issue could feature prominently in the negotiations.

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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