



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 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 described as “stage one” of a broader U.S.-Japan trade agreement, but further talks have yet to materialize. The Trump 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. The status of the pending second stage bilateral talks remains of interest to Congress but is uncertain under both Japan’s new Suga Administration and the incoming Biden Administration.

As the fourth-largest U.S. trade partner, Japan has been 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.

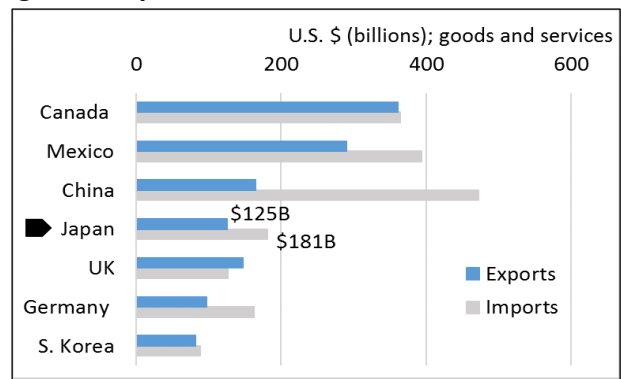
The USJTA does not include trade commitments on motor vehicles, a longstanding area of bilateral tension. In May 2019, the Trump Administration took initial steps to potentially impose increased tariffs on Japanese auto imports, proclaiming such imports a national security threat under Section 232 of the Trade Expansion Act of 1962. The Administration declined to take further action, which some analysts link to Japan’s concessions in the USJTA, although the agreement itself is silent on the issue. Japan strongly opposed U.S. Section 232 tariffs on imports of steel and aluminum in place since 2018, but did not retaliate, unlike other U.S. trade partners. Alleviating the auto tariff threat was a key objective of Japan in the bilateral 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 2019, U.S. exports to Japan totaled \$125 billion, with \$75 billion in goods and \$50 billion in services. U.S. imports totaled \$181 billion, with goods accounting for the bulk of imports (\$145 billion), most notably motor vehicles and parts (\$54 billion). The stock of U.S. foreign direct investment (FDI) in Japan was valued at \$132 billion in 2019, concentrated in finance and insurance. Japanese FDI stock in the United States totaled \$619 billion in 2019, with manufacturing accounting for the largest share.

The size of the bilateral goods trade deficit, which at \$70 billion was the fourth-largest U.S. deficit in 2019, 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.

Figure 1. Top U.S. Trade Partners, 2019



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

Japan’s FTAs with Other Major Markets

In recent years, Japan has concluded several major FTAs that exclude the United States, with potential implications for U.S. stakeholders. The Japan-led Comprehensive and Progressive Agreement for Trans-Pacific Partnership (or TPP-11) took shape after U.S. withdrawal from TPP and 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 2019. In November 2020, Japan signed the Regional Comprehensive Economic Partnership (RCEP) trade agreement, which will lower trade barriers among its 15 Asian members, including China, once it takes effect. U.S. exporters raise concerns that Japan’s reduced tariffs and nontariff barriers on imports from TPP-11, EU, and potentially RCEP countries, threaten U.S. export competitiveness for some products—Japan’s tariff reductions for certain agricultural goods in USJTA help alleviate some 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 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 Trump Administration’s decision to pursue negotiations with Japan in stages was 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 committed to second stage negotiations, but talks did not materialize in 2020. Several Members of Congress, U.S. businesses, and stakeholders strongly advocated for a more comprehensive deal; others questioned whether there will be sufficient political momentum in both countries to make further progress.

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.” Some Members of Congress have historically taken issue with other countries’ partial scope agreements. Though adherence to Art. 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 scope of next stage talks.

Initial Trade Agreement Provisions

The two “stage one” agreements cover some industrial goods and agricultural trade and cross-border digital trade. Neither includes a formal dispute settlement mechanism.

U.S.-Japan Trade Agreement (USJTA)

The USJTA commitments cover about 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 2019, Japan was the fifth-largest U.S. agriculture market, with exports of \$11.7 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, the Trump Administration 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; it imports few U.S.-made autos (\$2.5 billion in 2019). U.S. industry argues this stems from nontariff barriers, including discriminatory regulatory treatment, while Japan argues that U.S. producers’ inability to tailor to the Japanese market is the cause. Under the Trump Administration, the U.S. autos trade deficit was a heightened issue and U.S. goals in trade talks included market access outcomes that 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 25% of all U.S. foreign affiliate sales in the industry in 2018. 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 talks, as exchange rates have a significant effect on trade flows. A weaker yen makes imports from Japan cheaper, 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. Treasury Department’s currency monitoring list. USMCA includes the first-ever U.S. FTA commitments on exchange rates and could serve as a template in future Japan talks.

Issues for Congress

The Trump Administration’s decision to pursue a trade agreement with Japan in stages and enact the limited “stage one” agreements without the approval of Congress raised 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-11, and how has U.S. TPP withdrawal affected U.S. economic and strategic interests in Japan and the Asia-Pacific?

As Congress prepares to engage with the incoming Administration, key issues include whether the new Administration will continue to pursue partial agreements with Japan, or a more traditional comprehensive approach, as well as possible U.S. return to regional engagement.

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

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