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U.S.-Japan Trade Agreement Negotiations

Overview

In October 2019, 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 the digital aspects of international commerce. The trade deals, which took effect in January 2020, without formal action by Congress, constituted what the Trump and Abe Administrations described as "stage one" of a broader U.S.-Japan trade agreement, but further talks did not materialize. The Trump Administration used delegated tariff authorities in the 2015 grant of Trade Promotion Authority (TPA, P.L. 114-26 now expired) 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 Biden Administration has not pursued further bilateral trade talks with Japan, despite urging from some stakeholders to resume negotiation on issues left out of the initial agreements (e.g., auto trade and services).

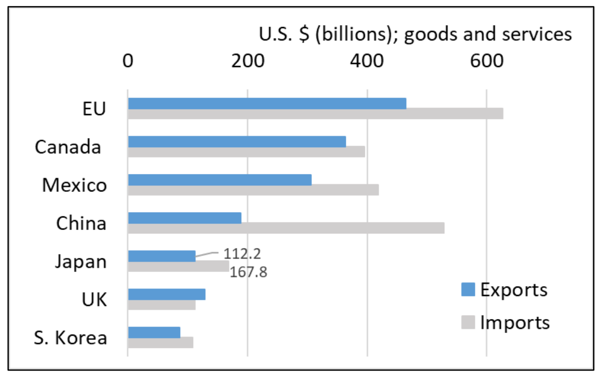
As the fifth-largest U.S. trade partner, Japan has been a priority for U.S. trade negotiations, especially as recent Japanese free trade agreements (FTAs) with the European Union (EU) and other major partners lower Japan's tariffs on imports from several countries, placing U.S. exporters at a disadvantage. Some Members of Congress have called for the Biden Administration to consider joining the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), of which Japan is a member. CPTPP took shape among the 11 remaining members of the proposed TPP after President Trump withdrew the U.S. signature from TPP in 2017. The Administration has stated it is not currently interested in joining, but announced plans for an Indo-Pacific Economic Framework (IPEF), presumably to include Japan, which would address limited trade issues (e.g., the digital economy, agriculture, trade facilitation, labor, the environment, transparency, and competition policy), but not market access through tariff reduction and elimination. In November 2021, the Administration also launched the U.S.-Japan Partnership on Trade, to advance collaboration and engagement on common areas of interest and address specific trade issues.

Bilateral Trade and Economic Relations

The world's third-largest economy, Japan is the fifth-largest U.S. trade partner, fourth-largest U.S. investment partner, and largest foreign holder of U.S. government debt. In 2021, U.S. exports to Japan totaled $112 billion ($76 billion in goods and $37 billion in services). U.S. imports totaled $168 billion, with goods accounting for the bulk of imports ($136 billion), most notably motor vehicles and parts. The stock of U.S. foreign direct investment (FDI) in Japan was valued at $132 billion in 2020, concentrated in finance and insurance. Japanese FDI stock in the United States totaled $648 billion in 2020, with manufacturing the largest share.

The size of the bilateral goods trade deficit, which at $56 billion was the fourth-largest U.S. deficit in 2021, has at times been a source of tension, with some observers arguing 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, 2021



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 CPTPP, for example, entered into force for Japan at the end of 2018. The EU and Japan also entered into an FTA in early 2019: these two trading partners accounted for about 25% of total U.S. trade in 2021. In 2022, the Regional Comprehensive Economic Partnership (RCEP) trade agreement, entered into force, which lowers certain trade barriers among Japan and 14 other Asian members, including China. U.S. exporters raise concerns that Japan's reduced tariffs and nontariff barriers on imports from CPTPP, EU, and RCEP countries, threaten U.S. export competitiveness for some products—Japan's tariff reductions for certain agricultural goods in the USJTA help alleviate some 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, CPTPP also suspended 22, largely U.S.-priority, provisions from the original TPP text. For more, see CRS In Focus IF12078.

Scope of U.S.-Japan Negotiations

The Trump Administration's decision to pursue a limited-scope agreement with Japan, covering only some tariffs and digital trade, was a departure from past U.S. FTA practice, which typically involves one comprehensive negotiation. Several Members of Congress, U.S. businesses, and other stakeholders strongly advocated for a more comprehensive deal. U.S. negotiating objectives, released in December 2018, as required by TPA, also suggested a broader range of issues would be covered, including services, investment, intellectual property, and state-owned enterprises. The Trump Administration stated it would address such issues in later negotiations, which it ultimately did not pursue. The Biden Administration has yet to resume the trade talks.

Analysts have questioned the extent to which the limited U.S.-Japan 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, but adherence to Art. XXIV has rarely been challenged at the WTO.

2020 Trade Agreement Provisions

The agreements cover some trade in industrial goods and agriculture and cross-border digital trade. Neither includes a dispute settlement mechanism. See CRS Report R46140, *"Stage One" U.S.-Japan Trade Agreements*.

U.S.-Japan Trade Agreement (USJTA)

The USJTA tariff 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 United States will also expand its global tariff-rate quota for beef imports. Japan agreed to reduce or eliminate tariffs on about 600 agricultural tariff lines (e.g., beef, pork, and cheese), and expand preferential tariff-rate quotas for a limited number of U.S. products (e.g., wheat).

Opening Japan's highly protected agriculture market and reaching parity with exporters from Japan's FTA partners is a major priority for the U.S. agriculture sector, as Japan is the fourth-largest U.S. agriculture market. While U.S. industry generally supported the USJTA, some sectors (e.g., dairy and rice) expressed concerns over lack of new market access or attention to other issues, such as geographical indications (GIs) and sanitary and phytosanitary standards (SPS), areas typically covered in comprehensive FTAs.

U.S.-Japan Digital Trade Agreement

On digital trade, an area in which the two countries have broadly similar goals and approaches, U.S. trade officials described the agreement as "comprehensive and high standard," in line with rules in the USMCA. Provisions include requirements for nondiscriminatory treatment, and commitments to prohibit or limit data localization, restrictions on cross-border data flows, and transfer of source code or algorithms as conditions of market access.

Potential Provisions in Future Talks

Most aspects of the trade relationship were not addressed in the 2020 agreements. Some priority issues, which may be a focus in any future talks, include the following.

Motor Vehicles. Trade in motor vehicles is a longstanding area of bilateral tension. Autos and auto parts account for more than one-third of U.S. imports from Japan, and a reduction of U.S. passenger auto and light truck tariffs (currently 2.5% and 25%, respectively), would likely be a Japanese goal in any future trade talks. Japan has no auto tariffs, but imports few U.S.-made autos ($2.1 billion in 2021). Japan argues that this reflects U.S. producers' failure to cater to Japanese tastes, while U.S. industry argues the low volume of exports stems from nontariff barriers, including discriminatory regulatory treatment, which would likely be a U.S. focus in future talks. While Japan buys few U.S. cars, Japanese FDI in U.S. production facilities is sizable and supports 170,000 U.S. jobs, according to BEA.

Prior to the USJTA negotiations, the Trump Administration considered imposing additional tariffs on Japanese auto imports using national-security-related authorities under Section 232 of the Trade Expansion Act of 1962. The U.S. threat was a key motivation for Japan to enter into trade negotiations, but abated with the signing of the USJTA.

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 about a quarter of all U.S. foreign affiliate sales in the industry. 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 CPTPP 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 that commitments on currency should be a priority in future 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 is on the Treasury Department's currency monitoring list. USMCA includes the first-ever U.S. FTA commitments on exchange rates and could serve as a template for provisions in future FTAs.

Issues for Congress

The 2020 partial-scope U.S.-Japan trade agreements and uncertain prospects for future U.S.-Japan negotiations raise a number of questions for Congress, including:

- What role should Congress play in limited agreements?
- How have the 2020 agreements affected U.S. firms' competitiveness in the Japanese market and what Japanese barriers remain a challenge for U.S. firms?
- How has deferment of talks toward a comprehensive bilateral FTA affected U.S. economic interests?
- How would the Biden Administration's proposed IPEF address U.S. trade issues with Japan?
- Should the U.S. consider participation in the CPTPP or other regional deals, to address bilateral trade concerns?

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