



# U.S.-Japan Trade Agreement Negotiations

## Overview

In April 2019, the United States and Japan held their first round of negotiations toward a new bilateral trade agreement. The Trump Administration is pursuing the talks with Japan under U.S. Trade Promotion Authority (TPA) procedures, potentially allowing for expedited legislative consideration of a concluded agreement. As the fourth-largest U.S. trade partner, Japan is a long-standing U.S. priority for trade negotiations, especially as recent Japanese trade agreements, including the EU-Japan FTA 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. In August, President Trump and Prime Minister Abe announced they reached an agreement on “core principles” of a trade agreement covering agricultural market access, some industrial goods tariffs, and rules on digital trade. Both sides have released few details on the exact terms, but indicate they aim to finalize and sign the deal by late September.

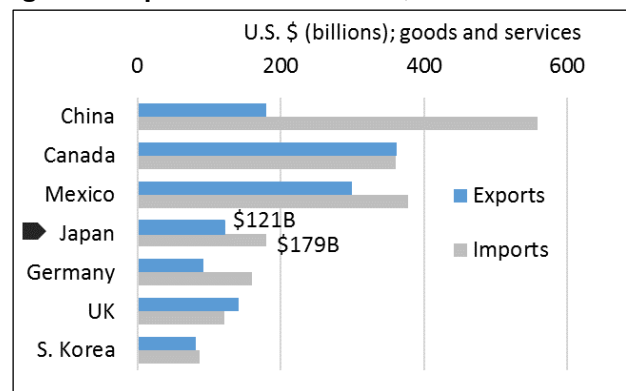
The announced deal reportedly does not cover trade commitments on motor vehicles, a long-standing area of bilateral tension. President Trump has stated he is using the threat of increased U.S. auto tariffs to influence the broader negotiations. On May 17, 2019, following a Section 232 investigation by the U.S. Department of Commerce, President Trump proclaimed motor vehicle and parts imports, particularly from Japan and the European Union (EU), a threat to U.S. national security. This grants the President the authority to impose import restrictions. The President directed the U.S. Trade Representative (USTR) to negotiate with Japan (and the EU) to address this threat and report back within 180 days. 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. Given that motor vehicles are the top Japanese export to the United States, U.S. import restrictions on the sector would likely create a strong backlash from Japan.

## 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 U.S., 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).

## Scope and Timing of Negotiations

The potential scope of the trade talks was unclear from the onset, in part due to differing characterizations by the two sides. Both sides appear to prioritize quick results over a more comprehensive negotiation. Prime Minister Abe initially referred to the talks as goods-only negotiations, differing from other comprehensive Japanese FTAs. Meanwhile, U.S. negotiating objectives released in December 2018 suggested a broad range of issues would be covered, including trade in goods, services, investment, intellectual property, state-owned enterprises, and digital trade. USTR indicated that it may pursue negotiations with Japan in stages, however, in consultation with Congress. This would depart from past U.S. FTA practice, which typically involves one comprehensive negotiation.

## 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 more than one-quarter 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).

## Announced Agreement in Principle

USTR specified that the agreement covers market access in agriculture and some industrial goods, and digital trade.

### Market Access in Agriculture and Goods

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. From the onset of negotiations, Japan stated its plans to limit additional agriculture market access to offers in existing FTAs, including the TPP-11. According to USTR Lighthizer, the announced agreement will "open up markets to over \$7 billion" of U.S. agricultural exports, and "lead to substantial reductions in tariffs and nontariff barriers," benefiting various products, including beef, pork, wheat, dairy, wine, and ethanol. Few details were offered on the specific tariff reductions for industrial goods, but USTR confirmed 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, Lighthizer referred to the announced agreement as a "gold standard." Many observers expect the terms to largely reflect the content of the TPP-11 and proposed USMCA. Key provisions in those agreements included prohibition of localization barriers in the digital space and commitments on cross-border data flows.

## Other Potential Provisions

U.S. negotiating objectives include several other issues of importance to the U.S.-Japan trade relationship. It is unclear to what extent these may be subject to future negotiations.

### Motor Vehicles

The announced deal reportedly does not cover trade commitments on autos or address pending U.S. Section 232 tariffs. Following the announcement, President Trump indicated that he is not considering increased tariffs "at this moment." Three major factors influence bilateral dynamics in the industry: (1) autos and parts are top U.S. imports from Japan (more than one-third of all imports); (2) despite being the third-largest world auto market, Japan imports few U.S.-made autos (\$2.4 billion in 2018), leading to a major bilateral U.S. deficit in the sector; and (3) major Japanese FDI in U.S. production facilities (\$51 billion in 2018, one-third of Japan's FDI in U.S. manufacturing, per the Japan Automobile Manufacturers Association).

Japan has no auto tariffs, but U.S. industry argues that nontariff barriers, including discriminatory regulatory treatment, disadvantage U.S. sales. Japanese stakeholders counter that failure by U.S. industry to adjust to its market

characteristics is to blame. TPP included commitments on nontariff issues, but arguably, the most significant provisions affecting auto trade were the 25- and 30-year phaseout periods for the 2.5% and 25% U.S. car and light truck tariffs, respectively. President Trump has repeatedly flagged the autos trade deficit and noted that U.S. goals in the talks include market access outcomes that will increase U.S. auto production and employment.

### 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 the talks may be a negotiating priority for the United States.

### Currency and Other Issues

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. Although Japan has not intervened directly in foreign exchange markets since 2011, Japan 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 (TPP included a nonbinding declaration on currency).

## Issues for Congress

**Scope and TPA.** As the agreement takes shape, there are questions regarding what areas will be prioritized, what areas may be subject to future talks, and if outcomes will meet TPA and congressional requirements. Chairman Grassley of the Senate Finance Committee has stated the agreement is not likely to require congressional action given certain delegated presidential tariff authorities, but other Members have raised questions about the appropriate congressional role. In reaction to the announced agreement, U.S. businesses advocated for continued progress toward a broader, comprehensive deal with Japan, similar to past U.S. FTAs. A narrow agreement could potentially violate the World Trade Organization (WTO) provision that requires FTAs cover "substantially all trade."

**U.S. Tariff Actions.** The President's declaration that auto imports threaten U.S. national security and the emphasis on "American-owned" production facilities is opposed by Japanese firms, which have significant U.S. investments supporting 170,000 U.S. jobs, according to the BEA. It also raises questions over the definition of national security and congressional intent for the President's use of Section 232.

For more information, see CRS Report RL33436, *Japan-U.S. Relations: Issues for Congress*.

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