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# Mizuho Economic Outlook & Analysis

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## *Japan-US leaders agreed to start new trade talks*

*A prelude to negotiating a Japan-US FTA?*

### < Summary >

- ◆ In the Japan-US summit meeting on April 17-18, issues on North Korea and trade were the main topics. Concerning the trade issue, the two leaders agreed to undertake new trade talks.
- ◆ US President Trump addressed the issue of America's "massive trade deficit with Japan" and showed his determination to slash the deficit, but he did not come up with any specific demands to Japan. He also made no reference to the currency issue, another area of concern.
- ◆ While Japan's Prime Minister Abe expressed his position that "the Trans-Pacific Partnership (TPP) is the best for the US and Japan," President Trump rejected the idea of returning to the TPP without renegotiating the conditions and emphasized his preference for bilateral talks. The new trade negotiations with the US are expected to be challenging for Japan.

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Mizuho Research Institute Ltd.

**Junichi Sugawara**, Senior Research Officer, Research Department – Public Policy

[junichi.sugawara@mizuho-ri.co.jp](mailto:junichi.sugawara@mizuho-ri.co.jp)

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## 1. The two nations agreed to launch new talks on trade

In the Japan-US summit meeting held in the US state of Florida on April 17 and 18, the main agenda included the issues of North Korea and trade between the two countries. Discussion on North Korea proved fruitful as the US promised to cooperate in returning the Japanese abductees, an issue of utmost importance for Japan. Meanwhile, on the issue of trade, at first it was believed that Japan would fall under US criticism and remain on the defensive, manipulated by President Donald Trump's statements and tweets. But as the United States did not come up with any specific demands to open the Japanese market, we can say that Japan was able to avoid the worst-case scenario, given also that the two nations did not agree to start negotiating a free trade agreement (FTA).

**Chart: Focal points and outcomes of the Japan-US summit meeting (trade issue)**

Focal points	Outcomes/Main remarks
US import restrictions on steel and aluminum products	<ul style="list-style-type: none"> <li>• Japan is subject to the import restrictions (not given an exemption).</li> </ul>
Concrete requests to Japan by the US	<ul style="list-style-type: none"> <li>• No reference was made to concrete requests and the foreign exchange rate issue.</li> </ul> <p>[ President Trump ]</p> <p>“Japan sends us millions and millions of cars, and we tax them virtually not at all. And we don't send so much product because we have trade barriers and lots of other things.”</p>
Japan-US FTA/US return to the TPP	<ul style="list-style-type: none"> <li>• Agreed to initiate “talks for free, fair, and reciprocal trade deals (FFR).”</li> </ul> <p>[ President Trump ]</p> <p>“The United States has a massive trade deficit with Japan.”</p> <p>“I don't want to go back into TPP.”</p> <p>“I much would prefer a bilateral deal, a deal directly with Japan.”</p> <p>[ Prime Minister Abe ]</p> <p>“[O]ur country's position is that TPP is the best for both of the countries.”</p>

Source: Made by MHRI based on various media reports.

One concrete outcome of the two leaders' talks on the trade issue can be summed up in the agreement to start “talks for free, fair, and reciprocal trade deals” between Japan's Minister of State for Economic and Fiscal Policy and Minister in charge of Economic Revitalization Toshimitsu Motegi and US Trade Representative Robert Lighthizer. It is also important to note the points which were not agreed upon or even mentioned during the talks this time. For example, Japan's exemption from the newly established US steel

and aluminum import restrictions – a request from Japan – was rejected by the United States. At the same time, Japan did not give promise to America’s request to reduce its trade deficit with Japan, nor to start bilateral FTA talks between the two countries (**Chart**). This suggests that everything will be left in the hands of the existing Japan-US Economic Dialogue and the new talks on trade that the two leaders agreed to begin after the summit meeting. In other words, all outstanding issues will be postponed to other occasions. Since the Trump administration may exert even more pressure on Japan to respond to America’s request in the coming days, Japan is expected to face a challenging situation for a while.

## **2. Four focal issues at the Summit**

In the Japan-US summit talk this time, the following four issues were expected to be the main discussion points prior to the meeting: (1) exemption of Japan from the US import restrictions on steel and aluminum products, (2) China’s “unfair trade practices” and the US unilateral measures against China, (3) concrete requests to Japan by the US, and (4) the Japan-US FTA and the return of the US to the Trans-Pacific Partnership (TPP).

### **(1) Exemption of Japan from the US import restrictions on steel and aluminum products**

The United States, based on Section 232 of the Trade Expansion Act of 1962, decided to implement import restrictions on steel and aluminum products from March 23 on the grounds that the importation of such products may threaten US national security. The United States imposed an additional 25% tariff on steel imports and a 10% tariff on aluminum imports, with temporary exemptions (up until the end of April) given to seven nations (region), including Canada, Mexico, Australia, Argentina, South Korea, Brazil and the EU (the European Union).<sup>1</sup> It is uncertain whether these provisional exemptions will remain effective after May 1, but South Korea is expected to receive a permanent exemption, since South Korea accepted the steel export quota (70% of 2015-17 average) with the US.<sup>2</sup>

The EU and other countries insist that the United States’ imposition of import restrictions for the reason of national security this time does not comply with the WTO (World Trade Organization) rules. The EU has already announced its intention to launch

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<sup>1</sup> The White House, “Presidential Proclamation Adjusting Imports of Steel into the United States,” March 22, 2018, and “Presidential Proclamation Adjusting Imports of Aluminum into the United States,” March 22, 2018.

<sup>2</sup> United States Trade Representative (USTR), “New U.S. Trade Policy and National Security Outcomes with the Republic of Korea,” March 28, 2018.

countermeasures against the United States. China actually implemented retaliatory measures against the US (April 2) and initiated a WTO dispute settlement procedure (April 5).<sup>3</sup> Meanwhile, to avoid economic losses from these US import restrictions, countries subject to the US import tariffs, including Japan, have sought exemption from the additional tariffs.<sup>4</sup> At the latest Japan-US summit meeting, whether the United States would exempt Japan from the additional import tariffs served as a talking point.

Japan's Prime Minister Shinzo Abe appealed to President Trump that Japan is a US ally and its steel and aluminum products represent no threat to US national security interests. Also, high-quality steel and aluminum products produced only in Japan make an important contribution to US industry and employment. But President Trump did not recognize Japan as a country to be exempted from the import tariffs and said this issue should be discussed in the future.

## **(2) China's "unfair trade practices" and the US unilateral measures against China**

Following the import restrictions based on Section 232, the United States decided to implement a range of additional trade measures against China based on Section 301 of the Trade Act of 1974 (March 23). These measures include the imposition of additional tariffs against Chinese imports, the initiation of dispute proceedings at the WTO, and the restriction of China's investment in the United States in response to China's infringement of US intellectual property rights,<sup>5</sup> and the US has already filed a claim with the WTO (March 23). The United States revealed a list of about 1,300 products subject to additional tariffs on April 3, stating that around 50 billion USD in Chinese imports could be affected by the tariffs, and internal procedures on public comments, etc. are now underway.<sup>6</sup> In response to these measures, China announced the imposition of retaliatory tariffs against US exports on the same scale and brought the case to the WTO (April 4). Having seen China's reaction, President Trump announced he would consider raising the

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<sup>3</sup> China's response to the US trade restrictions was to impose additional tariffs of 15% on 120 import items and 25% on another eight items, with an import value of about 3 billion USD. The EU does not believe the US measures this time are related to national security (justified under GATT (General Agreement on Tariffs and Trade) Article 21) but applies as a safeguard measure under GATT Article 19; therefore, the EU believes the EU can launch countermeasures in conformity with the WTO agreement under Article 8 of the WTO Safeguards Agreement (refer to the WTO document, G/SG/173, April 16, 2018). China seemed to have launched the countermeasures with the same logic (refer to the WTO document, WT/DS544/1, April 9, 2018). But this countermeasures also carry a problem from the WTO's perspective. For details of the US import restrictions and problems inherent in the countermeasures, refer to Tsuyoshi Kawase, "Exercise of Article 232 of the 1962 Trade Expansion Act by the US on steel and aluminum product imports" *Special Report*, Research Institute of Economy, Trade and Industry, March 29, 2018.

<sup>4</sup> In addition, there is a procedure of exempting specific products from additional tariffs if companies operating in the US apply for a tariff exemption and receive approval from the relevant authority. Japan's Minister of Economy, Trade and Industry Hiroshige Seko said that "Japanese steel and aluminum products play a vital role in US industry, and many of these products are not replaceable by other products. Hence, I believe there is a high possibility that many items will be exempted from the import restrictions." (The Ministry of Economy, Trade and Industry, "Press Conference by Minister of Economy, Trade and Industry Seko," March 20, 2018.)

<sup>5</sup> The White House, "Presidential Memorandum on the Actions by the United States Related to the Section 301 Investigation," March 22, 2018.

<sup>6</sup> USTR, "Under Section 301 Action, USTR Releases Proposed Tariff List on Chinese Products," April 3, 2018.

target amount by 100 billion USD, with China subsequently releasing a statement that “China will follow suit to the end and at any cost.”<sup>7</sup> How the two leaders would handle this issue in the summit meeting was also one of the points drawing much attention.

At present, the US’s additional tariffs imposed on China under Section 301 and China’s retaliatory tariffs on US products have yet to be imposed. America’s unilateral measure under Section 301, a measure the US has previously used to harass Japan, is something that US administrations have historically refrained from exercising after the establishment of the WTO in 1995, because the exercise of this measure often runs the risk of violating the WTO rules. The same applies to China’s retaliatory tariffs. Japan shares the same concerns with the United States on the issues of China’s excessive steel production and its infringement of intellectual property rights, which resulted in action being taken under Section 232 and 301, respectively. In fact, during the Japan-China High-Level Economic Dialogue held on April 16, Japan is said to have strongly demanded that China correct its excessive steel production and better protect intellectual property rights.<sup>8</sup>

But on the issue of China, Japan has always followed a basic policy of working together with the United States through such organizations as the WTO, as promised in the “response to concerns about third countries”<sup>9</sup> in the Japan-US Economic Dialogue, and as pledged in the Japan, US and EU trade ministers’ meeting to cooperate to “eliminate unfair market distorting and protectionist practices by third countries.”<sup>10</sup> At the same time, Japan has always requested joint efforts with the United States in handling such issues. One reason why Japan adopted this policy may have been to restrain unilateral actions by the US in resolving the issue, but recent unilateral actions taken by the US are contrary to Japan’s intention.

In sum, from Japan’s perspective, this issue is not only related to China but also to the United States. In the Japan-US summit meeting this time, the two leaders should have agreed to continue working together to address the issue of China, and Prime Minister Abe should have indicated to President Trump that the US should not take unilateral action that may invite retaliatory action and trigger a “trade war,” causing harm to the US itself. But looking at the various media coverage, including the joint press conference, it seems that the two leaders did not discuss these issues sufficiently.

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<sup>7</sup> Bloomberg, “China launches “fearless counterattack” – discussion heats up as President Trump instructs the imposition of additional tariffs,” *Bloomberg News*, April 6, 2018.

<sup>8</sup> The Nikkei, “Japan asks for correction of intellectual property and steel,” April 17, 2018.

<sup>9</sup> The Ministry of Foreign Affairs, “Joint Press Release from Vice President Mike Pence and Deputy Prime Minister Taro Aso on the U.S.-Japan Economic Dialogue,” April 18, 2017.

<sup>10</sup> The Ministry of Economy, Trade and Industry, “Joint statement by Japan, US and EU trade ministers,” December 13, 2017.

### **(3) Concrete requests to Japan by the US**

Prior to the latest Japan-US summit meeting, President Trump accused various countries with which the US has a trade deficit and made reference to Japan and Prime Minister Abe.<sup>11</sup> The US trade deficit with Japan in 2017 amounted to about 68.8 billion USD (8.6% of the total trade deficit), a significant figure following that of China and Mexico. The 2018 Trade Policy Agenda released by the USTR on February 28 stated that the United States “seeks equal and reliable access for American exports to Japan’s markets in order to address chronic trade barriers, imbalances, and deficits with Japan.”<sup>12</sup> In the Japan-US summit meeting held on November 6, 2017 in Tokyo, President Trump actually requested Japan to increase its purchase of US-made defense equipment during the joint press conference,<sup>13</sup> and we were watching whether a similar request would be made by President Trump this time.

But the outcome was that President Trump, despite touching upon the issue of US defense equipment and automobiles, made no specific requests to Japan.

Furthermore, on the problem of foreign currency exchange rates, whether President Trump would address this issue had drawn people’s attention since the US Treasury’s Foreign Exchange Report released on April 13 had placed Japan on the “watch list,” expressing dissatisfaction with Japan’s significant trade surplus with the United States.<sup>14</sup> But the two leaders did not mention this topic either during the summit meeting.

### **(4) The Japan-US FTA and the US return to the TPP**

The possibility of initiating the Japan-US FTA talks has been rumored since the outset of the Trump administration. Speculation that the US would officially request Japan to start FTA talks emerged right before the summit meeting. One factor behind this speculation was the statement made by US Trade Representative Lighthizer at the Committee on Ways and Means in the House of Representative, where he said, “We have told Japan that we are interested in having a free trade agreement with them at the appropriate time.”<sup>15</sup> Also, since the countries exempted from the US import restrictions on steel and aluminum products, effective from March 23, were either countries with a trade surplus with the US or countries currently negotiating FTAs, it strengthened the belief that the United States would ask Japan to start FTA negotiations in exchange for

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<sup>11</sup> The Nikkei, “Pressure grows on Japan again. President Trump says, ‘I won’t be cheated again,’” March 24, 2018.

<sup>12</sup> USTR, *2018 Trade Policy Agenda and 2017 Annual Report of the President of the United States on the Trade Agreements Program*, March 2018.

<sup>13</sup> The Nikkei, “President Trump urges purchase of US defense equipment,” November 7, 2017.

<sup>14</sup> U.S. Department of the Treasury, Office of International Affairs, *Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the United States*, April 2018.

<sup>15</sup> USTR, “Opening Statement of USTR Robert Lighthizer to the House Ways and Means Committee,” March 21, 2018.

exempting Japan from the additional import tariffs.<sup>16</sup> Furthermore, since the FTA renegotiations between the US and South Korea were concluded in favor of the US side, there were increasing concerns within Japan that Japan would be the next target.<sup>17</sup>

Meanwhile, concerning the possibility of the United States returning to the TPP, there has been no specific development after President Trump's reference to the TPP at the World Economic Forum's Annual Meeting (Davos conference) in January this year. But discussions on the TPP came under the spotlight again, triggered by President Trump, who instructed Robert Lighthizer, the US Trade Representative and Larry Kudlow, the director of the National Economic Council to examine the conditions for returning to the TPP, when he met with Republican senators on April 12. Nonetheless, President Trump has not changed the conditions of the United States returning to the TPP, as the US may return to the TPP "only if the TPP becomes a substantially better deal." On the night of April 17, when the first day of the Japan-US summit meeting was coming to an end, President Trump tweeted, "While Japan and South Korea would like us to go back into the TPP, I don't like the deal for the United States. ... Bilateral deals are far more efficient, profitable and better for OUR workers."<sup>18</sup> This suggested that the situation was far from hopeful that the US would return to the TPP talks.

For Japan, which wanted to avoid Japan-US FTA talks but could not respond positively to renegotiating the TPP,<sup>19</sup> it was believed that when asked by the United States to start the FTA negotiations, the best solution would be to conduct discussions within the Japan-US Economic Dialogue initiated with trade and investment as one of its main pillars. But as the two countries had already held the dialogue twice, and the US had begun to view Japan as using the dialogue to buy time, it was thought this option would be difficult for the two countries to take before the summit meeting. Under these circumstances, Japan prepared a new alternative to establish a new framework for dialogue.<sup>20</sup>

During the summit meeting, the two leaders agreed to start "talks for free, fair, and reciprocal trade deals" between Japan's Minister of State for Economic and Fiscal Policy

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<sup>16</sup> The Mainichi Shimbun, "US to exercise import barrier on steel; EU and South Korea exempted but not Japan," March 23, 2018. In the Committee on Financial Affairs of the House of Councillors held on March 29, government witness Tsutomu Koizumi, Deputy Director-General / Deputy Assistant Minister of the Economic Affairs Bureau in the Ministry of Foreign Affairs, stated that "we should prudently take note of the fact that the US is using the exemption of certain countries from the import restrictions as a tool to proceed with trade talks with each country." Following this statement, Finance Minister Taro Aso stated that "the most important thing is to avoid the situation where Japan will be drawn into bilateral negotiations in exchange for an exemption from import restrictions. ... We will firmly reject this situation." (The House of Councillors "the 196th Diet, record taken at the Committee on Financial Affairs, March 29, 2018, no. 8.")

<sup>17</sup> The Mainichi Shimbun, "The US-South Korea FTA – Japan feels threatened from pressure," March 27, 2018.

<sup>18</sup> Tweets by President Trump (@realDonaldTrump), April 18, 2018 11:49 (Japan time). It should be noted that although South Korea has not signed the TPP and CPTPP, it seems to be positive on joining them.

<sup>19</sup> On this issue, refer to Junichi Sugawara, "Conclusion of TPP11 and its outlook," *Mizuho Insight*, Mizuho Research Institute, February 15, 2018.

<sup>20</sup> The Nikkei, "US and Japan to start new trade talks, the government will make a proposal at the summit meeting," April 14, 2018.



and Minister in charge of Economic Revitalization Toshimitsu Motegi, who heads the TPP negotiations, and US Trade Representative Robert Lighthizer, who is responsible for trade negotiations. It was decided that details of the talks would be reported in the Japan-US Economic Dialogue.<sup>21</sup> Japan made it clear that the new trade talks would not be a preliminary deliberation to a Japan-US FTA, and Prime Minister Abe expressed to President Trump that he has no intention to conclude a Japan-US FTA.<sup>22</sup> But since President Trump has declared that a bilateral deal would be preferable, we cannot deny the possibility that the United States will try to persuade Japan to turn the new trade talks into Japan-US FTA negotiations.

### **3. Prompt the US to change its trade policy through “dialogue and pressure”**

From statements made by President Trump at the summit meeting, we could see there was no change in his thinking on the trade issue; that is, the US trade deficit with Japan is a major problem (“zero-sum thinking”), “balanced” trade between Japan and the US would be the ideal (extreme “reciprocity”), and a bilateral deal is more preferable than a multilateral agreement such as the TPP (preference for one-on-one “deals”). The US takes advantage of its power, disrespects for the WTO rules, and urges its counterparts to respond to the US requests by the threat or use of unilateral measures, and by such actions, the United States may substantially damage the multilateral free trade system originally established and maintained by US leadership.<sup>23</sup> The United States should change its trade policy, but this is not an easy option to take.

Japan must continue its efforts to prompt the United States to shift its trade policy by holding numerous dialogues with the US, not only in such arenas as the Japan-US Economic Dialogue and the trade talks newly set up this time, but also in the framework of the WTO and G20. Furthermore, since the issues of China’s violation of intellectual property and WTO reform, which the United States is questioning,<sup>24</sup> are common to Japan and other countries, they should be dealt with jointly with the US.

At the same time, it is also important to apply “pressure” to the United States. Here, “pressure” does not mean urging the United States to change its policy by imposing sanctions. That is neither realistic nor desirable. Japan should create an environment where the United States will be willing to review its policy on its own accord. In so doing, Japan should focus on promoting the conclusion of mega FTAs. Japan must enact the CPTPP (the “Comprehensive and Progressive Agreement for Trans-Pacific

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<sup>21</sup> The Ministry of Foreign Affairs, “The Japan-US Summit Meeting,” April 18, 2018.

<sup>22</sup> The Nikkei, “US ambitious on a bilateral agreement, Japan and US leaders agreed to start trade talks,” April 19, 2018.

<sup>23</sup> Junichi Sugawara, “Trump’s power-oriented trade policy” *Economist Eyes*, Mizuho Research Institute, January 19, 2017.

<sup>24</sup> The US insists on the need to reform the WTO because of malfunction as a body for trade negotiations and other reasons.

Partnership,” or TPP11), which was signed on March 8 without the United States, as early as possible and work to expand it. In addition, by signing the Japan-EU EPA (Economic Partnership Agreement) in as early as July and quickly enacting it, and reaching a basic agreement of the RCEP (Regional Comprehensive Economic Partnership) within this year and enacting the partnership as quickly as possible, Japan should place American exporters and firms in a disadvantageous position when competing in Japan and other Asian markets. It is necessary to strengthen pressure within the country to change the current trade policy by highlighting the demerits of withdrawing from the TPP. We expect Japan to lead this movement, just as it played a vital role in the CPTPP negotiations.