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# Mizuho Economic Outlook & Analysis

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## *Only a partial agreement reached on the Japan-US Trade Agreement “Initial Agreement” in line with the US wish for an early conclusion*

### < Summary >

- ◆ At the US-Japan summit held on September 25, the two nations reached a final agreement on the “Japan-United States Trade Agreement” and “Japan-United States Digital Trade Agreement.” These agreements were signed on October 7 and are expected to come into effect on January 1 next year following deliberations at the extraordinary Diet in Japan.
- ◆ Although the agreement is only a “partial agreement” with limited product coverage, the two nations were able to achieve the outcomes they desired most in line with the Joint Statement of the United States and Japan in September last year. In this sense, we can give a somewhat positive evaluation to this time’s agreement.
- ◆ But at the same time, the agreement is considered to have opened the door to challenging negotiations going forward, such as the second stage of the Japan-US Trade Negotiations and consultations with the CPTPP signatory nations to review the CPTPP.

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## 1. Agreement in line with the Joint Statement of the United States and Japan in September last year

At the US-Japan summit held on September 25, 2019, an agreement was reached on the Japan-United States Trade Negotiations ongoing since April this year. On October 7, the two nations signed the “Japan-United States Trade Agreement” and the “Japan-United States Digital Trade Agreement.” As the United States does not require congressional approval for these agreements, they are expected to come into effect on January 1 next year, after Japan completes the necessary procedures during the extraordinary Diet now in session (the 200th Session of the National Diet).

The contents of the Japan-US Trade Agreement can be viewed as being in line with the Joint Statement of the United States and Japan of last September (the “2018 Joint Statement”) when the two nations agreed to start trade talks (**Chart 1**). The main items of dispute in the negotiations were agricultural goods and motor vehicles.

**Chart 1: Outline of the Joint Statement of the United States and Japan (September 26, 2018)**

	Japan	United States	
Basic stance	Free, fair and rules-based trade	Reciprocal trade	
		Reduce the trade deficit with Japan and other countries	
Agreed matters	Enter into negotiations for a Japan-United States Trade Agreement on goods, as well as on other key areas including services, that can produce early achievements		
	Name	TAG: Trade Agreement on goods	USJTA: United States-Japan Trade Agreement
Matters understood	Have negotiations on other trade and investment items following the completion of discussions of the agreement mentioned above		
	Concerning agricultural, forestry, and fishery products, outcomes related to market access as reflected in Japan's previous economic partnership agreements constitute the maximum level	Market access outcomes in the motor vehicle sector will be designed to increase production and jobs in the US in the motor vehicle industries	
	Refrain from taking measures against the spirit of this joint statement during the process of these consultations		
	Make efforts for the early solution of other tariff-related issues		

Source: Made by MHRI based upon the Ministry of Foreign Affairs, *Japan-U.S. Summit Meeting (September 26, 2018) Joint Statement of the United States and Japan* (Japanese and English).

### (1) Agricultural products

In the 2018 Joint Statement, Japan clarified its stance that “with regards to agricultural, forestry, and fishery products, outcomes related to market access as reflected in Japan's previous economic partnership agreements constitute the maximum level.” The highest level of liberalization Japan has ever agreed to concerning agricultural, forestry, and fishery products was the TPP (Trans-Pacific Partnership) and the Japan-EU EPA (Economic Partnership Agreement). Having once reached an agreement with the United

States on the TPP, the focal point of this time's agreement was whether it would surpass the level of liberalization agreed to previously in the TPP negotiations. In this agreement, Japan has only promised market access equal to or below the level once agreed in the TPP on sensitive products, as seen in the exclusion of rice from the product coverage (**Chart 2**).

Nonetheless, we expect the United States to seek a higher level of liberalization compared with this time's agreement in future negotiations. Annex I of the agreement (Japan's schedule of concessions) states: "In future negotiations, the United States will be seeking preferential treatment with respect to agricultural goods." However, concerning the products subject to future negotiations, Foreign Minister Toshimitsu Motegi indicated that the items subject to further consultations will be those items defined in this time's agreement, saying "we do not assume any other products than that." We are not sure whether he means the US would not seek further liberalization for the products covered in this time's agreement or the Japanese government recognizes that the US would not ask to renegotiate the products excluded in the agreement.

**Chart 2: Outline of Japan's liberalization promises in the Japan-United States Trade Agreement and TPP**

Promises by Japan		
	This time's agreement	TPP
Agricultural products	Rice	No concessions (excluded)
	Beef	Same tariff rate with CPTPP signatory nations SG trigger level: 242,000 tons in FY2020 → 293,000 tons in FY2033
	Pork	Same ad valorem/specific duty as the CPTPP signatory nations SG of the specific duty portion is the aggregate volume of imports of the US and CPTPP signatory nations
	Dairy products	No import quotas for 33 products of the US Same tariff rate with CPTPP signatory nations
Industrial products	No concessions on taxable products	Rate of customs elimination: 100%

Source: Made by MHRI based upon documents created by the Japanese Government's TPP Headquarters at the Cabinet Secretariat Office, the Ministry of Agriculture, Forestry and Fisheries and the Ministry of Economy, Trade and Industry

## (2) Automobiles

There were two major issues concerning automobiles, the first one being the reduction or elimination of customs duties on US automobiles and auto parts, and the other being the exclusion of Japan from US import restrictions on automobiles and auto parts.

In the TPP, the United States agreed to eliminate customs tariffs on motor vehicles, which are Japan's largest export item bound for the US, in the 25th year after enforcement of the agreement. Moreover, with regards to auto parts, the United States said it would

eliminate customs duties immediately on 87.4% of the items (number of items basis/ 81.3% on a value basis). But in this agreement, the United States has gone only as far as to pledge that “customs duties on automobile and auto parts will be subject to further negotiations with respect to the elimination of customs duties.”

We can say that this outcome is in line with the US position stated in the “2018 Joint Statement”: “For the United States, market access outcomes in the motor vehicle sector will be designed to increase production and jobs in the US in the motor vehicle industries.”

Since Japan’s automobiles and auto parts are already customs duty-free, to realize an “increase in production and jobs in the US in the motor vehicle industries,” the US cannot respond to Japan’s requests to reduce or eliminate customs tariffs on related products that may lead to an increase in imports from Japan. It seems difficult to prompt the US to promise that customs tariffs on automobiles and auto parts will be eliminated in future negotiations.

The exclusion of Japan from US import restriction measures on automobiles and auto parts was Japan’s most important task in this time’s negotiations. As automobiles and auto parts are Japan’s key industries, accounting for about one-third of Japan’s total exports to the US and the largest Japanese export item to the US (around 5.5 trillion yen in 2018), exclusion from US import restrictions was a mission of utmost importance to Japan. In the light of this, the newly declared “Joint Statement of the United States and Japan” carries a statement similar to the 2018 Joint Statement: “While faithfully implementing these agreements [the Japan-United States Trade Agreement and the Japan-United States Digital Trade Agreement], both nations will refrain from taking measures against the spirit of these agreements and this Joint Statement.” Japan said it was able to confirm from this statement that the US would not impose additional tariffs or import quotas on Japan’s automobiles and auto parts for the reason that they may pose a threat to US national security, based on Section 232 of the Trade Expansion Act of 1962.

On May 17 this year, US President Donald Trump issued a proclamation directing United States Trade Representative (USTR) Robert Lighthizer to pursue negotiations with Japan on import restrictions contemplated on automobiles and certain auto parts, and to update him on the outcome of the negotiations within 180 days (November 13 this year). With the reporting deadline approaching, Japan avoiding the US imposition of import restriction measures should be considered as a significant achievement in this time’s round of talks.

Nonetheless, we cannot completely eliminate the possibility that the US will implement import restrictions on Japanese automobiles and auto parts. It should be noted that while USTR Lighthizer said after the US-Japan summit that the US had no intention to impose

such measures “at this point,”<sup>1</sup> there is concern that the threat of launching such measures on Japan may resurface if the upcoming negotiations end in deadlock.

### **(3) Digital Trade**

In the latest negotiations, digital trade was selected as a key area “that can produce early achievements,” as stated in the 2018 Joint Statement, and the Japan-United States Digital Trade Agreement was signed along with the Japan-United States Trade Agreement.

The contents of this agreement mostly follow the provisions laid out in the Digital Trade section (Chapter 19) of the United States-Mexico-Canada Agreement (USMCA). The Digital Trade section of the USMCA is based on the contents of the TPP’s Electronic Commerce section (Chapter 14) with certain additions. Hence, the Japan-United States Digital Trade Agreement contains some additional provisions to those in the TPP.

In the “United States-Japan Trade Agreement Negotiations: Summary of Specific Negotiating Objectives” released by the USTR in December 2018, the US requested the following five objectives: (1) ensure no imposition of customs duties on digital products, (2) ensure non-discriminatory treatment of digital products transmitted electronically, (3) establish state-of-the-art rules to ensure that Japan does not restrict cross-border data flows and does not require the use or installation of local computing facilities, (4) establish rules to prevent governments from mandating the disclosure of computer source codes or algorithms, and (5) establish rules that limit the non-IPR civil liability of online platforms for third-party content. Of these five items, the provision related to (5) does not exist in the TPP, and in item (4), the new term “algorithms” has been added to source codes that is already included in the TPP. Both have been incorporated in the USMCA and the newly agreement between Japan and the US.

It should be noted that while enactment of this agreement requires approval at the National Diet in Japan, the US president does not need congressional approval since it is treated as an Executive Agreement.

## **2. Only a “partial agreement” reached as the US desires an early conclusion and enactment**

It took only about six months from the outset to conclude the negotiations in this agreement. While the trade talks had the negotiation base of the TPP, this rapid pace is exceptional. We believe the speed was primarily due to the US attitude to prioritize an

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<sup>1</sup> Office of the United States Trade Representative (USTR), “ON-THE-RECORD PRESS GAGGLE BY AMBASSADOR LIGHTHIZER ON THE U.S.-JAPAN TRADE AGREEMENT,” September 25, 2019.

\* This report is based on the Japanese report dated September 30, 2019, with some additional analysis following the signing of the Trade Agreement on October 7

early conclusion of the agreement. With Japan enacting the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership, TPP11) at the end of last year and the EPA (Economic Partnership Agreement) with the EU (European Union) in February 1 this year, US exporters have been placed at a disadvantage in the Japanese market relative to competitors in the CPTPP countries and the EU. For such products as beef and pork, the US is effectively the only country excluded from the application of the EPA preferential rate. (The MFN [Most Favored Nation Treatment] tariff is applied.) For example, while the current customs tariff on US beef is 38.5%, it is reduced to 26.6% on beef from CPTPP nations such as Australia and Canada. The United States is impatient to improve these unfavorable conditions, and in light of this, the US Agriculture Secretary Sonny Perdue has even said that the US wants to reach a temporary trade agreement with Japan limited to agricultural products ahead of achieving a full-fledged bilateral deal.<sup>2</sup>

Furthermore, the US may have needed to provide new export opportunities to local agricultural producers, which have become the target of retaliatory tariffs by China during the course of the US-China trade friction. With the prolonged trade war with China, congressional approval of the USMCA not advancing as intended, and trade negotiations with the EU failing to make progress, the US seems to have rushed to negotiate with Japan as the lowest-hanging fruit.

The US desire to conclude and enact the agreement as early as possible is also apparent from the way domestic procedures are being executed. In the United States, enactment of a trade agreement usually requires congressional approval, but President Trump took an extraordinary measure to avoid the time-consuming congressional approval process by referring to a provision from the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA Act). According to the provision of this act (Section 103 [a]), the duty rate for products with a rate of duty that does not exceed 5% can be reduced or eliminated, and the duty rate for products with a rate of duty that exceeds 5% can be reduced by half under the president's authority. For this reason, in this agreement the United States has only promised to abolish customs tariffs for products with a current duty rate of 5% or less, while pledging to slash the duty rate by half for products with a duty rate of over 5%.

Given the US attitude to emphasize an early outcome and legislative requirements, product coverage in this agreement is limited, and in this sense, we can consider it as only a partial agreement. Although the United States listed such products as soy sauce and cut flowers for agricultural products, and machine tools for industrial products, all items of high interest to Japanese exporters, it only agreed to reduce or eliminate tariffs on 42

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<sup>2</sup> Nikkei Asian Review, "US seeks quick agreement on agriculture in Japan trade talks," April 12, 2019.

agricultural products and 199 industrial products (both at the 8-digit HS level). Japan also only promised to reduce or eliminate tariffs on agricultural and processed food products, excluding lumber and wood products for forestry products as well as all fishery products. For industrial products, Japan made no pledge to reduce or eliminate duties on taxable items (that are not duty free currently).

One interesting point is that the import value of the products subject to tariffs reduction or elimination was about 7.2 billion dollars each for both countries (**Chart 3**).

According to the documents compiled by the USTR,<sup>3</sup> the value of agricultural products<sup>4</sup> imported by Japan from the US that are subject to tariff reduction or elimination totals around 7.2 billion dollars, and as we have calculated, the value of the 199 industrial products the US imports from Japan that have become subject to reduced or eliminated tariffs amounts to about 7.2 billion dollars (2018 actual). With regards to the agreement this time, Japan’s Foreign Minister Motegi said the achievements on agricultural and industrial products are well-balanced, and we admit they are well-balanced from a product coverage perspective. But this value includes not only items subject to tariff elimination but also tariff reduction, and only accounts for 5% of the total US imports (about 142.4 billion dollars) from Japan.

**Chart 3: Liberalization commitments in the Japan and US agreement**

	Tariff Commitments of Japan	Tariff Commitments of the United States
<b>Agricultural products</b>	<ul style="list-style-type: none"> <li>● Over 90% of US food and agricultural imports into Japan will be subject to duty reduction/elimination or preferential tariff access</li> <li>● Out of the \$14.1 billion in US food and agricultural products imported by Japan, Japan will eliminate/reduce tariffs on an additional <b>\$7.2 billion</b> <ul style="list-style-type: none"> <li>- Currently duty free: \$5.2 billion</li> <li>- Immediate duty elimination: \$1.3 billion</li> <li>- Staged duty elimination: \$3.0 billion</li> <li>- Staged duty reduction: \$2.9 billion</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>● 42 products (equivalent to <b>\$42.64 million</b>) are subject to tariff reduction/elimination <ul style="list-style-type: none"> <li>- Duty elimination: \$19.9 million (19 products) <ul style="list-style-type: none"> <li>-- Immediate duty elimination: \$0.125 million (6 products)</li> <li>-- Staged duty elimination: \$19.776 million (13 products)</li> </ul> </li> <li>- Duty reduction by half: \$22.73 million (23 products)</li> </ul> </li> </ul>
<b>Industrial products</b>	<ul style="list-style-type: none"> <li>● No concessions on taxable products (new promise is 0 dollars)</li> </ul>	<ul style="list-style-type: none"> <li>● Duty reduction/elimination for 199 products (<b>\$7.17 billion</b>) <ul style="list-style-type: none"> <li>- Duty elimination: \$6.58 billion (150 products) <ul style="list-style-type: none"> <li>-- Immediate elimination: \$2.47 billion (51 products)</li> <li>-- Duty elimination from Year 2: \$4.11 billion (99 products)</li> </ul> </li> <li>- Duty reduction by half: \$0.59 billion (49 products)</li> </ul> </li> </ul>
<b>Newly promised trade value</b>	<b>About \$7.2 billion</b>	<b>About \$7.2 billion</b>

Note: Trade value is based on 2018 actual results.  
Source: Made by MHRI based upon documents of the Japanese government, United States Trade Representative, and United States International Trade Commission.

According to the Japanese government, the tariff elimination rate in this time’s agreement is roughly 84% for Japan and 92% for the United States (trade value basis for both figures). However, given that the US figure includes the value of automobiles and

<sup>3</sup> USTR, “FACT SHEET: Agriculture-Related Provisions of the U.S.-Japan Trade Agreement,” September 25, 2019.

<sup>4</sup> Nuts and similar products, which are categorized as forest products in Japan, are also included.

auto parts, the actual tariff elimination rate, excluding this value, is reduced to under 60%. The WTO (World Trade Organization) Agreement (GATT [General Agreement on Tariffs and Trade] Article 24) requires the elimination of tariffs on “substantially all trade” in trade agreements between developed nations, and the threshold is set at a tariff elimination rate of 90%. It is difficult to say that this time’s agreement is sufficient relative to this target. But considering that this is an initial agreement, if Japan can win tariff elimination for automobiles and auto parts from the US in the future, the final agreement may meet the WTO requirement.

### **3. Future negotiations are expected to be tough for Japan**

In this time’s agreement, both Japan and the United States were able to achieve the most wanted objectives in line with the 2018 Joint Statement: Japan could avoid the US imposition of import restrictions on automobiles and auto parts, while the United States could realize the same level of treatment as the CPTPP nations in the Japanese agricultural market, including beef and pork. But this agreement is positioned as only the “first-stage initial tariff agreement.”<sup>5</sup> According to the Joint Statement of the United States and Japan this time, Japan and the United States intend to conclude consultations within four months after the Japan-United States Trade Agreement enters into force, and “to enter into negotiations thereafter in the areas of customs duties and other restrictions on trade, barriers to trade in services and investment, and other issues in order to promote mutually beneficial, fair, and reciprocal trade.” At least the United States considers that the purpose of these negotiations is to ultimately conclude a comprehensive trade agreement.<sup>6</sup>

If the two nations commence negotiations on a comprehensive trade agreement, the United States will most likely make unreasonable demands upon Japan based on the 22 negotiating objectives for trade negotiations with Japan. As Japan had already responded to the US by opening up its agricultural market, especially beef and pork, there are not many cards left for Japan to win tariff elimination for automobiles and auto parts from the US as well as reject the various demands of the United States, including the currency clause. Hence the second round of negotiations is expected to be very challenging for Japan.

Consultations with CPTPP countries will not be easy as well. This time’s agreement contains such matters as agricultural safeguards for beef that necessitate Japan consulting with CPTPP nations. When the CPTPP was concluded, Japan did not remove the US portion from market access related measures, such as agricultural safeguards for beef, and it was decided that Japan would deal with the US portion bilaterally through the Japan-

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<sup>5</sup> Same as Note 3.

<sup>6</sup> The White House, “PRESIDENT DONALD J. TRUMP HAS REACHED AGREEMENTS WITH JAPAN TO IMPROVE TRADE BETWEEN OUR NATIONS,” September 25, 2019.

United States Trade Agreement. This made it necessary for Japan to ask the CPTPP countries for “special consideration” in the implementation of the agreement.<sup>7</sup> But from the viewpoint of CPTPP countries such as Australia, aggregating US imports when calculating the safeguard trigger levels offers nothing in return and has no merit, since it would place them in a disadvantageous position. Although the CPTPP has a review clause (Article 6), whether the conclusion of the Japan-United States Trade Agreement would suffice as a review condition is doubtful. The review clause stipulates that “if the entry into force of the TPP is imminent (with participation of the US)” or “if the TPP is unlikely to enter into force,” the parties shall, “on request of a Party,” review the operation of the agreement so as to consider any amendment to the agreement and any related matters. Since there is no prospect of the United States returning to the TPP, it is obvious that the current situation does not correspond to “entry into force of the TPP is imminent.” This raises the question: Are we in a situation where the “TPP is unlikely to enter into force” by the conclusion of the Japan-United States Trade Agreement? When the enactment of the CPTPP was determined, then Economic and Fiscal Policy/Economic Revitalization Minister Motegi stated that the Japan-US trade talks “would only be positive and would never be negative” toward bringing back the United States to the TPP, and therefore we believe the Japanese government would not expect the conclusion of the Japan-United States Trade Agreement to invite a situation where the “TPP is unlikely to enter into force.” In this case, Japan would not be able to seek consultations with the CPTPP countries based on the review clause of the CPTPP. Although Japan can still request consultations without relying on this clause, the other CPTPP countries are under no obligation to respond to Japan’s request.

We can give a somewhat positive evaluation to the agreement this time as Japan was able to secure the outcome it wanted most. But at the same time, we can also say that the agreement has opened the door to challenging negotiations going forward.

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<sup>7</sup> For example, in the case of beef safeguard measures, when calculating the quantity of the SG trigger level in the CPTPP, Japan will have to ask the CPTPP signatory nations to add imports from the US to the total import value from the CPTPP nations.