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A U.S.–Japan Free Trade Agreement in 2018

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The Trump Administration has stated that it will continue to engage in free trade negotiations, though there will be an emphasis on bilateral, rather than multilateral, agreements.[1] Compared to the current status quo of no trade agreement with Japan, the U.S. and Japan should pursue a bilateral free trade agreement (FTA) in order to increase opportunities for trade and investment on both sides.

Trade negotiations are a way of reducing government interference in economic interaction among private entities from different countries. These bilateral negotiations to reduce tariffs will take time. Negotiations to reduce non-tariff, service, and investment barriers will take even longer. In the process, negotiators should refrain from promoting special private or political interests. Any future trade agreement should exclusively focus on topics like trade, investment, and property-rights issues that affect international commerce.

The U.S.–Japan Economic Relationship

The U.S. and Japan have a long and complex history regarding trade and investment. The most recent milestone was marked by Vice President Mike Pence and Commerce Secretary Wilbur Ross's visit to Japan for the first meeting of the U.S.–Japan Economic Dialogue.

Over the past 60 years, the U.S.–Japan alliance has grown into one of the strongest in the world. Both countries not only support one another strategically and enjoy strong diplomatic relations, but have also prospered together economically. For the majority of the past 20 years, both the U.S. and Japan have prospered as mostly free economies.[2] Japan maintains a relatively strong rule of law, with slightly constricted investment and financial freedoms.[3] U.S. economic freedom has been falling for the past decade while the number of federal regulations has increased, putting undue burden on taxpayers and businesses.[4]

Two of the largest economic powers in the world, the U.S. and Japan, share roughly $200 billion in annual cross-border trade.[5] Japan is the largest Asia-based direct investor in the U.S. In 2015, Japan invested more than twice as much as all other Asian countries combined, at $411 billion.[6] The only other country in the world that invests more in the U.S. than Japan is the United Kingdom. And there is continued opportunity to increase both trade and investment between the U.S. and Japan. Future U.S.–Japan Economic Dialogues will focus on specific sectoral cooperation, such as within infrastructure and energy.[7]

The prospect of a U.S.–Japan FTA may focus less on the reduction of tariffs and more on business-environment issues. The average tariff rate for the U.S. and Japan are generally low at 3.5 percent and 4.4 percent, respectively, though agricultural tariffs are higher in Japan at 16.6 percent.[8] Meanwhile, the World Bank ranks the ease of doing business—an endogenous barrier for market access—in Japan

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at 34th in the world due to the relative difficultly of obtaining credit and starting a business. The U.S. ranks in 8th place.[9]

A Free Trade Agreement for the Trump Administration

While President Trump has the authority to negotiate agreements, Congress must make the changes in law and tariff rates that are necessary to implement them. Congress passed Trade Promotion Authority (TPA) in 2015 to reconcile these functions and to provide an expedited procedure to consider necessary legislation. In the process, it outlines objectives the Administration must consider in its pursuit of any FTA, including one between the United States and Japan.

The Trump Administration may be looking to reinvent the wheel regarding trade negotiations—the Trans-Pacific Partnership (TPP) did not live up to the standards the new Administration is looking for in a trade deal. But the Administration should avoid wasting time renegotiating areas that both the U.S. and Japan found amicable within the TPP, such as reduction of certain tariffs or rule-of-origin quotas that require a percentage of goods to be made in a specific location. The Administration should avoid throwing the baby out with the bathwater and use the beneficial achievements of the TPP as features to incorporate during bilateral negotiations.

A U.S.–Japan agreement should foremost be a modern FTA. Using trade agreements negotiated 20 years ago as an outline for a U.S.–Japan FTA will under-address concerns that emerge along with newer technologies.[10] A modern FTA should include provisions that reduce government-created barriers to digital trade and investment, such as requirements for sharing software code, data localization, measures that undermine privacy or fail to protect intellectual property, or overly censor products.

The goal of trade deals is to reduce trade barriers and increase market access. Non-trade issues brought by environmental or labor additions to trade agreements distract from the trade deal's true value. U.S. negotiators should focus on increasing economic freedom, not creating new international regulations. For example, state-owned enterprises' relative market power and transparency in funding should be questioned in negotiations as private companies seek to compete in domestic markets.

It should be clear that any provisions that address tariff and non-tariff economic barriers would not affect U.S. sovereignty. Agreement provisions are sovereign acts of government, and—as is obvious in the Administration's rhetoric about previous trade agreements (NAFTA and KORUS)—they can be undone by the U.S. legislation.

Finally, the U.S.–Japan bilateral FTA should make it easier to add new trading partners by join-

1. News release, "Presidential Memorandum Regarding Withdraw of the United States from the Trans-Pacific Partnership Negotiations and Agreement," The White House, January 23, 2017, https://www.whitehouse.gov/the-press-office/2017/01/23/presidential-memorandum-regarding-withdrawal-united-states-trans-pacific (accessed May 3, 2017).
2. Terry Miller and Anthony Kim, *2017 Index of Economic Freedom*, "Graph the Data" (Washington, D.C.: The Heritage Foundation, 2017), http://www.heritage.org/index/visualize?cnts=japan|unitedstates&src=country.
3. Miller and Kim, *2017 Index of Economic Freedom*, "Japan," http://www.heritage.org/index/country/japan.
4. James Gattuso and Diane Katz, "Red Tape Rising 2016: Obama Regs Top $100 Billion Annually," Heritage Foundation *Backgrounder* No. 3127, May 23, 2016, http://www.heritage.org/government-regulation/report/red-tape-rising-2016-obama-regs-top-100-billion-annually.
5. United States Census Bureau, "Foreign Trade: Trade in Goods with Japan," https://www.census.gov/foreign-trade/balance/c5880.html (accessed May 3, 2017).
6. Bureau of Economic Analysis, "Foreign Direct Investment in the U.S.: Balance of Payments and Direct Investment Position Data," https://bea.gov/international/di1fdibal.htm (accessed May 3, 2017).
7. News release, "Remarks by the Vice President and Japanese Deputy Prime Minister Aso at a Press Conference," The White House, April 18, 2017, https://www.whitehouse.gov/the-press-office/2017/04/18/remarks-vice-president-and-japanese-deputy-prime-minister-aso-press (accessed April 20, 2017).
8. World Trade Organization, "Tariffs and Imports: Summary and Duty Ranges–United States of America," http://stat.wto.org/TariffProfiles/US_e.htm (accessed May 3, 2017), and World Trade Organization, "Tariffs and Imports: Summary and Duty Ranges–Japan," http://stat.wto.org/TariffProfiles/JP_e.htm (accessed May 3, 2017).
9. The World Bank, "Doing Business: Measuring Business Regulations," http://www.doingbusiness.org/rankings (accessed May 8, 2017).
10. Brian Riley, "Three Recommendations for Renegotiating NAFTA," Heritage Foundation *Issue Brief* No. 4654, February 6, 2017, http://www.heritage.org/trade/report/three-recommendations-renegotiating-nafta.

ing the agreement subject to congressional approval. The U.S.–Japan FTA will also lay the groundwork for other bilateral trade agreements by the U.S. in the Asia–Pacific region.

It is not the case that exports are good and imports bad. That is possibly why many in the Trump Administration have rightly refrained from completely dismissing the benefits of free trade. But among policy experts and academia there continues an emphasis on aggregate gross domestic product growth and deficit numbers. Policies within a bilateral agreement aimed principally at reducing deficits may in fact harm U.S. economic well-being. There is no reason to expect U.S. trade with all countries to be balanced, or to equate a trade surplus with economic strength (or a deficit with a weak economy).

Taking into consideration the interests of the Administration, Congress, and the future of U.S.–Japan trade relations, Congress and the Administration should:

- **Begin negotiations on a U.S.–Japan FTA.** Once a U.S. Trade Representative is confirmed, he should begin working within the objectives established by Congress to lay out a time frame for engaging with Japan on trade talks. The second meeting of the U.S.–Japan Economic Dialogue toward the end of 2017 is a good time to coordinate with Japan on the future of a bilateral trade agreement.
- **Use progress made in past trade negotiations as a starting point.** When beginning negotiations toward a bilateral agreement, the tariff and non-tariff reductions from previous U.S. trade agreements should serve as a reference point for establishing a general agreement.
- **Aim to create a trade agreement that is modern and desirable for both parties.** Any bilateral agreement between the U.S. and Japan will create the framework for future U.S. trade agreements in the Asia–Pacific. Any agreements should be made with 21st-century economies, with modern technologies, and complex interconnected value chains in mind.

America First

For future trade negotiations, it is more important to address issues like tariff and non-tariff barriers that restrict economic freedom. The U.S. and Japan should pursue a free trade agreement as it will benefit both countries and further highlight the strong economic and diplomatic ties between the two allies.

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