

United States and Japan Reach “Agreement in Principle,” but Questions and Obstacles Remain

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On August 25, 2019, President Donald Trump and Japanese Prime Minister Shinzo Abe jointly announced that the United States and Japan have reached an agreement on core principles of a bilateral trade agreement covering agricultural market access, industrial tariffs, and digital trade. At this time, the two countries have provided few details regarding the core principles to which they have agreed, and it is expected that further negotiations and technical work will be required in order to finalize an agreement. However, the two countries have indicated that they intend to finalize and sign the agreement around the time of the United Nations General Assembly at the end of September. This report provides an overview of the announced agreement and the prospects and timing for its completion and entry into force.

Scope of the Agreement

As noted above, the United States and Japan have released few details regarding the “core principles” on which they have agreed. They have indicated, however, that the agreement covers the following issues:

- **Agriculture.** According to the White House, the United States has secured new market access for U.S. agricultural goods such as beef, pork, wheat, dairy products, wine, ethanol, and a variety of other products, which will lead to a “substantial reduction in tariffs and non-tariff barriers” affecting these products. At this stage, it is unclear how the level of market access the United States has secured from Japan compares to that which it secured from Japan in prior negotiations for the Trans-Pacific Partnership (TPP), from which the United States withdrew in 2017. According to US Trade Representative Robert Lighthizer, the bilateral trade agreement “will open markets to over \$7 billion” of the United States’ \$14 billion in annual agricultural exports to Japan. Separately, Senate Finance Committee Chairman Chuck Grassley (R-IA) has stated that the new agreement with Japan on agriculture “will make up for about 90 percent of what [the United States] lost when the president pulled us out of TPP, except in dairy”, though the basis for this statement is unclear. The Trump administration has faced pressure from the U.S. agricultural sector to secure market access in Japan at a level comparable to that negotiated under TPP, given increasing competition from agricultural exporters in countries that are parties to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the EU-Japan Economic Partnership Agreement, which have entered into force over the past year.
- **Industrial goods.** According to the White House, the United States “will reduce or eliminate tariffs on select industrial products, excluding autos and auto parts.” The parties have provided no further information regarding the scope of the United States’ commitments to reduce industrial tariffs, and press reports have provided conflicting information regarding the coverage of automotive goods. For example, Japanese news media have reported that the United States has agreed to “abolish tariffs on some of 400 auto parts[.]” Some sources have indicated that the United States has agreed to reduce tariffs on certain parts that are utilized in vehicles, but also are used in other types of transportation and industrial equipment, and thus are not considered by the United States to be automotive parts.
- **Digital trade.** According to the White House, the United States and Japan “have made good progress on the core elements of a high-standard digital trade agreement”. It is expected that the agreement will include commitments similar to those contained in the CPTPP and the recently-completed US-Mexico-Canada Agreement (USMCA), but this has not been confirmed (*please see our Trade Alert dated January 11, 2019 for an overview of the USMCA Digital Trade Chapter.*)

Neither side has confirmed whether the United States has agreed to exclude Japan from any potential restrictions on automotive imports that the United States might impose on “national security” grounds pursuant to Section 232 of the Trade Expansion Act of 1962. The threat of Section 232 measures on Japanese automotive goods was a key impetus for the bilateral negotiations, which Japan had previously resisted, and it is expected that Japan will insist on such an exemption as part of a final agreement (*please see our Trade Alert dated May 17, 2019 for an overview of the presidential Proclamation calling for bilateral negotiations with Japan.*) President Trump implied on August 26 that Japan would likely be excluded from any Section 232 measures on automotive goods if a bilateral agreement is

reached, but this has not been confirmed. Neither party has indicated whether a bilateral agreement between them would result in the removal of the United States' Section 232 tariffs on steel and aluminium products from Japan.

Following the joint announcement, the White House indicated that the Trump administration views the agreement that is expected to be signed next month as “the first stage” of a more comprehensive trade agreement with Japan, negotiations for which will address other core issues such as trade in services and will proceed after the signing of the first stage agreement. Japan so far has not made any official comments in response to its counterparty's recent suggestions of a “staged” approach.

Outlook

Several procedural and political obstacles remain before a bilateral agreement between the United States and Japan can enter into force. We summarize the main obstacles below.

- **Finalization of legal text.** The parties will need to convert the “agreement in principle” to final agreement text – a process that requires technical-level talks, drafting, and legal “scrubbing” before the signing of the final agreement. Although the announced agreement is relatively narrow in scope, this process could take time. In the case of the EU-Japan EPA, for example, official signing did not occur until about one year after Japan reached an agreement in principle with the EU.
- **Possible pushback from CPTPP parties.** Once the text of the bilateral agreement is signed and published, Japan may face certain complaints from other parties to the CPTPP. CPTPP sets forth tariff rate quotas (TRQs) for several sensitive goods including wheat and dairy products. Depending on the level of market access including TRQs that Japan will extend to the United States, CPTPP parties may raise concerns regarding dilution of their expected market access. Japan may take this potential issue into account before and after signing the bilateral trade agreement with the United States.
- **Ratification and implementation.** Each country will need to take steps to ratify and implement the agreement after it is signed. In Japan, a September signing would allow the bilateral trade agreement to be brought before Japan's parliament as early as this fall for ratification. The process could slow down if Japan faces complaints from CPTPP parties, as mentioned above. In the United States, it is expected that the Trump administration will seek to implement the agreement without congressional approval pursuant to provisions of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA) that may permit the President to unilaterally implement certain trade agreements that cover only tariff barriers. Specifically, the Trump administration might claim that the agreement qualifies as an “agreement regarding tariff barriers” under Section 103(a) of TPA, and that the President may therefore enact the tariff reductions necessary to implement the agreement by Proclamation (*i.e.*, without the need to seek congressional approval or satisfy certain notification and consultation requirements that apply to “agreements regarding tariff and non-tariff barriers” under Section 103(b) of TPA). Section 103(a) authorizes the President to:
 - “Enter into” trade agreements regarding tariff barriers “whenever the President determines that one or more existing duties or other import restrictions of any foreign country...are unduly burdening and restricting the foreign trade of the United States”; and
 - Proclaim “such modification or continuance of any existing duty...as the President determines to be required or appropriate to carry out any such trade agreement”, subject to certain limitations. For example, the President may not reduce any rate of duty (other than a rate of duty that does not exceed 5 percent) to a rate that is less than 50 percent of the rate that applied on the date of TPA's enactment. The President also may not reduce the rate of duty on any “import sensitive agricultural product” below the rate applicable under the Uruguay Round Agreements or a successor agreement. Any tariff reductions exceeding these limitations may take effect “only if a provision authorizing such reduction is included within an implementing bill provided for under section 106 [of TPA] and that bill is enacted into law.”

TPA also imposes fewer notification and consultation requirements with respect to tariff-only agreements, as opposed to comprehensive FTAs. For example, TPA requires the President to notify Congress of his intention to enter into (*i.e.*, sign) a tariff-only agreement, but it does not require him to do so at least 90 days in advance of signing, as is required for agreements covering tariff and non-tariff barriers. Several other notification and consultation requirements set forth in TPA do not apply to tariff-only agreements. It therefore is possible that the United States could finalize, sign, and implement an agreement with Japan relatively quickly.

While some Members of Congress (*e.g.*, Senate Finance Committee Chairman Grassley) have indicated that they would not object to the Trump administration's plan to implement an agreement with Japan without congressional approval, at least some Members are likely to object to this approach. Indeed, while Congress has delegated authority to the Executive Branch to negotiate and enter into trade agreements, it historically has sought to ensure that Congress is notified and consulted throughout such negotiations and has the final say in approving the resulting agreements. Though members of the Trump administration believe its approach is permissible under TPA, some Members might nonetheless argue that they have not been adequately consulted on the negotiations with Japan and that the resulting agreement should be submitted to Congress for approval. Should the Trump administration insist on implementing the agreement unilaterally, this approach may cause frictions with congressional Democrats, potentially impeding progress towards congressional approval of the USMCA.

- **WTO consistency.** Some WTO Members might question whether the US-Japan trade agreement is consistent with GATT Article XXIV, given the agreement's limitation in scope to agriculture, certain industrial goods, and digital trade. GATT Article XXIV:8 requires that regional trade agreements eliminate duties and other restrictive regulations of commerce on "substantially all the trade" among the constituent members. If the US-Japan agreement does not cover "substantially all the trade" between the two countries, the agreement may be found to be inconsistent with GATT Article XXIV:8 and, in turn, the most-favoured nation obligation set forth in GATT Article I.

This concern, however, might not apply to the US-Japan trade agreement if it qualifies as an "interim agreement" within the meaning of GATT Article XXIV:5, which provides that "the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area", so long as certain conditions are met. In particular, the duties and other regulations of commerce applicable at the time of the formation of the interim agreement "shall not be higher or more restrictive" than those that existed prior to the formation of the interim agreement, and any interim agreement "shall include a plan and schedule for the formation of [a customs union or free-trade area] within a reasonable length of time." On the other hand, Article XXIV:7(b) allows WTO Members to make recommendations to the parties of an "interim agreement" if the Members find that the agreement "is not likely to result in the formation of a customs union or of a free-trade area within the period contemplated by the parties to the agreement or that such period is not a reasonable one." The Members receiving such recommendations "shall not maintain or put into force" their interim agreement "if they are not prepared to modify it in accordance with these recommendations." These provisions are untested but may become relevant for the US-Japan agreement in light of the White House's characterization of the deal as "the first stage" of a comprehensive trade agreement between the two countries. Japan in particular is likely to be concerned about the agreement's consistency with WTO rules and, therefore, these procedural hurdles, which could affect the bilateral agreement and its implementation.

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