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EU-Japan FTA: Implications for U.S. Trade Policy

Overview

In July 2018, the European Union (EU) and Japan signed a free trade agreement (FTA) after 18 rounds of talks starting in 2013. The deal entered into force in February 2019. The EU and Japan account for about 40% of global trade and 30% of global GDP. Japanese and EU officials respectively touted the FTA as the “world’s largest, free, industrialized economic zone” and “most important bilateral trade agreement ever concluded by the EU.” Then EU Trade Commissioner Cecilia Malmström framed it in strategic terms as a “powerful signal” to the world that Japan and the EU stand together “to defend free and fair and sustainable trade in a climate where that is not taken for granted.”

The FTA talks concluded at a time of uncertainty for regional trade integration efforts. After abandoning Obama-era initiatives, the Trans-Pacific Partnership (TPP)—that included Japan—and the U.S.-EU Transatlantic Trade and Investment Partnership (TTIP), the Trump Administration notified Congress of new separate trade negotiations with Japan and the EU (and the United Kingdom, UK). The new talks were in part motivated by the EU-Japan FTA and concerns over U.S. firms’ diminished competitiveness in both markets. In late 2019, the United States completed “stage-one” deals with Japan covering some market access in agriculture and industrial goods (5% of bilateral trade), and rules on digital trade. The agreements entered into force in January 2020, and a next stage of talks on a more comprehensive deal is planned for later this year. U.S. trade talks with the EU have yet to progress, while UK talks began in May. As part of the backdrop, the EU and Japan have expressed concerns over recent U.S. tariffs imposed on their products, U.S.-threatened tariffs on auto imports, and the perceived waning in U.S. support for the multilateral trading system. Japan also advanced the TPP-11 without U.S. participation, ratifying the deal in 2018.

As the EU-Japan FTA was implemented, the United States faced increased pressure from stakeholders to secure comparable access to these important markets. The EU collectively is the largest U.S. trade partner and Japan the fifth largest. The FTA eliminates tariffs on substantially all EU-Japan trade and nontariff barriers in key sectors. Terms include market opening for EU agricultural products, while Japan will gain advantages for its competitive auto sector. The FTA not only has implications commercially for the United States, but also for the U.S. role in shaping debates over trade rules in areas central to U.S. competitiveness.

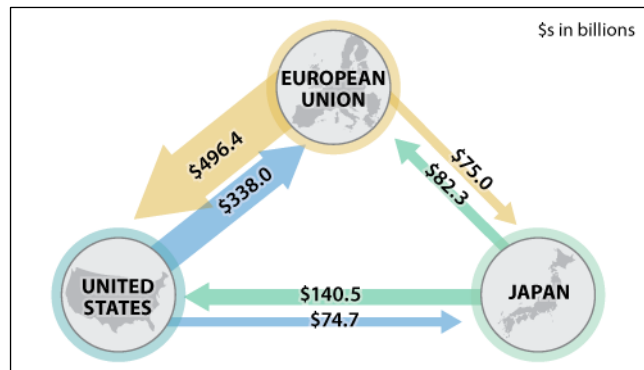
The final FTA terms were subject to some uncertainty. One concern was the pending withdrawal from the EU of the UK—a top destination for Japanese investment. The FTA applied to the UK while it was an EU member, but with the Brexit transition period ending in December 2020, the UK is rushing to complete new trade deals. UK-Japan talks

began in June, with Japan insisting on an expedited timeline to allow for its legislature’s approval this year. The UK and Japan have pledged to use the EU-Japan FTA as the baseline, but the proposed timeline may limit ambitions. The UK also announced plans to join the regional TPP-11.

Trade and Investment Ties

Drivers of the EU-Japan FTA included mutual desires to revitalize trade ties and recapture market share, in particular given the progress of other major trade deals like TPP-11. In the past decade, EU and Japanese shares of each other’s trade have declined, in part reflecting the rise of China. Japan is the EU’s sixth largest trading partner; the EU is Japan’s third largest. Like the United States, the EU runs a goods trade deficit with Japan, but a surplus in services. The EU accounts for a quarter of Japan’s outward foreign direct investment (FDI), but Japan retains a small share of EU outward FDI. By contrast, the United States and EU are each other’s largest FDI source and destination (\$5 trillion two-way FDI stock). The United States accounts for one-third of Japan’s outward FDI, the largest of any country.

Figure 1. U.S., EU, Japan Trade in Goods, 2019



Source: U.N. Comtrade accessed via International Trade Centre.

Notes: Figures reflect reporting country exports. UK included in EU.

Key Elements of the EU-Japan FTA

The FTA covers major areas of commercial engagement. In contrast to U.S. FTAs, however, EU-Japan commitments do not cover some U.S. priorities, while others are sensitive issues for the U.S. bilaterally with the EU and Japan.

Market Access

While EU and Japanese tariffs on average are relatively low, the elimination of tariffs on nearly all bilateral trade is expected to boost economic gains in key sectors. Japan will eliminate 97% of tariff lines upon full FTA implementation (86% on entry into force); the EU will eliminate 99% (96% on entry into force). Japan’s remaining tariffs for sensitive products, primarily agriculture, will be reduced incrementally or be subject to tariff-rate quotas (TRQs). (Rice, seaweed, and whale meat—banned in the EU—are

fully excluded.) Reduced nontariff barriers also aim to further market access (see below).

The EU expects large relative trade gains in agri-food products (see **text box**), textiles and clothing, machinery, footwear and leather products, among others, while Japan expects gains in industrial sectors (e.g., autos, machinery, and chemicals). In particular, the EU will cut its 10% tariff on passenger vehicles within 7 years, while most auto parts tariffs were eliminated immediately. Tariffs on trucks, buses and tractors, and motorbikes are liberalized in stages.

Highlights: Japanese Agriculture Commitments

- **Beef:** 38.5% tariff reduced to 9% over 15 years;
- **Dairy (e.g., cheese):** Hard cheeses tariffs up to 29.8% eliminated over 15 years; soft, fresh cheeses given duty-free TRQs that expand over time;
- **Pork:** 4.3% tariff eliminated and 482¥/kg specific duty reduced to 50¥/kg over 10 years;
- **Processed foods (e.g., pasta, chocolates):** Tariffs ranging up to 30% eliminated over 10 years;
- **Wine:** 15% tariff eliminated on entry into force.

FTA commitments also cover services, investment, and public procurement. **Services are liberalized** on a “negative list” basis (i.e., obligations apply to all sectors except those specified), with special attention to ensuring a level playing field in postal and courier services, financial services, and telecommunications. Other provisions aim to facilitate easier movement of company personnel between countries (known as “mode 4”). The FTA also ensures non-discriminatory **treatment for investments** and prohibits performance requirements—claimed by the EU as the most comprehensive list among FTAs to date. **Procurement access** goes beyond multilateral commitments, covering new municipalities and notably, Japan’s railway sector.

Standards and Regulatory Cooperation

Reducing nontariff barriers (NTBs)—e.g., divergent standards, technical requirements, and certification procedures—and regulatory cooperation were major EU-Japan priorities. The FTA has a separate chapter on regulatory cooperation, a first for the EU, which sets up a joint body. Several provisions promote greater transparency of regulations and mutual alignment with international standards—in particular for medical devices, textiles labeling, pharmaceuticals, and autos. For autos, Japan agreed to align its regulations with all standards of the United Nations Economic Commission for Europe (UNECE); as a result, motor vehicles will no longer need to be retested and certified upon export. A safeguard permits the snapback of tariffs if Japan reintroduces auto NTBs. Regarding agricultural products, sanitary and phytosanitary (SPS) provisions aim to simplify approval and import procedures and determine equivalence of measures.

Rules

EU-Japan FTA rules affect key areas increasingly important to commercial ties. Some question whether their approaches could set precedents for other FTAs. Features include:

- **Investment.** While provisions to promote FDI are included, investment protection and a related dispute mechanism are not, but are subject to ongoing talks. Japan’s FTA approach has been to maintain use of

investor-state dispute settlement (ISDS); the EU has pursued an alternative new investment court system, as per recent FTAs with Canada, Vietnam, and others.

- **Intellectual Property Rights.** The FTA reaffirms and expands on multilateral commitments, such as covering trade secrets. Enhanced protection is also ensured for geographical indications (GIs)—agricultural, food, and beverage products of specific geographic origin—a major EU priority. Japan recognized 205 GI-protected EU products; the EU recognized 56 Japanese products.
- **Digital Trade.** FTA commitments include not to impose duties on electronic transmissions or require disclosure of source code of software. Provisions on cross-border data flows are not included, however, unlike in Japan’s TPP-11, but both sides plan to review inclusion within 3 years. A separate 2018 agreement recognizes the adequacy of EU-Japan data protection standards to facilitate digital trade and complement the FTA.

Other rules cover state-owned enterprises (SOEs), corporate governance, small and medium-sized enterprises, and trade and sustainable development, including labor standards. For the first time in an FTA, both parties reaffirmed U.N. and Paris Agreement obligations related to climate change.

Potential Issues for Congress

Commercial Impact. In the absence of a comprehensive U.S. FTA with either major economy, certain U.S. industries could face competitive disadvantages or lost market share—e.g., those facing higher relative tariffs or regulatory hurdles—as the EU and Japan enjoy preferential access to each other’s markets. These concerns were partly assuaged by the U.S.-Japan stage-one deal, which helped level the playing field, with regard to tariffs, for U.S. agriculture. But the United States may continue to face disadvantages, due to the lack of other provisions on biotechnology, GIs, SPS, and other NTBs if Japan were to align its requirements more closely with the EU or TPP-11, and broader areas not covered like auto trade and services.

Objectives in Trade Talks. EU-Japan FTA outcomes likely influenced negotiating priorities and debates about U.S. trade talks with both partners. The scope of the talks remain uncertain, however—for example, in the U.S.-EU case, whether agriculture and auto sectors should be included or subject to staged talks, and in the U.S.-Japan case, what will be included in next stage talks this year. Differing approaches on politically sensitive areas, such as autos and rules of origin, NTBs and regulatory issues, data flows, and currency are likely to be sticking points.

Leadership in Global Trade Rules. The EU-Japan FTA is the latest in an expanding EU FTA network, putting a growing share of global trade under EU FTA rules. For Japan, the deal was a strategic priority, after concerted leadership to finalize TPP-11. Observers question whether such FTAs will set precedents for future deals and will affect U.S. influence on the trading system. Differing U.S.-EU approaches—e.g., on regulatory issues, standards, scope of intellectual property protections, and data flows—may be consequential for shaping the direction of trade rules. At the same time, recent U.S.-EU-Japan efforts related to new subsidies and SOEs rules and plurilateral efforts on digital trade could be signs of other avenues for joint cooperation.

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