

Call for the Start of Joint Study for a Japan-U.S. Economic Partnership Agreement

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Nippon Keidanren

Introduction

Japan-U.S. relations remain unprecedentedly good. In the economic field, with the exception of the BSE problem, there are no issues that are giving rise to friction. The United States is Japan's largest trading partner, and for the U.S. Japan is the largest export market outside the North American Free Trade Area (NAFTA), and after China is its second largest supplier of imports. In addition, the U.S. is the biggest investor in Japan and is Japan's largest destination for foreign direct investment. As our economic relationship deepens, which is reflected in the fact that Japanese companies in the U.S. now employ as many as 610,000 people, we see no more major frictions that arise from the expansion of the market shares of Japanese products in the U.S. The majority of Nippon Keidanren member companies regard the U.S. as being an "important market,"¹ and believe that the U.S. market offers promise for the future².

When viewed against the backdrop of the trade friction and structural talks between Japan and the U.S. from the second half of the 1980s through the first half of the 1990s, it is certainly welcome that such good relations with the U.S., the country that is the most important for Japan both politically and economically, have continued to date. Nevertheless, although the situation is calm at present, that does not mean that we should be lulled into resting on our laurels. In the East Asian region, negotiations for bilateral and plurilateral (with ASEAN) Economic Partnership Agreements (EPAs) between Japan and countries in the region are proceeding steadily, and there are also moves towards an EPA among ASEAN + Japan, China, and Korea, and India, Australia, and New Zealand. With these, recognition of the relative importance of the Japan-U.S. relationship is tending to weaken. However, the economic development of the East Asian region is impossible without a solid Japan-U.S. relationship at its base. It is precisely the present time, with its absence of pressing problems, that offers an excellent opportunity to strengthen the foundations for maintaining good relations into the future. The time has been reached for us to recognize anew the efforts expended by our predecessors on bringing harmony to more than 40 years of Japan-U.S. economic friction, and to mold the framework for a comprehensive economic partnership.

In recognition of this, since May 2006 our Committee on U.S. Affairs has been studying a Japan-U.S. EPA by such means as canvassing the opinions of experts and interested organizations such as government ministries and agencies, the U.S. Embassy in Japan, and the American Chamber of Commerce in Japan, and conducting a questionnaire survey of member companies. This proposal constitutes a compilation, based upon the results of the study, of the thinking of the business community on the framework for a Japan-U.S. economic partnership for the new era.

1. Background to the Importance of a Japan-U.S. EPA

(1) The necessity for a Japan-U.S. EPA in the present international situation

First, we should examine the significance of a Japan-U.S. EPA as a political message that proclaims the importance placed on the Japan-U.S. relationship. The character of the alliance relationship between Japan and the U.S., based on the Japan-U.S. Security Treaty, has changed since the collapse of the Soviet Union and China's transformation, but the role of the alliance as the pivot of the two countries' political and national security will remain immutable. From the same general perspective, the creation of a framework for a systematic partnership in the economic field will also be essential for maintaining that pivot. The conclusion of an EPA will also symbolize close and friendly relations between the parties to it, not only in the economic field, and to that extent its impact will be considerable.

Next, amid the current global trend towards trade liberalization, Japan is promoting the conclusion of both bilateral and plurilateral EPAs within East Asia. It is also essential to direct these efforts towards the building of a network of economic partnerships in the region, and to give study to the desirable future form of regional economic integration based on that network. However, no framework for the economic stability and prosperity of East Asia would be conceivable without the relationship with the U.S. In view of this it is important that a Japan-U.S. EPA be concluded to serve as a bridge between East Asia, including China, and the U.S. It could serve as a basis of a Free Trade Agreement of the Asia-Pacific (FTAAP), which is to be considered in the future.

In addition, in recent years the U.S. has been proceeding steadily with the conclusion of bilateral Free Trade Agreements (FTAs) with countries such as Singapore, Chile, and Australia in addition to NAFTA, and this has resulted in those countries' being granted more favorable treatment than Japan in such areas as tariffs and investment conditions. Of particular note is the concern that if the U.S.-Korea FTA, currently under negotiation, is concluded and brought into effect, Japanese companies will be placed at a marked competitive disadvantage relative to Korean companies when conducting business with the U.S. To avoid such a situation it is essential for Japan not to fall behind other countries in entering into an EPA with the U.S.

(2) Evaluation of the current framework for dialogue between Japan and the U.S.

Between Japan and the U.S. there is already the framework known as the Japan-U.S. Economic Partnership for Growth, which was inaugurated in 2000, under which intergovernmental dialogue is conducted regularly in specific fields such as regulatory reform and competition policy initiatives, and investment initiatives. Efforts such as these have achieved results, for example the start of trial visa issuance by the U.S. in Sapporo in addition to Tokyo and Osaka. In most cases, however, the same requests have been repeated to each other every year, yet it has been difficult to move towards concrete solutions. In the questionnaire survey mentioned above, the majority of respondents indicated that they had heard of the name of this partnership, but were not acquainted with its specifics, a fact that showed clearly the low level of recognition.

The Japan-U.S. Economic Partnership for Growth has thus been achieving some results, but cannot be described as adequate as a framework for strengthening the economic

partnership between Japan and the U.S. in a manner suitable for the new era. It is essential that the partnership be evolved into a new framework on the basis of the relationship of trust between the two countries' governments that has been nurtured under the partnership, and for that purpose, it will be very meaningful to study the conclusion of a Japan-U.S. EPA to serve as such a framework.

2. Benefits Expected of a Japan-U.S. EPA

An EPA concluded between two major industrialized countries such as Japan and the U.S. should be an comprehensive and high-level agreement that is in no way bound by the conventions of existing EPAs. Below, we set out just some of the items for which the Japanese business community has a strong need and that could be expected to be resolved comfortably within the framework of an EPA and have a major impact.

(1) Simplification, facilitation of consular procedures

In particular as a result of the steady stiffening of U.S. national security regulations since 9/11, major problems have arisen in the fields of consular affairs and goods distribution. In our questionnaire survey there was a heavy concentration of replies to the questions on these fields.

In regard to consular affairs, the situation has become particularly difficult since July 2004, as it has become impossible to conduct visa revalidation procedures within the U.S. As a result, Japanese companies' representatives residing in the U.S. have to go to a third country or return to Japan temporarily when they revalidate their visas, and this hampers their work, increases the burden of travel expenses, including those of family members, and interferes with their children's education. In addition, it is necessary to revalidate the Arrival-Departure Record (Form I-94) several times during the period (5 years) of work (E) visas, and since it is not possible to leave or enter the country during the period of two to three months when the revalidation procedures are being conducted by mail within the U.S., business activities are impaired. Among other problems, the periods of validity of driver's licenses are unclear, and it takes from several weeks to two months to obtain a social security number.

The area of consular procedures is one in which it is normally difficult to request exceptional treatment, owing to its close linkage with national security. Nevertheless, we believe that the existence of a bilateral EPA within the strong alliance relationship between Japan and the U.S. could make it possible to grant special treatment on a reciprocal basis. Specifically, measures could be formulated that would, for example, exempt nationals of either country from visa requirements or simplify and shorten visa issue and revalidation procedures, increase the number of locations for dealing with the procedures, and extend the periods of validity. This would facilitate the movement of essential business personnel and benefit the economies of both countries.

(2) Assurance of national security and facilitation, enhancement of efficiency of trade and distribution

In the questionnaire survey, a matter on which the number of responses ranked equally with those regarding consular procedures was the matter of the balancing of the strengthening of U.S. national security on one hand, and greater efficiency of goods distribution on the part of private-sector businesses on the other. With regard to the Customs-Trade Partnership Against Terrorism (C-TPAT) program³, in which participation is supposed to be voluntary, major importers are pressured into participating, giving it the character of a compulsory program, and giving rise to very substantial costs for validating and enhancing the security of the import supply chain into the U.S. In addition, in order to meet the 24-hour rule the lead time for loading vessels has increased by some two days from previously, increasing costs for private-sector operators. This issue needs to be addressed urgently.

As in the case of consular procedures, there is a need to devise a new mechanism that accords with business realities, both assuring national security and at the same time facilitating and enhancing the efficiency of trade and distribution. Specific aspects might include the following, [1] the establishment of a mechanism under which enterprises certified to comply with the rules by either the U.S. or Japanese government are also recognized mutually by the other government, [2] the provision of clear benefits that encourage companies to give active and voluntary cooperation for assuring national security, and [3] agreements on such matters as information and data exchanges and risk management. We also propose the establishment of a mechanism for dispute settlement in this field.

(3) Removal of tariffs

The dismantlement of tariffs on goods is a vital, core element of an EPA. The U.S. still has tariffs on imports of goods such as the following: pickup trucks and other commercial vehicles (25%), automobiles (2.5%), car parts (approx. 3%), tires (4%), thermal power station turbine and boiler-related products (steel 15%, etc.), titanium sponge and wrought titanium materials (15%), bearings (4.4%–9.9%), and flat-screen TVs (PDP, LCD)(5%). Large volumes of these goods are exported from Japan, and their cost is increased as a result. On the Japanese side, goods such as cables (4.8%), plastic products (3.9%–4.8%), and aluminum products (4.1%) are subject to tariffs, and since there are no domestic substitutes for these products, the cost to the importing companies is increased and their profits are squeezed. The removal of tariffs can be expected to have a certain impact, for example cost reduction and the enhancement of competitiveness.

(4) Harmonization of IPR systems

Unlike other major countries, which apply the first-to-file rule, the U.S. is alone in applying the first-to-invent rule, causing filing companies a great deal of uncertainty, for example in regard to the possibility of submarine patents. In 2005 a bill to amend the U.S. Patent Act was tabled in Congress for the purpose of shifting to the first-to-file rule, and the course of that bill is being watched closely. There is also a growing movement to harmonize patent systems globally, the first step of which was the start of a trial cooperation initiative between Japan and the U.S. called the Patent Prosecution Highway⁴. Assuming that the U.S. does transfer to the first-to-file rule, we hope to develop the Patent

Prosecution Highway scheme and, within the framework of an EPA, to progress with the harmonization of systems including mutual recognition of patents.

In addition, patent litigation in the U.S. has undesirable features such as the increasingly large amounts of compensation and litigation costs, patent trolls in which plaintiffs who do not manufacture products file injunction motions for the purpose of gaining high license fees, and inappropriate judgments passed down by juries with little expertise. We would also like to consider establishing a mechanism under the auspices of the EPA for discussions relating to intellectual property rights, in order to discuss points such as these.

Additionally, we believe that it would be possible, within an EPA, to pursue cooperation with respect to strengthening the protection of intellectual property rights in third countries.

(5) Liberalization of government procurement

The U.S. is a signatory to the WTO Government Procurement Agreement (GPA). Therefore, for procurements of US\$190,000 or more in value by the federal government and by 37 state governments, national treatment is granted to the suppliers of the products and services of other signatory countries. However, with regard to government procurement that falls outside the scope of the agreement, preference is given to the procurement of U.S. products in accordance with the federal Buy American Act. There are also other regulations relating to suppliers for government procurement, such as the Burmese Freedom and Democracy Act (for Myanmar) and exceptions relating to government procurement of Chinese products, and these give rise to numerous lost business opportunities for foreign companies amid the ongoing spread of the international division of labor.

If a Japan-U.S. EPA were to stipulate national treatment for procurements that are not covered by the GPA, namely procurements of up to US\$190,000 in value and procurements by the other 13 state governments, which are not covered by the agreement, that would eliminate discriminatory treatment between domestic and overseas companies, such as in the system for the purchase of U.S.-made steel used for public works. That could be expected to increase business opportunities for Japanese companies in the area of government procurement.

(6) Restriction of invocation of antidumping measures

Many problems are evident in the U.S. antidumping system and the way in which it is operated. As a result of the antidumping tariffs levied on goods such as steel products, bearings, and chloroprene rubber in a improper manner, a very heavy burden is placed on the industries concerned. Of particular concern is that the Byrd Amendment⁵ prescribes transitional measures up to the end of September 2007, in spite of the fact that a bill to repeal it has been approved after it lost its case at the WTO, and this means that U.S. companies will continue to enjoy an unfair advantage.

In the negotiations for the U.S.-Korea FTA currently under way it appears that the Korean side aims to ensure that restrictions of some kind are imposed on the U.S. ability to invoke

antidumping measures though the U.S. has never agreed to include such a provision in the FTAs it has concluded so far. If a similar provision were to be included in a Japan-U.S. EPA, that would be of great benefit to Japanese companies that have been suffering from protectionist U.S. antidumping duties.

(7) Convergence of environmental standards

Environmental standards, in particular recycling laws (California, Maine, Washington, etc.), regulations governing harmful substances (California, Vermont, Connecticut, etc.), and regulations on car CO₂ emissions (California) differ from state to state. In some states the regulations are set at extremely severe levels, imposing a major cost burden on companies seeking to satisfy them.

Domestic regulations such as these, which do not necessarily discriminate between domestic and overseas, are difficult to eliminate by imposing an obligation to do so by agreement between governments. Therefore, we believe that the only way to proceed would be to establish a discussion framework within the EPA similar to existing regulatory reform and competition policy initiatives, and then endeavor to improve the situation by engaging in dialogue aimed at bringing about the convergence of different state environmental standards.

(8) Enhancement of collaboration relating to transfer pricing taxation

In order to invigorate corporate activity between Japan and the U.S. it is important to prevent tax risk arising from the application of transfer pricing taxation, and to hold mutual discussions directed at eliminating double taxation promptly in the event that they are applied.

By enhancing collaboration between authorities by means of an EPA, we could endeavor to accelerate and facilitate advance pricing arrangements (APA) and mutual discussion. That should make it possible in future for the authorities to reach agreement on the distribution of income prior to the application of transfer pricing taxation, and for linked tax payments between the two countries to be institutionalized.

3. Matters to Be Considered When Concluding a Japan-U.S. EPA

If an EPA is concluded between Japan and the U.S., there are of course, certain challenges that cannot be avoided.

(1) The agricultural sector

The U.S. is, it need hardly be said, one of the largest producers of agricultural goods, and therefore a key issue to address is that of how to deal with produce that is sensitive for Japan's agricultural sector. If we look at goods imported from the U.S., in the year 2003, before they were affected by BSE, industrial goods such as electrical equipment, general machinery, and transportation machinery ranked the highest, while foodstuffs accounted

for approximately 27%⁶ of the total value of imports. Even if an item constitutes a small proportion of total imports from the U.S. the amount is extremely large in absolute terms, and compared with imports from other countries it has a very heavy impact on domestic agriculture. In view of this, in the negotiations for a Japan-U.S. EPA it will be essential to give full consideration to the sensitivity of Japan's domestic agricultural sector and to take up appropriate measures, including steps to enhance the competitiveness of domestic agriculture.

In addition, imports from the U.S. account for 31% (2005) of Japan's total imports of agricultural goods, and on an itemized basis account for 52% of beef imports (2003) and 55% of wheat imports (2005)⁷. Given this, it must be examined whether it is appropriate or not that Japan would be expected to increase its dependence on the U.S. still further for these goods with the tariffs on these imports removed entirely or lowered by the EPA. In this relation, it would be useful to study the inclusion in an EPA of provisions prohibiting export restrictions, so as to guard against situations such as the restrictions on exports of soy beans imposed by the U.S. in the past.

(2) The services

In some areas of the service sector, we will have to be very cautious when studying an economic partnership. For example, the U.S. business community is interested in such sectors as financial, legal, education, healthcare, civil aviation, and energy services. It may require that these sectors be further liberalized and deregulated by the Japanese government. If that were to occur, it would be essential to give consideration to factors such as the inherent circumstances and social imperatives in each individual sector when engaging in careful discussion with the U.S. side, and to deepen mutual understanding.

(3) Impact of an EPA between two major economic powers on multilateral trade liberalization

Multilateral trade liberalization, the development of rules, and dispute settlement mechanism within the WTO framework remain important for Japan's external commercial and trading strategies, and from that perspective Japan hopes for an early resumption of the currently suspended Doha Round negotiations. In this context it has been pointed out that, with respect to a Japan-U.S. EPA, when pursuing the conclusion of an agreement between two major economic powers that together account for some 40% of the entire world economy, consideration should be given to the impact this will have on the framework of multilateral trade liberalization.

However, there are no clear grounds behind the logic that the conclusion of an EPA between two major economic powers will have a negative impact on the WTO negotiations. The possibility that Japan and the U.S. will form a bloc is out of the question. The reality is that for both countries their economic relations with other countries are essential to their existence, and each is in the process of concluding or negotiating a considerable number of bilateral or regional FTAs/EPAs. Assuming it complies with the WTO rules, an unprecedented high-level agreement between the two most advanced industrialized countries can be expected to serve as a model for other nations' FTAs and multilateral trade negotiations.

Conclusion

As explained above, Japan and the U.S. have reached the stage at which they need to give study to a new institutional framework for building closer economic relations for the future. In order to ensure the ongoing development of the economic interdependence between them that has grown deeper and wider during the six decades of the postwar era, and to resolve problems arising in the business activities between them, a Japan-U.S. EPA will be the most beneficial solution. Strategic study should now be given to concluding that EPA, while giving full consideration to the sensitive fields within each country, such as the agricultural sector. To analyze the merits and demerits of a Japan-U.S. EPA and to investigate its desirability and feasibility, we request the governments of both countries to rapidly initiate joint industry-academia-government study and research.

¹ The reasons given include the scale of the economy, the existence of stable demand and business opportunities, legal stability, and the assurance of reasonable profits.

² The reasons given include that the U.S. has a massive domestic market in which stable growth in demand is expected to continue; that in view of factors such as sound policy management, a stable investment environment, and advanced social infrastructure, it is possible to project stable profits at low risk; and that the U.S. plays a leading role in such spheres as new business models and state-of-the-art technologies.

³ The Customs-Trade Partnership Against Terrorism (C-TPAT) is a supply-chain security program initiated in April 2002 by U.S. Customs and Border Protection (CBP) with the objective of preventing the entry of terrorists, weapons of mass destruction, etc., concealed in import cargoes. It is a voluntary program in which companies involved in importing (importers, carriers, customs brokers, warehouse operators, and overseas -- currently only Mexico, Canada -- manufacturers) formulate compliance programs in accordance with the CBP's security recommendations, and implement them with the CBP's cooperation. Companies that are screened and recognized as participating by the CBP benefit in such ways as being subjected to a lower ratio of random freight inspections.

⁴ The Patent Prosecution Highway, the pilot of which commenced in July 2006, is a key issue within the joint Japan-U.S. cooperation initiative relating to intellectual property that was agreed in March 2006 between Japanese Minister of Economy, Trade and Industry Toshihiro Nikai, and U.S. Secretary of Commerce Carlos M. Gutierrez. It will enable patent applicants to enjoy accelerated granting of rights overseas, lightening the workload on both patent offices and enhancing the quality of patent examinations. It does so by enabling an application whose claims are determined to be allowable/patentable in the office of first filing to undergo an accelerated examination in the office of second filing by a simple procedure if so requested by the applicant.

⁵ The Byrd Amendment, which constituted a partial amendment of the U.S. Tariff Act of 1930, is an act whose purpose was to disburse antidumping duties and countervailing duties collected by the U.S. government to domestic manufacturers that filed or publicly supported petitions for protection against foreign competitors. It was included in the fiscal 2001 Agriculture Appropriations bill and approved by the U.S. Congress in October 2000. A panel established by the WTO at the request of 11 Members, including Japan, the EC and Canada, reached the judgment in September 2002 that

the act violated WTO agreements, and called for its repeal. The U.S. appealed, but in January 2003 the WTO Appellate Body backed the judgment of the panel and distributed a report to all Members with a recommendation that the act be rectified by the end of that year, after which the WTO's Dispute Settlement Body adopted the report. The U.S. did not comply with the recommendation within the time allowed, whereupon in May 2005 the EC and Canada, in August Mexico, and in September Japan invoked retaliatory measures with WTO authorization. In February 2006 the US Congress approved the Deficit Reduction Omnibus Reconciliation Act, which included a provision to repeal the Byrd Amendment and related legislation, but a transitional measure permits disbursements to continue with respect to goods passing through customs until the end of September 2007.

⁶ Source: *Gaikoku boeki gaikyo* [Summary Report Trade of Japan], December 2003 edition

⁷ Source: Ministry of Agriculture, Forestry and Fisheries material