UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

USCIB Comments on Negotiating Objectives Regarding U.S.-Japan Trade Agreement December 19, 2018

On October 16, 2018, the Trump Administration notified Congress of its intention to initiate negotiations on a U.S.-Japan Trade Agreement. The United States Council for International Business (USCIB) supports negotiation of a comprehensive trade agreement with Japan as part of a broader strategy to open international markets for U.S. companies and remove barriers and unfair trade practices in support of U.S. jobs.

USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and regulatory coherence. Its members include U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world, generating $5 trillion in annual revenues and employing over 11 million people worldwide. As the U.S. affiliate of the International Chamber of Commerce, the International Organization of Employers and Business at OECD, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.[1]

Japan is an important trade partner for the United States. Japan is currently the 4th largest goods trading partner of the United States and in 2017, Japan was the United States' 4th largest export market as well. U.S. goods and services trade with Japan totaled an estimated $283.6 billion in 2017, with exports totaling $114 billion. The United States also has a surplus in services trade with Japan, totaling $13.4 billion. A successful trade agreement with Japan should cover not just market access for goods, but also address important services issues, as well as issues like digital trade and intellectual property.

USCIB welcomed the conclusion of the Trans-Pacific Partnership Agreement (TPP) back in October 2015, noting at the time that a comprehensive, market-opening agreement would provide a significant boost to the United States. Accordingly, we urge the Administration to draw from that agreement for many provisions we are looking to see included in a bilateral U.S.-Japan agreement.

USCIB recommends the governments approach these negotiations as a singular undertaking. While ad hoc, sector-specific negotiations are an important tool, broad-based free trade agreements (FTAs) have traditionally yielded the highest level of benefits for the U.S. economy as a whole. Given Japan was the largest foreign economy in the Trans-Pacific Partnership negotiations, and is

[1] More information is available at www.uscib.org.

the third largest market in the world, an FTA with Japan would be an important legacy of the Trump Administration.

Digital Trade

The United States and Japan are close allies on digital trade. An FTA should create a formal mechanism for the governments to coordinate on fighting digital trade barriers in third country markets and working together to negotiate new rules regionally and globally, for instance through a U.S.-Japan Digital Trade Steering Committee (or Commission) to be created under the FTA.

As part of FTA negotiation, USCIB urges that the United States and Japan reach an agreement under the U.S. CLOUD Act to ensure law enforcement access to data. This would further cement the U.S.-Japan digital trade alliance and cooperation.

A U.S.-Japan FTA should also better enable importation of Information and Communications Technology (ICT) devices into Japan before they are certified, to enable pre-market testing etc. The U.S. Federal Communications Commission (FCC) has such a rule to enable devices to come in to the United States before it certifies, and Japan should have one too to ensure reciprocity and market access for U.S. firms.

Specifically, we urge USTR to seek a commitment from Japan allowing imported ICT devices that do not yet have regulatory authorization into Japan for purposes of testing, development, and demonstration. Currently, Japan does not allow for the importation of any devices that do not hold regulatory authorizations for these purposes. This is a particular hardship for technology companies trying to develop and test devices for the Japanese market.

For global companies where engineering is completed in multiple countries, it is necessary in the development process to be able to import devices that have not received their regulatory authorizations so that Japanese engineers can iterate on devices and collaborate with engineering teams located in the United States. This also allows for testing of devices on carrier networks in Japan, as necessary. For a product to be successful, the device has to be tested locally to ensure that it will function as intended in the local conditions and that it meets the expectations of local users.

U.S. companies are unfairly disadvantaged against local Japanese companies if thorough testing of performance cannot be completed until a device has received its full authorization and is able to be imported. It is also necessary to import devices prior to being fully certified to further design, develop, and create accessories, companion products, and marketing materials, as well as to ensure that the product is compatible with other devices. Finally, it is important that devices lacking regulatory authorization can be imported for demonstration purposes to potential customers or at trade shows. This will allow U.S. companies to enjoy the benefit of customer feedback during the development process, as well as ensure a successful launch to market.

The U.S. Federal Communications Commission (47 C.F.R. 2.1204(a)(3)) provides for import conditions under these circumstances. Specifically, devices that have not yet obtained regulatory authorization can be imported in limited quantities for demonstration at industry trade shows and for testing and evaluation to determine compliance with the FCC Rules and Regulations, product development, or suitability for marketing. We ask USTR to seek commitments that will allow for common opportunities in Japan's market.

A U.S.-Japan trade agreement should secure market access for evolving business models, including in the digital marketplace. Notably, however, during the TPP negotiations Japan did reserve the right to discriminate in new services not technically feasible when the TPP enters into force; this type of non-conforming measure undercuts one of the fundamental benefits of the negative list structure. The United States should reject such a measure in a U.S.-Japan agreement.

Finally, a U.S.-Japan FTA should address cross-border data flows, requiring countries to permit the cross-border flow of data necessary to conduct business, and prohibiting data localization requirements, including for financial services. A digital trade chapter should also include prohibitions or requirements to disclose source code or algorithms or grant access to encryption technologies, as provided in USMCA Digital Chapter Article 19.16. For financial services, USMCA Article 17.17 Transfer of Information is a good example of a strong free flow of data provision that a U.S.-Japan agreement can draw upon. Also, USMCA Article 17.18 Location of Computing Facilities prohibits data localization as long as financial institutions provide the access to data to regulators for their regulatory and supervisory purposes. Inclusion of such a provision in a U.S.-Japan agreement is critical to the affirmation of this U.S. Government policy for the provision of financial services in a global economy.

Coordination and collaboration on Cybersecurity

In the USMCA Digital Chapter, Article 19.15, the Parties agreed to endeavor to build capacities of the national entities responsible for cyber incident response and to strengthen collaboration and cooperation to identify cybersecurity incidents and engage in information sharing. Such provisions may be expanded recognizing the long-standing relationship between Japan and the United States.

Intellectual Property

An agreement with Japan should include a comprehensive Intellectual Property (IP) chapter. A strong outcome on an IP chapter is critical to about 40% of the U.S. economy, 30% of all U.S. employment, and over half of all U.S. exports.

In general, Japan provides high levels of protection for intellectual property, so an agreement provides an opportunity to set a high precedent on IP that builds upon the chapter negotiated in the USMCA. Areas of particular focus would be predictable, deterrent-level statutory damages, strong protections against circumvention of technological protection measures. In addition, secondary liability for copyright infringement should be clarified.

Patent Term Adjustment

The U.S. Government should seek inclusion of provisions for patent term adjustment in the event of patent office delays in Japan. Specifically, this should include provisions to ensure patent applications are processed in an efficient and timely manner, with a view to avoiding unreasonable or unnecessary delays, and provide procedures by which a patent applicant can request expedited review and examination of its patent application. If there are unreasonable delays in issuance of patents, the term of the patent should be adjusted to compensate for such unreasonable delays.

Regulatory Data Protection

In addition, the negotiations with Japan offer an opportunity to refine the provision of regulatory data protection (RDP) in Japan, particularly for biologics that effectively receive eight years of protection through Japan's post-marketing surveillance system. RDP complements patents on innovative medicines and provides incentives for investment in new treatments and cures. RDP is particularly critical for biologic medicines, which may not be adequately protected by patents alone. Consistent with U.S. law, the U.S. Government should seek 12 years of RDP for biologics in Japan.

Pharmaceutical Pricing and Reimbursement

U.S.-Japan negotiations provide an opportunity to eliminate discriminatory revisions to Japan's Price Maintenance Premium (PMP) system. Recent estimates of the impact of revisions to Japan's PMP criteria implemented in late 2017 indicate that approximately one-third of patented medicines would no longer qualify, resulting in USD $1.7 billion in lost revenues annually. Furthermore, the criteria appear to be inherently biased towards local companies, which seriously calls into question Japan's commitment to fair and non-discriminatory policies. Further, revisions to the PMP criteria would severely impact patented medicines and undermine U.S. intellectual property.

U.S.-Japan negotiations also provide an opportunity to ensure that procedures and rules that apply to pharmaceutical pricing and reimbursement decisions are predictable and transparent. Accordingly, the United States should support maintenance of existing biennial pharmaceutical price revisions rather than a proposed shift to annual re-pricing in Japan. Industry has serious concerns about a move to annual repricing in Japan, starting with the planned revision of drug prices—potentially in April 2019—in conjunction with a consumption tax increase in October 2019.

Media and Entertainment Services

Japan has a vibrant and globally competitive media and entertainment services sector. Bilateral negotiations with Japan therefore provide an opportunity to set an example of high standard commitments for open investment and market access in the media and entertainment services sector. There should be no anachronistic "cultural" discrimination provision nor last century "new

services" limitation like Japan obtained in the TPP, which could fundamentally undercut many commitments over time.

Investment

USCIB supports strong investor and investment protections. Those protections, which include robust investor-state dispute settlement (ISDS) rule-of-law provisions must be included in any final trade agreement. The provisions concluded in USMCA on ISDS, favoring specific sectors and not providing comprehensive protections to all investors alike should not be viewed as precedent.

What constitutes an investment must be defined broadly, to include investment agreements, without carving out any industries or sectors from the protections of this chapter. The pillars of the investment chapter also must remain intact, including national treatment, most-favored-nation (MFN) treatment, minimum standard of treatment, guarantees for compensation in case of expropriation, free transfers, prohibition of performance requirements, and ISDS. A U.S.-Japan agreement should include protection from performance requirements to purchase or use a particular technology for all sectors, including financial institutions. It should also include protection from any requirement to transfer technology for all sectors, including financial services. It is also critical that an agreement reached with Japan include rules prohibiting Parties from requiring companies to transfer their technology, production process, or other proprietary information to persons in their respective territories as a condition of market access.

The most effective dispute settlement mechanism for investors is ISDS. A U.S.-Japan agreement should include such a mechanism and ensure it extends to all sectors, including financial services, to enable investors to bring their claims on a depoliticized basis and seek damages for breaches of the obligations.

Customs and Trade Facilitation

Given the dramatic rise in e-commerce globally and the uptick in Free Trade Agreements that Japan has been involved with over the last few years, including the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP), the United States should encourage Japan to implement high standard trade facilitation measures. This includes raising the customs *de minimis* level to be at or similar to the level of the United States, inclusive of duties and taxes.

Specifically, the United States should encourage Japan to change Article 14, Item 18 of the Customs Tariff Act from JPY10,000 to JPY100,000, inclusive of duties and taxes. Raising the customs *de minimis* levels contributes to faster and more efficient customs procedures for express shipments, particularly for international express shipments derived from e-commerce, thereby

alleviating the workload for the government customs officials charged with targeting and risk analysis. Meaning, this frees up Japan Customs to target high-risk imports, such as illegal or illicit material, because those Customs agents can refocus their resources on risk-based targeting and analysis, as opposed to the considerable administrative burdens of clearing small or low-value shipments.

Japan should also be encouraged not to require Harmonized Tariff Schedule codes on imports entering under the new, higher customs *de minimis* levels. Also, the new, higher customs *de minimis* amount should apply to imports from all origins, and not exclusively goods of U.S.-origin. USCIB also urges a permanent prohibition on the application of customs duties and customs processes on or to electronic transmissions, and that the agreement include no restrictions on drawback or duty referral programs.

In the area of customs valuation, an important topic for our members, Japan should be encouraged to re-instate "First Sale", a practice which remains in place in the U.S. and benefits Japanese importers. In addition, we urge the U.S. to reinstate previous U.S. FTA text related to customs valuation of digital content (any type of digital content) embedded on carrier medium (any type of carrier media without exclusion) on the basis of the cost of value of the carrier medium alone. We believe that this an important provision, a precedence that our members can point to, and proves for expanded scope and application of Decision 4.1. Lastly, we urge parties to secure a commitment to prohibit the use of reference price databases and minimum pricing, practices which undermined the WTO Customs Valuation Agreement.

Express Delivery Services

The United States should support the drafting of a Delivery Services Annex to ensure U.S. and Japanese businesses have access to world-class delivery service options. The parties should also commit to fair, non-discriminatory treatment of non-postal service providers. Both the United States and Japan should ensure that some of the unique challenges associated with market dominant players, (i.e., national postal operators) in the sector are addressed with appropriate safeguards against abuse of that position.

A competitive market in which both Japan Post Co., Ltd. (JPC) and private sector express carriers compete on an equal footing to offer the best service at the lowest possible price will benefit Japanese consumers and the Japanese economy as a whole. The concept should be applied to competitive, value-added delivery services, including JPC's Express Mail Service (EMS).

Electronic Payment Services

A U.S.-Japan trade agreement should follow the financial services commitments in the U.S.-Mexico-Canada agreement (USMCA), providing for both market access and national treatment,

to ensure a level playing field for domestic and foreign-based suppliers of electronic payment services (EPS) in both markets. Regulation should account for, and be respectful of, different business models, encouraging a diverse set of players in the payments space. This competition among players will not only result in greater consumer choice, but will also spur innovation, contributing to a more robust payments ecosystem that will allow all market participants to develop and supply a wide range of payment services with differing product features and value propositions.

The agreement should also apply digital trade provisions to electronic payment services suppliers. Specifically, digital trade provisions of the agreement should: a) ensure EPS suppliers are able to transfer information across borders; and b) prohibit requirements to use or locate computing facilities in a Party's territory as a condition for supplying EPS in that territory.

Regulatory Coherence / TBT

A U.S.-Japan agreement should preserve current rules and expand upon WTO rules for technical barriers to trade (TBT) and sanitary and phytosanitary standards (SPS), as well as seek to implement horizontal commitments to facilitate regulatory cooperation to promote regulatory coherence and the use of good regulatory practices, including public consultation and assessment of the costs, benefits, and alternatives to regulation.

Food Sanitation Act

The Food Sanitation Act requires importers to submit testing reports with specific Japanese standards that are not identical with other countries standards for toys and food products. These requirements increase costs and the amount of time it takes to import certain products. The requirements only apply to importers, not domestic manufacturers. In addition to seeking a modification to Ministry of Health, Labour and Welfare regulations, USTR should ensure Japan accepts testing methods that are in line the TBT Agreement at the WTO, including testing conducted under ISO standards.

Financial regulatory co-operation and coherence

The U.S.-Japan trade agreement is a unique opportunity to use the negotiation of a trade and investment agreement between Japan and the United States to establish a formal and comprehensive mechanism for cross-border financial regulatory cooperation. Such a mechanism can be principles based, with clear requirements agreed between the respective regulators to mitigate conflict and complexity before they manifest themselves. Improving cross-border regulatory development, implementation and enforcement would, in turn, improve the efficiency of cross-border regulation, benefit market participants and - importantly - their end-user clients, with scope for added rigor without any threat to existing domestic rules and standards.

- **Stakeholder Engagement**: Robust transparency obligations that ensure stakeholders have the opportunity to review and comment on proposed measures. Such obligations would ensure industry and other stakeholders can engage with regulators to craft meaningful

outcomes to meet regulatory objectives while not hindering the industry's ability to serve its clients. The agreement should also set clear rules regarding how regulators will engage with applicants for a license, including timelines and fees.

- **Options for Architecture**: We believe these options should be evaluated and discussed between industry and the respective Governments in coming months. Effective regulatory cooperation between Japan and the United States will be vital not just in terms of the standards developed in those markets but also in terms of setting policies and procedures at the global level and enabling the two countries to demonstrate leadership in multilateral fora such as the Financial Stability Board and International Organization of Securities Commissions.
    - Enshrine, within the text of a Japan-U.S. trade agreement, a joint regulatory coordinating mechanism.
    - House regulatory cooperation outside of a trade agreement, similar to the existing U.S-EU Regulatory Forum but with more ambitious outcomes and stronger transparency and industry engagement.

Fintech

USCIB also urges the United States and Japan to explore how to deepen regulatory cooperation and coherence in fintech developments, complimenting multilateral and bilateral efforts aimed at promoting cross-border financial technology and growth.

Government Procurement

A U.S.-Japan agreement should ensure that financial institutions will not be discriminated against in the procurement of services by the government and its related entities. Too often in trade agreements government procurement is excluded through government procurement chapters or in financial services chapters themselves. A new and fresh approach is warranted to ensure this type of business continues to be open to financial institutions.

Financial Services

Maximize cross-border market access in trade and investment

Ensure broad and deep market access commitments enhancing volumes of cross-border financial services transactions and foreign direct investment. A U.S.-Japan agreement should utilize a negative-list approach when scheduling commitments supported by a "ratchet mechanism" that will capture future liberalization in the sector of the trading partner. Traditional free trade agreements have covered very few commitments in the area of cross-border trade in financial services. At a minimum cross-border supply of financial services must include traditional insurance commitments, investment advice, portfolio management and electronic payment systems. The two parties should engage with the financial sector to explore other services that could also benefit from commitments for the cross-border supply of those services.

Subsidies

A U.S.-Japan agreement should set a high standard to discipline subsidies to financial services related entities. Provisions in the financial services chapter should discipline the granting of subsidies to state-owned financial institutions with limited exception for certain programs.

Priority Sector Lending

Today governments seek to require foreign financial institutions to participate in programs that require lending in particular sectors or to domestic firms. Often these sectors are not the sectors of typical business expertise for the foreign financial institution and require it to take on risk it otherwise would not. These programs undermine stability and opportunities to engage in other types of business when capital must be reserved for such programs. The United States and Japan should set a high standard to prohibit these types of requirements in trade policy.