There was an audible sigh of relief in Tokyo following the recent summit between Prime Minister Shinzo Abe of Japan and President Donald Trump. All the right boxes were checked: personal rapport between the leaders; reaffirmation of the basic tenets of the U.S.-Japan alliance; no outbursts (tweeted or otherwise) about unfair Japanese trade or currency practices; announcement of a new bilateral economic dialogue led by the vice president and deputy prime minister. These are welcome signs of “normalization” of one of the United States’ most important bilateral relationships after a stream of intemperate remarks about Japan by candidate and president-elect Trump.

But Tokyo should not break out the celebratory sake just yet. President Trump has spent over three decades arguing that Japan is “taking advantage of” the United States on both the security and economic fronts. One of his first acts as president was to walk away from the organizing principle of U.S.-Japan economic relations for the past five years, the Trans-Pacific Partnership (TPP). And even in his measured statement in the joint press conference with Prime Minister Abe, President Trump put Japan on notice that he expected the bilateral relationship to be “free, fair, and reciprocal.” Tokyo still has work to do if it wants to gain the trust of the new U.S. president and put bilateral economic relations back on a productive path.

U.S.-Japan economic ties have had a colorful history over the past several decades. Trade tensions were a persistent feature of the relationship after Japan ran its first bilateral trade surplus in 1965. In the 1970s, Washington and Tokyo sparred over everything from color televisions surging into the U.S. market to Japanese companies’ purchases of Iranian oil during the 1979 hostage crisis. The 1980s were worse, featuring conflict over Japan’s currency policy and growing anger over its closed domestic market. The nadir of the relationship was arguably reached in the summer of 1987, when angry members of Congress took sledgehammers to a Toshiba radio on the steps of the Capitol building in response to the company’s sale of sensitive technology to the Soviet Union. After a final outburst of trade tensions in the early 1990s, Washington lost interest in the economic relationship as Japan’s financial bubble burst and a “lost decade” stretched into two.

Though official ties atrophied, the economic relationship was being transformed on the ground. In particular, Japanese companies began to invest heavily in North America, both to avoid trade and currency frictions and to exploit supply-chain-management efficiencies following enactment of the North America Free Trade Agreement (NAFTA) in 1994. Today, Japan is the second-largest source of foreign direct investment (FDI) in the United States, and Japanese auto investment alone supports an estimated 1.5 million American jobs. Investment is also becoming more of a two-way street: the stock of American FDI in Japan, though still low by international standards, has roughly doubled since the turn of the century.

The trade relationship has also changed, though less visibly. The United States still runs a large trade deficit with Japan; indeed, at almost $69 billion, it resumed its place in 2016 as the second-largest source of the U.S. goods trade deficit. But Japan’s share of the deficit has fallen from over 50 percent in 1991 to around 10 percent today, particularly as China’s bilateral surplus has ballooned. Moreover, the United States has seen the dollar value of its exports to Japan...
rise almost 50 percent over the past decade, growing faster than Japanese exports to the United States despite the virtual flat-lining of Japan’s economy.

Meanwhile, Trump’s view of Tokyo as an inveterate currency manipulator—reaffirmed as recently as early February when he met with U.S. pharmaceutical CEOs—is also out of date. The Japanese government has not intervened in currency markets in a meaningful way since 2011, and even then, the purpose was to stabilize the markets in the wake of the Fukushima triple disasters. The persistent weakness in the yen in recent years is mainly a reflection of the easy monetary policies pursued by the Bank of Japan in its protracted war against deflation—efforts sanctioned by the United States and other G20 countries.

But the persistence of the large bilateral trade deficit and the perception—not entirely unfounded—that Tokyo favors a weak yen are inconvenient truths for Tokyo as it tries to win President Trump’s trust and move the bilateral economic relationship onto a more productive footing. Moreover, as Vice President Mike Pence and Deputy Prime Minister Taro Aso sit down in Tokyo in April for the first round of their new economic dialogue, the two sides will have to work hard to overcome the setback to the relationship caused by President Trump’s decision to withdraw from TPP.

Completion of TPP represented the pinnacle of U.S.-Japan economic cooperation, arguably fulfilling the mandate of Article II of the bilateral security treaty of 1960. As discussed here many times before, a ratified TPP would not only have brought significant economic and strategic benefits to both countries, but even more important, it would have updated and upheld the rules of the regional trading order in line with shared U.S. and Japanese interests and values. Job one for the Pence-Aso dialogue will be to find ways to keep those rule-making gains—on the digital economy, on state-owned enterprises, on labor—alive and central to Asia-Pacific economic integration.

Capturing these gains through a bilateral trade agreement, as some believe the Trump administration would like to do, is one possible approach. But a dose of realism about how hard that would be is in order. Negotiators would have to climb at least three steep hills. First, in keeping with the president’s persistent rhetoric, the Trump administration is likely to insist that enforceable currency disciplines be added to the rules agreed in TPP. Second, the administration’s “buy American, make American” mantra suggests it is almost certain to reject the relatively low TPP rules of origin and to demand that Japanese auto and other manufacturers produce more content in the United States (production in Mexico and Canada will not count). And third, U.S. agricultural interests—especially rice, dairy, and other sectors that saw few gains in TPP—could well demand far greater market access in Japan in any reopened negotiations. Any one of these issues could be a deal breaker for Tokyo; at a minimum, they suggest protracted and painful negotiations.

Instead, the two sides could look for other channels for cooperation on rule making. They could build on the existing good work on the digital economy in the Asia-Pacific Economic Cooperation (APEC) forum by jointly advocating for the principles of free data flows and no forced data localization. The United States could encourage Japan to be more assertive in carrying forward high-standard rules in the alternative mega-regional trade arrangement, the Regional Comprehensive Economic Partnership (RCEP). And each side could work to gain acceptance of these rules in their bilateral engagements with other Asia-Pacific countries.

Beyond TPP-style rule making, there are a number of other promising areas for U.S.-Japan economic cooperation, from enhancing research and development collaboration on cutting-edge technologies such as artificial intelligence to spreading best practices in infrastructure investment as these connections grow across Central and Southeast Asia.

For this productive collaboration to gain traction, it will require a shift in views at the top. Tokyo will need to move out of its comfort zone and be more willing to take the lead in global rule making. The Trump administration will need to get beyond its misplaced focus on bilateral trade deficits and outdated charges of currency manipulation, acknowledge the value of international engagement to address the challenges and opportunities the United States faces in the twenty-first century, and recognize that Japan is not an economic rival. Rather, it is a vital partner with shared values and interests, capable of playing an independent leadership role in Asia that advances our shared interests, and whose economic success brings direct and indirect benefits for Americans.

Matthew P. Goodman is senior adviser for Asian economics and holds the William E. Simon Chair in Political Economy. David A. Parker is an associate fellow with the William E. Simon Chair in Political Economy, where his research focuses on U.S. economic statecraft toward the Asia Pacific. Global Economics Monthly is published by the Center for Strategic and International Studies (CSIS), a private, tax-exempt institution focusing on international public policy issues. Its research is nonpartisan and nonproprietary. CSIS does not take specific policy positions. Accordingly, all views, positions, and conclusions expressed in this publication should be understood to be solely those of the author. © 2016 by the Center for Strategic and International Studies. All rights reserved.