Coalition of Services Industries (CSI) Submission: U.S.-Japan Trade Agreement Objectives

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The Coalition of Services Industries (CSI) appreciates the opportunity to submit comments to the Office of the United States Trade Representative (USTR) and the Trade Policy Staff Committee (TPSC) on negotiating objectives for a U.S.-Japan Trade Agreement.

CSI, established in 1982, is the leading industry association devoted exclusively to advocating on behalf of America's services businesses regarding services and investment trade barriers. CSI member companies represent a broad spectrum of the U.S. services sector, including distribution services, express delivery, financial services, media and entertainment, information and communication technology services, and professional services. These services are critical enablers for U.S. economic growth.

As part of the formation of the World Trade Organization (WTO), Japan entered into broad set of services market access commitments as part of its General Agreement on Trade in Services (GATS) schedule, leading to a significant opening of the Japanese market to a wider range of U.S. services. It also agreed to the principle of National Treatment in Article XVII, which requires WTO Members to "accord to services and service suppliers of any other Member…treatment no less favourable than that it accords to its own like services and service suppliers."

In addition, USTR led a series of negotiations in the 1980s and 1990s aimed at addressing barriers to U.S. services, including financial services, insurance, and telecommunications. Finally, under Prime Minister Abe's leadership, Japan has undertaken sweeping market-based regulatory initiatives by opening up previously protected sectors in order to introduce greater competition and boost stagnant economic growth, including in the area of privatizing and reforming Japan's remaining state-owned enterprises (SOEs) and adopting world-class financial regulatory systems.

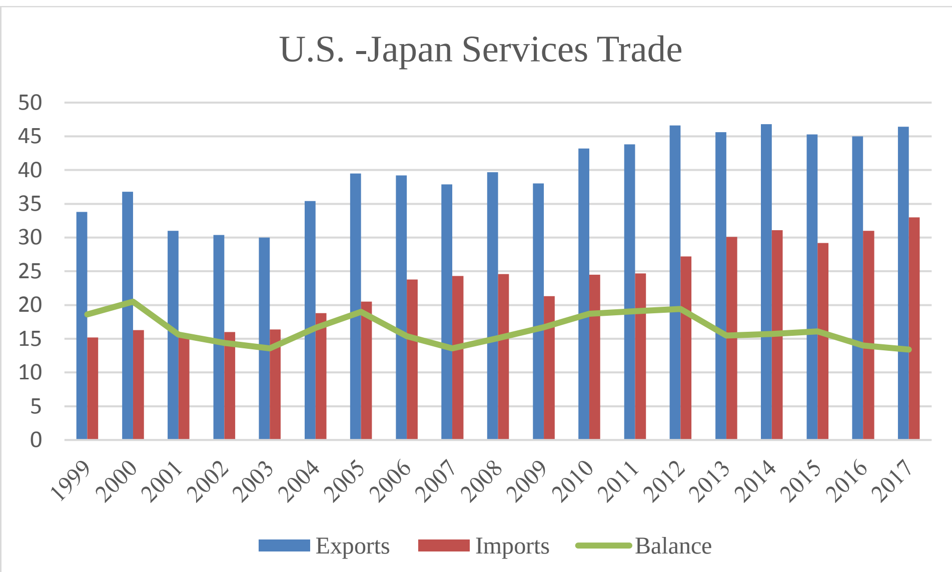
As a result, many of the trade barriers and bilateral trade tensions of past decades have disappeared. The trade frictions that prevailed during the 1970s, 1980s, and early 1990s have given way to strengthened bilateral cooperation on issues of mutual interest, such as regional security and the challenges posed by state capitalism. As the two countries embark on new trade negotiations, the U.S.-Japan economic relationship is strong and mutually advantageous. The U.S. and Japanese economies have become highly integrated with increasing trade in goods and services and large two-way investment and capital flows. The United States and Japan are vital markets for each other's goods and services and important sources of imports and foreign direct investment.

CSI members believe it is vitally important that the services and digital trade objectives set out in this submission be included in the upcoming negotiations. These objectives are based on the services and digital trade elements included in the Trans-Pacific Partnership (TPP) negotiations and the U.S.-Mexico-Canada Trade Agreement (USMCA). In light of the large degree of common support for these objectives in the United States and Japan, CSI members' preferred approach is a comprehensive free trade agreement (FTA) consistent with the Bipartisan Congressional Trade Priorities and Accountability Act (TPA) of 2015.[i] We believe that these services objectives should remain priority as the bilateral negotiations proceed and can be addressed in the initial stage of negotiations with Japan.

I. U.S.-JAPAN SERVICES TRADE AND INVESTMENT

The United States has maintained a services trade surplus with Japan since 1999 and it is the United States fifth largest services export market. In 2017, the U.S. services trade surplus with Japan was $13.4 billion.[ii] Sales of services in Japan by majority U.S.-owned affiliates were $72 billion in 2016, while sales of services in the United States by majority Japan-owned firms were $158.6 billion.[iii],[iv]

Transport, financial services, licensing and intellectual property fees, telecommunications, and business services represent over two-thirds of U.S. services exports to Japan. Over the last decade, the United States has increased its financial services exports to Japan by 35 percent, hitting $3.5 billion in 2017.[v] Telecommunications and computer services sector have been a strong area of growth. U.S. business services exports have grown by 27 percent over the last decade.[vi]



II. GENERAL PRINCIPLES

These bilateral negotiations have potential to be a win-win opportunity for two longstanding allies to demonstrate leadership in forging 21st century trading rules in the Asia-Pacific region and establishing a model for future regional trade.

To take full advantage of this historic opportunity, CSI urges the U.S. and Japanese governments to promote core principles of open and free trade and build a U.S.-Japan alliance to address trade-distorting practices arising from state capitalism.

Given the importance of U.S. bilateral services trade and investment with Japan, CSI urges that any bilateral negotiation with Japan be consistent with negotiating objectives set forth in TPA. This will ensure proper consultation with Congress and that due consideration is given to the congressionally mandated objectives for services, investment, digital trade, transparency, regulatory cooperation, and enforcement, and that any implementing legislation benefits from TPA. The negotiations should be carried out in a transparent and efficient manner that minimizes commercial uncertainty and enables trade and investment flows to continue to promote economic growth.

III. SERVICES AND DIGITAL TRADE OBJECTIVES

Cross-Cutting Priorities

CSI believes that it is critically important that services be a priority in bilateral negotiations with Japan. The negotiations should promote services market access in trade and investment that meets or exceeds the level achieved in TPP. The United States should seek to expand cross-border commitments in financial services along the lines of the USMCA. The United States should also ensure that any new services that may emerge in the future are protected from future discrimination. There should also be no cultural carve-outs, including no discrimination or investment restrictions in online services.

U.S.-Japan trade negotiations can also take a step forward in finding common regulatory approaches by establishing a commitment for both countries to refrain from applying consumer protection regulations to services offered to enterprises, whose terms are often different and set through negotiated contractual agreements.

Negotiations should also promote greater regulatory transparency, due process, and non-discrimination and provide for a consultative mechanism on regulatory cooperation across services sectors. Finally, negotiations should aim to simplify and streamline border clearance processes to reduce complexity, cost, and the time required to release goods.

Digital Trade

Data flows are the building blocks of technological advances such as cloud computing, the Internet of Things, Artificial Intelligence and the rapidly evolving services and technologies of the Fourth Industrial Revolution. Ensuring the free flow of data across borders and prohibiting data localization is imperative if we are to realize the full potential of services, particularly internet enabled services, in promoting global economic growth and innovation. The United States and Japan are leaders in this technological revolution, which impacts virtually all services suppliers and the global digital economy. Data localization requirements and other policies that restrict data flows ultimately constrain growth and innovation, as well as reduce the scope for U.S. and Japanese service firms to engage in business and investment contributing to both markets' competitiveness and growth. Further, a March 2016 report by the McKinsey Global Institute found that in 2015, for the first time, the global value of international data flows ($2.8 trillion USD) exceeded the value of global merchandise trade. The 2016 McKinsey report also found that the application of digital technologies and services, including cloud computing, will increase global GDP by $2 trillion USD by 2020.[vii]

Cloud-based services have become more central to the way consumers conduct business and live their daily lives around the globe. According to a 2017 U.S. Department of Commerce report on cloud computing markets, Japan ranked second in size to the United States, which maintains the largest cloud computing market in the world. The United States exported nearly $3.5 billion in cloud computing services to Japan, as of 2015, and poses the opportunity for even further growth given the size and demand of the Japanese market.[viii]

U.S.-Japan trade negotiations offer an important opportunity to recognize both countries' mutual interest and leadership in digital trade, drawing from the digital provisions of the USMCA. These include commitments to protecting privacy and the cross-border flows of data. Building on the commitments made in the USMCA and taking into consideration Japan's privacy law and existing U.S. privacy protections, both parties should enshrine a commitment that personal data can be transferred between the two countries without any additional transfer mechanisms. Further, given U.S. and Japanese leadership in this area, the parties should establish a mechanism for both governments to further coordinate on digital trade barriers in third-country markets, and coordinate on regional and global negotiations involving digital trade.

As the United States and Japan continue to ally and advocate to make permanent the customs duty moratorium on electronic transmissions, bilateral negotiations offer another opportunity to lead the way on promoting global digital trade by including binding prohibitions on applying customs duties and other customs processes on electronic transmissions. Bilateral negotiations should also include agreement to streamline and modernize customs processes, such as the use of electronic customs forms, electronic signature and authentication, and secure on-line payment, as well as upgraded *de minimis* levels.

<u>Telecommunications</u>

Bilateral negotiations with Japan should include provisions on communications services – including fixed and mobile services, as well as the Internet of Things – to ensure market access and a pro-competition, pro-investment environment, and avoidance of barriers such as limitations on technology choice or disproportionately burdensome regulatory requirements. They should also ensure that foreign services providers rely on global technology standards developed through voluntary and industry-led processes, and prohibit parties from imposing conflicting national standards, to address standardization and interoperability issues.

<u>Media and Entertainment Services</u>

Both the United States and Japan have vibrant and globally competitive media and entertainment services. Accordingly, bilateral negotiations with Japan provide an opportunity to set an example of a high standard level of commitments in media and entertainment services. Not only should any agreement reject the anachronism of a "cultural carve-out," it should commit both countries to allow open and non-discriminatory trade and investment in media and entertainment services.

Financial Services

Japan's financial regulatory regime, long known for adopting a so-called *goso sendan* (convoy) system, has undergone a major transformation in the last 30 years.

The convoy system viewed "excessive competition" as a threat and allowed weaker financial institutions to survive to maintain market "order." It was characterized by an emphasis on maximum regulatory control, a lack of transparency, barriers to distribution, and practices that kept out competitors, including foreign financial institutions. This regime became the subject of intense bilateral trade negotiations, which resulted in agreements under the U.S.-Japan Framework for a New Economic Partnership, including the U.S.-Japan Insurance Agreement in 1994, the U.S.-Japan Financial Services Agreement in 1995, and the Supplementary Measures for the U.S.-Japan Insurance Agreement in 1996. These bilateral and multilateral agreements led to Government of Japan commitments to enhance transparency, due process, market liberalization, and competition policy in the Japanese market, including the implementation of a robust public comment process in forming new or amended regulations in Japan.

Today, the convoy system is a thing of the past. Since the Government of Japan launched the financial "Big Bang" program to create a "free, transparent and fair global financial market," Japan has steadily implemented market-oriented reforms to open up the financial services sector. To become a global leader in best practices for financial services regulation, the Financial Services Agency (FSA), which has taken over regulatory authority of the financial sector from the Ministry of Finance, adopted a rules-based regulatory approach when it was established in 2001 as Japan's single financial regulator. This creates incentives for compliance through transparency and the notion of self-responsibility by financial institutions. Starting in 2007, the FSA has taken further steps to achieve the best mix of principles- and rules-based regulation, dubbed "Better Regulation."

American firms can thrive in any market if they can compete on a level playing field. Japan's reforms and market liberalization over the years have coincided with substantial growth for U.S. firms in the Japanese market. Over the last decade, the United States has increased its financial services exports to Japan by 35 percent, hitting $3.5 billion in 2017.[ix] American financial institutions have established a major presence in the Japanese market, and Japanese financial institutions have a major presence in ours.

Despite all the progress over the years, one area of Japan's financial services sector that remains outside the FSA's jurisdiction is "*kyosai* insurance," or cooperatives offering insurance services. The Government of Japan continues to give discriminatory and more favorable treatment to *kyosai* insurance, which remains a longstanding level playing field issue, but was not addressed in the TPP or any other regional agreements that involve Japan. Even though *kyosai* insurance compete directly with U.S. and Japanese private-sector insurance services providers, Japan's FSA has no authority to regulate them. They are regulated by patron agencies, such as the Ministry of Health, Labour and Welfare (MHLW) and Ministry of Agriculture, Forestry, and Fisheries (MAFF). The upcoming bilateral negotiations offer an important opportunity to address this longstanding disparity, ensure a "level playing field," and end the discriminatory and more favorable regulation of *kyosai* insurance, which raises both trade, prudential, and systemic concerns.

Further, negotiations provide the opportunity to memorialize commitments from TPP already achieved by the United States and Japan on senior management and boards of directors that prevent a government from requiring "more than a minority" of the board of directors be composed of nationals. The United States should also seek inclusion of commitments on corporate form that would guarantee the ability of U.S. insurers to operate in the corporate form of their choice, as typical in U.S. FTAs to date.

The upcoming negotiations also offer the opportunity to affirm previous successful discussions on establishing and maintaining a level playing field with respect to postal financial institutions. TPP and its successor, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), include disciplines on postal insurance entities in the financial services chapter and State-Owned Entities (SOEs) chapter. The Government of Japan has made substantial progress in reforming Japan's postal institutions and including these disciplines in a bilateral agreement would secure those achievements and support their eventual completion.

Currently, the FSA is implementing a comprehensive reform plan that emphasizes balancing regulation with economic growth. This perspective is closely aligned with the Trump Administration's financial regulatory policy and underscores Japan's commitment to promote fair competition in an open-market economy. The two governments' shared view has been confirmed under the U.S.-Japan Economic Dialogue co-chaired by Vice President Mike Pence and Deputy Prime Minister Taro Aso. Specifically, the joint statement from the Second Round of the U.S.-Japan Economic Dialogue (October 16, 2017) states: "The United States and Japan share the view that financial regulatory regimes should be calibrated to reduce regulatory costs and burdens, while maintaining high standards of safety and soundness and ensuring the accountability of the financial system to the public."

In fact, the U.S. and Japanese governments have worked closely in development of global financial regulatory standards, including at the Financial Stability Board (FSB), Basel Committee on Banking Supervision, International Organization of Securities Commissions (IOSCO), and International Association of Insurance Supervisors (IAIS). Building on this, a formal regulatory cooperation mechanism would be a beneficial outcome for the U.S.-Japan Trade Agreement, drawing from the outcomes the EU-Japan Economic Partnership Agreement specific to cooperation in financial regulation.

Bilateral cooperation can also be found in areas such as data localization, payment services, and fintech. For instance, the United States and Japan are already closely aligned with respect to principles which should govern digital trade, and the coming negotiations offer a vital opportunity to lock in rules governing the cross-border flow and storage of digital information with respect to financial services trade and establish a framework for the future handling of such issues in the Asia-Pacific region. In particular, by incorporating the provisions adopted in the USMCA, the agreement should safeguard the ability of financial services institutions to move data freely across borders by prohibiting requirements for localization of financial services data and establishing an alternative to third countries' data localization requirements. The provisions should also ensure that the financial services sector is not carved out of digital trade provisions as in TPP, including provisions with regard to security technologies, software source code and algorithms.

Because Japan's financial services markets are already open to U.S. financial services providers, we expect the negotiation of market access and national treatment obligations drawn from the USMCA to be relatively straightforward, providing for both market access and national treatment, in order to ensure a continued level playing field for domestic and foreign-based suppliers, including for electronic payment services (EPS), in both markets. The agreement should build on use of electronic payments systems in Japan by encouraging a diverse set of players in the payments space. By supporting vigorous competition among players, the agreement 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, and establishing a regional alternative to requirements to use specific national payments systems.

Given the strong existing ties between U.S. and Japanese regulators, the bilateral negotiations should also explore how to further deepen regulatory cooperation and coherence in "fintech" developments, complimenting multilateral and other bilateral efforts aimed at promoting cross-border financial technology development and growth and fending off the further spread of protectionist and trade-distorting regulatory practices, such as priority sector lending requirements, in the Asia-Pacific region, which pose a threat to U.S. and Japanese financial institutions alike and appear driven by mercantilist objectives as opposed to legitimate systemic, consumer protection, and prudential concerns.

Express Delivery Services

The United States should support 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 mutual recognition and implementation of fair and non-discriminatory treatment for U.S. and Japanese express delivery services, memorialized through a U.S.-Japan trade agreement, should address the treatment of JPC and JPC's Express Mail Service (EMS), where disparate procedural and regulatory treatment are faced by foreign competitors. For example, the United States and Japan should work together to remove EMS from the postal universal service definition and eliminate advantageous regulations for EMS or application of discriminatory regulations to private international express carriers.

Other areas, such as treatment of quarantine shipments, customs clearance regulations, and security requirements should also be addressed in negotiations to level the playing field between domestic and foreign service providers.

Establishing equivalent conditions of competition for private express delivery service providers is a mutually beneficial objective for the United States and Japan to achieve within negotiations.

Trade Facilitation

Given the dramatic rise in e-commerce globally and the uptick in FTAs that Japan has been involved with over the last few years, including the 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 U.S.'s level, inclusive of duties and taxes, and streamlining shipments under $2500 through an informal clearance channel.

The U.S.-Japan agreement should have forward-looking trade facilitation measures that enable e-commerce and ease the participation of small and medium-sized enterprises (SMEs) in trade through e-commerce. As most e-commerce shipments are low-value, we recommend simplifying and automating customs processes for all shipments.

Foremost, this can be done through an adoption of an $800 *de minimis* level, for which duties and taxes are waived and simplified entries are permitted. 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. In other words, raising the *de minimis levels* would free up Japan Customs to target high-risk imports because those Customs agents could refocus their resources on risk-based targeting and analysis, as opposed to the considerable administrative burdens of clearing small or low-value shipments. Higher customs *de minimis* amount should apply to imports from all origins, and not exclusively goods of U.S.-origin. Japan should also be encouraged not to require Harmonized Tariff Schedule codes on imports entering under the new, higher customs *de minimis* levels.

Further areas to aid this objective include streamlining documentation, updating clearance processes, adopting electronic payment of duties and taxes, establishing returns procedures, among others, as well as expanding on the work done in the USMCA with regards to customs formalities ad processes.

To support the implementation of the U.S.-Japan trade agreement that keeps up with ever changing supply chains, we recommend the creation of a Trade Facilitation Committee – a mechanism supporting inter-agency coordination and private sector consultation. The Committee will serve as a mechanism for trouble-shooting and addressing trade and customs problems, consulting with the private sector on emerging and future trends impacting import, export, and supply chains.

Direct Selling

Bilateral negotiations with Japan should recognize the direct selling distribution-services system, through which companies outsource sales and sales-management services to independent contractors. This distribution system was recognized within the USMCA and would make for the appropriate baseline for bilateral negotiations with Japan. In addition, negotiations should look to the definition of "direct selling" laid out in the USMCA in its entirety.

Government Procurement

A U.S.-Japan agreement should ensure that services providers, and particularly 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.

We commend the United States and Japan for implementing Cloud First policies. Cloud computing has brought forth a new and more efficient means of managing government information technology resources, and has opened up avenues for modernization, innovation, and cost savings, and improves cybersecurity. Commercial cloud computing for government entities spurs innovation, facilitates inter-agency collaboration for greater efficiency and better citizen services, results in faster deployment of services, enhances cybersecurity, increases operational continuity and business recovery, allows for greater budget control, decreases spending on legacy infrastructure, and increase efficiency and sustainability. Given these numerous benefits, we believe the U.S.-Japan trade negotiations should include first of its kind measures on implementation and maintenance of Cloud First policies, applicable to all sectors, including financial services. This would cement U.S.-Japan leadership in cloud computing, while also setting an important precedent for other agreements being negotiated in the Asia-Pacific and the rest of the world.

Investment

An agreement with Japan must ensure that the same scope of enforceable investor protections for all services sectors investing in Japan, including financial services. The USMCA and other agreements have not afforded financial services the same broad scope of protections and enforcement. All services providers should be protected in a U.S.-Japan agreement from non-discriminatory treatment, direct and indirect expropriation, under the minimum standard of treatment, including fair and equitable treatment, performance requirements and ensure free transfers.

Negotiations should also ensure that an enforceable state-to-state dispute settlement mechanism provides for the highest standards of protection for services providers including prohibitions on forced technology transfer. Provisions should be included to prevent parties from blocking the formation of dispute settlement panels and ensuring that monetary damages are available.

State-Owned Entities (SOEs)

The Abe administration has sought to use its recent trade initiatives to solidify and move forward its proactive reform agenda. A key example of this has been in the area of SOEs, where the Government of Japan has made new international commitments under the CPTPP and EU-Japan EPA to extend the principle of "national treatment" to SOEs in general and postal insurance specifically.
These new commitments build upon Japan's GATS commitments, which prohibit discriminatory treatment against foreign services suppliers, as well as voluntary international guidelines aimed at ensuring that SOEs are operated independently and on a level playing field in the marketplace.

As a member state to the Organization for Economic Cooperation and Development ("OECD"), the Government of Japan has pledged to comply with OECD guidelines outlining best practices for SOE governance, last updated in 2015, which state that government owners such as the Government of Japan:

- "should allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management."
- should "let SOE boards exercise their responsibilities and should respect their independence."
- should ensure that the "legal and regulatory framework for SOEs… ensure[s] a level playing field and fair competition in the marketplace when SOEs undertake economic activities."
- should ensure that "transactions between the state and SOEs, and between SOEs, should take place on market consistent terms."

Negotiations should include provisions to ensure a level playing field is in place so that where any SOEs/SSEs must compete fairly and transparently against the private sector in providing services to the market, building on what was agreed to in the USMCA. Historically, and in many instances and markets where U.S. services firms operate, private firms are often faced in competing with "local champions" of state-owned and state-supported entities (SOEs/SSEs), in an unfair, disadvantaged and uncompetitive manner.

Before initiation of the privatization process of Japan Post public corporation, CSI joined a coalition of organizations calling for a level playing field, and among other things, "fair and open opportunities to compete for the privatized Japan Post's distribution of financial products consistent with commercial best practices."

Today, Japan Post Holdings, Japan Post Bank, and Japan Post Insurance are publicly traded companies, with the Government of Japan owning 56.9% of shares in the holding company as part of a longstanding divestment process. Japan Post Group companies are now operated as private companies under Japan's Companies Act on the basis of commercial considerations. CSI applauds the fundamental changes in Japan Post Group's operations and governance under the Abe administration's reforms. At present, a wide range of private-sector financial institutions—including foreign firms—offer their products at post offices, with varying distribution footprints.

At the same time, as described in the "express delivery services" section, concerns remain regarding unequal treatment between Japan Post and private international express delivery companies in areas that are not included in Japan's scheduled commitments in GATS.

Negotiations that include disciplines on SOEs would help to reaffirm that a level playing field is in place, especially for express delivery, and further promote the above-mentioned impressive reforms at Japan's postal institutions and set the stage for their completion. This in turn will support a competitive landscape free of distortions from SOEs, both in the Japanese and third country markets.

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[i] [i] "Bipartisan Congressional Trade Priorities and Accountability Act of 2015," https://www.congress.gov/114/plaws/publ26/PLAW-114publ26.pdf
[ii] Bureau of Economic Analysis, "Table 2.3. U.S. Trade in Services, by Country or Affiliation and by Type of Service," Japan, October 19, 2018, https://www.bea.gov/itable/.
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[viii] U.S. Department of Commerce, "2017 Top Markets Report Cloud Computing Sector Snapshot," November 15, 2018, https://www.trade.gov/topmarkets/pdf/Sector%20Snapshot%20Cloud%20Computing%202017.pdf
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