

**Chapter 2 Economic trends and external economic policies in major countries/regions**

In this chapter, we will look at economic trends and external economic policy developments by major country/region. As will be described in Part II, the global economy is at a critical turning point as it faces such major challenges as the challenge posed to the free trade system based on the WTO, the progress in the digital revolution, including expansion of digital trade, and the rise of emerging and developing economies. Looking at the situation by major country/region, significant changes are also occurring. In this chapter, we will conduct analysis with particular attention paid to trade policy developments in the United States and Europe, and moves in emerging and developing economies/regions to deepen and expand regional economic partnerships and the progress in the digital revolution.

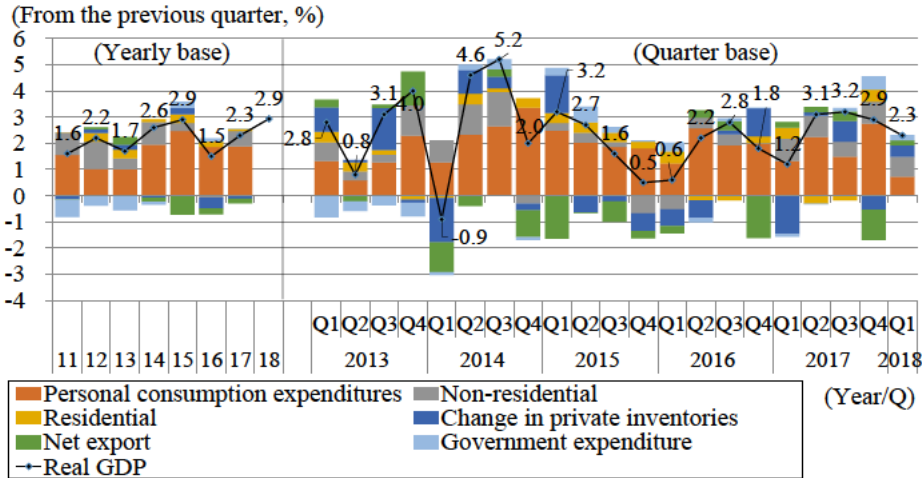
**Section 1 United States**

**1. Macroeconomic trends**

**(1) Macroeconomic trends**

In 2017, the real GDP growth rate of the United States accelerated from 1.5% in 2016 to 2.3% compared with the previous year, suggesting that the economy has continued to recover steadily. By expenditure, private consumption, which accounts for around 70% of GDP, continued to steadily increase, and in addition, the growth in capital investment also led the increase in overall demand. According to a forecast by the IMF, although the U.S. economy is expected to continue to recover steadily, recording annual growth of 2.9% from the previous year in 2018, attention should be paid to future policy trends, the policy effects, and the effects of changes in financial and capital markets. The longest-ever economic expansion phase of the U.S. economy after the end of World War II spanned the 10-year period from April 1991 to March 2001, and the current economic expansion phase, which started in July 2009, will enter its 10th year soon (Figure I-2-1-1).

**Figure I-2-1-1 Changes in contributions of GDP by expenditure in the United States**



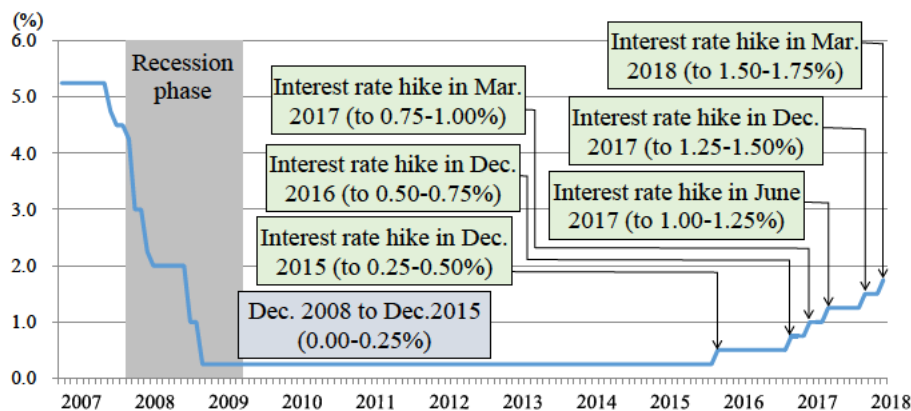
Notes: Figures are seasonally adjusted. Those for the real GDP in 2017 are IMF estimates.

Source: United States Department of Commerce, *World Economic Outlook* (IMF).

## (2) Financial market trends

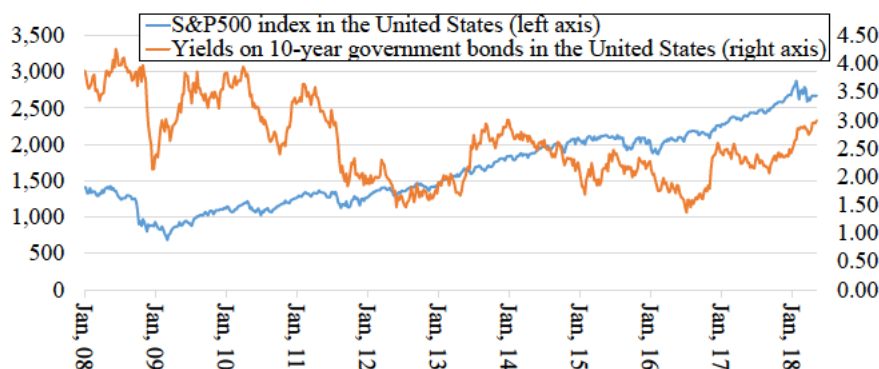
The U.S. FRB is proceeding with the normalization of the monetary policy.<sup>23</sup> For example, in October last year, it started to reduce reinvestments in U.S. government bonds and mortgage-backed securities (MBS) after maturity<sup>24</sup> and also raised the federal funds rate (FF rate), its policy interest rate (Figure I-2-1-2). As if to respond to this move, the U.S. long-term interest rate (the yield on 10-year government bonds) has been rising since the second half of 2017 (Figure I-2-1-3). Among the factors presumed to be behind the interest rate rise are expectations for economic expansion due to the enactment of the bill for tax system reform and an increase in fiscal expenditure through a rise in the ceiling on discretionary expenditure by the Trump administration, as well as the rise in the crude oil price. The possibility has also been pointed out that upward pressure is placed on the long-term interest rate if the budget deficit expands due to the effects of the tax reduction policy while the FRB scales back its balance sheet and if the issuance of U.S. government bonds is increased as a result, disrupting the supply-demand balance of U.S. government bonds.

**Figure I-2-1-2 Changes in federal fund rates in the United States**



Source: Federal Reserve System.

**Figure I-2-1-3 Changes in the S&P500 index and yields on 10-year government bonds in the United States**



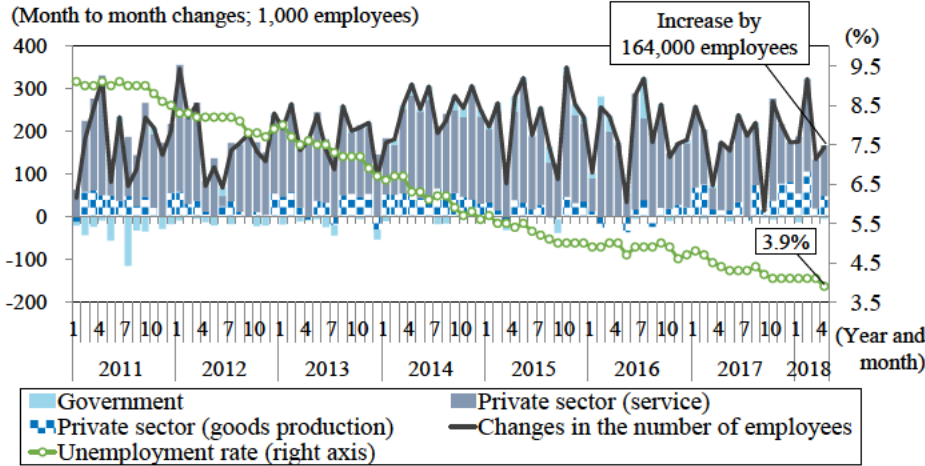
Source: Thomson Reuters.

23 Regarding the impact of the normalization of the U.S. and European monetary policy on the global economy, see Chapter 1, Section 1.5.

24 Generally called a policy of balance sheet shrinkage.

The U.S. economy has been performing well, as indicated by the record high level reached by the major U.S. stock price index (Figure I-2-1-3) in addition to the accelerated GDP growth rate. As the employment environment is favorable (Figure I-2-1-4)<sup>25</sup> and the price index is gradually rising<sup>26</sup> (Figure I-2-1-5), the prevalent view is that the FRB will continue to gradually raise the policy interest rate.

**Figure I-2-1-4 Changes in the number of employees in the non-farm sector and unemployment rates**



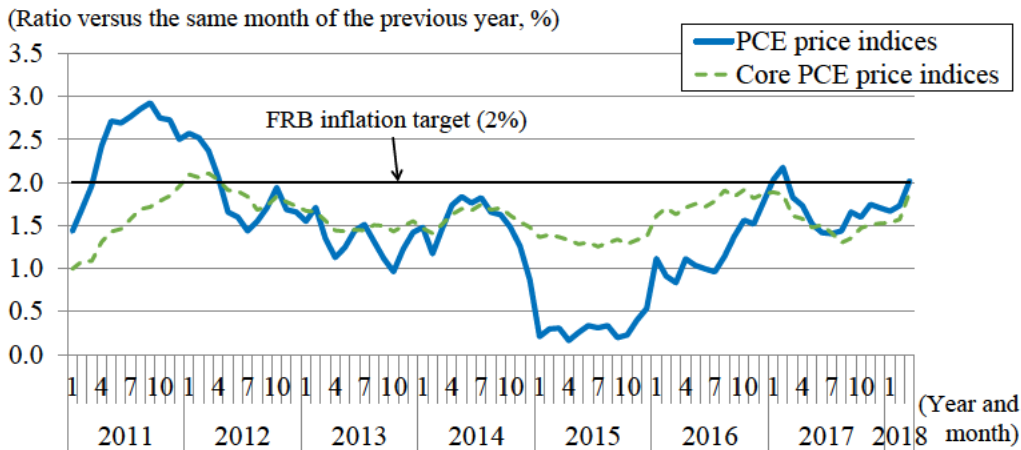
Notes: Figures are seasonally adjusted.

Source: United States Department of Labor, CEIC Database.

25 As for the employment environment in 2017, job growth decreased by 14,000 jobs in September compared with the previous month due to the effects of a hurricane, but annual job gains totaled 2.17 million jobs (monthly average job growth of 181,000 jobs). Former FRB Chair Janet Yellen estimated the monthly job growth sufficient to keep the unemployment rate stable in the long term at 75,000 to 125,000 jobs (FRB, The Economic Outlook and the Conduct of Monetary Policy, January 19, 2017). Since 2010, jobs have continued to increase at a pace higher than this level. In addition, the unemployment rate has continued to improve steadily: after peaking at 10.0% in October 2010, the unemployment rate was down to 3.9% in April 2018, falling to the lowest level since December 2000. This is lower than the unemployment rate of 4.5% forecast by the FRB’s long-term projections that were published at the time of the FOMC meeting in March. The unemployment rate as broadly defined (U-6), which covers people who stopped looking for jobs because of the labor market situation and people who are willing to work full-time but who are forced to work part-time for economic reasons, averaged 8.5% in 2017, returning to the level before the financial crisis.

26 The personal consumption expenditure (PCE index), adopted by the FRB as an inflation indicator, came to 2.1%, higher than the FRB’s inflation target of 2.0%, in February 2017, but subsequently, it has stayed below 2%. However, as the unemployment rate has fallen to the level of full employment and the wage level is rising as a trend, the FRB forecast at the FOMC meeting in March 2018 that the inflation rate will rebound moderately in 2018 and will stay at around 2% in the medium term.

**Figure I-2-1-5 Changes in PCE price indices**



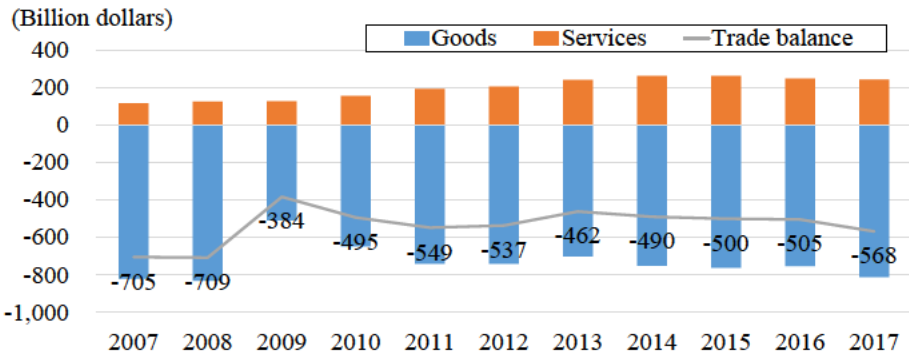
Notes: The core PCE price indices are calculation results excluding figures for foods and energy that are highly volatile.

Source: United States Department of Commerce, CEIC Database.

**(3) Trade**

As a result of the steady recovery of the U.S. economy and the moderate recovery of the global economy, the value of U.S. trade increased in terms of both imports and exports. In particular, reflecting the firmness of the U.S. economy, the deficit in the U.S. goods and services trade balance (international balance of payments basis) increased in 2017 (a deficit of 568.4 billion dollars, up 12.6% from the previous year’s deficit). A breakdown shows that the goods trade balance recorded a deficit of 811.2 billion dollars, and the services trade balance recorded a surplus of 242.8 billion dollars. While the goods trade deficit grew 7.8% from the previous year, the services trade surplus declined 2.0%. The deficit in the U.S. goods and services balance in 2017 was the largest since 2008 (Figure I-2-1-6).

**Figure I-2-1-6 Changes in trade balance in the United States**



Notes: International balance of payments basis.

Source: United States Department of Commerce.

The main items of export included general machinery, electrical equipment, mineral fuels and aircraft (Table I-2-1-7). Of the main items of export, industrial supplies and materials (positive contribution of 66.4 billion dollars), including crude oil, and capital goods (positive contribution of 13.2



billion dollars), including general machinery and aircraft, contributed to the growth in exports. The main items of import included electrical equipment, general machinery, automotive vehicles, mineral fuels, and pharmaceutical products (Table I-2-1-8). Of the main items of import, industrial supplies and materials (positive contribution of 64.3 billion dollars), including crude oil, and capital goods (positive contribution of 50.7 billion dollars), including computers, contributed to the growth in imports.<sup>27</sup> Among the presumed factors behind the growth in imports and exports of crude oil are an increase in oil production volume due to the shale revolution and the effects of the oil price rise.

**Table I-2-1-7 Major export items from the United States**

Exports	2016	2017		
	Billion dollars	Billion dollars	Composition rate (%)	Growth rate (%)
General machinery	191	202	13.0	5.8
Electrical equipment, etc.	167	174	11.3	4.3
Mineral fuels, etc.	94	138	8.9	47.3
Aircraft, etc.	135	131	8.5	-2.7
Automotive vehicles, etc.	125	130	8.4	4.4
Optical equipment, etc.	82	84	5.4	1.9
Plastics, etc.	59	62	4.0	4.9
Jewelry	58	60	3.9	4.6
Pharmaceutical products	47	45	2.9	-4.1
Organic chemical products	34	36	2.3	6.6
World total	1,451	1,547	100	6.6

Notes: Census basis (before seasonal adjustment).

Source: United States Department of Commerce, Global Trade Atlas.

**Table I-2-1-8 Major import items from the United States**

Imports	2016	2017		
	Billion dollars	Billion dollars	Composition rate (%)	Growth rate (%)
Electrical equipment, etc.	331	351	15.0	6.2
General machinery	309	342	14.6	10.6
Automotive vehicles, etc.	281	290	12.4	3.3
Mineral fuels, etc.	154	195	8.3	26.7
Pharmaceutical products	92	96	4.1	4.2

<sup>27</sup> U.S. International Trade In Goods and Services December 2017 (Department of Commerce) (<https://www.bea.gov/newsreleases/international/trade/2018/trad1217.htm>).

Optical equipment, etc.	80	85	3.6	6.7
Furniture	59	63	2.7	6.1
Jewelry	66	59	2.5	-10.9
Plastics	48	52	2.2	8.9
Organic chemical products	49	45	1.9	-7.6
World total	2,188	2,343	100	7.1

Notes: Census basis (before seasonal adjustment).

Source: United States Department of Commerce, Global Trade Atlas.

Concerning trade in goods, the trade partner countries/regions with which the United States recorded a surplus include Hong Kong, the Netherlands, the UAE, Belgium and Australia (Table I-2-1-9). In trade with Hong Kong, with which the largest surplus of all regions/countries was recorded, the United States exported many agricultural and livestock products, including meat and fruits, in addition to electrical equipment and general machinery. On the other hand, the countries with which the United States recorded a trade deficit include China, Mexico, Japan, Germany and Viet Nam (Table I-2-1-10). The trade deficit with China, which accounts for around half of the overall U.S. trade deficit, rose to a record high, and the deficit with Mexico also expanded. The deficit with Japan remained almost flat.

**Table I-2-1-9 Top 10 trade surplus economies in 2017 for the United States**

Top 10 trade surplus economies in 2017 for the United States (unit: billion dollars)			
Economy	Exports	Imports	Trade balance
Hong Kong	40.0	7.6	32.5
Netherlands	42.2	17.7	24.5
UAE	20.0	4.3	15.7
Belgium	29.9	15.1	14.8
Australia	24.6	10.1	14.6
Singapore	29.8	19.4	10.4
Brazil	37.1	29.4	7.7
Panama	6.4	0.4	6.0
Argentina	9.5	4.8	4.7
United Kingdom	56.3	53.1	3.3
World total	1,546.7	2,342.9	-796.2

Notes: Census basis (before seasonal adjustment).

Source: United States Department of Commerce, Global Trade Atlas.

**Table I-2-1-10 Top 10 trade deficit economies in 2017 for the United States**

Top 10 trade deficit economies in 2017 for the United States (unit: billion dollars)			
Economy	Exports	Imports	Trade balance
China	130.4	505.6	-375.2
Mexico	243.0	314.0	-71.1
Japan	67.7	136.5	-68.8
Germany	53.5	117.7	-64.3
Viet Nam	8.2	46.5	-38.3
Ireland	10.7	48.8	-38.1
Italy	18.3	50.0	-31.6
Malaysia	12.8	37.4	-24.6
India	25.7	48.6	-22.9
ROK	48.3	71.2	-22.9
World total	1,546.7	2,342.9	-796.2

Notes: Census basis (before seasonal adjustment).

Source: United States Department of Commerce, Global Trade Atlas.

#### (4) Foreign direct investments

The Trump administration places emphasis on direct investments by Japanese and other foreign companies and the creation of jobs through investments. In the State of the Union Address on January 30, 2018, President Trump, while referring to investment projects by Toyota Motor and Mazda Motor to build new factories, expressed his hope that jobs will be created through the construction of factories in various U.S. locations amid the active influx of foreign direct investments into the United States.

As for the relationship with Japan, the U.S. government's fact sheets<sup>28</sup> intended to strengthen the Japan-U.S. relationship, which was announced before the Japan-U.S. summit meeting in April 2018, referred to such economic matters as the number of employees at Japanese companies operating in the United States and the value of direct investments and major investment projects by those companies.

The balance of foreign direct investments in the United States has continuously increased in recent years and stood at 3,725.4 billion dollars at the end of 2016, around 1.9 times as large as the balance at the end of 2007. In 2016, Japan was ranked second in the rankings of investor countries in terms of the balance of foreign direct investments in the United States, after the United Kingdom. While the balance of direct investments in the United States by many foreign countries has declined since the global economic crisis in 2008, the balance of Japanese direct investments in the United States has continuously increased. By industry, the manufacturing industry had the largest share, 40%, in the total balance of foreign direct investments in the United States, followed by financial services (19%), wholesale trade

28 <https://www.whitehouse.gov/briefings-statements/president-donald-j-trump-prime-minister-shinzo-abe-working-together-strengthen-u-s-japan-alliance/>.

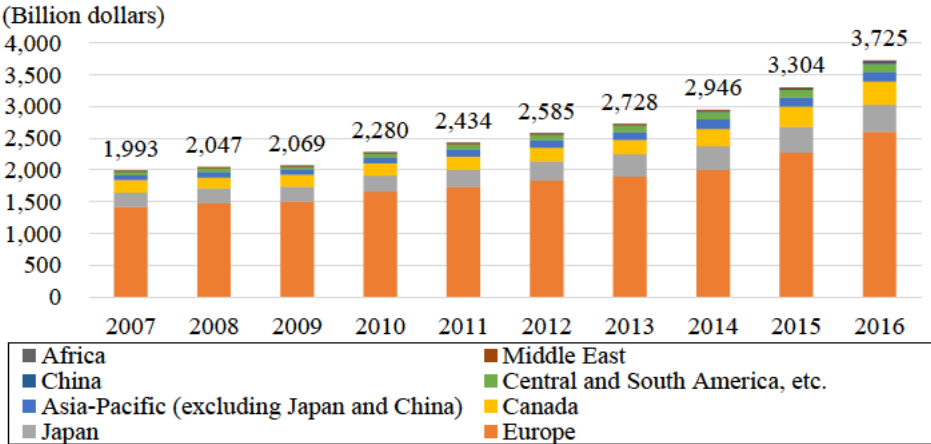
(10%), professional services (5%), information services (5%), real estate (2%) and retail trade (2%) (Figures I-2-1-11 and I-2-1-13).

In addition to the increase in the balance of foreign direct investments, activities by Japanese companies operating in the United States are also growing. In 2015, by parent company nationality, Japanese parent companies' subsidiaries in the United States were directly employing the second largest number of workers, 860,000, after U.K. parent companies' subsidiaries. In terms of the number of directly employed workers in the manufacturing industry, Japanese parent companies' subsidiaries were employing the largest number, 400,000 workers.<sup>29</sup>

Furthermore, the value of exports from the United States by Japanese companies has continuously increased. In 2015, Japanese companies were ranked No. 1 in terms of the value of exports from the United States with a total export value of 75.71 billion dollars. At the same time, the share of exports to sales including exports to third countries is also increasing, indicating that Japanese companies operating in the United States are being integrated further into global supply chains.

U.S. companies are also conducting brisk activities abroad. In 2016, the balance of outward foreign direct investments by the United States was 5,332.2 billion dollars, 1.8 times as large as the balance in 2007. By region, Europe had the largest share, 60%, as a recipient of foreign direct investments by the United States, followed by Central and South America, etc. (16%), Asia-Pacific (excluding Japan and China) (12%), Canada (7%), Japan (2%), China (1.7%), Africa (1%) and the Middle East (0.9%). By industry, holding companies had the largest share, 50%, followed by financial services (15%), manufacturing (13%), wholesale trade (5%), mining (4%), information services (4%) and professional services (2%) (Figures I-2-1-12 and I-2-1-14).

**Figure I-2-1-11 Inward direct investment (by region; balance)**



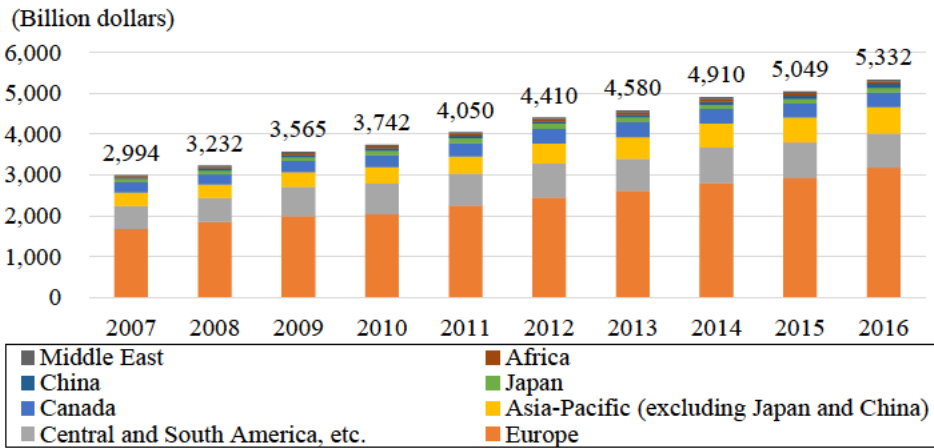
Notes: The term “Central and South America, etc.” includes regions in the Western Hemisphere, etc., e.g., the Bahamas, Bermuda, Curacao, British Commonwealth islands, and the West Indies.

Source: United States Department of Commerce.

<sup>29</sup> *Activities of U.S. Affiliates of Foreign Multinational Enterprises: Preliminary 2015 Statistics* (Department of Commerce).



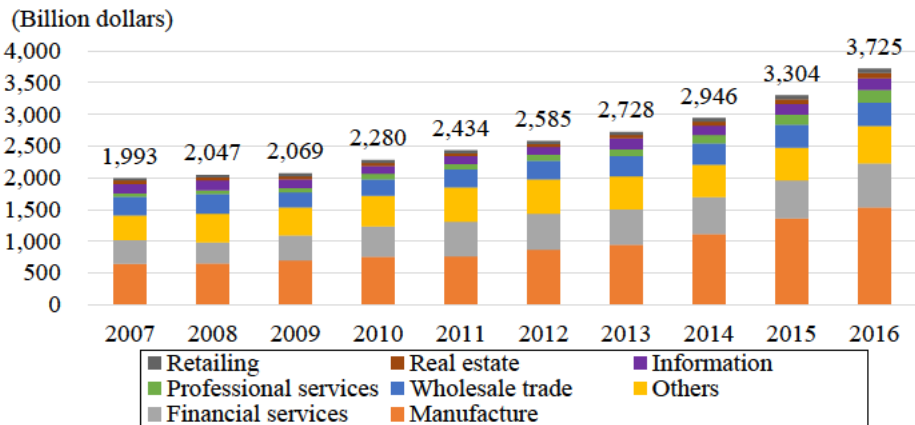
**Figure I-2-1-12 Outward direct investment (by region; balance)**



Notes: The term “Central and South America, etc.” includes regions in the Western Hemisphere, etc., e.g., the Bahamas, Bermuda, Curacao, British Commonwealth islands, and the West Indies.

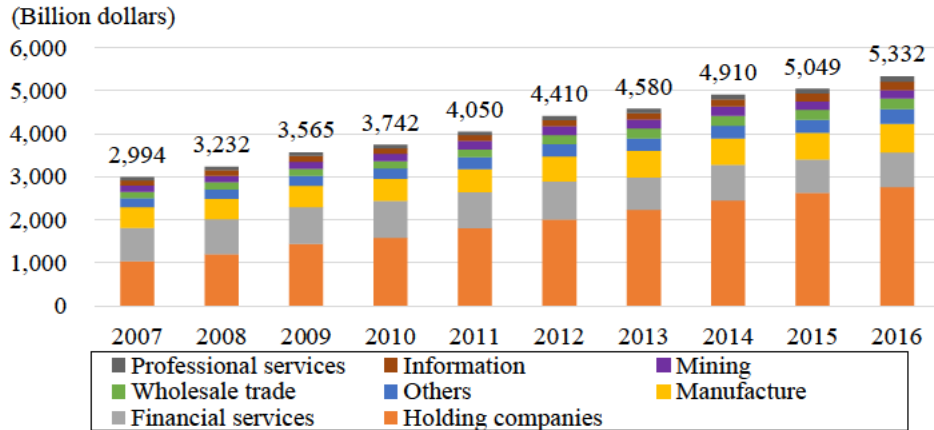
Source: United States Department of Commerce.

**Figure I-2-1-13 Inward direct investment (by industry; balance)**



Source: United States Department of Commerce.

**Figure I-2-1-14 Outward direct investment (by industry; balance)**

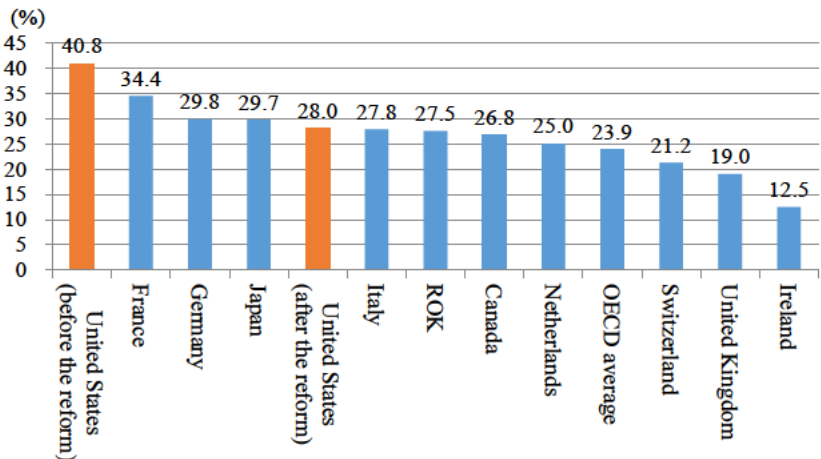


Source: United States Department of Commerce.

**(5) U.S. tax system reform**

The Tax Cuts and Jobs Act, the enactment of which was one of the Trump administration’s public commitments, was enacted on December 22, 2017. As a result, the federal corporate tax rate has been lowered from 35% to 21%, and the effective tax rate, including local taxes, fell from 40.75% to 27.98%.<sup>30</sup> Before the tax system reform, the effective tax rate in the United States was high compared with the rates in other advanced economies. However, after the tax system reform, the effective tax rate has become lower than the rates in France, Germany and Japan (FigureI-2-1-15). Regarding capital investments, it has become possible to implement immediate depreciation of specified tangible fixed assets as a provisional measure that will remain in effect for five years.<sup>31</sup> The deduction for research and development expenditure (R&D), which was a focus of attention, has been retained. On the other hand, some revenue-increasing measures have also been adopted. For example, while interest payments related to excessive borrowing from some related parties were not permitted to be counted as losses before the reform, the portion of interest payments in excess of 30% of the adjusted taxable income related not only to transactions involving related parties but to all transactions should not be counted as losses after the reform. In addition, the special deduction related to domestic manufacturing activity was abolished.

**Figure I-2-1-15 International comparison of effective tax rates for companies**



Notes: This figure shows the results of comparison between international tax rates and U.S. tax rates before the reform in 2018, including local taxes. The U.S. tax rates are estimates calculated by the Ministry of Finance (MOF) of Japan (the local taxes represent those in the State of California). Source: OECD, MOF.

Concerning individual income tax, the seven bracket structure has been retained but the tax rates and bracket criteria have been changed and the top tax rate has been lowered. The new tax rates are 10%, 12%, 22%, 24%, 32%, 35% and 37%. While a personal exemption of 4,050 dollars per person has been

30 An estimate by the Department of Treasury. The local corporate tax used in the estimation is the one in the state of California.  
 31 The measure covers tangible fixed assets that were or will be acquired and started or will start to be used between September 28, 2017, and December 31, 2022. The covered assets are mainly tangible movables, excluding buildings and intangible assets. To be gradually reduced in and beyond 2023.

abolished, the standard deduction has been about doubled from the existing level (to 12,000 dollars for each single person and to 24,000 dollars for joint filing by a married couple).

In the field of international taxation, in principle, the United States has shifted from global income taxation<sup>32</sup> to territorial principle taxation (source-country taxation). Under global income taxation, income earned by foreign subsidiaries was taxed when it was repatriated to U.S. parent companies as dividends, which means that although the foreign tax deduction<sup>33</sup> was applicable, the higher U.S. tax rate was applied. As a result, it is said that many U.S. companies' subsidiaries avoided paying dividends to their U.S. parent companies. As a transitional measure, it was decided to apply a one-time tax to assets that have been earned and accumulated abroad in or later than 1986, with the tax rate set at 15.5% for assets held in the form of cash or cash equivalents and 8% for other assets. Other changes include the adoption of the provision for the prevention of tax base erosion (Base Erosion and Anti-Abuse Tax (BEAT) taxation),<sup>34</sup> the expansion of the definition of a controlled foreign corporation (CFC),<sup>35</sup> and taxation on Global Intangible Low Taxed Income (GILTI).<sup>36</sup>

Figure I-2-1-16 shows the value of the impact on the ratio of revenue to GDP of major tax system reforms implemented in the past in the United States. The tax system reform at the time of the Reagan administration is considered to have had the greatest impact in the past, and the impact of the Trump administration's tax system reform will have the second greatest impact. The value of tax reduction is expected to be 135.7 billion dollars in fiscal 2018 and 280 billion dollars in fiscal 2019 (Figure I-2-1-17).<sup>37</sup>

Estimates of the impact on GDP over the next 10 years range from zero to 0.29%, meaning that the dominant view is that the impact will be limited (Figure I-2-1-18).<sup>38</sup> The Tax Policy Center cited the following effects as factors of economic growth: the demand-stimulating effect of individual tax reduction; the short-term investment-increasing effect of giving companies the option of immediate

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32 Under this system, all corporate incomes are taxed by the United States regardless of whether their source is domestic or foreign.

33 In order to prevent double taxation, there is a system to deduct the value of taxes paid outside the United States from the value of taxes that should be paid in the United States.

34 Under the Beat taxation (Base Erosion and Anti Abuse Tax) system, U.S. corporations are subject to taxation on the excess of the value obtained by multiplying by 10% (tax rate applicable between 2019 and 2025) in principle the sum of their taxable income plus the portion of payments made to related parties (\*) outside the United States which are included among their tax-deductible losses (Base Erosion Tax Benefit), including insurance premium payments and payments for acquisition of assets, over the value of the corporate tax calculated through an ordinary method. \*(A) shareholders whose share in the corporations is 25% or larger (25% shareholders); (B) parties who are related to the corporations through their share of larger than 50% in 25% shareholders; (C) parties who are related to the corporations through their share of larger than 50% in the corporations themselves.

35 Regarding controlled foreign companies (CFCs), previously, sister companies in third countries with a direct capital relationship with U.S. subsidiaries owned by foreign parent companies were regarded as CFCs. However, as a result of this reform, sister companies in third countries are regarded as CFCs even when U.S. subsidiaries do not have direct investment in them.

36 Under the GILTI (Global Intangible Low-taxed Income) taxation, the value of deemed ordinary income is calculated by multiplying the value of tangible depreciable assets held by a CFC by 10% and the portion of income in excess of the calculated value is regarded as GILTI and is taxed together with the income of the shareholder company in the United States.

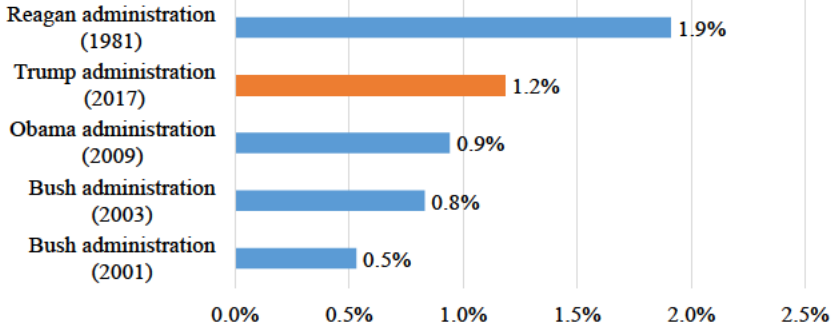
37 Materials released on December 18, 2017, by Joint Committee on Taxation (<https://www.jct.gov/publications.html?func=startdown&id=5053>).

38 The website of Committee for a Responsible Federal Budget (article on January 5, 2018) (<http://www.crfb.org/blogs/resources-tax-reform>).

deduction of their new investments to be made over the next five years; the effect of a rise in the after-tax wage rate in giving low-income spouses an incentive to work longer hours, thereby expanding labor supply; and the effect of corporate tax reduction in increasing fund inflows from savings and from abroad and domestic and foreign investments. However, regarding individual income tax in particular, as it is mainly high-income families, whose consumption propensity is low, rather than low-income families, that enjoy the benefits of the tax reduction, the estimated impact is small. With respect to the corporate sector, the Tax Policy Center estimates, in light of the current full employment situation, that the demand-boosting effect will be small while forecasting that the investment-promotion effect of corporate tax reduction and immediate depreciation of capital investments implemented as provisional measures will last for some time.

According to the Tax Foundation, the reduction of the corporate tax rate is expected to lead to the expansion of economic size, accompanied by a wage rise, as capital cost declines. Although the tax system reform will result in a revenue decrease of around 1.5 trillion dollars<sup>39</sup> over the next 10 years, it has the effect of raising the GDP growth rate by 2.86% (an annual average of 0.29%), which is equivalent to 5 trillion dollars in economic effect, over the same period. Therefore, the revenue decrease can be sufficiently covered, according to the Tax Foundation. As indicated above, the Tax Foundation emphasizes the supply side effects of the tax reduction, such as the expansion of labor supply and an increase in investments.<sup>40</sup>

**Figure I-2-1-16 Comparison of the scales of tax reduction**



Notes: This figure shows the average of impacts over the first two years. The year in parentheses refers to the year of establishment. The scale of tax reduction during the Trump administration (ratio to GDP) is the result of calculating the impact to the ratio of revenue, data released by the Joint Committee on Taxation (JCT), and the potential GDP, data released by the Congressional Budget Office (CBO). Other values are excerpts from the data released by the United States Department of the Treasury.

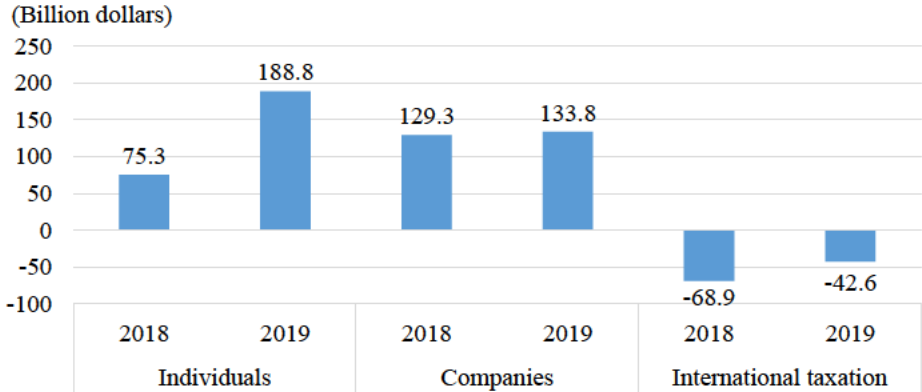
Source: United States Department of the Treasury, JCT, CBO.

39 The Tax Foundation made a static projection and a dynamic projection. Revenue is expected to decline by 1.5 trillion dollars over the 10 years under the static projection and by 448.0 billion dollars under the dynamic projection.

40 President Trump stresses the importance of increasing production and supply capacities by simplifying tax systems and lowering tax rates. He argues that the tax system reform will stimulate consumption activity, promote savings, expand investments and increase labor supply, thereby maximizing economic growth (Source: Tax Reform that will make America great again, etc.).

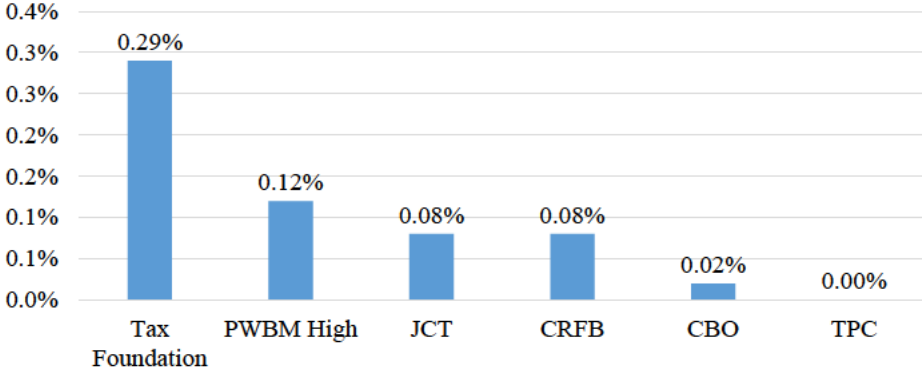


**Figure I-2-1-17 Total amount of tax reduction**



Source: JCT.

**Figure I-2-1-18 Impacts of tax system reforms to GDP**



Notes: Impacts over ten years.

Source: Penn Wharton Budget Model (PWBM), JCT, Committee for a Responsible Federal Budget (CRFB) and CBO.

**2. Trade policy trends**

**(1) Trump administration’s trade strategy**

On February 28, 2018, the Office of the U.S. Trade Representative (hereinafter referred to as the “USTR”) announced the 2018 Trade Policy Agenda.<sup>41</sup> This features the following five pillars: (A) a trade policy supporting national security, (B) strengthening the U.S. economy, (C) negotiating better trade deals that benefit all Americans, (D) aggressive enforcement of U.S. trade laws, and (E) reforming the multilateral trading system.

Under the first pillar, it is stated that the national sovereignty of the United States should be preserved so as to avoid a situation in which the American people are forced to live under obligations to which they do not agree. It is also stated that the impact of the Chinese and Russian policies that challenge American power extends beyond the realm of national security to affect trade policy. With respect to China in particular, the Trump administration regards a lack of sufficient progress in China’s shift to a

41 This is required to be submitted to Congress by March 1 every year under the amended Trade Act of 1974. The 2017 annual report is published at the same time.

market economy since its accession to the WTO as a problem and indicates its readiness to use all available means to protect U.S. national interests under President Trump's leadership if China or any other country adopts policy that may undermine fair economic competition.

Under the second pillar, it is stated that the corporate tax rate was lowered from 35% to 21% as a result of the Tax Cuts and Jobs Act, which was enacted in December last year, enabling the United States to compete with its major trading partners on an equal footing. It is also stated that the U.S. administration will reduce regulatory burdens imposed on American businesses and citizens (revise or abolish regulations).<sup>42</sup>

Under the third pillar, references are made to the renegotiation of the North American Free Trade Agreement (hereinafter referred to as "NAFTA") and the United States-Korea Free Trade Agreement (KORUS), the possibility of holding negotiations with the United Kingdom over a trade and investment agreement after Brexit and the possibility of holding negotiations with member countries of the Trans-Pacific Partnership (TPP) agreement. Concerning TPP, it is stated that the U.S. administration will make active efforts to improve the trade relationship with Japan, which is the largest economy among the 11 TPP member countries, and will explore the possibility of negotiating with TPP member countries either bilaterally or collectively.

Under the fourth pillar, it is stated that the U.S. administration will aggressively use U.S. trade laws and international enforcement measures in order to ensure a fair competitive environment conforming to existing international trade agreements. Specifically, the following measures were cited: investigation by the USTR of China's acts, policies and practices related to technology transfer, intellectual property and innovation based on Section 301 of the Trade Act; the implementation of safeguard measures against imports of large residential washing machines and solar cells based on Section 201 of the Trade Act; restriction on imports of steel and aluminum for national security reasons based on Section 232 of the Trade Expansion Act of 1962; and trade remedy measures, including the implementation of antidumping duties (AD) and countervailing duties (CVD), and the use of the dispute settlement procedures based on the WTO Agreement.<sup>43</sup>

Under the fifth pillar, the U.S. administration indicates its policy of conducting vigorous activity at the WTO in order to contribute to the establishment of a better multilateral trade system. On the other hand, the U.S. administration points out that in light of the WTO's activities in the past 20 years, the WTO has not necessarily functioned sufficiently with respect to the dispute settlement procedures and the formation of consensus concerning important points of debate related to the modern global economy, and regarding negotiations between WTO member countries, which have remained in a stalemate since the Doha Round, the administration insists that realistic discussions should be held. With respect to development issues, the U.S. administration voices doubt about affording a "special and differential

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42 In the 2017 edition, there were four policy pillars--(A) defending U.S. national sovereignty over trade policy, (B) strictly enforcing U.S. trade law, (C) using leverage to open foreign markets and (D) negotiating new and better trade deals--and the second pillar in the 2018 edition is a newly added one.

43 As examples of the use of the WTO's dispute settlement procedures, the United States cited the cases of market-distorting measures implemented by the government of China, a Canadian complaint that AD and CVD measures implemented by the United States are in violation of the WTO Agreement, Indonesia's import-licensing system, and a dispute with Europe over the subsidy for Boeing.

treatment” universally to developing economies under the WTO framework amid the widening gap between emerging economies with a relatively high degree of development, including Brazil, China, India and South Africa, and less developed economies. The administration indicates its willingness to actively engage in the reform of the WTO to address problems like this and promote the development of appropriate rules concerning new challenges, such as digital trade.

**(2) Renegotiation of NAFTA**

In this section, we will analyze the impact on companies’ global value chains of the renegotiation of NAFTA, which is a major item of change concerning the U.S. trade policy under the Trump administration.

**(A) Overview of NAFTA**

NAFTA, which was put into effect in January 1994, is a free trade agreement between the United States, Canada and Mexico. At the time of its establishment, NAFTA absorbed the Canada-United States Free Trade Agreement (CUSFTA), which was put into effect in 1989.

Over the period of more than 20 years from the effectuation of NAFTA, between 1993 and 2017, the volume of intra-regional trade increased 3.8-fold (Table I-2-1-19). NAFTA represents a huge market with a population of around 500 million people and GDP worth 20 trillion dollars, and the three member countries’ combined value of trade with the rest of the world is higher than 5 trillion dollars (2016) (Table I-2-1-20).

**Table I-2-1-19 Trade in goods between three NAFTA member countries**

	1993	2017	2017/1993
	(Billion dollars)		(Times)
Imports by three NAFTA member countries	296.2	1,120.1	3.8
Imports by the United States			4.1
Canada	110.9	300.0	2.7
Mexico	39.9	314.0	7.9
Imports by Canada			2.9
United States	100.2	285.5	2.8
Mexico	2.9	16.4	5.6
Imports by Mexico			4.8
United States	41.6	194.4	4.7
Canada	0.6	9.8	16.3

Source: United States Department of Commerce, Statistics Canada, IMF, Global Trade Atlas.

**Table I-2-1-20 Population, GDP and trade value of NAFTA**

2016	Population	GDP		Value of goods trade
	(100 million people)	(Billion dollars)	To other economies (%)	(Billion dollars)
NAFTA	4.9	19,926	25.8%	5,252
TPP11	5.0	11,902	15.4%	4,775
Japan-EU	6.4	24,272	31.4%	11,630
ASEAN	6.4	2,648	3.4%	2,218

Source: World Bank, UNComtrade, JETRO.

In terms of the value of trade with the United States by trading partner economy (Table I-2-1-21), Canada and Mexico are ranked second and third, respectively. With both Canada and Mexico, the United States is recording a trade deficit. In particular, the U.S. trade deficit with Mexico was 71.1 billion dollars, the second largest after the deficit with China.

A list of items of trade within the NAFTA area (Table I-2-1-22) shows that automotive vehicles and parts, general machinery, and electrical equipment are the main items of export from the United States to Canada. On the other hand, the main items of import by the United States from Canada are mineral fuels, automotive vehicles and parts, and general machinery. The main items of export from the United States to Mexico are general machinery, electrical equipment and mineral fuels. On the other hand, the main items of import by the United States from Mexico are automotive vehicles and parts, electrical equipment and general machinery. As indicated above, automotive vehicles and parts have a very large share in trade within the NAFTA area.

**Table I-2-1-21 Trade value with the United States by trading partner economy (2017)**

(Billion dollars)	Exports	Imports	Trade value	Trade balance	Ranking of trade imbalance
1 China	130.4	505.6	636.0	-375.2	1
2 Canada	282.5	300.0	582.4	-17.5	12
3 Mexico	243.0	314.0	557.0	-71.1	2
4 Japan	67.7	136.5	204.2	-68.8	3
5 Germany	53.5	117.7	171.2	-64.3	4
6 ROK	48.3	71.2	119.4	-22.9	10
7 United Kingdom	56.3	53.1	109.4	3.3	235
8 France	33.6	48.9	82.5	-15.3	14
9 India	25.7	48.6	74.3	-22.9	9
10 Italy	18.3	50.0	68.3	-31.6	7
11 Taiwan	25.8	42.5	68.2	-16.7	13



12 Brazil	37.1	29.4	66.5	7.7	238
13 Netherlands	42.2	17.7	60.0	24.5	243
14 Ireland	10.7	48.8	59.6	-38.1	6
15 Switzerland	21.7	36.0	57.7	-14.3	15
16 Viet Nam	8.2	46.5	54.6	-38.3	5
17 Malaysia	12.8	37.4	50.2	-24.6	8
18 Singapore	29.8	19.4	49.2	10.4	239
19 Hong Kong	40.0	7.6	47.6	32.5	244
20 Belgium	29.9	15.1	45.0	14.8	241
Top 20 economies	1,217.4	1,946.1	3,163.5	-728.7	
Total trade value	1,546.7	2,342.9	3,889.6	-796.2	

Source: Global Trade Atlas.

**Table I-2-1-22 Trade items within the NAFTA area in the United States**

Imports-export items between the United States and Canada (2017; 100 million dollars)					Imports-export items between the United States and Mexico (2017; 100 million dollars)				
#	Exports		Imports		#	Exports		Imports	
1	Automotive vehicles and parts	514	Mineral fuels	733	1	General machinery	429	Automotive vehicles and parts	836
2	General machinery	422	Automotive vehicles and parts	559	2	Electrical machinery	413	Electrical machinery	619
3	Electrical machinery	252	General machinery	214	3	Mineral fuels	261	General machinery	540
4	Mineral fuels	190	Plastics	109	4	Automotive vehicles and parts	211	Precision instruments	140
5	Plastics	131	Lumber	104	5	Plastics	166	Mineral fuels	111
6	Precision instruments	84	Aluminum	84	6	Precision instruments	70	Furniture	108
7	Aircraft and parts	83	Electrical machinery	76	7	Organic chemical products	55	Fruits and nuts	70
8	Iron and steel products	61	Paper and pulp for paper making	58	8	Iron and steel products	52	Vegetables	60
9	Furniture	50	Aircraft and parts	53	9	Iron and steel	46	Jewelry and precious metals	53

10	Paper and pulp for paper making	49	Iron and steel	52	10	Paper and pulp for paper making	40	Plastics	51
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Source: Global Trade Atlas.

### (B) Benefits of NAFTA

Various analyses have been conducted with respect to the macroeconomic impact of the effectuation of NAFTA. According to the results of an analysis shown in a report by USITC, NAFTA has had the effect of reducing the annual U.S. unemployment rate by 4.4 percentage points and a job creation effect of 0.3%.<sup>44</sup>

The abolition of tariffs and non-tariff barriers contributed to the expansion of trade within the NAFTA area. After the effectuation of NAFTA, tariffs on most product items were immediately abolished or were phased out over periods of five to 15 years. By January 1, 2008, all tariffs and quantitative restrictions listed in the schedule of concessions had been abolished.<sup>45</sup> In addition, most non-tariff barriers were abolished. Following the effectuation of NAFTA, Mexico's exports to the United States increased by a factor of around eight by 2017, so NAFTA tends to be considered to be beneficial mainly for Mexico. However, it should be kept in mind that NAFTA has been very favorable for the United States as well from the viewpoint of tariff rate improvement. That is because in 1993, the tariff rates in the United States, an advanced economy, were lower than the rates in Mexico. The average tariff rate for exports from Mexico to the United States in 1993 was 2.07%, and on top of that, more than 50% of exports from Mexico to the United States were exempt from tariffs under the Generalized System of Preferences (GSP). Meanwhile, the average tariff rate for imports by Mexico from the United States in 1993 was 10%.<sup>46</sup> Below, we will look at the tariffs on an item-by-item basis in detail.

Tables I-2-1-23 to I-2-1-26 shows a list of product items for which NAFTA's tariff-reduction effect has been substantial from the viewpoint of the value of imports. The abolition of tariffs has had the greatest impact on the automobile industry because of the large value of trade in automotive-related products between the three NAFTA member countries. Among the main items of export from Mexico to the United States are passenger cars, trucks and automotive parts, while automotive-related products, such as parts, engines, and steering wheels and gears, are also conspicuous among items of export from the United States to Mexico. In the trade relationship between the United States and Canada, too, the main items of import and export include passenger cars and automotive parts. This indicates the importance of the presence of the automobile industry in trade between the three NAFTA member countries. Among other major items of import by the United States from Canada and Mexico is oil. On the other hand, the main items of export from the United States to Mexico and Canada include light oil and preparations, plastic products and other oil products, indicating that oil-related industries are also benefiting significantly from NAFTA. The American Petroleum Institute (API) is emphasizing the need

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44 USITC (2016).

45 USTR (2018). While Canada has maintained tariffs on imports of dairy products, poultry, and eggs, the United States has maintained imports of dairy products, sugar and peanuts from Canada. On the other hand, trade between the United States and Mexico has become completely tariff-free.

46 Congressional Research Service (2017).

to maintain NAFTA as an agreement beneficial for all three member countries given that crude oil imported by the United States from Canada and Mexico is not only essential for stable domestic supply of energy but are also refined, processed and reexported to Mexico and other countries.<sup>47</sup>

**Table I-2-1-23 MFN tariff rates and NAFTA tariff rates  
(exports from Mexico to the United States)**

Category of item	Import value (2016) Unit: Million dollars	MFN tariff rate	NAFTA tariff rate
Passenger cars (1,500cc-3,000cc)	18,042	2.5%	0%
Trucks (5 tons or less)	15,455	25.0%	0%
Liquid-crystal displays	8,729	0-3.9%	0%
Oil	7,780	5.25-10.5 cents per barrel	0%
Sets of wirings (for vehicles, aircraft or ships)	7,079	5.0%	0%
Automotive parts (for bodies)	5,041	0-2.5%	0%
Tractors permitted to run on roads	4,778	4.0%	0%
Switchboards to control power	4,121	2-2.7%	0%
Passenger cars (1,000cc-1,500cc)	3,624	2.5%	0%
Engines for automobiles	3,310	0-2.5%	0%

Source: Trade Compass (Deloitte).

**Table I-2-1-24 MFN tariff rates and NAFTA tariff rates  
(exports from the United States to Mexico)**

Category of item	Import value (2016) Unit: Million dollars	MFN tariff rate	NAFTA tariff rate
Light oil and preparations	10,046	0-4%	0%
Automotive parts (for bodies)	2,903	0-5%	0%
Plastic products	2,288	0-15%	0%
Engines for automobiles	1,804	0-5%	0%
Parts for tractors	1,805	0-5%	0%
Electrical medical equipment	1,272	0-10%	0%
Steering wheels and gears	1,229	0-5%	0%
Insulation cables	1,222	5.0%	0%
Drive shafts	1,204	0-5%	0%
Brakes and parts thereof	981	5.0%	0%

Source: Trade Compass (Deloitte).

47 API (2017). Regarding the need to maintain NAFTA, API cited the following four points: (A) employment, (B) benefits for consumers, (C) enhancement of energy security, and (D) market opening.

**Table I-2-1-25 MFN tariff rates and NAFTA tariff rates  
(exports from Canada to the United States)**

Category of item	Import value (2016) Unit: Million dollars	MFN tariff rate	NAFTA tariff rate
Oil	38,937	5.25-10.5 cents per barrel	0%
Passenger cars (more than 3,000cc)	21,953	2.5%	0%
Passenger cars (1,500cc-3,000cc)	21,587	2.5%	0%
Light oil and preparations	3,837	10.5-52.5 cents per barrel	0%
Other oil products	3,565	1.3-84 cents per barrel 5-7%	0%
Automotive parts (for bodies)	3,507	0-2.5%	0%
Aluminum	2,344	0-2.6%	0%
Automotive parts (others)	2,049	0-2.5%	0%
Aluminum alloy	1,973	0-2.6%	0%
Ethylene	1,776	0-6.5%	0%

Source: Trade Compass (Deloitte).

**Table I-2-1-26 MFN tariff rates and NAFTA tariff rates  
(exports from the United States to Canada)**

Category of item	Import value (2016) Unit: Million dollars	MFN tariff rate	NAFTA tariff rate
Trucks (5 tons or less)	7,276	6.1%	0%
Passenger cars (more than 3,000cc)	7,275	6.1%	0%
Passenger cars (1,500cc-3,000cc)	5,544	6.1%	0%
Light oil and preparations	4,931	0-5%	0%
Automotive parts (for bodies)	4,627	0-8.5%	0%
Other oil products	2,667	0~5%	0%
Automotive parts (others)	2,363	0~6%	0%
Gearboxes	1,931	0~6%	0%
Tractors permitted to run on roads for semi-trailers	1,239	6.1%	0%
Brakes and parts thereof	1,163	0~6%	0%

Source: Trade Compass (Deloitte).

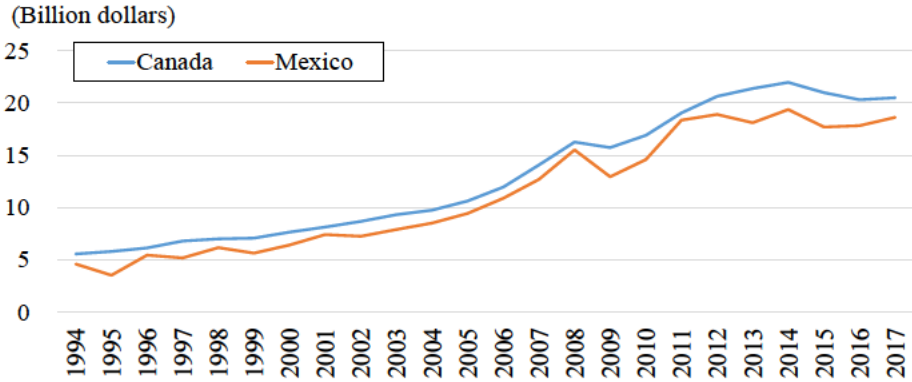
In addition, the agricultural and textile industries are also benefiting from the abolition of tariffs due to NAFTA. Canada and Mexico are the largest and third largest destinations (the second largest destination is China), respectively, for U.S. exports of agricultural products in terms of the export value (2017). The value of exports to both Canada and Mexico has increased considerably since the



effectuation of NAFTA (Figure I-2-1-27). In addition, Mexico and Canada are the largest and second largest source of imports of agricultural products by the United States in terms of the import value. This indicates that both countries are indispensable to the United States in terms of both import and export (Figure I-2-1-28). According to a comparison of the MFN tariff rates (2016), the effects of the abolition of tariffs are particularly significant for exports of agricultural products from the United States to Mexico. The average MFN tariff rate for exports of agricultural products from Mexico or Canada to the United States is around 1 to 4%, while the average MFN tariff rate for exports from the United States to Mexico is around 5 to 18% (Table I-2-1-29). As the United States exports corn, soybeans and wheat to Mexico, it is greatly benefiting from the abolition of tariffs.

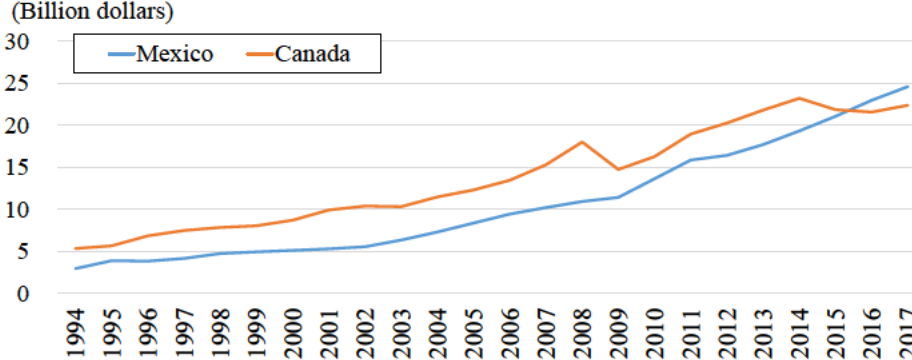
With respect to the textile industry, the average MFN tariff rate is relatively high, around 10 to 15%, in all three NAFTA member countries, so they are mutually benefiting from the abolition of tariffs by each other (Table I-2-1-30). In particular, in trade between the United States and Mexico, the value of exports from the United States to Mexico and the value of exports from Mexico to the United States are large, at 4.0 billion dollars and 5.2 billion dollars (2016), respectively.

**Figure I-2-1-27 Changes in export values of agricultural products from the United States**



Source: United States Department of Agriculture.

**Figure I-2-1-28 Changes in import values of agricultural products to the United States**



Source: United States Department of Agriculture.

**Table I-2-1-29 MFN tariff rates and NAFTA tariff rates (agricultural products)**

Agricultural products

Exporter => importer	Total import value (Million dollars)	MFN tariff rate	NAFTA tariff rate
U.S. => Mexico	7,552	5.31-17.89%	0%, except a few cases
U.S. => Canada	5,682	0.45-1.63%	0%
Mexico => U.S.	13,126	1.63-3.6%	0%
Canada => U.S.	4,966	0.62-1.59%	0%

Source: UN Comtrade, Trade Compass (Deloitte).

**Table I-2-1-30 MFN tariff rates and NAFTA tariff rates (textiles)**

Textiles

Exporter => importer	Total import value (Million dollars)	MFN tariff rate	NAFTA tariff rate
U.S. => Mexico	4,005	9-10.1%	0%
U.S. => Canada	2,159	5.32-7.46%	0%
Mexico => U.S.	5,208	5.31-15.72%	0%
Canada => U.S.	1,894	5.72%-11.12%	0%

Source: UN Comtrade, Trade Compass (Deloitte).

**(3) Background to the renegotiation of NAFTA**

Pointing out the possibility that the U.S. trade deficits with Mexico and Canada and the wage gap between the United States and Mexico have deprived the United States of jobs, the Trump administration aims to modernize NAFTA and realize fair trade.<sup>48</sup>

On May 18, 2017, the Trump administration notified Congress of its intention to renegotiate NAFTA, and on July 17, it announced the NAFTA Negotiating Objectives, which comprises 22 items<sup>49</sup> (Table I-2-1-31). On August 16, the first round of negotiation was held in Washington, D.C., and a total of seven rounds of negotiation were held by the end of March 2018. Since April, working-level consultations and cabinet-level meetings, instead of formal rounds of negotiation, have been held on a sector-by-sector basis.

48 The United States frequently states that the benefits that should be enjoyed by the three NAFTA member countries should be rebalanced in the NAFTA Negotiating Objectives (which will be mentioned later), the 2018 Trade Policy and other documents.

49 Under the Bipartisan Congressional Trade Priorities and Accountability Act of 2015, the U.S. administration was required to give a written notice of an intention to start negotiations and negotiating objectives at least 90 days in advance and to announce more detailed negotiating objectives 30 days in advance. The NAFTA Negotiating Objectives, presented by the USTR, are comprised of 22 items, but it is said that the actual number of negotiating fields is around 30.

In the negotiations, attention has been focused on the revision of the rules of origin concerning automotive vehicles and parts, the revision of trade remedy measures and the introduction of a sunset clause, among other matters. Below, we will outline the revisions concerning these items and describe expected effects.

**Table I-2-1-31 NAFTA renegotiating objectives**

Trade in goods	Sanitary and phytosanitary measures	Customs, trade facilitation, and rules of origin
Technical barriers to trade	Good regulatory practices	Trade in services
Digital trade in goods and services and cross-border data flows	Investment	Intellectual property
Procedural fairness on pharmaceutical products and equipment	State-owned enterprises	Competition policy
Labor standards	Environmental standards	Anti-corruption
Trade remedies	Government procurement	Small- and medium-sized enterprises
Energy	Dispute settlement	General provisions
Currency		

**(D) Points of debate concerning the renegotiation of NAFTA**

**(a) Revision of the rules of origin concerning automotive vehicles and parts**

The first point is the revision of the rules of origin concerning automotive vehicles and parts. In the Summary of Specific Negotiating Objectives for the Initiation of NAFTA Negotiations,” which was announced in July 2017, regarding the rules of origin, the United States refers to the introduction of a system to “incentivize the sourcing of goods and materials from the United States and North America” and proposes the enhancement of the rules of origin, including a gradual increase in the required NAFTA local content ratio for automobiles.<sup>50</sup> In the calculation of the NAFTA local content ratio concerning finished vehicles (excluding large buses and trucks), a special rule called the tracing rule is used. The United States has proposed the addition of all automotive parts, including steel products, to the scope of items subject to this rule.<sup>51</sup> However, the U.S. government’s proposal concerning the rules of origin has met with strong opposition from the governments of Mexico and Canada and the U.S. automobile and

50 According to various media stories reported in mid-April 2018, the proposal to reduce the U.S. local content ratio to 50% was withdrawn.

51 Under the tracing rule, only when product items corresponding to the prescribed tariff number (Annex 403.1) (product items subject to tracing) are imported from outside the NAFTA area, it is necessary to include the value of the items at the time of import in the value of non-originating materials. Items not corresponding to Annex 403.1 are not treated as non-originating materials even when they are imported from outside the NAFTA area. Moreover, the U.S. proposals apparently include a proposal to abolish a tariff number revision standard that allows manufactured products using non-originating materials and parts to be recognized as originating products if those materials and parts conform to the digit revision rule (four digits) under the tariff number system (HS code) (TSUUSHOU KOUHOU, November 1, 2017).

auto parts industries.<sup>52</sup>

Automakers are transferring production bases to Canada and Mexico on the premise of selling automobiles assembled there in the United States by taking advantage of NAFTA. As a result, U.S. imports of automobiles from Canada and Mexico surpassed imports from outside the NAFTA area in 2010. As long as the benefits of tariff-free trade are available because of NAFTA, this trend is expected to continue (Figure I-2-1-32). There are concerns that if the rules of origin are changed, U.S. consumers will bear an increased cost because of disruptions associated with the restructuring of the supply chain and a rise in the number of companies to which the MFN tariff rates are applied. According to a private-sector estimate, if NAFTA is abandoned, 50,000 jobs will be lost in the U.S. auto parts industry because Mexico and Canada will restore the tariff rates to the levels before the effectuation of NAFTA.<sup>53</sup>

If companies export automobiles to the United States at the MFN tariff rates applicable to WTO member countries instead of taking advantage of NAFTA, tariff rates of 2.5% and 25% will be applied to passenger cars and trucks (pickup trucks, SUVs, etc.), respectively. By vehicle type, trucks account for most (77.9%) of the automobiles exported by U.S. automakers from Mexico to North America. This share is much higher than the share of 30.8% in Japanese automakers' export, meaning that the impact on U.S. automakers will be greater. From the viewpoint of production bases, U.S. automakers are also fully taking advantage of the merit of using Mexico as an export base, so they will face significant adverse effects if the rules of origin are revised. Automakers operating in Mexico export most (82.2%) of the automobiles made there, and in particular, the share of exports to North America in production in Mexico is very large. This trend is more conspicuous among U.S. automakers: U.S. automakers' ratio of dependency on exports to North America (the ratio of exports to North America to production volume) is 83.4%, higher than Japanese automakers' dependency ratio (55.5%). With respect to exports of automobiles from Mexico to North America, U.S. automakers export around 1.47 million units (56.4% of the total production volume in Mexico) to North America, much larger than the export volume of 740,000 units (28.4%) for Japanese automakers. The share of exports to North America in the total export volume for U.S. automakers, at 91.7%, is much larger than the share for Japanese automakers, at 77.6% (Table I-2-1-33).

On the other hand, if the required NAFTA local content ratio is raised, Japanese automakers may be forced to make broad-ranging changes through such measures as reviewing procurement sources, exporting at the MFN tariff rates and transferring production bases because their local content ratio tends to be lower than the ratio for U.S. automakers.<sup>54</sup>

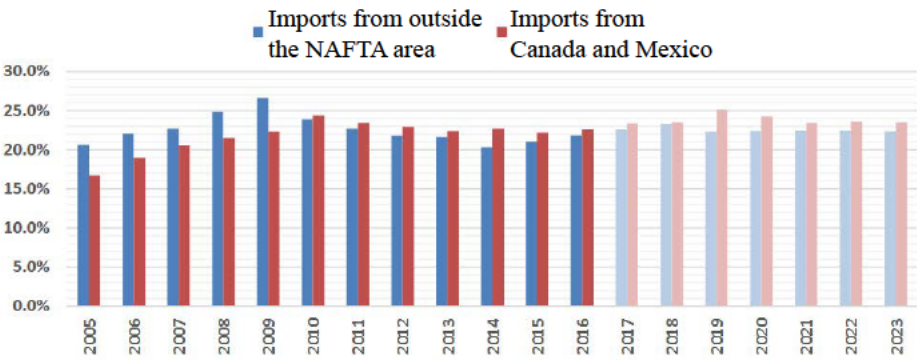
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52 The position of Mexican Economy Minister Guajardo and Canadian Foreign Minister Freeland is that they do not wish to establish rules of origin on a country-by-country basis. Meanwhile, President Matt Blunt of the American Automotive Council stated his view that if rules specific to the United States are established, it will become very difficult for companies, including small and medium-size ones, to enjoy the benefits of NAFTA (Source: various media reports).

53 Boston Consulting Group (2017) announced the results of an analysis sponsored by the Motor & Equipment Manufacturers Association (MEMA).

54 According to data compiled by the National Highway Traffic Safety Administration (NHTSA), the U.S. and Canadian local content ratios of some vehicle types for which Mexico is the location of final assembly tend to be higher at U.S. automakers (7-55%) than at Japanese automakers (5-20%) (<https://www.mizuho-ri.co.jp/publication/research/pdf/insight/us171019.pdf>).

**Figure I-2-1-32 Changes in imports of automobiles to the United States  
(imports from outside the NAFTA area, Canada and Mexico)**



Source: IHS Markit, Center for Automotive Research.

**Table I-2-1-33 Number of automobiles exported from and produced in Mexico**

2017	US companies				Japanese companies					Total
	US companies	FCA	Ford	GM	Honda	Mazda	Nissan	Toyota		
Total production (1,000)	1,760	639	315	806	1,331	209	142	829	151	3,774
Ratio of exports to production volume (%)	91.0%	93.9%	97.4%	86.1%	71.5%	89.6%	104.3%	56.5%	98.1%	82.2%
Ratio of exports to North America to production volume (%)	83.4%	86.2%	89.7%	78.7%	55.5%	68.6%	54.4%	45.3%	94.7%	69.0%
Total exports (1,000)	1,601	599	307	694	952	187	148	469	148	3,103
Exports to North America (1,000)	1,468	551	283	634	739	143	77	376	143	2,602
Ratio of exports by company to exports to North America (%)	56.4%	21.2%	10.9%	24.4%	28.4%	5.5%	3.0%	14.4%	5.5%	100.0%
Ratio of exports to North America to total exports (%)	91.7%	91.9%	92.0%	91.4%	77.6%	76.6%	52.2%	80.1%	96.5%	83.9%



[Exports by vehicle type to North America]	US companies				Japanese companies				Total	
	FCA	Ford	GM		Honda	Mazda	Nissan	Toyota		
Passenger cars (1,000)	324	10	283	32	512	46	77	353	36	1,171
Trucks (1,000)	1,143	541	0	602	228	97	0	23	107	1,432
Ratio of trucks (%)	77.9%	98.3%	0.0%	95.0%	30.8%	68.0%	0.0%	6.1%	74.8%	55.0%

Source: Asociación Mexicana de la Industria Automotriz (AMIA).

### (b) Revision of trade remedy measures

Concerning trade remedy measures, the United States indicated its policy of revising clauses regarding the implementation of trade remedy measures in the NAFTA Negotiating Objectives. It indicated its aim of abolishing Chapter 19 of NAFTA, which has established a dispute settlement system concerning AD and CVD and Article 802 of NAFTA, which prescribes the exemption of the NAFTA member countries from the application of safeguard measures, in order to facilitate enforcement based on U.S. domestic laws.<sup>55</sup>

Under the dispute settlement system established by Chapter 19 of NAFTA, when a NAFTA member implements AD or CVD against another member, a bilateral panel examines the appropriateness of the measure. The examination focuses on whether the implementation of the AD or CVD measure is in accordance with the importing country's domestic laws, so the judgment criteria are different from the criteria used in the WTO's dispute settlement procedures, which examine whether measures implemented by WTO member countries comply with the provisions of the WTO Agreement. NAFTA's dispute settlement system is one which was originally established under CUSFTA as a result of the U.S. government's partial acceptance of the Canadian government's request for exemption from the application of AD and CVD measures by the United States under CUSFTA and which has been inherited under NAFTA with support from Mexico, too. In a dispute between the United States and Canada over coniferous lumber that continued since the 1980s, the Canadian government filed a complaint against the U.S. government and won a favorable ruling. In December 2017, the U.S. Department of Commerce decided to impose a tariff of around 292%, including AD and CVD, on a new type of passenger aircraft made by Bombardier, a Canadian transportation equipment maker. Over this decision, the confrontation between the United States and Canada escalated, with the Canadian government cancelling the purchase of fighter aircraft made by Boeing of the United States. However, in a ruling in January this year, the U.S. International Trade Commission (ITC) refrained from recognizing injury to the U.S. domestic industry, so AD/CVD measures have not been implemented.<sup>56</sup>

55 'KAMEIKOKU NI TAISURU BOUEKI KYUUSAI SOCHI NO HATSUDOU WO YOUI NI' (TSUUSHOU KOUHOU, JETRO, July 21, 2017).

56 'BONBARUDHIA SEI RYOKAKUKI NO YUNYUU NI YORU SONGAI MITOMEZU--USITC GA SAISHUU SAITEI, BOOINGU HA 'SHITSUBOU' WO HYOMEI--' (TSUUSHOU KOUHOU, JETRO, January 31, 2018).

The provision of Article 802 of NAFTA, which prescribes exemption from the application of safeguards, has until now held significance for Canada and Mexico. In principle, safeguard measures are applicable to imports from all countries/regions, but in some cases, NAFTA member countries were exempted from application based on Article 802 of NAFTA. In March 2002, the Bush administration implemented safeguard measures concerning 14 items of steel products, imposing tariffs ranging from 8% to 30%, in addition to the MFN tariff rates that are usually applicable, on imports from other countries, including Japan, but granted exemption to imports from Mexico and Canada.<sup>57</sup>

However, the Trump administration's stance on exemption from the application of safeguards has become strict not only with respect to requests for exemption in the renegotiation of NAFTA but also in actual enforcement. What is noteworthy is the contents of a presidential proclamation concerning the safeguards against imports of large residential washing machines and solar cells, which was issued on January 23 this year.<sup>58</sup> The U.S. government announced that it would implement safeguard measures concerning large residential washing machines and solar cells starting on February 7, 2018, on the grounds that a rapid increase in imports of these items is causing serious injury to the U.S. domestic industry. The main intended targets of the safeguard measures were presumed to be ROK companies regarding washing machines and Chinese companies regarding solar cells,<sup>59</sup> while Canada and Mexico were expected to be exempted from application based on Article 802 of NAFTA.<sup>60</sup> However, as it turned out, only imports of washing machines from Canada were exempted, and regarding solar cells, it was decided to apply the safeguard to imports from all countries.<sup>61</sup>

### **(c) Introduction of a sunset clause**

The United States is also considering introducing a sunset clause<sup>62</sup> that requires a review of NAFTA every five years to determine whether or not to extend the trade agreement. The United States would like to periodically revise the parts of NAFTA that fail to function by adding a sunset clause. Although Canada and Mexico have shown readiness to agree to a periodic review, they have pointed out that a sunset clause intended to let NAFTA expire unless an agreement is reached on renewal would create uncertainty for companies making long-term investments. From within the United States as well, voices of opposition have been raised. For example, the U.S. Chamber of Commerce stated that the Trump

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57 Regarding this measure, the United States abolished the tariffs as its argument was rejected by the WTO in 2003.

58 The implementation of safeguards by the U.S. government was the first in 16 years since 2002.

59 Concerning washing machines, Whirlpool, a major U.S. home electric appliance maker which requested the investigation, accused Samsung Electronics and LG Electronics, both of the ROK, of having evaded the U.S. AD measure by transferring production activity. Concerning solar power generation products, the USTR accused Chinese companies of having evaded the U.S. trade remedy tariffs by transferring production bases out of China (*TSUUSHOU KOUHOU*, January 30, 2018).

60 The USITC report also recommended that both Canada and Mexico should be exempted from application on the ground that the share of imports of washing machines from the two countries in overall imports has not reached a threshold level. In addition, the USITC determined that imports of solar power generation products from Canada were not causing serious injury to the U.S. domestic industry.

61 Section 201 of the Trade Act of 1974 gives the president the power to implement safeguard measures, such as raising tariffs on imports of specified products from all countries and setting tariff quotas, for a limited period of time (up to four years in principle and eight years at maximum) based on the determination of injury by USITC.

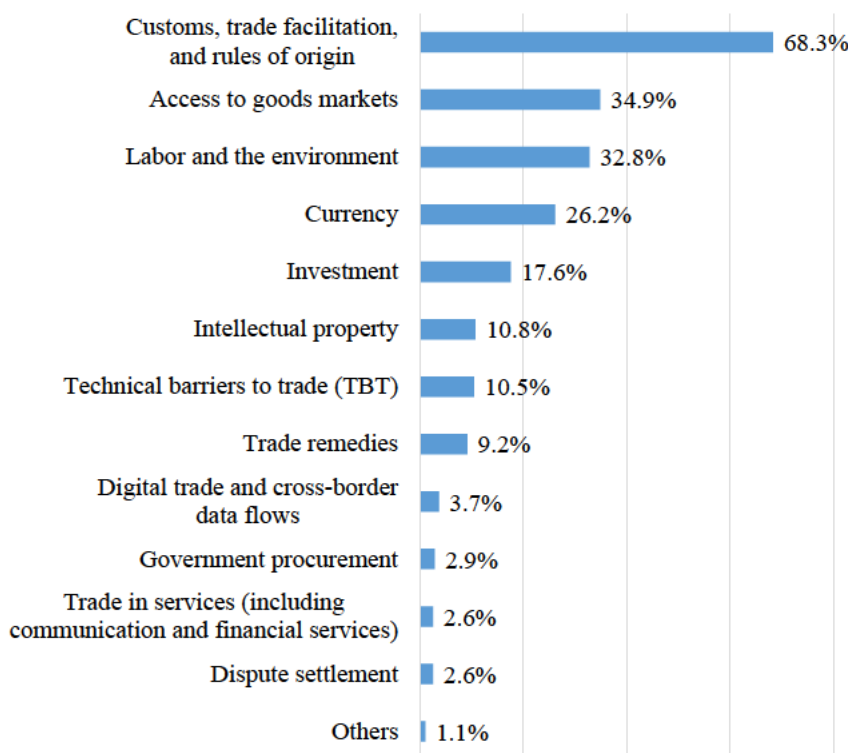
62 Under this clause, NAFTA would automatically expire unless the NAFTA member countries agree on renewal after review of the agreement every five years.

Administration’s demands include poison pills that “could doom the entire deal.”

**(d) Japanese companies’ reactions**

JETRO has conducted a survey with Japanese companies operating in the United States concerning the items of negotiation in the renegotiation of NAFTA that may have a significant impact on them (Figure I-2-1-34). According to the survey, “customs clearance, trade facilitation and rules of origin,” “access to goods markets,” and “labor and the environment” were among the most widely cited items. On an industry-by-industry basis, 100% of the respondent companies belonging to the transportation equipment and parts industry (railway vehicles, ships, aircraft and land transportation vehicles) cited “customs clearance, trade facilitation and rules of origin” as an item that may have an impact. “Access to goods markets” was cited as an item that may have an impact widely among companies belonging to the rubber product industry (57.1%) and the textile industry (53.8%), and “labor and the environment” was widely cited among companies belonging to the textile industry (61.5%). Many transportation equipment makers expressed concerns over cost changes due to the revision of the rules of origin, while some companies in the chemicals and oil product industry replied that the renegotiation will have no impact. In short, the reaction varied from industry to industry. Until now, few companies have taken specific countermeasures, such as revising production plans, and many companies are apparently waiting to see how the renegotiation will unfold.

**Figure I-2-1-34 Impact derived from the renegotiation of NAFTA**



Notes: The number of respondent companies was 619. Multiple answers was possible.

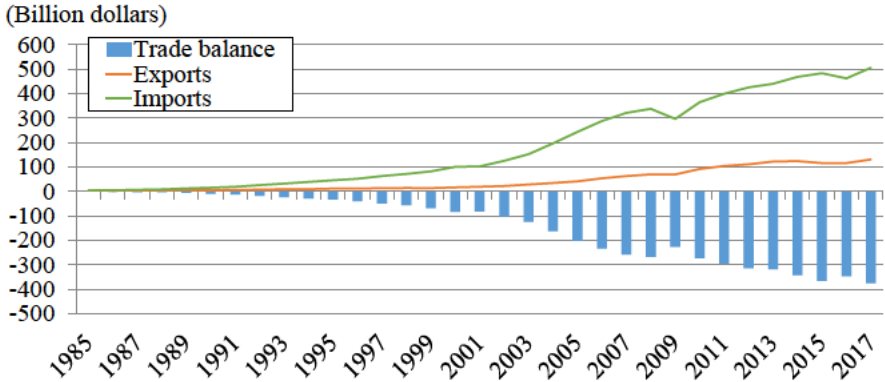
Source: Results of the *FY2017 Survey on Business Condition of Japanese Companies in the U.S. (36th annual survey)* (JETRO).

**(3) U.S.-China trade**

**(A) Overview of U.S.-China trade**

After establishing a diplomatic relationship in 1979, the United States and China concluded a bilateral trade agreement, which went into effect in 1980. The value of trade in goods between the two countries was around 4 billion dollars at that time. China, which was only the 24th largest trading partner for the United States in 1980, has become its largest trading partner now, nearly 40 years later, with the value of bilateral trade (2017) at around 636 billion dollars (the value of U.S. exports to China: approx. 130.4 billion dollars; the value of U.S. imports from China: approx. 505.6 billion dollars). The U.S. trade deficit with China in 2017 was around 375.2 billion dollars (Figure I-2-1-35).

**Figure I-2-1-35 U.S.-China trade balance**



Notes: Census basis.

Source: United States Census Bureau, CEIC database.

For the United States, China is the third largest export destination, after Canada and Mexico. Among the top 10 items of export from the United States to China are industrial products such as aircraft, passenger cars and semiconductors (Table I-2-1-36). In particular, exports of passenger cars have increased by a factor of about 10 compared with 10 years ago amid growing demand in China. In addition, China is the second largest export market for agricultural products from the United States, and soybean is an important item of export. On the other hand, China is the largest import source for the United States. China exports mobile phones, computers and communication equipment, among other items, to the United States (Table I-2-1-37).

**Table I-2-1-36 Export items from the United States to China**

Category of item	2008	2017	Rate of change (Times)
	(Million dollars)		
Private aircraft, engines, equipment and parts	3,904	16,266	4.2
Soybeans	7,260	12,362	1.7
Passenger cars	1,100	10,526	9.6
Semiconductors	6,494	6,077	0.9
Industrial machinery	2,797	5,442	1.9
Crude oil	N.A.	4,434	N.A.
Plastics	3,068	4,004	1.3
Medical equipment	1,049	3,454	3.3
Pulpwood and wood pulp	2,234	3,395	1.5
Lumber and sawing wood	481	3,179	6.6

Notes: The classification is based on the end-use code (five-digit).

Source: United States Department of Commerce (Bureau of Economic Analysis (BEA)).

**Table I-2-1-37 Export items from China to the United States**

Category of item	2008	2017	Rate of change (Times)
	(Million dollars)		
Mobile phones, etc.	27,505	70,394	2.6
Computers	25,040	45,520	1.8
Communication equipment	14,497	33,482	2.3
Computer accessories	27,012	31,612	1.2
Toys and sports gear	29,167	26,773	0.9
Clothing, and textiles and apparels	15,295	24,152	1.6
Furniture	13,279	20,667	1.6
Automobile parts	6,090	14,418	2.4
Household commodity	8,988	14,146	1.6
Electrical machinery	8,997	14,073	1.6

Notes: The classification is based on the end-use code (five-digit).

Source: BEA.

As “the world’s factory,” China has established huge supply chains and is manufacturing high-tech products, such as mobile phones and computers, with most of them exported to the United States and

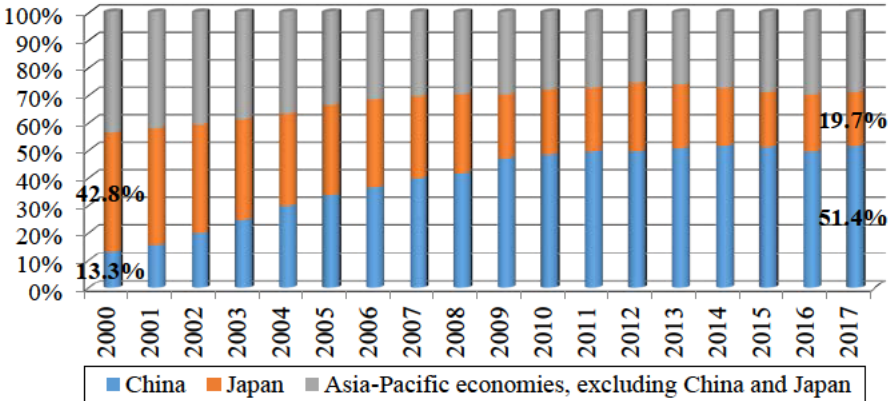


other countries around the world, but it depends heavily on imports from the United States for the supply of semiconductor products that constitute the core of those products. Therefore, in 2014, the government of China announced the National Guideline for the Development and Promotion of the IC Industry, with a view to raising the self-sufficiency rate of semiconductors by 2020. In addition, in order to obtain technology quickly, China is stepping up activity to acquire U.S. semiconductor makers, and the United States is keeping vigilance against this activity.

**(2) China as part of the global supply chain**

The expansion of U.S. imports from China has much to do with the transfer of production bases in the Asia-Pacific region. For example, looking at changes in exports of machinery and transportation equipment to the United States from Asia-Pacific economies, exports from Japan accounted for 42.8% of the total in 2000, before China’s accession to the WTO, while exports from China accounted for 13.3%. However, in 2004, China’s share surpassed Japan’s share, and in 2017, the share was 19.7% for Japan and 51.4% for China (Figure I-2-1-38). Regarding computers, which is one of China’s main items of export, exports from China to the United States increased by a factor of around seven compared with 2000, while exports from Japan to the United States declined to less than a tenth (Figure I-2-1-39).

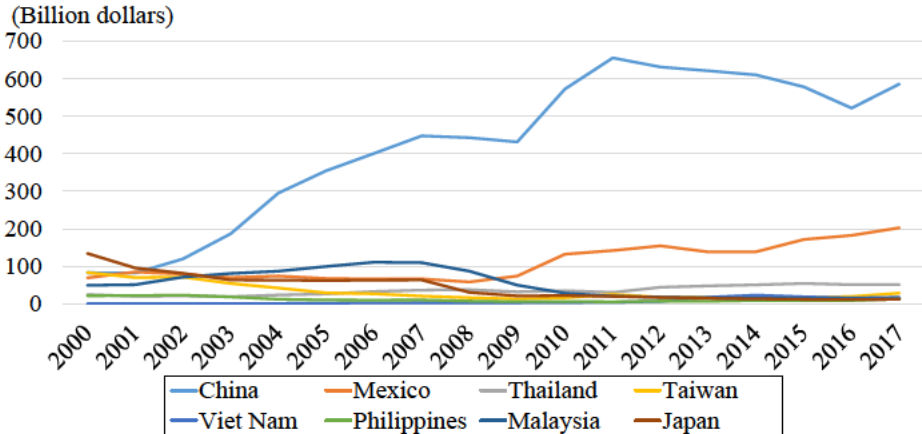
**Figure I-2-1-38 Changes in exports of machinery and transportation equipment from Asia-Pacific economies to the United States**



Notes: The data is based on the category of machinery and transport equipment under the Standard International Trade Classification (SITC). The Asia-Pacific economies are: Japan, China, Australia, Brunei Darussalam, Cambodia, Hong Kong, Indonesia, the ROK, Lao PDR, Macao, Malaysia, New Zealand, the Philippines, Singapore, Taiwan, Thailand and Viet Nam.

Source: USITC.

**Figure I-2-1-39 Changes in export value of computers to the United States**



Notes: The data is based on the category of “33411: computer equipment” under the North American Industry Classification System (NAIC).

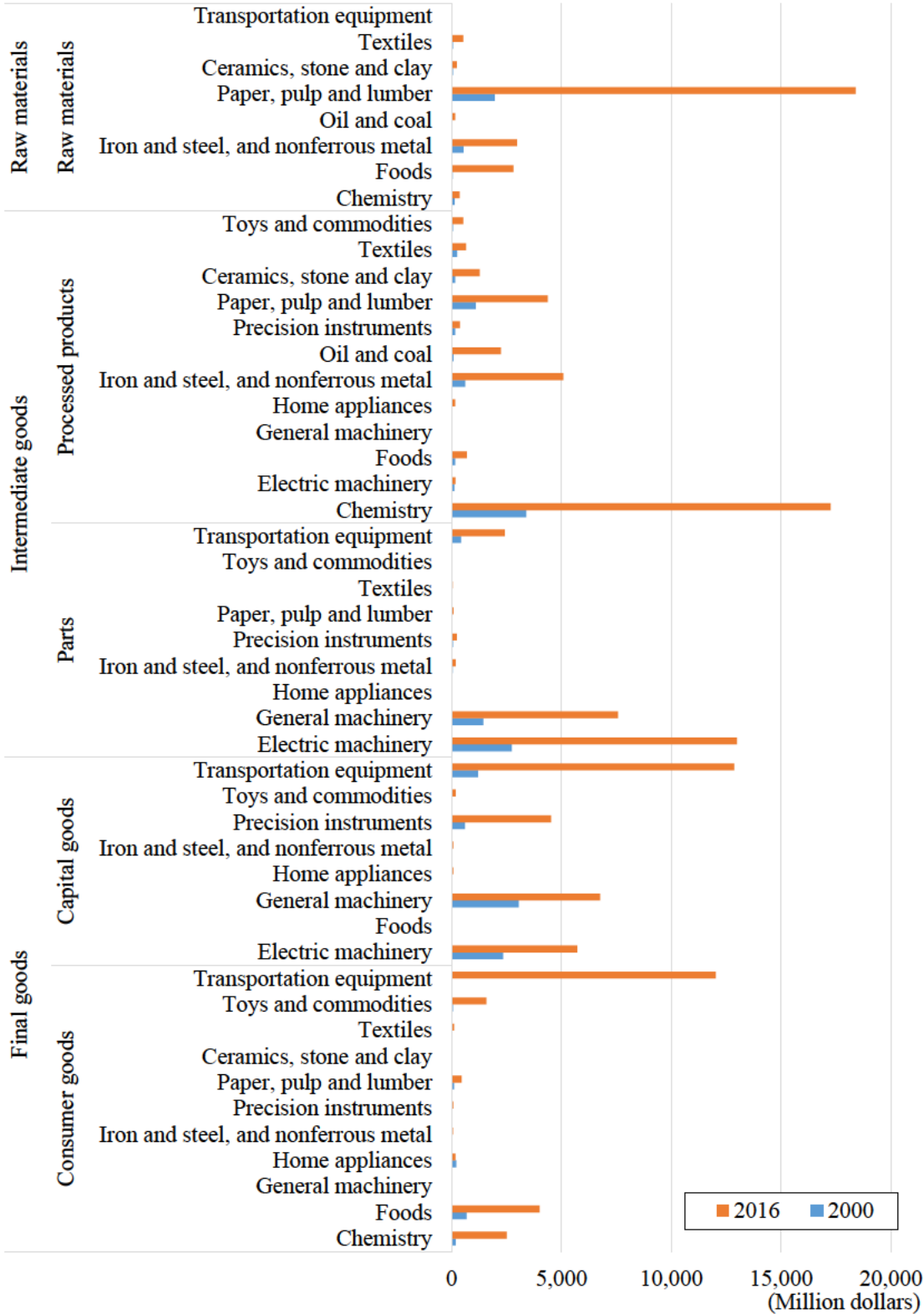
Source: USITC.

In the Asia-Pacific region, China is responsible for the final process in the supply chain: parts manufactured in Japan, the ROK, and Taiwan, among other countries, are assembled in China into finished products, most of which are exported to the United States.

Likewise, from the viewpoint of the supply chain, finished products exported from China contain parts manufactured in the United States. As shown in Figure I-2-1-40, in which products are classified into raw materials, intermediate goods and final goods, exports of raw materials, such as paper, pulp and lumber, and exports of intermediate goods, such as chemicals-related processed products and electrical machinery parts, have large shares in overall exports from the United States. On the other hand, exports from China to the United States are heavily concentrated on exports of final goods, with exports of capital goods such as electrical and general machinery recording marked growth (Figure I-2-1-41). These trends indicate that China processes raw materials and parts imported from the United States into finished products and exports them to countries around the world, including the United States.<sup>63</sup>

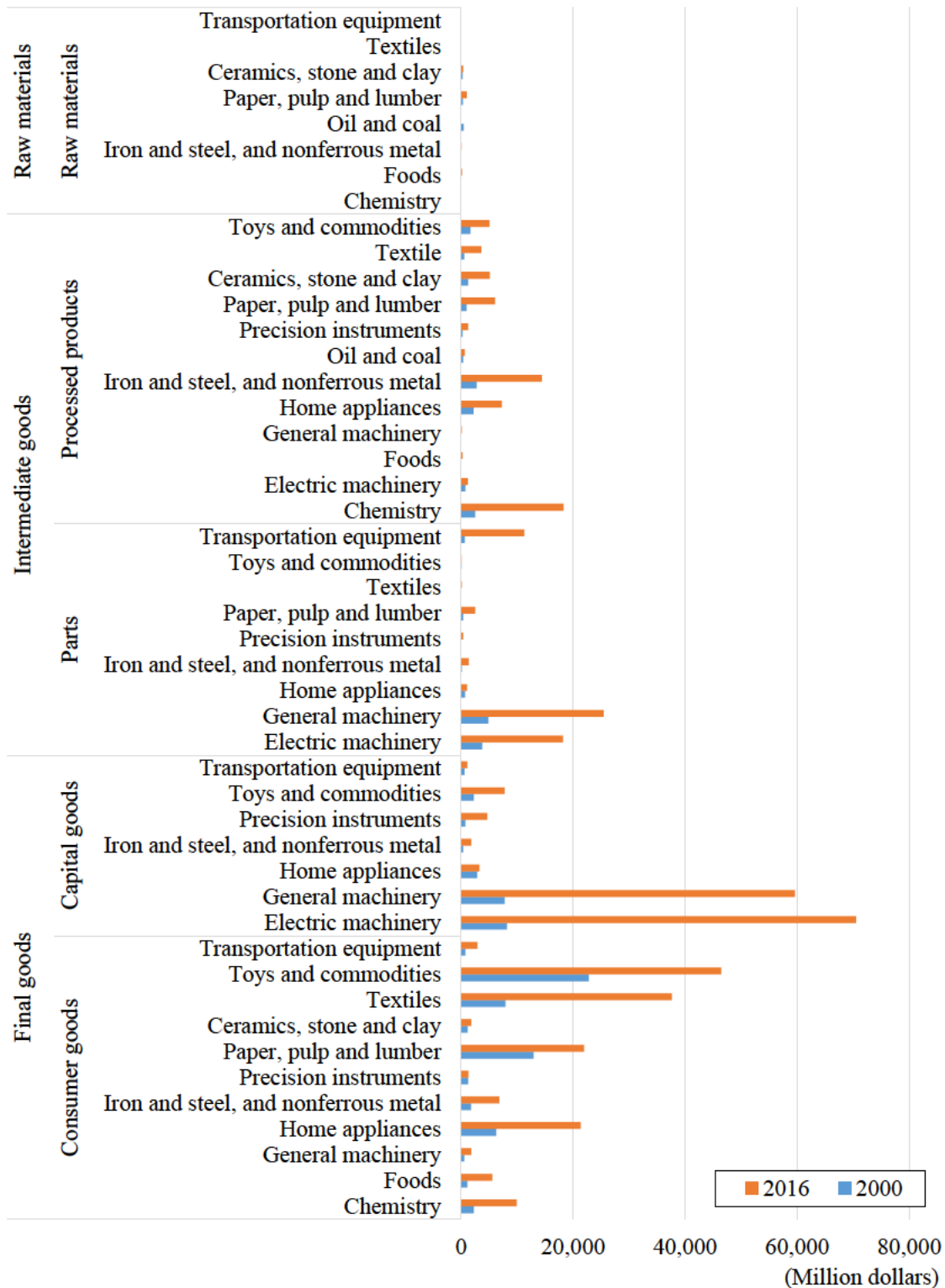
63 One example of China being responsible for the final process in the supply chain is an activity of Apple, a U.S. high-tech company. Apple has concluded contracts with 200 suppliers around the world and has 900 production bases (as of 2017). Apple’s iPhones are assembled mainly by Taiwanese companies operating in China using intermediate goods imported from around the world. According to analyses by many analysts, China is merely assembling parts manufactured abroad or owned by foreign companies and most of the profits from sales of iPhones go to Apple because China’s contribution to the creation of value in production of iPhones is very small. According to a study by ADBI, the total value of iPhones exported from China to the United States as of 2009 was higher than 2 billion dollars but 96.4% of the total value added is attributable to other countries, including the United States. It should be kept in mind that as indicated above, ordinary trade statistics do not accurately reflect the allocation of value added in production processes of iPhones and that U.S. trade statistics count the value of finished products imported from China, which geographically corresponds to the final process (Summarized from Morrison (2018) and Xing and Detert (2010)).

Figure I-2-1-40 Exports from the United States to China (by production step)



Source: RIETI-TID.

**Figure I-2-1-41 Exports from China to the United States (by production step)**



Source: RIETI-TID.

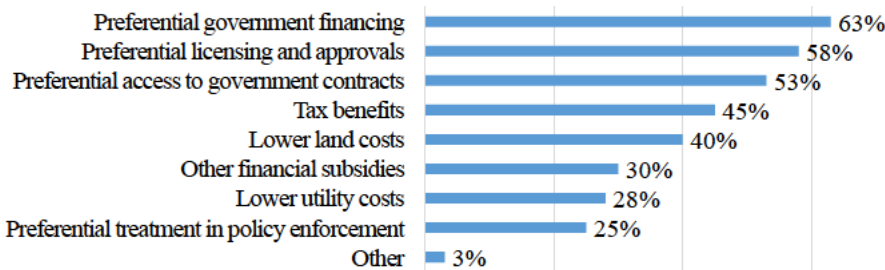
**(C) U.S.-China trade friction**

**(a) U.S. trade deficit with China**

Regarding its trade deficit with China, the United States believes that there are underlying problems behind both an increase in imports from China and sluggish exports from the United States. First, the

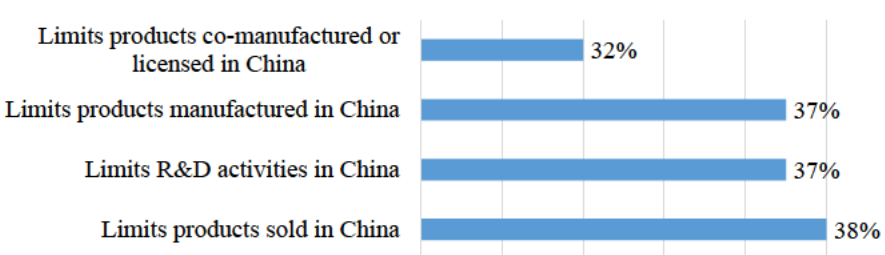
United States believes that the underlying problems behind the increase in imports from China include Chinese state-owned enterprises' overseas expansion backed by governmental support, excess production of steel and aluminum, and the exchange rate of the Chinese yuan. Meanwhile, regarding U.S. exports to China, the United States is criticizing the closed nature of the Chinese market and business practices, China's infringements on intellectual property rights, and China's requirement for U.S. companies operating in China to transfer technology. According to the results of a survey conducted by the U.S.-China Business Council with member companies doing business in China, for example, the Chinese government provides favorable treatment to Chinese state-owned enterprises in terms of fund-raising, licensing, and taxation, putting U.S. companies at a competitive disadvantage (Figure I-2-1-42). In addition, U.S. companies operating in China have to limit their research and development, production and other activities in order to protect intellectual property (Figure I-2-1-43). Of the respondent companies, 19% said that they had been required by Chinese business partners or the Chinese government to transfer technology to China. In short, the survey made clear the difficulty of doing business there.

**Figure I-2-1-42 Benefits that Chinese state-owned enterprises (SOE) competing with U.S. enterprises enjoy**



Source: 2017 China Business Environment Member Survey (US-China Business Council).

**Figure I-2-1-43 Measures taken by U.S. companies in China to protect their own intellectual property rights**



Source: 2017 China Business Environment Member Survey (US-China Business Council).

In April 2017, after taking office, U.S. President Trump agreed to the 100-Day Action Plan of the U.S.-China Comprehensive Economic Dialogue, intended to correct the trade imbalance, in order to resolve these problems with China, and in July, the first round of the U.S.-China Comprehensive Economic Dialogue was held in Washington, D.C. Through a series of negotiations, the United States



achieved some results,<sup>64</sup> including the resumption of beef exports to the Chinese market, the conclusion of a contract to sell liquefied natural gas to China, permission for sales of U.S. biotechnology products,<sup>65</sup> and the partial opening of access to the financial services market in China. On the other hand, the United States was apparently unable to reach agreement on many of the aforementioned underlying problems behind the U.S. trade deficit with China.<sup>66</sup>

Under these circumstances, the United States is taking increasingly strong warning actions against China. For example, the United States imposed sanctions against China based on Section 301 of the Trade Act of 1974 and implemented a measure to adjust imports of steel and aluminum from other countries, including China, based on Section 232 of the Trade Expansion Act of 1962. Furthermore, attention is also focusing on moves to protect the U.S. domestic industry through such measures as antidumping measures and safeguards and moves to strengthen the investigative power concerning foreign investments in the United States. Below, we will provide an overview of the implementation status of U.S. trade remedy and investment screening measures against China.

#### **(b) Antidumping measures**

Based on the recognition that imports from China are causing injury to the U.S. domestic industry, the United States has been increasing AD measures as a trend. The AD measures are special tariff measures implemented by importing countries, in cases where products exported from other countries at unfairly low prices are causing injury to the importing countries' domestic industry, in order to correct the dumping prices and raise them to normal levels. The AD measures are permitted under the WTO Agreement. Usually, regarding products imported from abroad, the domestic price in the exporting country and the export price are compared, and when the export price is lower, dumping is recognized and an antidumping duty equivalent, at a maximum, to the dumping margin, or the difference between the domestic and export price, is imposed. When determining the AD against China, the United States uses third-country prices as the basis for judging whether or not China has exported products at prices lower than fair prices. The reason behind this is that when China acceded to the WTO in 2001, it accepted a provision stipulating that it would be treated as a non-market economy for 15 years. Although this provision expired in 2016, the United States, the EU and Japan still refuse to recognize China as a market economy. The government of China is accusing the United States of unfairly imposing high duties on Chinese products under a provision that is supposed to have expired.<sup>67</sup>

We will provide an overview of the implementation of AD measures by the United States and China. In 2016, the number of cases in which AD measures were implemented by the United States against other countries came to 35, surpassing the previous record high of 33, which was set in 2001 (Figure I-2-1-44). The number of cases in which the United States implemented AD measures against China varied from year to year, but in 2017, the country implemented AD measures in eight cases in the first

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64 USCC (2017).

65 E.g., genetically engineered products.

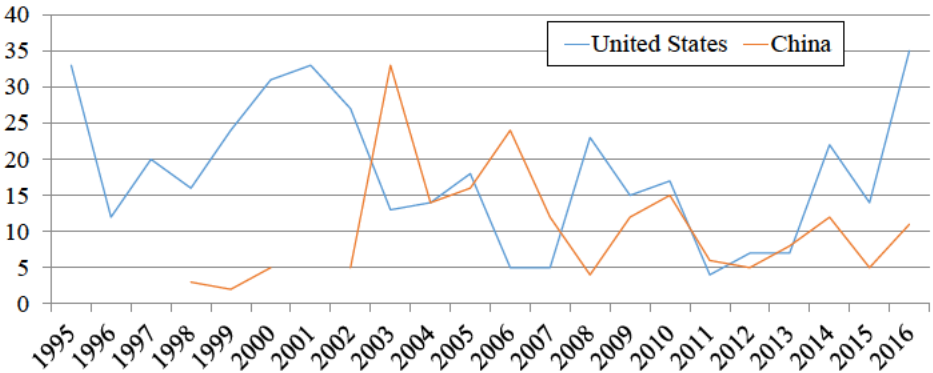
66 Regarding the first round of the U.S.-China Comprehensive Economic Dialogue, the two countries' planned joint press conference was cancelled, and a joint statement was also not issued.

67 On December 12, 2016, China requested bilateral consultations with the United States and the EU under the WTO rules with respect to issues related to its status as non-market economy (WTO dispute settlement case numbers: DS515 (the case involving the United States) and DS516 (the case involving Europe)).

half alone, indicating that the number has recently been trending upward (Figure I-2-1-46). By sector, the number of cases in which the United States implemented AD measures against China (the cumulative total between 1995 and the first half of 2017) is particularly large in the base metals sector (38 cases), including steel products, in the chemicals sector (31 cases), and the machinery and electronics equipment sector (10 cases). Regarding steel products in particular, the reason behind the aggressive implementation of AD measures is that U.S. steelmakers have suffered injury from low-priced steel products exported from China, where steel is produced in excess of demand. On March 3, 2017, after the inauguration of the Trump administration, the U.S. International Trade Commission (ITC) issued a final determination that AD and CVD should be imposed on steel sheets imported from China.<sup>68</sup> Although the investigation in this case was started under the Obama administration, the Trump administration also intends to make active use of AD measures against imports from China. As a result, an antidumping duty of 68.27% and a countervailing duty of 251.0% were imposed on steel sheets imported from China.<sup>69</sup>

On the other hand, attention should also be paid to the trend in the implementation of AD measures by China against products manufactured in the United States. Looking at the past trend (Figure I-2-1-47), the annual number of cases of implementation of AD measures is one to three on average. However, as Chinese imports of livestock feed have been increasing steeply against the backdrop of growing demand for meat and dairy products, China implemented an AD measure against distillers dried grains solubles (DDGS) in January 2017. In addition, in February 2018, the Chinese Ministry of Commerce announced the start of an investigation into alleged dumping of U.S.-produced sorghum, which is used as material for baijiu liquor. In March, the ministry also announced the start of an investigation into suspected imports of phenol, a chemical product used for production of plastics, from the United States and other countries<sup>70</sup> at unfairly low price.

**Figure I-2-1-44 Changes in the number of implementations of AD issued by the United States or China**



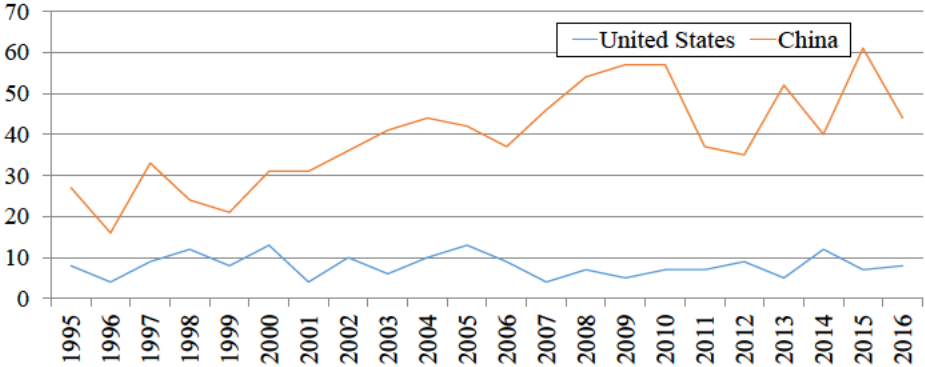
Source: WTO Statistics.

68 USITC News Release (March 3, 2017) ([https://www.usitc.gov/press\\_room/news\\_release/2017/er030311731.htm](https://www.usitc.gov/press_room/news_release/2017/er030311731.htm)).

69 Federal Register (March 20, 2017) (<https://www.federalregister.gov/documents/2017/03/20/2017-05440/certain-carbon-and-alloy-steel-cut-to-length-plate-from-the-peoples-republic-of-china-antidumping#footnote-4-p14352>).

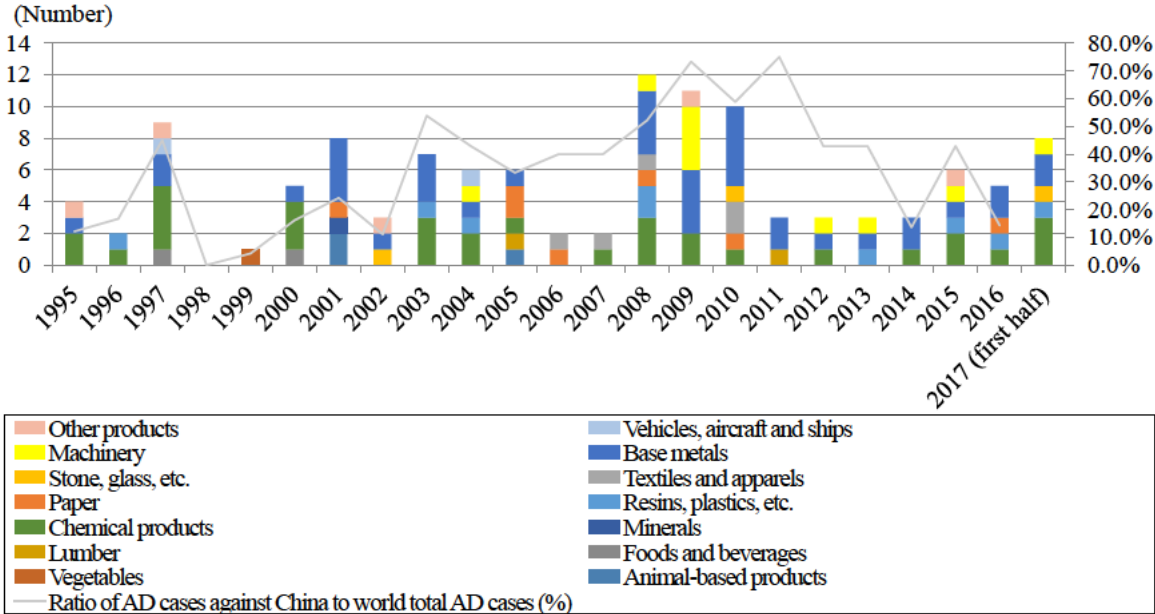
70 In addition to the United States, the EU, the ROK, Japan and Thailand are subject to the investigation.

**Figure I-2-1-45 Changes in the number of implementations of AD against the United States or China**



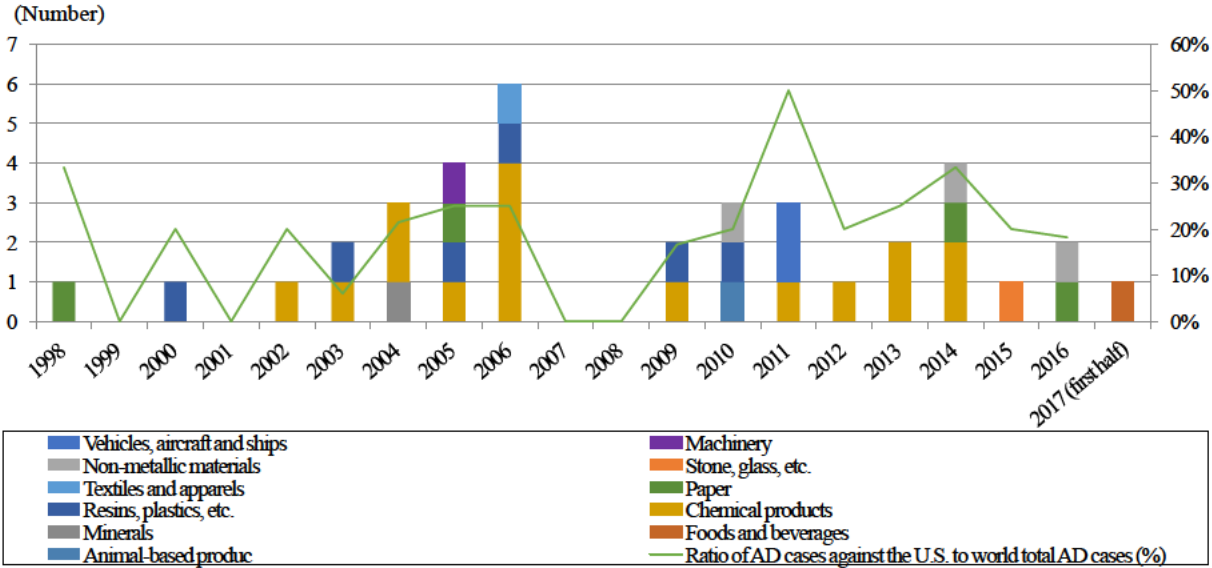
Source: WTO Statistics.

**Figure I-2-1-46 Changes in the number of implementations of AD issued by the United States against China (by sector)**



Source: WTO.

**Figure I-2-1-47 Changes in the number of implementations of AD issued by China against the United States (by sector)**



Source: WTO.

**(c) U.S. measures based on Section 301 of the Trade Act and Section 232 of the Trade Expansion Act of 1962 and China’s reactions**

On March 22, 2018, President Trump signed a presidential memorandum ordering the implementation of sanctions against China based on Section 301 of the Trade Act.<sup>71</sup> This order for the implementation of sanctions was issued in light of the finding of an investigation conducted since August 2017 by the USTR on President Trump’s instruction based on Section 301 that the government of China was conducting unfair interventions to force U.S. companies to transfer intellectual property and technology to Chinese companies.

Specifically, the memorandum instructed the USTR to announce a list of product items subject to additional tariffs of 25%, address China’s discriminatory technology licensing practices through the WTO’s dispute settlement procedures and strengthen the regulation of Chinese investments in sensitive U.S. technologies. The list of product items subject to the additional tariffs covered a broad range of items totaling 1,300,<sup>72</sup> including semiconductors, agricultural machinery, machinery and industrial robots, medical equipment, and aircraft and aerospace-related products, with the combined annual value of imports estimated at 50 billion dollars. Of the items subject to the additional tariffs, general machinery (nuclear reactors, boilers, and machinery) will be affected most as it accounts for more than 40% of overall U.S. imports, followed by electrical equipment, which accounts for 30% (Table I-2-1-48).

71 Section 301 of the U.S. Trade Act gives the USTR the power to implement some measures when the U.S. interests under trade agreements are infringed or when measures and policies implemented by foreign countries are in violation of or inconsistent with the provisions of trade agreements, for example.

72 Announced on April 3, 2018. The USTR invited public comments concerning the list of product items subject to the additional tariffs until May 11. Public hearings were scheduled to be held on May 15-17. Comments responding to testimonies at the public hearings were to be accepted until May 22. The USTR was scheduled to issue a final determination regarding the measure to be implemented after going through these processes.

Regarding the strengthening of the regulation of investments in the United States, the details are unclear, but it has been pointed out that the Committee on Foreign Investment in the United States (CFIUS; to be mentioned later) will be enhanced and that the Exon-Florio provision<sup>73</sup> or the International Emergency Economic Powers Act<sup>74</sup> will be applied.

**Table I-2-1-48 Trade value and composition rates of items subject to the Section 301 of the Trade Act in 2017**

HTS code (chapter)	Title of chapter	100 million dollars	Composition rate
84	Nuclear reactors, boilers, machinery and mechanical appliances	200	43%
85	Electrical machinery	145	31%
90	Optical and checking instruments and apparatus	64	14%
87	Vehicles and parts thereof	20	4%
76	Aluminum and articles thereof	13	3%
30	Pharmaceutical products	6	1%
88	Aircraft, spacecraft, and parts thereof	5	1%
94	Furniture	3	1%
73	Articles of iron or steel	3	1%
86	Railway and parts thereof	2	0%
29	Organic chemicals	1	0%
72	Iron and steel	1	0%
40	Rubber and articles thereof	0	0%
83	Miscellaneous articles of base metal	0	0%
93	Arms and ammunition	0	0%
89	Ships, boats and floating structures	0	0%
28	Inorganic chemicals, and compounds of precious metals, rare-earth metals or radioactive elements	0	0%

<sup>73</sup> Section 721 of the Defense Production Act of 1950. This provision gives the president the power to implement appropriate measures at an appropriate time in order to suspend or prohibit transactions that could undermine the national security of the United States (U.S.C. App. 2170 (d) (1)). It also stipulates that the actions and findings of the president in this respect should not be subject to judicial review (U.S.C. App. 2170 (e)).

<sup>74</sup> Put into force in 1977. This law allows the government to declare a national emergency and the president to temporarily seize various economic powers when the United States is confronted with an unusual and extraordinary international threat. Among the measures that may be implemented are restricting or prohibiting foreign exchange transactions, imports and exports of currencies and securities, and seizing foreign nationals' assets (<https://www.gpo.gov/fdsys/pkg/USCODE-2008-title50/pdf/USCODE-2008-title50-chap35.pdf>).



38	Miscellaneous chemical products	0	0%
Total	—	464	100%

Notes: This figure does not describe Chapter 91 (clocks and watches and parts thereof), which is also subject to Section 301, since the statistical values of the items are not clear.

Source: USITC.

On March 23, 2018, the United States determined that imports of steel and aluminum are posing a national security threat and started to impose additional tariffs of 25% and 10% on imports of steel and aluminum, respectively, based on Section 232 of the Trade Expansion Act of 1962.<sup>75</sup> In terms of the value of imports of steel and steel products by the United States, China is the 10th largest import source, and in terms of the value of imports of aluminum and aluminum products, it is the second largest import source. Therefore, the impact on imports from China in terms of the value will be great (Table I-2-1-49).<sup>76</sup>

**Table I-2-1-49 Imports of iron and steel and aluminum to the United States (by economy)**

Iron and steel				Aluminum			
#	Economy	Import value (Million dollars)	Share (%)	#	Economy	Import value (Million dollars)	Share (%)
1	Canada	5,187	17.9	1	Canada	6,999	40.8
2	ROK	2,787	9.6	2	China	1,746	10.2
3	Mexico	2,494	8.6	3	Russia	1,576	9.2
4	Brazil	2,450	8.4	4	UAE	1,388	8.1
5	Japan	1,659	5.7	5	Bahrain	585	3.4
6	Germany	1,525	5.3	6	Argentina	547	3.2
7	Russia	1,431	4.9	7	Germany	370	2.2
8	Taiwan	1,264	4.4	8	India	370	2.2
9	Turkey	1,192	4.1	9	South Africa	340	2.0
10	China	1,009	3.5	10	Qatar	307	1.8

<sup>75</sup> In a presidential proclamation dated March 23, 2018, the United States said it would exempt Canada, Mexico, Australia, Argentina, the ROK, Brazil and EU member countries from the tariffs until the end of April on a provisional basis and would continue discussions about alternative means to address the threatened impairment of national security. Later, the United States issued a new presidential proclamation dated April 30, under which the ROK would be exempted indefinitely with respect to steel alone because an agreement with the country was reached on alternative means. Meanwhile, the United States decided to exempt Brazil, Australia and Argentina until an agreement on alternative means is reached while extending the exemption period for Canada, Mexico and the EU until the end of May in order to hold further negotiations. (As of April 30).

<sup>76</sup> Product items subject to the additional tariffs in Table I-2-1-49 are: steel, etc. (720610-721650, 721699-730110, 730210, 730240-730290, 730410-730690) and aluminum, etc. (7601, 7604, 7605, 7606, 7607, 7608, 7609, 7616995160, 7616995170).

Notes: 2017.

Source: Global Trade Atlas.

In light of those U.S. moves, on April 1, China announced that it would impose additional tariffs on a total of 128 product items imported from the United States, including fruits, wine and pork, as a retaliatory measure against the U.S. measure based on Section 232 of the Trade Expansion Act, and the additional tariffs took effect on April 2. Specifically, additional tariffs of 15% were imposed on 120 items, including fresh and dried fruits, nuts, wine and seamless steep pipes, while additional tariffs of 25% were imposed on eight items, including pork and aluminum scrap.<sup>77</sup> The value of exports of the items subject to the additional taxes from the United States to China in 2017 was around 3 billion dollars, and the estimated value of additional tariffs calculated based on the export value is around 640 million dollars.

In addition, on April 4, China announced that it would impose additional taxes of 25% on imports of 106 items from the United States as a retaliatory measure against the U.S. measure against Chinese products based on Section 301 of the Trade Act. The value of exports of the items subject to the additional tariffs from the United States to China in 2017 was around 49 billion dollars, accounting for 32.6% of the total value of U.S. exports to China (Table I-2-1-50).

The impact will be particularly great on exports of aircraft, soybeans and automobiles, for which the imposition of additional tariffs of 25% was announced on April 4 and the combined export value of which is around 39 billion dollars, or some 80% of the total export value of the items subject to the additional tariffs. The estimated value of additional tariffs imposed on these three items alone is about 10 billion dollars.

**Table I-2-1-50 Imposition of additional tariffs by China against the United States  
(export value from the U.S. to China and total value of additional tariffs)**

128 items in total released on April 1 (related to Section 232)				
Ranking	Eight-digit HS code	Product Item	Export value	Tariff
			(100 million dollars)	
1	02064900	Guts of hogs for frozen foods (excluding livers thereof)	8.7	2.2
2	76020000	Aluminum waste and scrap	8.3	2.1
3	08025100	Pistachios	1.8	0.3
4	08092900	Cherries	1.7	0.3
5	02032900	Other frozen meat of hogs	1.7	0.4
6	02032200	Frozen hams of hogs, etc.	1.2	0.3
7	08051000	Oranges	0.9	0.1
8	22042100	Other wine	0.8	0.1

<sup>77</sup> *BJINESU TANSIN* (JETRO, April 5, 2018).

9	73045910	Boiler tubes	0.8	0.1
10	08021200	Shelled sweet almonds	0.7	0.1
Others (11-128)	—	—	3.2	0.5
[i] Total (additional tariffs)			29.7	6.4
[ii] Total (U.S. => China: All product items of exports)			1,496.6	—
[i] / [ii] (%)			2.0%	—

106 items in total released on April 4 (related to Section 301)				
Ranking	Eight-digit HS code	Product Item	Export value	Tariff
			(100 million dollars)	
1	12019010	Yellow soybeans	139.6	34.9
2	88024010	Aircraft	102.6	25.6
3	87032362	4-wheel-drive vehicles of a cylinder capacity exceeding 2,500 cc but not exceeding 3,000 cc	54.3	13.6
4	87032342	4-wheel-drive vehicles of a cylinder capacity exceeding 1,500 cc but not exceeding 2,000 cc	23.6	5.9
5	27111200	Liquefied propane	17.6	4.4
6	87038000	Passenger cars	14.0	3.5
7	52010000	Cotton	9.8	2.5
8	10079000	Grain sorghum for seed	9.6	2.4
9	87032343	Station wagons of a cylinder capacity exceeding 1,500 cc but not exceeding 2,000 cc	8.6	2.2
10	38249999	Chemical products	7.8	1.9
Others (11-106)	-	-	100.7	25.2
[i] Total (additional tariffs)			488.1	122.0
[ii] Total (U.S. => China: All product items of exports)			1,496.6	-
[i] / [ii] (%)			32.6%	-

	Export value	Tariff
[iii] Major product items of all exports (aircraft, soybeans and passenger cars)	39,240 million dollars	9,810 million dollars
[iv] Total value of product items subject to the additional tariffs on April 1st and 4th	51,770 million dollars	12,850 million dollars
[iii] / [iv]	75.8%	76.4%

Notes: The data is as of 2017. The value of additional tariffs is a calculation result based on the estimates that additional tariffs may be imposed on the current tariff rates. As for those on April 1st, such additional tariff rates were estimated to be 15% or 25%, while as for those on April 4th, they were estimated to be 25%.

Source: Global Trade Atlas, Ministry of Finance of China.

#### (d) Committee on Foreign Investment in the United States (CFIUS)

In the United States, there is a system to review foreign companies' plans to acquire U.S. companies from the viewpoint of national security and block acquisitions when there are national security concerns. Because of the need to maintain the comparative advantage of U.S. technologies in the high-tech sector and prevent technology leakage to abroad, interest in inward investments by foreign companies from the viewpoint of national security has recently been growing in the United States.<sup>78</sup>

Over the past 10 years, the number of acquisitions of U.S. companies by Chinese companies has increased significantly,<sup>79</sup> with investments concentrated in high-tech companies in particular (Figure I-2-1-51). The Committee on Foreign Investment in the United States (hereinafter referred to as "CFIUS") has the investigative power whereby it reviews planned acquisitions of U.S. companies and blocks acquisitions if necessary.

CFIUS, which is an interagency committee of the U.S. government established on the basis of Section 721 of the Defense Production Act of 1950 (Table I-2-1-52), conducts reviews to determine whether planned acquisitions of U.S. companies by foreign companies could pose a national security threat. The president has the power to block acquisitions by foreign companies based on CFIUS' recommendations.

At a public hearing of the U.S. House Financial Services Subcommittee on Monetary Policy and Trade on December 14, 2017, Subcommittee Chairman Andy Barr, of the Republican Party, pointed out as follows: "The Chinese Government, for example, has set aside 250 billion dollars (around 28 trillion yen) to be used in dominating the vital semiconductor market." He stressed the need to strengthen CFIUS' functions in order to deal with new threats.<sup>80</sup> Under these circumstances, in mid-September

<sup>78</sup> See below as an example.

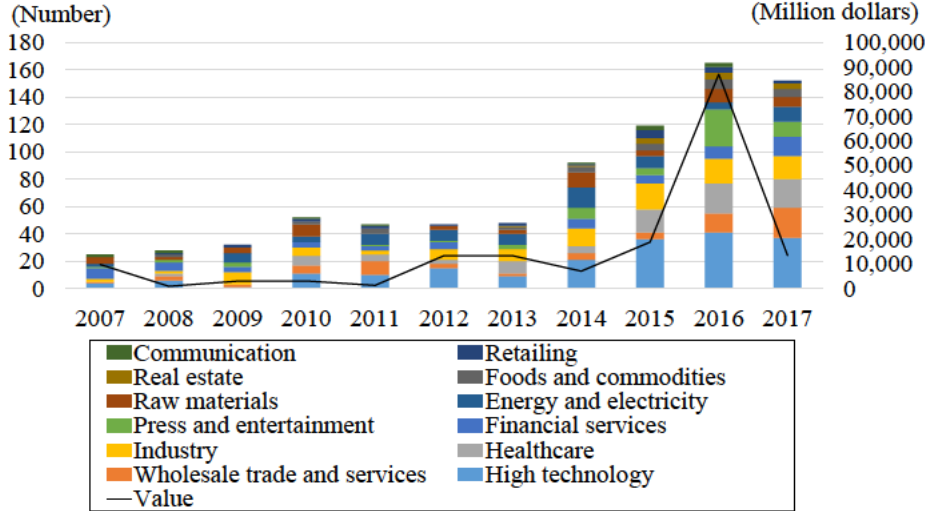
<https://obamawhitehouse.archives.gov/blog/2017/01/09/ensuring-us-leadership-and-innovation-semiconductors>

<sup>79</sup> In 2017, the number started to decline presumably because the government of China strengthened surveillance over Chinese companies' acquisitions of foreign companies and related loans. (Rhodium, 2018).

<sup>80</sup> From the press release concerning the public hearing of the U.S. House Financial Services Subcommittee on Monetary Policy and Trade (December 14, 2017) and various media reports

2017, a presidential order prohibiting the acquisition of Lattice Semiconductor (based in the state of Oregon), a U.S. semiconductor maker, by a Chinese investment fund for national security reasons, was issued. Moreover, in January 2018, Ant Financial, a financial subsidiary of Alibaba of China, abandoned its planned acquisition of MoneyGram International, a U.S. money transfer service provider, because it was unable to obtain approval from CFIUS.

**Figure I-2-1-51 Changes in the number of M&As of U.S. companies by Chinese companies**



Notes: Released-case basis.  
Source: Thomson Reuters.

**Table I-2-1-52 Composition of CFIUS**

<p>[Members] Heads of the following administrative organizations</p> <p>[i] Organizations having voting rights</p> <p>Department of the Treasury (chair), Department of Justice, Department of Commerce, Department of Homeland Security, Department of Defense, Department of State, Department of Energy and other governmental organizations that the President or the Secretary of the Treasury considers as appropriate for each case</p> <p>[ii] Organizations having no voting rights</p> <p>Department of Labor and National Intelligence Council</p> <p>[Observers]</p> <p>Office of Management and Budget, Council of Economic Advisors, National Intelligence Council, National Economic Council and National Security Council</p>
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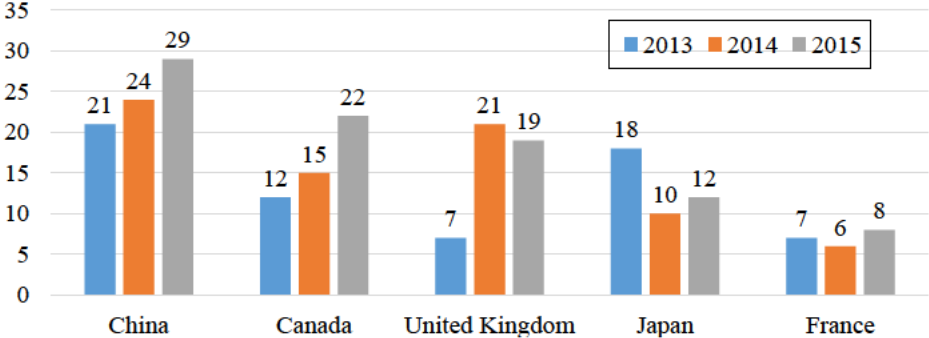
According to CFIUS’s annual report, Chinese investment transactions accounted for 19% (74 transactions) of the total number of transactions announced and reviewed between 2013 and 2015, and in each of the years, China topped the investor country rankings. Canada and the United Kingdom,

(<https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=402831>).



which were ranked second and third, respectively, had a share of 12% each (49 transactions and 47 transactions, respectively), while Japan was ranked fourth with a share of 10% (40 transactions). By industry, the number of Chinese investment transactions (the cumulative total between 2013 and 2015) in the manufacturing industry was the largest at 39 (Figure I-2-1-53).

**Figure I-2-1-53 Changes in the number of reviewed transactions by economy**



Source: *Annual Report* (CFIUS).

Since 1988, when CFIUS’s powers were strengthened, there have been only five cases in which a foreign company’s acquisition was blocked by a U.S. president, but Chinese companies were involved in four of the five cases. In particular, concerning Chinese companies’ plans to acquire semiconductor businesses, the planned acquisitions of Aixtron and Lattice<sup>81</sup> were blocked in 2016 and 2017, respectively (Table I-2-1-54).<sup>82</sup>

In November 2017, a bipartisan group of lawmakers submitted to Congress the bill for the Foreign Investment Risk Review Modernization Act (FIRRMA) in order to enhance the control of inward foreign investments by strengthening CFIUS’s functions. The bill provides for the extension of the review period, expansion of the scope of transactions subject to prior notification, information sharing with foreign governments, and factors of consideration in the review. For example, regarding factors of consideration, various viewpoints have been added, including whether technology leakage from companies planned to be acquired could affect the United States’ technological advantage, whether or not a country of special concern that has expressed an intention to acquire technology is involved, and whether or not a cybersecurity threat could arise.<sup>83</sup>

81 <https://www.whitehouse.gov/briefings-statements/statement-press-secretary-president-donald-j-trumps-decision-regarding-lattice-semiconductor-corporation/>.  
 82 For the Qualcomm case, references are made to CFIUS’ recommendations (March 18, 2018) (<https://www.qcomvalue.com/wp-content/uploads/2018/03/Letter-from-Treasury-Department-to-Broadcom-and-Qualcomm-regarding-CFIUS.pdf>) and a press release on the presidential order by White House (March 12, 2018) (<https://www.whitehouse.gov/presidential-actions/presidential-order-regarding-proposed-takeover-qualcomm-incorporated-broadcom-limited/>).  
 83 White & Case (2017).

**Table I-2-1-54 Cases where investment was blocked under Executive Order**

Year of blocking	President	Outline
1990	George H. W. Bush	The president ordered the cancellation of the acquisition contract of MAMCO Manufacturing Co., an aircraft-parts manufacturer in Seattle, by China National Aero-Technology Import and Export Corporation (CATIC) since this acquisition might cause CATIC to access technologies subject to the export control.
2012	Barack Obama	The president ordered the cancellation of the acquisition contract of four companies in the wind power generation industry in the State of Oregon by Ralls Corporation and other Chinese companies since the site of wind farms in Oregon according to the plan by Ralls Corporation was located in a flight restricted area close to the Navy training facilities in Oregon.
2016	Barack Obama	The president ordered the blocking of the acquisition of a US subsidiary company under Aixtron, a German semiconductor company having assets in the U.S., by Fujian Grand Chip Investment Fund, a Chinese investment fund. Citing media reports, the Congressional Research Services explained the potential risk of transfer of Aixtron's technologies and achievements for military purposes.
2017	Donald Trump	The president ordered the blocking of the acquisition of Lattice Semiconductor Corporation, a U.S. semiconductor company, by Canyon Bridge Fund, a Chinese investment fund in which China Venture Capital & Private Equity Forum (CVCF), a company related to the Chinese government, invested. As Lattice Semiconductor Corporation was involved in military-related devices that the U.S. government utilizes, the U.S. government considered the leakage of intellectual property to China as a potential threat to national security.
2018	Donald Trump	The president issued an Executive Order to ban the acquisition of Qualcomm, a large U.S. company in mobile chips, by Broadcom Inc., a large Singapore company in semiconductors since the acquisition would cause Qualcomm's long-term technical competitiveness and its influence on development of standards to decrease and this might threaten U.S. national security.

Source: Documents released by the U.S. government, JETRO.

## Column 2 Relationship between the U.S. policy interest rate and long-term interest rate

As the U.S. economy has been growing steadily, the FRB started shrinking its balance sheet in October last year and it expects to continue raising its policy interest rate this year, with around three hikes forecast. In line with the normalization of the monetary policy, the U.S. long-term interest rate has been trending upward since the beginning of this year (Column Figure 2-1). Here, we will provide an overview of the relationship between the policy interest rate and the long-term interest rate.

First, we will describe the relationship between the long-term interest rate (the yield on the 10-year U.S. government bond), the economic conditions and stock prices. In the past, when the long-term interest rate surpassed a certain level, stock prices fell due to concerns over economic slowdown. On the other hand, the possibility has been pointed out that if the long-term interest rate is too low, rapid inflation may emerge due to an economic overheating or the financial intermediary function will be undermined due to pressure on financial institutions' profits, causing adverse economic effects.<sup>84</sup> It cannot be denied that negative economic effects may be caused by an either excessively low or excessively high long-term interest rate, so it is desirable to keep the rate at an appropriate level. The level of interest rate that is neither accommodative nor restrictive is known as the neutral interest rate, and whether or not the long-term interest rate surpasses the neutral interest rate level serves as a benchmark in the assessment of the impact of the monetary policy on economic conditions.

The neutral interest rate represents the point of long-term equilibrium for the policy interest rate and it is not directly related to the long-term interest rate. Even so, as the long-term interest rate is said to be comprised of the weighted average of future short-term interest rates (policy interest rate) expected by investors and the term premium,<sup>85</sup> the neutral interest rate is used as a reference in the assessment of the level of the long-term interest rate. The current neutral interest rate is considered to be expressed as: "natural rate of interest + expected inflation rate." Column Figure 2-2 shows a comparison between changes in the federal funds (FF) rate and the nominal  $r^*$  ( $r$  star), whose value was obtained as the sum of  $r^*$ , which is known as the estimated value of the natural rate of interest, and the year-on-year rate of change of the core PCE price index, which corresponds to the expected inflation rate.<sup>86</sup> The monetary policy is accommodative if the FF rate is lower than the nominal  $r^*$  and restrictive if the FF rate is higher. As shown in Column Figure 2-2, the FRB implemented monetary easing (accommodative policy) from 2008 onwards by guiding the FF rate below the nominal  $r^*$ . However, the FRB started interest rate hikes

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84 Bank of Japan Governor Haruhiko Kuroda, in a speech at the University of Zurich on November 13, 2017, explained the concept of the reversal rate in relation to the economic impact of excessive drops in the long-term and ultra-long-term interest rates. The reversal rate refers to the possibility that if the central bank lowers interest rates too far, the banking sector's capital constraint tightens through the decline in net interest margins, impairing financial institutions' intermediation function, so that the effects of monetary easing on the economy reverse ([https://www.boj.or.jp/announcements/press/koen\\_2017/ko171114a.htm/](https://www.boj.or.jp/announcements/press/koen_2017/ko171114a.htm/)).

85 The term premium refers to an extra interest rate that investors demand because of additional price change risk or liquidity premium that may arise when they hold a relatively long-term bond instead of purchasing a succession of short-term bonds over the same period. It is also called term-related premium interest (a glossary of securities terms compiled by Nomura Securities) (<https://www.nomura.co.jp/terms/japan/ta/A03050.html>).

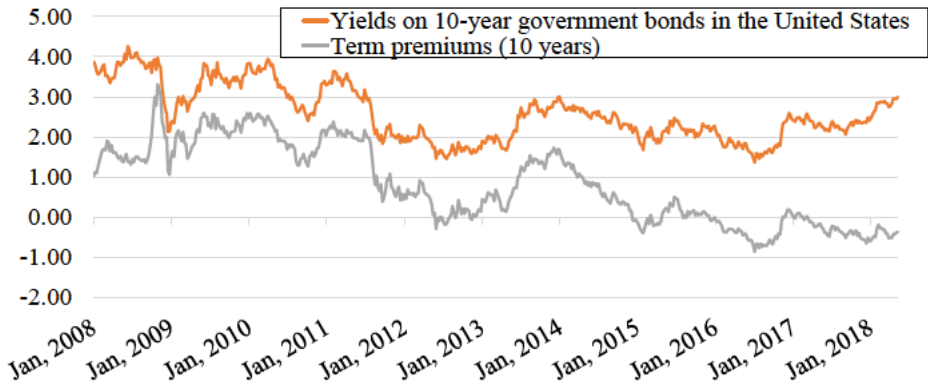
86 In some cases, the break-even inflation rate based on a market estimate is used, but in this white paper, we referred to the core PCE price index, which the FRB regards as important.

in December 2015, and as of March 2018, the policy interest rate was at a level very close to the nominal  $r^*$ . The monetary policy is in effect about to enter the monetary tightening phase (restrictive policy).

Monetary tightening is started when concerns over an economic overheating grow. When the GDP gap, which represents the supply-demand balance of the whole of the macroeconomy, is positive, that is an indication of the economy tilting toward overheating due to robust demand. As shown in Column Figure 2-3, the GDP gap and the monetary policy stance (FF rate – nominal  $r^*$ ) move mostly in tandem with each other. In other words, when the GDP gap was negative, monetary easing was implemented, and when the gap was positive, monetary tightening was implemented. The current GDP gap indicates that the economy is close to a state of overheating in which demand outpaces supply, so the FRB is implementing monetary tightening in order to enable the economy to continue growing at a moderate pace. As of March 2008, the long-term neutral interest rate (longer run rate) as recognized by the FOMC was 2.875%. According to the FOMC’s economic projections, the economic growth is expected to continue for a while and interest rate hikes are expected to continue with a view to raising the policy interest rate to the neutral interest rate level. The long-term interest rate is expected to continue rising in anticipation of future interest rate hikes.

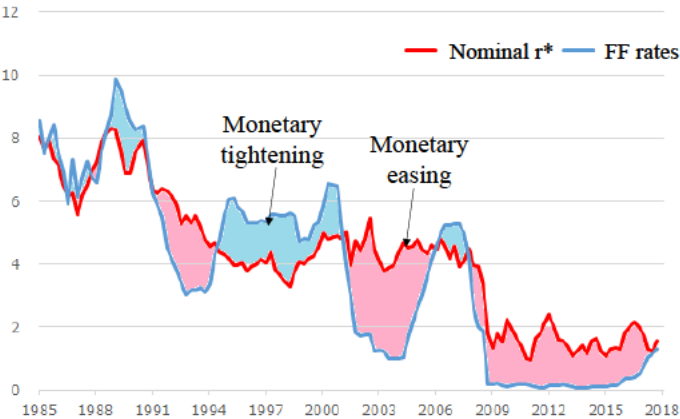
Until now, a decline in the term premium has worked to lower the long-term interest rate. The reason behind this situation was that excessive liquidity has been supplied to the market by quantitative easing (purchases of government bonds and other assets) by the Bank of Japan and the European Central Bank (ECB) as well as the FRB, resulting in a decline in the price change risk of U.S. government bonds. However, central banks in various countries have started to withdraw liquidity. For example, the FRB started to shrink the balance sheet in October 2017 and the ECB started to reduce the value of asset purchases in January 2018. As a result, since the beginning of 2018, the term premium has shown signs of ceasing to decline (Column Figure 2-1). It is essential to keep a close watch over future trends.

**Column figure 2-1 Changes in yields on 10-year government bonds and term premiums in the United States**



Source: Thomson Reuters, Federal Reserve Bank of New York.

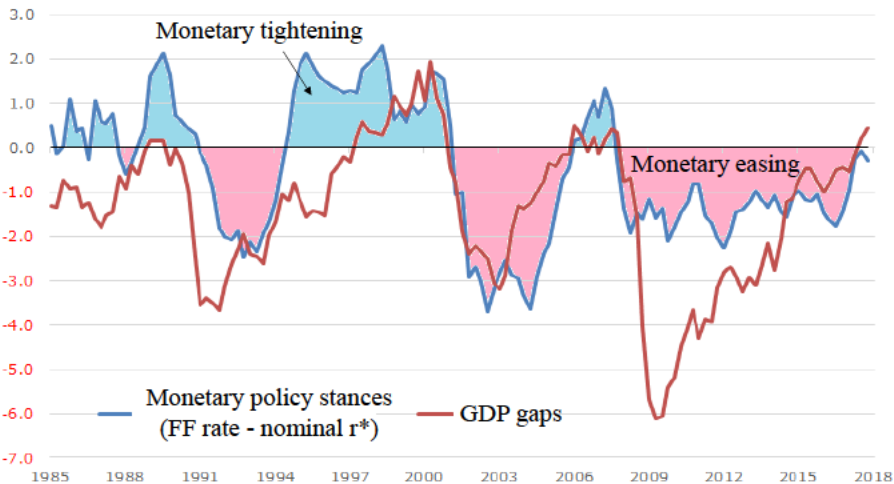
**Column figure 2-2 Changes in neutral interest rates and federal funds rates (FF rates)**



Notes: The data on nominal r\* are the results of adding the year-on-year rate of change of the core PCE price index to the estimated value of the natural rate of interest r\* using the Laubach–Williams model.

Source: FRB, Laubach and Williams Updated Estimates (as of Feb. 2018), CEIC database.

**Column figure 2-3 Changes in monetary policy stances and GDP gaps**



Notes: The data on GDP gaps are the results of calculation:  $(\text{real GDP} - \text{potential GDP}) / \text{potential GDP}$ , and the data on potential GDP are estimates by United States Congressional Budget Office (CBO). Monetary policy stances are the results of deducting nominal r\* from FF rates (if the result is positive, monetary tightening is conducted, while if the result is negative, monetary easing is conducted).

Source: CBO, FRB, United States Department of Commerce (BEA), Laubach and Williams Updated Estimates, CEIC Database.