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Japan gets lower tariffs but potential for friction remains

Key takeaways

- The Japanese government secured an executive order from the Trump administration that will reduce tariffs on Japan's exports – including automobiles – to 15% as agreed to in July.
- However, securing the tariff reduction also required Japan's accepting a written memo outlining the terms by which Japan will provide up to USD 550bn in investment in the United States.
- The US and Japanese governments have continued to characterize the investment framework in different terms, and there is enough ambiguity in the framework that the two governments could clash over its implementation.

With trade negotiator Akazawa Ryōsei in Washington again – after having canceled a trip last week – the US and Japanese governments announced that the implementation of the bilateral trade agreement concluded in July will move forward after the Trump administration issued an executive order on Thursday, 4 September that will make the new tariff levels official. This announcement will provide relief to Japanese exporters in the near term, but the "price" Japan paid for lower tariff rates – the USD 550bn in investments – could be a source of both friction between the two governments and of domestic political trouble in Japan in light of questions about what the Japanese government will actually be providing, how proceeds will be distributed, and how projects will be selected.

As agreed, the US will implement the agreed tariffs of 15% on all imports, including, importantly, automobile exports to the United States, the latter of which had been excluded from earlier statements. It will also not "stack" the new reciprocal tariffs on top of existing tariffs on some product lines that would have meant tariffs above 15%. These levels will be backdated to 7 August, and excess revenues collected will be rebated.

The new executive order also signaled that the US will reduce tariffs on Japan's exports of generic drugs and steel and aluminum used for airplanes and airplane parts could be exempted from sectoral tariffs soon. Meanwhile, the Japanese government is working out how to fulfill its obligations to the United States, including how to increase rice purchased from the US through the minimum access system by 75%, how to arrange what the executive order describes as USD 8bn per year in purchases of corn, soybeans, fertilizer, and bioethanol, and how to accommodate increased purchases of defense equipment in the context of the current mid-term defense program that runs through FY2027.

However, the biggest question going forward is the agreement for the Japanese government to "invest" USD 550bn in the United States. While in Washington, Akazawa signed an memorandum of understanding (MOU) with Commerce Secretary Howard Lutnick regarding the agreement, a document that the Ishiba government was reluctant to accept – given its preference not to have a written agreement – but which the Trump administration reportedly insisted on in order for the new tariff levels to be introduced into the Federal Register. (It was likely that disagreements over the MOU text that led Akazawa to cancel his trip last week.) In his remarks on the agreement, Prime Minister Ishiba Shigeru stressed that this framework is consistent with his vision of strengthening bilateral cooperation through investments that boost growth and economic security.

Despite the MOU, however, there remains the potential for friction between Tokyo and Washington over the implementation of the investment agreement. Akazawa insisted again in a press conference Thursday that the USD 550bn figure is an upper limit on what could be a mix of investment, loans, and loan guarantees that could be allocated by Japanese public financial institutions if they see the benefit. Meanwhile, both President Donald Trump and Lutnick have hailed the agreement, with Lutnick saying in a television appearance on Friday that "the Japanese in order to buy down their tariff rate…have given President Trump $550 billion for President Trump to direct where and how he wants it invested in America."

The reality may lie somewhere between these messages. The MOU reportedly refers to an US government investment committee that will present options for the president to select, following consultations with a bilateral oversight committee. The MOU gives Japan the right of refusal following prior consultation with the US government, though the new executive order reiterates that if Japan "fails to implement its commitments," higher tariffs could be introduced, suggesting that refusing US requests too frequently or vociferously will not be costless. Meanwhile, the MOU is also vague on how proceeds from Japan's investments will be distributed, referring to a fifty-fifty split until a "deemed allocation amount" is reached, after which the profits are split ninety-ten between the United States and Japan, accruing to a special purpose vehicle that will either be US-directed or directed by a US-designated agent.

These ambiguities will likely attract scrutiny from the Diet, as lawmakers in both ruling and opposition parties seek clarity on the discrepancies between the Japanese and US government accounts of the investment framework. The Liberal Democratic Party (LDP) and Constitutional Democratic Party (CDP) have already agreed to convene a recess session of the lower house budget committee later this month to discuss the terms of the MOU and the executive order.

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