# JAPAN

## TRADE SUMMARY

Beset with structural rigidity, excessive regulation, and market access barriers, the Japanese economy continues to underperform. The global economic slowdown in 2001 caused Japanese exports to fall sharply, further crimping growth. The U.S. trade deficit with Japan declined to $69 billion in 2001, down $12.6 billion from the $81.6 billion deficit in 2000. U.S. goods exports to Japan (primarily electrical machinery, computers and computer parts) in 2001 fell 11.2 percent from a year earlier to $57.6 billion, while U.S. imports from Japan (primarily autos, auto parts and electrical machinery) declined by 13.6 percent to $126.6 billion.

U.S. exports of private commercial services (i.e., excluding military and government) to Japan were $34.2 billion in 2000, and U.S. services imports from Japan were $17.2 billion. Sales of services in Japan by majority U.S.-owned affiliates were $27.9 billion in 1999, while sales of services in the United States by majority Japan-owned firms were $28.8 billion.

Although U.S. foreign direct investment (FDI) in Japan dropped off in the first half of Japan Fiscal Year (JFY) 2001, it has seen steady increases in recent years. Specifically, the stock of U.S. FDI to Japan was $55.6 billion in 2000. This amount was an increase of 12.5 percent from 1999 levels.

## REGULATORY REFORM OVERVIEW

Over-regulation in Japan continues to hamper economic growth, raise the cost of doing business, restrain efficiency, restrict competition, and impede imports and investment. Typical of highly regulated economies, the Japanese economy also suffers from a misallocation of resources and a lack of entrepreneurial innovation. The 1990s have been dubbed Japan's "Lost Decade," during which Japan's gross domestic product (GDP) growth rate only averaged 1.6 percent, or less than half the 3.8 percent average of the preceding decade. A Ministry of Economy, Trade and Industry (METI, formerly MITI) Advisory Council study in August 2000 reported that structural reform would put Japan on a 3 percent annual growth track from 2006 through 2010. Over-regulation also raises prices for Japanese businesses and consumers. A July 2001 Cabinet Office study estimated that deregulation in thirteen sectors from 1989 to 2000 generated consumer savings worth approximately $127 billion – the equivalent of about 4 percent of Japan's FY 2000 national income. In addition, Japanese Government over-regulation lies at the heart of many market access problems faced by U.S. companies. Recognizing that a vibrant Japanese economy is vital for a healthy global economy, the United States continues to urge regulatory reforms that will enable Japan to more fully realize its economic potential.

### The U.S.-Japan Regulatory Reform and Competition Policy Initiative

Launched by President Bush and Prime Minister Koizumi on June 30, 2001, the Regulatory Reform and Competition Policy Initiative (the Regulatory Reform Initiative) is one of the six "pillars" of the U.S.-Japan Economic Partnership for Growth (the Partnership). This Initiative addresses key sectors, including telecommunications, information technologies, energy, medical devices and pharmaceuticals, and financial services. It also addresses crosscutting issues, including competition policy, transparency and other government practices, legal system reform, revision of Japan's commercial law, and distribution. Within the context of the Regulatory Reform Initiative, the United States continues to advocate the reform of laws, regulations, administrative guidance and other measures that impede access for U.S. goods and services in Japan.

The Regulatory Reform Initiative builds on progress achieved during the 1997-2001 Enhanced Initiative on Deregulation and Competition Policy (the Enhanced Initiative). In the Fourth Joint Status Report issued in June 2001 under the Enhanced Initiative, important progress was noted in eliminating Japan's regulatory barriers in numerous sectors including telecommunications, information technology, energy, medical devices and pharmaceuticals, financial services, and housing. Notable achievements were also made in key areas such as competition policy, transparency, legal system reform, revision of Japan's Commercial Code, and distribution.

In October 2001, the United States presented its first annual submission of reform recommendations to Japan under the Regulatory Reform Initiative. The United States has been urging Japan to adopt these measures at working-level meetings, the first series of which were held in Tokyo and Washington in November/December 2001. A meeting of high-level officials took place in March 2002 to review the status of these recommendations and to narrow differences on outstanding issues. The United States looks forward to completing a report with Japan this summer that details measures Japan will implement under the Regulatory Reform Initiative. This report then will be presented to the President and the Prime Minister.

## SECTORAL REGULATORY REFORM

### Telecommunications

Japan introduced important changes to its laws and regulations governing the telecommunications sector in 2001. Still, this sector remains encumbered by excessive, outdated regulations – the legacy of a period of bureaucratic direction of industry – and the inability of Japan to implement a regulatory framework adequate to address the overwhelming market power of the dominant carrier group, Nippon Telegraph and Telephone Corporation (NTT). NTT companies control access to greater than 98 percent of the local telephone network, giving them the ability to inhibit new competitors and services while promoting their own products and technologies. These problems are compounded by the fact that the Ministry of Public Management, Home Affairs and Posts and Telecommunications (MPHPT) is hemmed in by political and industry interests that can inhibit competition enhancing measures.

Under the Regulatory Reform Initiative, the United States is seeking regulatory changes to promote competition – and thereby innovation and choice – in Japan's telecommunications sector. Given that the Japanese telecommunications and broadcasting services market is worth an estimated $130 billion per year (and has the potential to expand significantly), a more open and accessible Japanese telecommunications market will translate into significantly increased opportunities for U.S., other foreign, and Japanese domestic carriers and service providers. Telecommunications carriers must increasingly demonstrate global reach with enhanced services in order to meet customers' needs. A regulatory framework in Japan that enables carriers to assemble and access efficient, cost-effective networks is essential to delivering competitive services.

The United States has strongly urged Japan to adopt a legal framework that establishes the promotion of competition for the benefit of consumers as the clear primary objective of telecommunications regulation and to make "dominant carrier regulation" the key component of this system. Under this approach, regulators promote competition by focusing regulatory oversight on "dominant carriers" – carriers in a

position to hold consumers and competitors "hostage" through control over services or underlying facilities – while allowing carriers without such market power to operate with minimal restraint in order to speed the introduction of new services and technologies.

In 2002, Japan will conclude a review of telecommunications policy intended to put the regulatory framework on a pro-competitive footing and create conditions to promote the development of a networked society. This ongoing review resulted in revisions to the Telecommunications Business Law in 2001 that acknowledged the importance of competition, enhanced Japan's system of dominant carrier regulation, established a category for wholesale services, clarified competitive and anti-competitive behavior, and introduced a new dispute resolution mechanism. Japan has also moved ahead to open optical fiber networks held by NTT and other organizations to competing firms.

As a result of bilateral discussions under the Enhance Initiative, Japan introduced a pro-competitive methodology (LRIC, for long-run incremental cost) for setting interconnection rates in JFY 2000. This will result in rate reductions of 20 percent (for interconnection at the local switch) to 50 percent (at the regional switch) by JFY 2002. Partly as the result of lower interconnection rates, which enable competitors to pay interconnection charges to NTT and still offer competitive rates to final customers, competition in local services has increased and local calling rates fell by 15 percent or more in 2001. The United States and Japan have agreed to discuss further reductions in interconnection rates as well as the application of the LRIC pricing methodology to unbundled portions of the local network when the LRIC model is revised in 2002.

These measures, which the United States continues to monitor closely, should help address important market access and regulatory barriers. Nevertheless, ensuring effective competition in Japan, especially in the local telecommunications markets, will require an independent regulator attuned to ensuring equitable opportunities for new entrants and unbiased treatment of all operators. In November 2001, Japan established a Telecommunications Dispute Resolution Commission within MPHPT. The United States is encouraged that Japan recognizes the need to address disputes in the industry more effectively. Whether this panel, which addresses issues after they arise rather than minimizing the occurrence of disputes, has the independence, full-time expertise, and enforcement powers necessary to ensure a competitive telecommunications market in Japan is yet unclear. Enforcement actions taken over the past year by the Japan Fair Trade Commission (JFTC) regarding access to NTT facilities and unfair marketing practices represent a very important step toward ensuring competition in the market and illustrate the importance of establishing a truly independent regulatory authority that can exercise oversight and take necessary measures to safeguard competition in this sector.

The United States has asked Japan to address specific market access impediments related to a wide range of areas in this sector, both through its October 2001 Regulatory Reform Initiative submission and in bilateral consultations:

*Interconnection and Pricing:* One of the most significant examples of insufficient safeguards on dominant carriers impeding competition is the high cost and onerous conditions that NTT regional operators are allowed to impose on their competitors. Even with the implementation of agreed rate reductions, the interconnection rates that these operators charge their competitors to use their network are substantially higher than similar rates in the United States or Germany.

Full implementation of a revised LRIC model is expected to address this concern. In addition, MPHPT has permitted NTT to recover costs for developing and introducing new services such as ISDN by charging these costs to competitors while it subsidizes this service for its retail customers. Japanese law now prohibits anti-competitive behavior such as this classic "price squeeze" – forcing its competitors to lose money if they are to price a competing service at or below NTT's retail rates – but does not give MPHPT effective means to identify its occurrence. This also highlights the inherent contradiction of Japan's regulatory regime in that MPHPT is simultaneously engaged in industrial policy – promotion of ISDN and fiber-to-the-home – while trying to regulate a dominant carrier.

This type of behavior has had a major impact on local competitors, which are losing money on many local services and have been paying as much as 70 percent of the revenues they receive from all calls back to NTT in interconnection charges. Compounding this problem, MPHPT has also allowed NTT regional companies to adopt discriminatory pricing schemes that leverage their virtual monopolies (greater than 98 percent of all local subscribers) to ensure that traffic stays on NTT's network. Under these pricing schemes, NTT regional company subscribers cannot get discounts on calls to numbers on competitors' local networks, even if they are in the same area. As most of these discount plans are used for Internet access, they effectively force Internet Service Providers (ISPs) to locate on NTT's network if they want to service NTT's huge customer base. This denies competitors the ability to host ISPs on their own network, a lucrative business, and forces competitors to pay substantial interconnection fees when their subscribers access ISPs on NTT's network. Under these circumstances, not only do competitors lose the ability to host ISPs, but they also are unable to match the flat rates for dial-up services offered by NTT (for customers who do not rely on DSL) because of the interconnection fees the competitors must pay NTT.

New entrants to Japan's telecommunications market have expressed concern about the extremely high and non-transparent interconnection and access rates charged by NTT DoCoMo, the dominant wireless service provider, as well. There is no explanation of how these exorbitant rates are calculated. In addition, DoCoMo has used its market power (servicing nearly 39 million subscribers) to insist that it be allowed to set prices for both incoming and outgoing calls for its network. This puts new entrants at a severe disadvantage, as they are unable to compete on price – one of their most important strategies. Reforms to the Telecommunications Business Law in 2001 extended weak asymmetrical regulations over NTT DoCoMo that may permit greater scrutiny of NTT DoCoMo's interconnection regime, but the law places the onus on competing carriers to identify anti-competitive behavior and press for corrective action.

*Rights-of-way:* New competitors in Japan find it extremely time-consuming and expensive to build competing networks in Japan because of costs and difficulties related to access to "rights-of-way." The Government of Japan promulgated guidelines in April 2001 related to access to poles, ducts and conduits held by NTT and is considering extending some obligations to utility companies. However, there are few safeguards against exorbitant rates for the use of poles, ducts, conduits and other rights-of-way facilities. Moreover, if new entrants seek to dig roads to lay their own cables and facilities, they encounter a labyrinth of restrictions that industry sources say makes construction about ten times more expensive and can result in digging times six times longer than in other major international cities. The United States has proposed that

Japan establish pro-competitive rules to ensure non-discriminatory, transparent, timely, and cost-based access for telecommunications carriers and cable TV operators. The United States continues to urge mandatory rights-of-way access for new competitors.

*Unbundling:* Enhanced government oversight to assist new entrants in building their networks is also needed to require dominant local carriers to provide other carriers access to their network on an "unbundled" (or separate) basis. Japan has made advances in this area, but one notable exception is access to the operations support system (OSS) essential to customer acquisition and support. Extending unbundling obligations to this area would assist new carriers in building their networks more rapidly and efficiently.

*Leased lines:* Japan's regulatory framework is based on whether carriers own or lease lines. Although new carriers have several means to use other carriers' facilities, they must apply for MPHPT approval of these arrangements. This adds extra time and expense for new carriers and increases uncertainty in business planning because many of the criteria MPHPT uses to evaluate these requests are non-transparent. The United States has urged MPHPT to eliminate current restrictions and allow carriers to freely combine both owned and leased facilities in their network without the need for government approval.

**Information Technologies**

The United States welcomes and supports the measures Japan has taken to become a global leader in information technologies. A key component in helping Japan to return to sustainable economic growth will be building a vibrant information technology sector. Recognizing the importance of this sector, the United States and Japan created a separate IT Working Group under the Regulatory Reform Initiative. The aim of this working group is to foster an environment that is not over-regulated and to promote the development of IT-related businesses and innovative information technologies to spur growth in other key sectors of the economy.

In its October 2001 Regulatory Reform Initiative submission the United States made several recommendations and proposals on protecting intellectual property, increasing consumer confidence in electronic commerce, and promoting electronic commerce and IT in the private sector. The United States recommended steps to improve the regulatory environment in Japan for operating and investing in the IT sector through: 1) establishing a legal framework that ensures competition, promotes innovation and provides adequate protection of intellectual property rights for the digital age; 2) emphasizing a self-regulatory approach to consumer protection and privacy; 3) facilitating online transactions with the government and greater use of electronic commerce for government procurement; 4) continuing to review and amend existing laws that hinder electronic commerce to allow for paperless transactions in sectors such as consumer finance; and 5) committing to market-based approaches to technology standards (versus government-mandated standards) to ensure technology-neutral approaches that are open and internationally interoperable.

The United States is working with Japan in this important sector through cooperative efforts in areas such as electronic education, the promotion of IT and electronic commerce in the private sector, and network security. However, the United States is concerned that Japan's progress in building a vibrant information technology sector may be seriously hindered by the lack of progress in such areas as intellectual property rights protection, on-line privacy, paperless transactions, and laws that either

continue to or would hinder electronic commerce in the future.

Although Japan signed both the WIPO Copyright Treaty (WCT) and the Performances and Phonograms Treaty (WPPT), which are a single package designed to provide necessary protection for copyrighted works and sound recordings on-line, Japan ratified only the WCT and not the WPPT. During 2001, the United States sought Japan's ratification of the WPPT in various fora. The United States is encouraged by the fact that legislation to ratify and implement the WPPT was submitted to the Diet earlier this year. The United States continues to urge Japan to expeditiously ratify the WPPT and enact the implementing legislation so that our respective music industries are adequately protected in this digital age.

The current lack of clear-cut liability rules for certain carriers such as Internet Service Providers (ISP) in Japan fails to provide adequate protection for right holders and creates significant uncertainty over whether carriers can be held responsible for illegal activities by users (e.g. copyright violations). The lack of adequate protection for right holders prevents them from obtaining appropriate remedies when infringement has occurred, adversely affects the financial stability of several creative industries such as the music, game software and movie industries, and also puts a chill on creative works and the development of new products that could be subject to online piracy. Business is also unacceptably risky for carriers without proper liability protection because they could be subject to broad-based legal attacks for actions of users over which they have no knowledge or control. The United States learned in drafting the Digital Millennium Copyright Act that there is a complex and delicate balance among the interests of telecommunications carriers, service providers, right holders and website owners. The United States urges Japan to implement the recently passed carrier liability legislation in a manner that ensures that these interests and issues are fully and properly addressed.

The lack of explicit protection under Japan's Copyright Law for "temporary copies," e.g. digital copies made in the RAM of a computer, could erode the ability to protect copyrighted materials in Japan. The United States urges Japan to clarify this issue and ensure that its Copyright Law explicitly provides protection for temporary copies. Further discussion of this issue can be found in the Copyright subsection.

The Japanese Diet is currently considering legislation on privacy. If passed, the United States urges Japan to ensure that the implementing ordinances and regulations provide adequate protection of the privacy of personal information while also recognizing and respecting self-regulatory approaches in order to avoid undue restrictions on trans-border data flows. In addition, the United States urges the Government of Japan to utilize its public comment procedure to the fullest extent in developing the implementing ordinances or other measures required by any privacy legislation that becomes law.

The United States welcomes and supports the Government of Japan's electronic government initiatives. Recognizing the key role that electronic government has in providing the impetus for spurring electronic commerce in the private sector, the United States recommends that Japan further expand and accelerate its electronic government programs to facilitate online transactions between the government and consumers and businesses for procurement, information and online services such as applications and licensing.

Under current law, the consumer credit sector cannot benefit from the security, speed and efficiency of electronic transactions. As a

result, consumer credit customers are not able to apply for credit cards or receive bills and notifications electronically as a substitute for paper-based transactions. The United States urges Japan to revise the E-Notification Law to include the Money Lending Business Law so that lenders can allow customers who have consented to electronic notification to receive notification by electronic means.

Japan implemented legislation in 2001 to establish a system for certifying agencies to grant digital signatures, which in some cases can substitute for written signatures or seals. The United States will closely monitor implementation of the law to ensure that it is technology-neutral and allows for the use of all appropriate technologies.

The United States urges Japan to expeditiously address these specific areas of concern as it responds to the challenges that lie ahead for creating a vibrant information technology sector.

**Energy**

As Japan moves to liberalize its energy sector, the United States views ongoing bilateral discussions as a key forum for input into the process and support of Japan's goals of improved energy efficiency and lower energy costs, which are among the highest in the world. To achieve its goals, Japan must attract new entrants into its electricity market – the third-largest power market in the world – and create robust competition in this sector.

*Electricity:* In March 2000, the Japanese Government liberalized the retail sale of electricity for large-scale users, who represent about 27 percent of total electricity consumption in Japan. During the same time period, Japan also abolished its antimonopoly exemption for natural monopolies, including electricity and gas. While the United States welcomes these steps, Japan's partial market opening has yielded little progress in lowering energy costs and improving efficiency. The sector also has seen minimal market entry – new entrants command only 0.39 percent of the liberalized retail electricity market. This is generating concern among potential market entrants that the current system is not adequately encouraging competition.

Japan took several additional steps in 2001 toward further liberalization of its electricity sector. For example, METI's newly formed Electricity Market Division will work with the JFTC to promote fair and open access to electricity transmission networks. Japan also agreed to monitor the need for new transmission line construction as a more competitive electricity market develops. In addition, METI will take measures to promote new entry, including: (1) conducting a study, where appropriate, of existing regulatory requirements for siting of new generating units and transmission lines, and; (2) actively consulting with parties interested in entering the market. To bolster transparency, Japan also agreed to conduct a third-party audit of utility accounts and monitor the neutrality of wheeling services.

More recently, the United States has stressed the need for broader reforms in the oversight and functioning of Japan's energy market. These reforms, which would promote a healthy, competitive retail and wholesale energy market, include: (1) development of a roadmap for future energy sector liberalization; (2) promotion of regulatory authority independence; (3) strengthened competition policy safeguards; (4) unbundling and open access to transmission and distribution grids; (5) increased transparency of pricing for electricity transmission and distribution, and; (6) promotion of new market entry through expansion of electricity infrastructure. The United States and Japan have been discussing these proposals in the

Regulatory Reform Initiative's Energy Working Group, which held it most recent meeting in November 2001.

In a welcome development, a new advisory panel called the Electricity Industry Subcommittee began holding public hearings in Japan in November 2001 to discuss regulatory reform of the energy sector. The subcommittee is expected to generate recommendations on next steps for further liberalization. The United States hopes this body will propose forward-looking measures towards greater liberalization. As this process unfolds, the United States will continue to urge Japan to take vigorous steps to liberalize its electricity market in a timely manner, promoting market efficiency and reduced energy costs through competition.

*Natural Gas:* While the Japanese gas sector has experienced only limited liberalization, Japan took a number of steps in 2001 to further this process. For example, METI's recently established Gas Market Division will work with the JFTC to promote fair and open access to gas transportation networks. METI has also developed a list of major regulatory requirements for siting of new pipelines and liquified natural gas (LNG) facilities, a move that should increase transparency in the siting process. In addition, METI has established rules requiring large-scale general gas utilities to establish fair and transparent terms for open access to their pipeline networks. Further, the Gas Market Development Basic Issues Study Group, which was created in January 2001, has been meeting regularly to examine a wide range of possible issues that could increase the gas market's transparency and efficiency. Despite these positive developments, no foreign firms or subsidiaries have entered Japan's gas market to date.

To spur further liberalization in this important sector, the United States continues to urge Japan to take stronger measures toward open access, new construction, transparency, and new entry, which in turn will ensure a stable and competitive gas market. Recent proposals from the United States in this regard were detailed in the Regulatory Reform Initiative recommendations presented to Japan in October 2001. Paralleling electricity sector recommendations, the United States proposed that Japan promote an independent regulatory authority and strengthen competition policy safeguards in the gas sector. The United States also recommended that Japan: (1) promote a competitive gas and LNG market through unbundling and transparency of usage charges and information; (2) facilitate new construction of gas pipelines between gas services areas and LNG facilities within electricity service areas; and (3) encourage new entry of competitive generators and gas suppliers through expansion of transmission infrastructure. The United States will continue to address these issues with Japan in the Energy Working Group.

**Medical Devices and Pharmaceuticals**

Since the 1986 Report on Medical Equipment and Pharmaceuticals Market-Oriented, Sector-Selective (MOSS) discussions, the United States and Japan have continued to address regulatory and market access concerns in the medical device and pharmaceutical sectors. The MOSS Med/Pharm working group now also serves as a venue for discussions of medical sector topics under the Working Group on Medical Devices and Pharmaceuticals established under the Regulatory Reform Initiative.

In its October 2001 Regulatory Reform Initiative recommendations, the United States proposes a number of reforms to this important sector. In particular, the United States places a high priority on addressing market access issues associated with Japan's current reimbursement

system in order to promote fairness and transparency and ensure that pricing decisions are not made in an arbitrary manner. In formulating its health care reforms, Japan has agreed to formally recognize the value of innovation so as not to impede the introduction of innovative products that bring improved and more cost-effective treatments to patients.

However, changes to reimbursement rules for medical devices and pharmaceuticals have raised serious concerns about Japan's commitment to rewarding innovative products. Specifically, Japan will implement a new "foreign reference pricing" system for medical devices on April 1, 2002. The proposed system would link prices in Japan to those prevailing in the United States, the United Kingdom, Germany, and France. The approach is arbitrary because it sets a cap on prices without taking into full account the high cost of doing business in Japan. The United States will therefore continue to urge Japan to implement an alternative pricing mechanism for medical devices. It is also critical that Japan move to address the real cost-drivers of its health care system – systemic inefficiencies such as the longest average hospital stays in the world, over-capacity of hospitals, lack of IT systems and limited hospital specialization.

New pharmaceutical pricing rules slated for implementation in April 2002 are also an issue of concern. The proposed rules appear designed to provide the Japanese Government with wider discretion to minimize the prices received for drugs reimbursed under the national health insurance system. The United States has urged Japan to continue to discuss the pharmaceutical pricing system with related parties, including U.S. industry, in order to promote innovation and increase the availability of innovative pharmaceutical products. As part of this reform process, Japan is revising the system under which drugs used as price comparators are selected. It is essential that this process proceed in a transparent manner based on recognized scientific principles.

On a more positive note, Japan has agreed to ensure greater transparency in the consideration of health care policies by allowing foreign pharmaceutical and medical device manufacturers meaningful opportunities to provide their views. The United States urges Japan to carefully consider input by U.S. industry and to incorporate this input in policies ultimately adopted.

Expediting regulatory review and new product approval procedures also remains a key goal. Japan shortened its regulatory processing time for new drug applications (NDA) from 18 months to 12 months in April 2000. The reduction of this processing time, combined with other measures Japan has implemented (including permitting direct communication between reviewers and applicants), should aid in reducing NDA review times. In addition, Japan is encouraging the active use of binding consultations between reviewers and applicants before NDA submission. Parties are taking advantage of this opportunity and, as a result, some reduction in approval times is already evident.

Another key to improving Japan's regulatory approval system for new drugs is the broader use of foreign clinical data. The United States urges Japan to continue its work within the International Council on Harmonization (ICH) process to resolve issues regarding the implementation of the ICH E5 guideline, which addresses the evaluation of foreign clinical data. The United States continues to closely monitor Japan's implementation of these measures and urges Japan to achieve total approval times of 12 months. The United States is also suggesting that Japan create special treatment within the existing new drug approval system to evaluate

"legacy products," (i.e., drugs that have a wide exposure in a geographically and ethnically diverse population and have not been previously registered in Japan, but are available in other major markets).

As for medical devices, delays in regulatory approval can result in significant revenue losses for manufacturers and slow patient access to new technologies. On April 1, 2000, Japan took steps designed to reduce redundant medical device reviews. However, significant confusion regarding how individual product applications will be classified and reviewed continues to plague this new system. The United States has sought to clarify the medical device approval categories and to ensure that the new system does not result in product approval delays. Japan also agreed to allow applicants to consult with reviewers prior to application submission regarding proper device classification. However, steps need to be taken to ensure that such advice is treated as binding.
The United States continues to urge Japan to exempt from regulation under the Measurement Law thermometers and blood pressure gauges that are proven to be safe and accurate through the Pharmaceutical Affairs Law's approval process. The United States will continue to actively address market access barriers and market-distorting trade practices in the medical device and pharmaceutical sectors.

Although not an issue at the time of the U.S. Government's Regulatory Reform Initiative submission to the Government of Japan in October 2001, concerns have arisen regarding newly proposed Japanese legislation aimed at ensuring a steady supply of blood plasma and blood products in Japan. The United States believes that this market-managing legislation, which would be enforced through company closures, is neither desirable nor necessary.

**Financial Services**

Japanese financial markets traditionally have been highly segmented and strictly regulated, restricting business opportunities for foreign firms and discouraging introduction of innovative products where foreign firms may enjoy a competitive advantage. Among the restrictions that have impeded access are the use of administrative guidance, lack of transparency, inadequate disclosure, the use of a positive list to define securities, and lengthy processing of applications for new products. These restrictions have hindered the emergence of a fully competitive market for financial services.

In an effort to eliminate or reduce these barriers, the United States and Japan concluded a comprehensive financial services agreement in February 1995. This agreement featured an extensive package of market-opening actions in the key areas of asset management, corporate securities, and cross-border financial transactions. In the seven years since the agreement was signed, Japan has implemented the specific commitments made within the specified time frames. In some instances, the timetable for implementation was accelerated, and Japan has taken or announced additional actions in several areas to improve the liberalization of Japanese financial markets.

The past few years have seen notable changes in Japan's financial sector. Foreign financial institutions have made important acquisitions in securities brokerage, insurance, and banking. Consolidation among Japanese financial institutions has increased in an effort to cut costs and boost competitiveness, while traditional segmentation among various types of financial institutions is steadily being phased out. These changes have expanded opportunities for foreign financial firms in Japan to compete on a clear and level playing field. While supervision and disclosure have improved, it is important that Japan continue to move forward in establishing clear and consistent regulation and supervision

of financial institutions, in line with international standards and best practice.

Financial sector deregulation continued in 2001. Accounting standards were strengthened in April 2001, with broader application of market-value accounting and impairment accounting. Implementation of the "no-action" letter procedure by financial regulators, a measure taken by Japan as part of the Enhanced Initiative, will increase transparency and encourage introduction of innovative financial products. Japan has legislated elimination of the requirement for physical certificates for commercial paper (to be implemented from April 1, 2002). In June 2001, exchange-traded funds (ETFs) were introduced allowing contributions in-kind. Public pension fund management rules were eased to simplify transfer of securities to a new asset manager and to permit investment advisors to directly manage public pension funds. Defined contribution pension plans were introduced in October 2001.

Following authorization of Internet banks in 2000, non-financial corporate ownership of banks was permitted in 2001. The Japanese government also developed procedures to permit exemption from withholding tax for foreign holders of government bonds, held through foreign custodians, and to allow global risk management and the provision of other shared services by financial conglomerates. Outsourcing of services and rules on firewalls between corporate entities were relaxed to include fund management affiliates in 2001.

The United States continues to monitor implementation of the 1995 agreement and Japan's progress under the "Big Bang" initiative, to ensure that foreign firms are provided opportunities equivalent to those offered domestic firms.

## STRUCTURAL REGULATORY REFORM

### Antimonopoly Law and Competition Policy

Under the Regulatory Reform Initiative, the United States has proposed a number of progressive measures to strengthen competition policy and enforcement of Japan's Antimonopoly Act (AMA) that are critical to bolstering competition and improving market access. Foreign companies continue to face anticompetitive practices and related impediments to accessing Japan's distribution channels across a wide range of sectors.

A key reason for the persistence of anticompetitive business practices in Japan is the historically weak antitrust enforcement record of the JFTC. The JFTC routinely has faced domestic criticism for its lack of bureaucratic clout and inability to exercise its enforcement powers aggressively. There have been improvements in recent years due in large measure to sustained U.S. efforts under the Structural Impediments Initiative, the U.S.-Japan Framework Agreement, the Enhanced Initiative, and annual bilateral antitrust consultations.

*Independence of the JFTC:* An independent JFTC has been a longstanding and important principle of Japan's antimonopoly enforcement system that the United States strongly believes should be maintained. In this regard, the United States urged Japan to ensure the continued independence of the JFTC when it was subsumed under MPHPT in January 2001. Since MPHPT is also responsible for postal services and telecommunications, there is a real risk that the JFTC will not be able to act independently in these crucial areas, both in enforcement decisions and competition advocacy. In April 2001, Prime Minister Koizumi called for examining the possibility of transferring the JFTC out of MPHPT and into the Cabinet Office. The results of this examination are pending.

*Anticartel Enforcement:* Bid rigging and collusive cartel activity continue to be serious problems in Japan. While JFTC's enforcement actions have increased in recent years (in terms of actions taken and administrative surcharges collected from violators of the AMA), the JFTC still faces serious constraints in building an effective enforcement program. Total surcharges remain modest in absolute terms, and have declined recently. Surcharges imposed in 2001 were 3.29 billion yen, down from 9.23 billion yen in 2000, which was a 10-year high. While the JFTC is not alone among competition enforcement agencies in the world in its heavy reliance on administrative actions instead of criminal penalties, the JFTC's infrequent use of the AMA's criminal provisions undermines its deterrence of cartel behavior. In fact, no corporate executive has ever been imprisoned for violating the AMA and the JFTC has not initiated any criminal prosecutions of AMA violations since 1999.

There are a number of factors that limit criminal enforcement against hard core AMA violations. First, the JFTC does not have powers enjoyed by other Japanese criminal investigation authorities, including the power to conduct compulsory searches and seizures. Nor does it have the ability to reduce criminal sanctions or administrative surcharges for companies that come forward to expose illegal activities. These weaknesses make it difficult for the JFTC to gather enough evidence to support filing a criminal complaint with the Ministry of Justice. Second, an extraordinary provision in the AMA that requires the Ministry of Justice to explain to the Prime Minister why it has not pursued a criminal referral from the JFTC has resulted in the Ministry of Justice demanding an exceptionally high degree of evidence before accepting such a referral from the JFTC. These systemic weaknesses make criminal prosecution of executives and firms for hard core AMA violations the exception rather than the rule in Japan.

In its October 2001 regulatory reform recommendations to Japan, the United States called for (1) strengthening the JFTC's investigatory capabilities by adopting a cooperation leniency program, improving the JFTC's powers and procedures for criminal accusations and ensuring severe punishment of those who impede JFTC investigations; (2) increasing the effectiveness of AMA enforcement actions by improving the deterrent effect of surcharge orders and extending the scope of cease and desist orders; and (3) implementing a series of measures to eliminate bid rigging, including the introduction of effective legislation to prevent bureaucrat-led bid rigging and bolstering administrative controls on bid rigging by the Ministry of Land, Infrastructure and Transport (MLIT).

*Private Remedies:* The United States believes that the unfettered availability of injunctive relief and monetary damages to private litigants is an integral part of a comprehensive and effective antimonopoly legal regime. Private AMA enforcement can help reinforce for Japanese firms the importance of conforming their business practices to the AMA, which in turn will keep markets free, open and competitive. Legislation providing for private actions seeking injunctions against an alleged violator of the AMA went into effect on April 1, 2001. Five cases were filed in 2001 under the new law. Nevertheless, there is concern that the new law does not apply to the most egregious AMA violations, such as cartel behavior and monopolization, and that the Japanese court system lacks the capacity and expertise to effectively implement the new law. Regarding private actions for monetary damages, legal remedies do exist. However, only 14 private actions for damages have been brought under the AMA since 1947. Further improvements in

the private litigation system are needed before it will become a reliable avenue for the deterrence and redress of antimonopoly violations. In its October 2001 reform recommendations, the United States urged Japan to expand the antimonopoly private injunctive relief system to cover all egregious violations, as well as violations by trade associations.

*Promotion of deregulation by the JFTC:* Successful regulatory reform in Japan must be built on a solid foundation of effective competition policy. As the only Japanese agency charged with promoting competition throughout the economy, the JFTC should substantially boost its actions as an advocate of competition policy and regulatory reform. The United States has proposed that the JFTC actively participate in the process of deregulating Japan's public utilities. This is necessary to ensure both that maximum deregulation occurs in the electricity, natural gas, telecommunications and transportation sectors consistent with sound competition policy, and that anticompetitive conduct by incumbent firms will be strictly dealt with under the AMA. Some steps have been taken. In April 2001, the JFTC established the Information Technologies and Public Utilities Task Force to investigate and take enforcement action against AMA violations in industries undergoing deregulation. In November 2001, the JFTC, in cooperation with the telecommunications regulators in MPHPT, released guidelines for the promotion of competition in the telecommunications sector. In December 2000, the JFTC issued a warning to NTT East and West concerning possible anticompetitive behavior – the second time the JFTC had pursued the telecommunications monopoly for abuse of market power. The United States has urged Japan to be vigilant in enforcing the AMA against violations in these sectors. With regard to the distribution sector, the United States recommended that the JFTC take further steps to promote competition, for example, by surveying manufacturer-distributor equity and personnel relationships in highly concentrated sectors.

*JFTC Staffing & Resources:* The JFTC's ability to enforce Japan's AMA is hindered by its shortage of personnel. The United States has urged for more than a decade that the JFTC's budget and staff be increased significantly to ensure that it is able to fully carry out its mandate. For JFY 2002, the JFTC's budget will be increased by two percent, and its staff by seven percent – 40 persons, 28 of whom are to be assigned to the Investigation Bureau. These increases are welcome, particularly in the face of pressure to cut government spending generally. Nonetheless, the JFTC remains understaffed to adequately enforce the AMA and to engage in necessary competition promotion. This is especially true given the potential effects on Japan's competitive environment of the increase in mergers, the liberalization of holding companies, the elimination of many AMA exemptions, and stepped up deregulation that now requires the JFTC to police more business behavior.

## Transparency and Other Government Practices

An essential prerequisite for a vibrant Japanese economy is a transparent, fair, predictable and accountable regulatory system. It is important that domestic and foreign firms alike have full access to information and opportunities to participate in the regulatory process. The Japanese Government has made the need for greater transparency a crosscutting theme of its Three-Year Program for Promoting Regulatory Reform (Cabinet Decision of March 30, 2001). The measures in the Three-Year Program that could improve the transparency and

accountability of the Japanese regulatory system include: the strict enforcement and promotion of the 1994 Administrative Procedure Law; increased transparency of administrative guidance; full and effective implementation of the Law Concerning the Disclosure of Information Retained by Administrative Agencies; wide and effective use of the Public Comment Procedures for Formulating, Amending and Repealing Regulations; introduction of the "No Action Letter" system; comprehensive and objective evaluation of the regulatory process; and examination of the need, effects and costs of new proposed regulations.

Building on these measures, the United States in its Regulatory Reform Initiative submission in October 2001 recommended that Japan undertake additional reform of its regulatory system and ensure universal access by all interested parties to government information and the policymaking process.

*Public Comment Procedures:* Japan's adoption in 1999 of Public Comment Procedures for Formulating, Amending and Repealing Regulations (PCP) offered the potential of filling a significant gap in its regulatory system by allowing all interested parties to review and submit comments on draft regulations before they are finalized and implemented. However, after two years of implementation of the PCP, there are serious concerns with the effectiveness of the Procedures. Surveys conducted by MPHPT and a predecessor entity (the Management and Coordination Agency) on the use of the PCP since implementation point to deficiencies in the Procedures. The majority of comment periods were less than 30 days. Also, the comments are having little, if any, impact on the final regulations. According to a FY 2000 survey, final regulations were revised to respond to public comments in less than 20 percent of the cases in which PCP use was required – and even in those cases, few of the revisions appear to be substantive. The survey results fuel a growing perception that the PCP are serving little purpose, and that governmental agencies are working out draft regulations with special interests before they are published for public comment (as was the practice before the PCP process was introduced). To address these concerns, and to make the PCP a useful and effective regulatory mechanism, the United States urged Japan to take measures to make them an effective regulatory mechanism, including establishing a central registry for all solicitations, requiring a minimum 30-day comment period, authorizing an independent review of use of the procedures, and establishing a study group to examine the procedures.

*Administrative Guidance:* Despite the transparency provisions in the 1994 Administrative Procedure Law, Japanese governmental agencies have issued administrative guidance in writing in only a small number of cases. In order to increase the transparency and predictability of the Japanese regulatory system, the United States recommended that Japan, consistent with the Structural Impediments Initiative Reports, take necessary measures to reduce the use of administrative guidance and require all administrative guidance to be issued in writing (except in special cases).

*Public Participation in the Development of Legislation:* Japanese governmental agencies generally do not provide a formal opportunity for interested parties, other than those represented on advisory councils or with special access, to provide input into the development of legislation. In its October 2001 reform recommendations under the Regulatory Reform Initiative, the United States recommended that Japan develop a mechanism that would enable all interested foreign and domestic parties to review and comment on draft legislation before governmental agencies submit it to the Diet.

*Judicial Review of Administrative Actions:* Administrative actions that are reviewable by Japanese courts are narrowly circumscribed. The United States has recommended that Japan augment judicial oversight over governmental agencies by expanding the types of administrative actions that may be reviewed by the courts as well as by expanding the parties that are allowed to ask the courts to review agency actions. On June 12, 2001 the Judicial Reform Council recommended a comprehensive study of judicial oversight over administrative agencies, including review of the Administrative Case Litigation Law.

*Public Corporations:* The United States has noted with interest Prime Minister Koizumi's drive to restructure and privatize Japan's public corporations. The United States recognizes that, if implemented vigorously, this reform effort could have a major impact on the Japanese economy, stimulating competition and efficiency and leading to a more productive use of resources. In its reform recommendations, the United States urged Japan to ensure that the process of restructuring and privatizing public corporations is transparent and that private sector entities have an opportunity to provide input.

*Regulatory Impact Analysis:* Building on Japan's three-year regulatory reform program and its Policy Evaluation System, which Japan introduced in 2001, the United States has proposed that Japan introduce a government-wide Regulatory Impact Analysis system that would apply to significant regulatory changes.

**Commercial Law**

The United States has commended Japan for undertaking a major initiative to reform its Commercial Code and other commercial laws. Revision of Japan's commercial law, the first comprehensive review in half a century, will have a profound effect on the ability of firms to structure themselves effectively in order to participate in modern global capital markets and operate efficiently. The current Code stifles investment (both domestic and foreign) and is hurting Japan's efforts to integrate more fully into the international economy. If done correctly, revision of the Code should introduce greater flexibility in the organization, management and capital structure of companies, and improve their efficiency and accountability. The reforms should also enhance the ability of foreign firms to enter and operate in the Japanese market, as well as help revitalize Japan's economy.

The United States has urged Japan to ensure that Code reform is sufficiently comprehensive and bold so as to remove the substantial impediments to investment and financial transactions in the current Code and to make corporate management more accountable and efficient. Building on the commitments contained in the Fourth Joint Status Report of the Enhanced Initiative, the United States has recommended that Japan consider revisions of the Commercial Code that would: (1) make corporate boards more independent of management and accountable to shareholders; (2) eliminate many of the current restrictions on a company's capital structure, including by providing corporations the option to use an audit committee composed of at least a majority of independent directors, instead of outside statutory auditors *(shagai kansayaku*); and (3) permit and promote cross-border share exchanges and other mechanisms to facilitate merger and acquisition activities. In addition, the United States has urged Japan to oppose proposals that would require foreign corporations to appoint statutory agents who would be jointly and severally liable for all liabilities of the corporation.

Modernization of the Code will be a highly technical and complex process. To be done effectively, it will require close cooperation with those most affected by the changes and with other experts. The United States therefore has further recommended that Japan formally open its revision process to international business and academic experts with broad experience in the issues involved. This process began with U.S. private sector participation in official Regulatory Reform Initiative discussions on the Commercial Code in November 2001.

**Legal System Reform**

Reform of the Japanese legal system is essential to the establishment of a legal environment in Japan that is conducive to international business and investment and that supports deregulation and structural reform. The Japanese Government has taken significant steps to address the need to modernize its legal system, most notable of which was the establishment of the Judicial Reform Council (JRC). In June 2001, the JRC made significant recommendations on needed legal reforms. To implement the recommendations, the Japanese Government enacted the Judicial Reform Promotion Law in November 2001 and set up the Judicial Reform Promotion Headquarters (headed by Prime Minister Koizumi) in December 2001.

In its October 2001 Regulatory Reform Initiative submission to Japan, the United States urged the Japanese Government to take decisive action to expeditiously implement the JRC's recommendations. The United States emphasized: (1) increasing the number of legal professionals, which as a general principle should be determined by the market, and not by regulatory authorities or professional organizations; (2) reforming Japan's arcane Arbitration Law to meet modern international business needs; (3) improving the efficiency and speed of civil litigation by cutting in half the length of time required to complete trials, increasing the number of judges, reducing the time between court filings and decisions, facilitating litigants' collection of evidence at early stages of litigation, making the specialized departments that handle cases involving intellectual property rights at both the Tokyo and Osaka District Courts function substantially as "patent courts;" and (4) undertaking a comprehensive study of judicial oversight over administrative agencies. The United States recommended further improvements in the Japanese judicial system, such as improving the ability of courts to issue and enforce prompt and effective orders to remedy legal violations; improving the transparency of judicial proceedings; and ensuring that Japan's civil litigation system is compatible to the greatest extent possible with foreign court procedures and needs. (See the Professionals Services section with regard to legal services.)

**Distribution and Customs Clearance**

Distribution and customs clearance issues, particularly processing costs and delays, have been an irritant in U.S. trade relations with Japan for a number of years. Japan has made improvements in this area, although more remains to be done to facilitate the rapid delivery of goods and information vital to the development of the global economy.

The United States has argued the case for continuing improvements in the context of the Enhanced Initiative and more recently in the Regulatory Reform Initiative. The need for the rapid delivery of goods and information has produced a number of new industries that are now seen as vital for the development of the global economy. One of these industries is the express carrier industry, which has seen exponential growth in recent years and is now an essential tool for the conduct of international

business and for the timely distribution of goods and information. The ability to move goods quickly and inexpensively from producers to consumers is not only a key measure of economic efficiency, but also of vital importance to economies like Japan seeking to benefit from the information technology revolution.

In its October 2001 Regulatory Reform Initiative recommendations, the United States urged adoption of the following measures that would further modernize customs clearance procedures, allowing Japan to take full advantage of the economic benefits provided by such new industries as the express carrier business.

*Adjustment of the Simplified Declaration Procedures:* The new law applies only to actual importers and their agents who regularly carry out more than 24 import actions a year involving the same designated goods. The United States has recommended that the regulations be adapted to make the Simplified Declaration Procedures available to a wider range of companies involved in the importation of air cargo, including express carriers. This request is consistent with the risk management principles noted in Chapter 6, Customs Control, of the International Convention on the Simplification and Harmonization of Customs Procedures (also known as "The Revised Kyoto Convention"), which encourages signatories to ease restrictive regulations. The United States believes that even if the new regulations were eased as recommended, imports eligible for entry under the Simplified Procedures would remain low risk.

*Nippon Automated Cargo Clearance System (NACCS):* The United States has urged the Ministry of Finance to continue its consultations with users of Air NACCS to ensure that an equitable fee structure is installed after the expiration of the current three-year arrangement.

*Increasing the De Minimis:* The United States has urged Japan to increase the *de minimis* value in its Customs Clearance Law from 10,000 yen to 30,000 yen. The United States has argued that increasing the *de minimis* value would facilitate clearance and decrease Custom's workload, especially at postal facilities. This request is consistent with the guidelines to Chapter 4, Duties and Taxes, of the Revised Convention that state in part "the collection and payment of duties and taxes should not be required for negligible amounts of revenue that incur costly paperwork, both for Customs administration and for the importer/exporter."

## IMPORT POLICIES

### High Tariffs on Beef, Citrus, Dairy, and Processed Food Products

Japan maintains a high-tariff regime on a number of food products that are important trading items for the United States, including red meat, citrus, and a variety of processed foods. Examples of double-digit import tariffs include 38 percent on beef, 32 percent on oranges, 40 percent on processed cheese, and 30 percent on natural cheese. These higher tariff items generally reflect food products where Japan is protecting the domestic sector.

High tariffs limit sales of U.S. farm products in Japan by encouraging substitution for local competitors and/or reducing consumption of a category altogether. Given the significant potential trade impacts from tariff reduction, the United States will make tariff reduction a priority in our WTO negotiations with Japan.

### Rice Import System

Japan is now the largest overseas market for U.S. rice, with purchases of $120 million annually. Although Japan has generally met commitments made during the Uruguay Round and subsequent negotiations with respect to import volumes, Japan's highly regulated distribution system for imported rice assures that Japanese consumers do not have access to stable supplies of reasonably priced, high quality U.S. rice.

Japan has established a tariff-rate quota which assures access to the Japanese market for 682,000 metric tons of imported rice annually. Since Japan tariffied rice imports in 1999, no rice has been imported outside of the import quota because it would be subject to a duty of 341 yen per kilogram, which is equivalent to about 400 percent *ad valorem*. Of the total amount of rice that is imported under the tariff quota, 582,000 tons are imported under the minimum access system operated by the Ministry of Agriculture, Forestry and Fisheries (MAFF) Food Agency. The U.S. rice industry has been disappointed by the Food Agency's record of buying medium quality rice for industrial use, food aid, and blending, rather than top quality rice for table use. U.S. exporters were further disappointed last year when the Food Agency began buying more broken rice from the United States, rather than higher value whole kernel rice.

The remaining 100,000 tons of rice which Japan has agreed to import each year enters Japan through a complex Simultaneous-Buy-Sell (SBS) system, which is also administered by the Food Agency. This system does enable U.S. industry to get small amounts of high quality U.S. table rice directly into the hands of Japanese distributors, but U.S. exporters find it increasingly difficult to market U.S. rice through this system because of the lack of transparency. Japan's rice import regime significantly increases the cost of imported rice. As a result, the price of U.S. rice sold in Japan is generally three times higher than the import price and consumers cannot enjoy the full benefits of reasonably priced high quality U.S. rice.

The United States has pressed Japan to reform its import procedures to facilitate the distribution of high quality table rice. The United States will also continue to urge Japan to lower the percentage of broken rice in its purchases of U.S. rice. Increased and more meaningful access to the Japanese rice market will be high priorities during the agriculture negotiations in the WTO.

### Wheat Import System

Japan requires that wheat be imported through the MAFF Food Agency, which then releases wheat to Japanese flour millers at prices that are substantially above import prices. High wheat prices discourage wheat consumption by increasing the cost of wheat-based foods in Japan. The United States will address the problem of trade-distorting state trading in the WTO agriculture negotiations.

### Corn for Industrial Use

In order to support the price of domestically produced potatoes, the Japanese government requires Japanese corn starch manufacturers to blend potato starch with corn starch in manufacturing corn sweeteners. The tonnage of corn starch production must be matched by purchases of domestic potato and sweet potato starch in the ratio of one part of potato starch for 13 parts of corn starch. If corn sweetener producers use potato starch at a lower ratio than 1:13, they cannot import corn at the zero tariff rate accorded to the pooled quota. Instead, they must pay a tariff on corn of 12,000 yen per ton or 50 percent of the value of a shipment, whichever is higher.

The blending requirement discourages consumption of imported corn by raising the cost of corn sweeteners, and directly displaces over 200,000 metric tons of U.S. corn sales annually. The United States will address this issue in the WTO agriculture negotiations.

**Pork Import Regime**

U.S. pork exports to Japan, valued at approximately $800 million annually, comprise about 60 percent of all U.S. pork exports. Japan's pork import system, negotiated during the Uruguay round, is inflexible and fails to meet the needs of either Japan or the United States. The system includes a gate-price and a safeguard that automatically raises tariffs if imports exceed the three year average by 19 percent.

The gate-price system distorts pork trade by encouraging Japanese importers to buy mixed shipments with different cuts of pork. Importers buy mixed shipments in order to minimize tariffs by keeping the average CIF price of their shipments below the gate-price.

Japan's pork safeguard, which was triggered in 2001 when quarterly pork import exceeded the three year average, is also of concern because it results in erratic purchasing patterns. The safeguard system encourages high imports when the safeguard is not in place, and the high imports then tend to trigger the safeguard. Once the safeguard is triggered, importers tend to buy less pork and to buy more expensive cuts in order to raise the cost of their import shipments to the new gate-price.

The United States seeks substantial reductions in pork tariffs, elimination of the gate-price system and safeguard, and greater transparency in Japan's import regime. Japan's consumers would ultimately benefit from reasonably-priced, plentiful, high-quality supplies of imported pork. The United States will address this issue in the WTO agriculture negotiations.

**Fish Products**

Japan is the most important export market for U.S. fish and seafood, accounting for approximately 40 percent of U.S. exports of such products in 2001. Japan maintains several species-specific import quotas on fish products. U.S. fish products subject to import quotas include pollock, surimi, pollock roe, herring, Pacific cod, mackerel, whiting, squid, and sardines. During the Uruguay Round, Japan agreed to cut tariffs by about one-third on a number of fishery items, but avoided commitments to modify or eliminate import quotas.

The United States and Japan hold annual fish consultations to discuss marine science, ecology and other bilateral and international fishery-related issues. U.S. exporters have been concerned about the quota application process and other administrative procedures. However, over the past few years, Japan has made substantial improvements in its import quota system for fish products, due in large part to recommendations from the United States and European Union. These changes include greater transparency in disclosing the recipients of quota allocations, changes in the timing of quota allocations, and the breakout of several types of fish (including mackerel, sardines, Pacific cod and others) from the "Fish and Shellfish" category into individual categories with quotas listed by weight rather than value.

**Wood Products and Housing**

Japan is the second largest overseas export market for U.S. wood products, with U.S. exports totaling more than $1 billion in 2001. Japan continues to restrain the import and use of U.S. wood products through tariff escalation

(i.e., progressively higher tariffs on processed wood products). The elimination of tariffs on wood products has been a longstanding U.S. objective, and the United States will continue to urge Japan to eliminate wood product tariffs in the current WTO negotiations.

Overly restrictive building codes and standards continue to impede the import of U.S. wood products by unnecessarily restricting the use of wood in buildings. Interested parties are often not provided adequate time to comment on changes in codes and standards. The newly revised Japanese Agricultural Standards (JAS) Law has limited the ability of companies to certify wood products to Japanese standards. Specifically, Japan implemented a burdensome accreditation scheme, which required protracted government-to-government negotiations to demonstrate the equivalency of the U.S. wood products standards system. This led to disruptions in export relationships.

In the Fourth Joint Status Report under the Enhanced Initiative, Japan pledged to cooperate with the United States to obtain recognition of the equivalency of U.S. standards for grading and certifying wood products. The United States and Japan also agreed to continue technical discussions on issues related to performance-based codes, implementation of test methodologies and procedures in evaluating fire resistance and other housing/wood product-related issues in the Wood Products Subcommittee, the Building Experts Committee, and the JAS Technical Committee. The next Wood Products Subcommittee meeting will take place in the first half of 2002, at which time the two Governments will review the progress made on performance-based building codes, equivalency, and other key issues.

**Marine Craft**

Japan's non-transparent system of small craft safety regulation for boats, marine engines, and marine equipment is a serious impediment to market access in this sector. The regulations, which are administered by the Ministry of Land, Infrastructure and Transport (MLIT) and the Japan Craft Inspection Organization, are often vague and subject to arbitrary and inconsistent interpretation. Testing requirements can be expensive and documentation requirements are non-transparent and burdensome, forcing companies to disclose sensitive proprietary information about product design, material specifications, and manufacturing techniques. Inspection fees are high or not in line with the costs of conducting the inspections.

This regulatory system unnecessarily increases costs for U.S. manufacturers; burdens Japanese consumers with higher prices and reduced access to imported boats, motors, and equipment; and provides no increased safety benefits compared with U.S. and European regulations. Japan has expressed its intent to adopt international safety standards for small craft and marine engines, and participates actively on international standards drafting committees. Japan has made little progress, however, in harmonizing its small craft regulations with international practices.

In 2001, the United States held a series of discussions with Japan in an effort to address these issues. While many of the U.S. concerns remain unresolved, Japan announced its intention at the end of 2001 to modify licensing requirements for the operation of certain pleasure boats, which should make it easier for U.S. firms to market these products in Japan. The new rules would allow those possessing the most widely held license (covering about 70 percent of licensed boat operators) to operate vessels of up to twenty tons. Previously, this license only covered the operation of vessels of up to five tons, and licenses allowing the

operation of larger boats were difficult and costly to obtain. This change should remove an unnecessary restriction on the size of the market for U.S. boats by allowing holders of the most easily obtainable license to purchase and operate larger boats. The U.S. Government will monitor the implementation of the new operator license requirements.

### Distilled Spirits

As a result of 1996-1997 WTO dispute settlement rulings and subsequent negotiations between the Japanese and U.S. Governments, Japan agreed to bring its liquor taxation system into WTO conformity in December 1997. Japan proceeded to revise its liquor excise system in stages until taxation rates on all distilled spirits were brought into WTO conformity by May 1998, with the exception of low-grade *shochu*, which was harmonized in October 2000. At the same time, the liquor tax for imported whiskey and brandy was reduced by 58 percent.

In April 2002 Japan is due to eliminate tariffs on all brown spirits (including whisky and brandy), and on vodka, rum, liqueurs, and gin. This will complete the tariff and tax measures needed to comply with the 1996-97 WTO dispute settlement agreement. The United States will continue to monitor Japan's implementation of the settlement to ensure that tariffs are eliminated and that no measures are adopted that would undermine the settlement's benefits.

### Leather/Footwear

The process by which the Government of Japan establishes quotas lacks transparency. U.S. industry reports that there is no consultation with leather shoe importers to determine anticipated import levels. Indeed, Japanese authorities make no effort to limit quota allocations to firms that plan to use them. The U.S. Government will continue to seek elimination of these quotas.

In 1991, Japan liberalized treatment of footwear imports, setting a footwear quota of 2.4 million pairs per year. By JFY 1998 it had raised this quota to roughly 12 million pairs per year. In the Uruguay Round, Japan agreed to reduce tariffs over an eight-year period on under-quota imports of leather footwear, crust leather and other categories.

Above-quota imports of footwear still face market access barriers, despite the fact that Japan has met its Uruguay round agreements to lower the *ad valorem* ceiling rate by 50 percent and the alternative "per pair" or specific-rate ceiling by 10 percent. According to the latest Government of Japan Customs Tariff Schedule, the above-quota rates have declined to the higher duty of either 30 percent *ad valorem* or 4,300 yen per pair. However, because Japan is entitled to apply the higher of the two rates, which is typically the 4,300 yen per pair specific-rate, the effect of the larger *ad valorem* rate reduction is negated.

## STANDARDS, TESTING, LABELING AND CERTIFICATION

Japan's farm constituencies continue to support human, plant and animal, health and safety requirements with an apparent objective of restricting imports. Japan has always been conservative on questions involving food safety standards. However, recently there appears to have been an increase in Japan's use of standards and other administrative requirements to limit agricultural imports and a greater tendency to deviate from scientific principles in setting new import policies.

### Ban on U.S. Poultry

U.S. poultry exports to Japan are valued at approximately $170 million annually. Japan implemented a temporary ban on poultry imports from the United States in January 2002 when a

low pathenogenic strain of avian influenza was detected in a limited area in the United States. According to standards set by the international animal health organization, the Office of International Epizootics (OIE), quarantine procedures are only necessary for highly pathenogenic strains of avian influenza, and not for low pathenogenic strains. A previous ban against U.S. poultry disrupted trade for two weeks in November 2001 without any scientific basis.

The United States will continue to urge Japan to adhere to OIE standards and to the WTO Agreement on the Application of Sanitary and Phytosanitary Measures, which requires WTO members to adhere to science in establishing sanitary measures.

**Ban on Imports of Rendered Livestock Products Due to BSE**

Japan placed global bans on imports of various livestock products after bovine spongiform encephalopathy (BSE) was found in Japan in the fall of 2001. The bans were applied to U.S. products, such as meat and bone meal and tallow, even though the United States is free of BSE. Japanese imports of U.S. animal products affected by the import bans totaled about $14 million in 2001.

Since the United States meets criteria as a country which is "free of BSE" set by the OIE, there is no scientific reason to ban imports of livestock products from the United States. Moreover, the ban includes products processed from cattle parts, such as tallow, and products from non-bovine species, such as pork blood, which could not possibly transmit BSE.

Although there is no scientific reason for the bans, Japan has indicated that they will remain in place until it has completed a country risk assessment for the United States. Despite the fact that the United States provided information to Japan in response to this risk assessment questionnaire in a timely manner, Japan's assessment has yet to be completed.

**Fresh Apples – Quarantine Requirements for Fireblight**

Japan imposes burdensome quarantine restrictions on apples, limiting the ability of U.S. growers to access the Japanese market. Of particular concern are Japan's requirements that aim to prevent transmission of fireblight. Scientific evidence does not support Japan's assertion that mature, symptomless apples can transmit the fireblight bacteria. Japan's quarantine restrictions for fireblight include the prohibition of imports of U.S. apples from any orchard containing fireblight, three orchard inspections at different times in the growing season, maintenance of a 500-meter fireblight-free "buffer" zone surrounding export orchards, and post-harvest treatment of apples with chlorine. These requirements are not scientifically based, significantly raise costs, and reduce the competitiveness of U.S. apples in Japan.

Joint research conducted by U.S. and Japanese government scientists confirmed the results of earlier studies that mature, symptomless apples are not carriers of fireblight and provided additional scientific support for the United States' position that Japan's restrictions are unwarranted. In light of Japan's continued refusal to modify its restrictions on the basis of the scientific evidence, on March 1, 2002, the United States requested consultations under WTO dispute settlement procedures.

**Ban on Fresh Potatoes**

Japan bans imports of fresh potatoes from the United States, alleging that such a ban is necessary to prevent the introduction of golden

nematode and potato wart into Japan. The United States has urged Japan to immediately lift the ban on fresh potatoes for processing from major production areas not infested by the golden nematode, such as the Pacific Northwest, California, and other U.S. potato exporting areas. Potato wart is not found in the United States. Separately, MAFF has raised new concerns regarding a number of viruses that would necessitate post-entry quarantine of imported potatoes even if the ban were lifted. The United States will continue to urge Japan to recognize disease-free areas in the United States for golden nematode. The United States is also urging Japan to permit imports of peeled potatoes for use in the food service industry.

### Ban on Fresh Bell Peppers and Fresh Eggplant

Japan continues to ban imports of fresh bell peppers and fresh eggplant based on concerns over tobacco blue mold (TBM). In initial bilateral discussions held in August 1999, the United States emphasized that the fruit of peppers and eggplants are outside any pathway of transmission of TBM. In bilateral technical meetings held in September 2000, Japan agreed to consider lifting its ban if it can be demonstrated that the fruit is not a host to the disease. The United States is currently developing test data to demonstrate that bell peppers and eggplants are not a host for TBM. Through discussions in both bilateral and international fora, the United States will continue to urge Japan to permit imports of U.S. bell peppers and eggplant.

### Excessive Use of Fumigation

Japan requires unnecessary fumigation for a number of imported fresh horticultural products. The fumigation requirement is particularly detrimental to trade in fresh fruits and vegetables, including lettuce, avocados, and cut flowers, which generally do not survive fumigation and must be destroyed. The U.S. lettuce industry estimates that exports would increase by at least $100 million if this issue could be resolved.

Japan routinely requires that imported produce be fumigated for insect species which are already present in Japan. This practice is inconsistent with international practice, and with the International Plant Protection Convention (IPPC). Japan claims that these pests are under "official control" by MAFF in order to limit their spread within Japan. However, in practice, MAFF does not have any official control programs requiring the fumigation of locally grown produce.

After repeated requests by foreign governments for reform, MAFF has begun to implement a non-quarantine pest list by partially amending the Plant Quarantine Law to exempt 53 pests and 10 plant diseases from fumigation requirements. While this appears to be an important positive step, the exemption list does not include ten common insect species found on U.S. fresh fruits and vegetables, which are also known to occur in Japan. The United States will continue to urge Japan to adopt international standards, develop a comprehensive list of non-quarantine pests, and reduce excessive, unnecessary, trade distorting fumigation requirements.

### Biotechnology

Japan has adopted a largely scientific approach in its approval process for genetically modified (GM) foods. To date, MAFF and the Ministry of Health, Labor, and Welfare (MHLW), which regulate biotechnology products, have approved the importation of 39 GM plant varieties for food, including corn, potatoes, cotton, and soybeans. U.S. and Japanese regulatory approaches to assessing the safety of

biotechnology products have been closely aligned.

However, the United States is concerned about the lack of timely consideration of approvals for biotechnology foods in Japan. During 2001, recalls of finished potato products containing a bioengineered potato variety approved and consumed in the United States, but not approved in Japan, cost U.S. and Japanese food companies tens of millions of dollars. The United States is committed to meeting Japan's import regulatory requirements, but urges Japan to complete science-based food safety assessments in a timely manner, and to recognize the need to balance the need for data with the requirement to complete a timely safety review.

The United States is also seriously concerned by Japan's efforts to expand mandatory labeling of foods made from the products of biotechnology, because such labeling may discourage consumers from purchasing foods derived through biotechnology by suggesting a health risk when there is none. In 2001, MAFF included high oleic acid soybean oil in the mandatory GM labeling scheme even though no traces of biotechnology protein are found in the oil. The United States believes consumers should have information on foods that have been produced through biotechnology, but alternatives to mandatory labeling, such as educational materials, public discussions, and voluntary labeling regimes can provide more meaningful information to consumers. The United States is also concerned by MAFF's plans to expand mandatory labeling on feed and seed, possibilities that are now being discussed internally in the Ministry.

The United States is urging Japan to continue to participate in discussions on biotechnology advancement and regulation in international fora, such as the WTO, the Codex Alimentarius Commission, the OECD and APEC. Given the continuous development of new biotechnology-produced food products, the United States and Japan should work together to promote effective food safety policies.

### New Standards for Organic Foods

The United States lost its lead in Japan's growing market for organic foods when MAFF implemented impractical accreditation requirements for foreign companies as part of the Ministry's new Japanese Agricultural Standards organic labeling requirements. Of particular concern are new requirements that imports be channeled through government-licensed importers, disrupting longstanding business relationships. MAFF had banned U.S. certifiers from participating in Japan's organic market until extensive government-to-government negotiations led to an agreement whereby MAFF recognized USDA organic accreditation for organic food ingredients. The United States is currently in negotiations whereby MAFF would recognize USDA accredited certification for all organic food.

### Restrictive Food Additive List

Japan's overly restrictive list of food additives limits imports of U.S. food products, especially processed foods. Japanese regulations, which are out of step with international practice, require that food additives be approved on a product-by-product basis. For example, Japan refuses to allow the importation of light mayonnaise, creamy mustard, or figs containing potassium sorbate, a food additive evaluated and accepted by numerous national and international standard-setting organizations, including the Joint FAO/WHO Experts Committee on Food Additives. However, Japan allows its use in 36 other foods, most of which are traditional

Japanese food products not normally produced outside of Japan.

### Dietary Supplements

Dietary supplements (vitamins, minerals, herbs, and non-active ingredients) have traditionally been classified as drugs in Japan. As a result, severe restrictions have been imposed on the shape, dosage, and retail format for such supplements. These regulations create excessive costs and difficulties for most foreign supplement firms participating in the Japanese market.

Consistent with progress achieved under the Enhanced Initiative, Japan is proceeding to allow producers of dietary supplements to make nutritional and health benefit claims in the marketing of their products, if there are scientific data and information to support such claims. However, concerns have been raised regarding the type of data that may be required to make such claims. The data requirements of the regulatory system should be reasonable and appropriate, and limited to criteria necessary to ensure safety and efficacy. Furthermore, regulatory decisions should be based on clear scientific grounds, taking into full consideration all available data and information. Japan has agreed to continue to discuss the scope of using non-Japanese data and information required to evaluate and approve products. This and other dietary supplement issues are being taken up under the MOSS/Regulatory Reform Initiative.

### Veterinary Drugs

Japan typically waits for the joint FAO/WHO Codex Alimentarius Commission (Codex) to adopt an international standard before evaluating scientific evidence. However, this policy results in significant delays in establishing tolerance levels for veterinary drugs in Japan. The United States has urged Japan to undertake this procedure in a timely fashion, and not to delay the process while waiting for the outcome of Codex deliberations, thereby improving the safety review process for veterinary drugs sold in Japan.

## GOVERNMENT PROCUREMENT

### Computers

While U.S. producers of computer goods and services are global leaders in technology and performance and continue to be among the largest and most successful foreign firms in Japan's private sector, access to the Japanese public sector computer market remains problematic. The last bilateral review under the 1992 bilateral Computer Agreement was held in Washington in March 2001, at which time Japan presented data showing a very slight increase in the foreign share of the public sector market (up 1.2 percent over the previous year to 17.7 percent). According to Japanese Government data, the foreign share of the public sector computer market remains roughly equivalent to what it was when the Computer Agreement was concluded. Further, it has never even approached the approximately 30 percent market share foreign companies have maintained in Japan's private sector for many years.

Given the continued gap between the U.S. share of the Japanese private and public sector computer markets, as well as the rapid technological advancements in this sector, the United States has proposed that Japan more fully utilize the Internet for public procurements, broaden its use of "overall greatest value method" (OGVM) in bid evaluations, and provide advance information to potential bidders on a larger number of upcoming procurements. In a positive step forward, Japan has announced its intention to shift government procurement to the Internet in JFY 2005. The U.S.

Government will continue to monitor developments in this sector.

**Construction, Architecture and Engineering**

Two public works agreements are in effect: the 1991 U.S.-Japan Major Projects Arrangements (MPA) and the 1994 U.S.-Japan Public Works Agreement, which includes the "Action Plan on Reform of the Bidding and Contracting Procedures for Public Works" (Action Plan). The MPA included a list of 42 projects in which international participation is encouraged. Under the 1994 Agreement, Japan must use open and competitive procedures for procurements valued at or above the thresholds established in the WTO Agreement on Government Procurement (GPA). The 1994 Agreement remains in effect, but the consultative provision in the 1994 Agreement expired in March 2000. The United States will continue to engage Japan on construction issues using opportunities such as the Trade Forum established under the Partnership.

The U.S. share of Japan's $250 billion public works market remained well below one percent in 2001. This is a troubling fact given the competitiveness of American design/consulting and construction companies throughout the rest of the world. The United States believes there are significant problematic practices that impede U.S. companies from participating effectively in design/consulting and construction projects in Japan's public works sector. These practices include rampant bid-rigging, unreasonable restrictions on the formation of joint ventures, use of vague and discriminatory qualification and evaluation criteria, and the structuring of individual procurements so they fall below the thresholds established in international agreements.

Entrenched bid-rigging (*dango*), under which companies consult with one another and prearrange a bid winner, continues to be widespread in Japan's public works market. Recent cases include bid-rigging in Tokyo's Tama district and several instances on the local level. In addition, the United States remains concerned about some disturbing bidding patterns whereby Japanese construction firms have submitted bids that are so low that they raise the question as to whether the work can be performed at that price. The problems created by *dango* are augmented by the "cozy relationships" (*yuchaku*) between politicians, bureaucrats and construction firms where politicians use their influence to obtain advantageous bid/contract conditions for particular Japanese firms in public works projects. Recent cases were reported in Ibaraki, Wakayama, and Tokushima Prefectures. This problem has been compounded by the actions of procuring agency officials who knowingly have assisted bid-rigging conspiracies. The United States urges the Government of Japan, including the JFTC and procuring agencies, to take strong measures to eliminate these practices and sanction government officials who aid them.

Unreasonable restrictions on the formation of joint ventures impede foreign firms' participation in Japan's public works market. In construction, these restrictions include the three company joint venture rule, which limits to three the number of members in joint ventures for most construction projects. In design, architectural design firms are prohibited from working together on artistic design work even when two or more companies could bring their respective expertise to bear in a way that would ensure a higher quality project. The United States continues to urge Japan to allow companies, not procuring entities, to determine if a joint venture is appropriate and, if so, the number of members, based on the scope of the work and various firms' abilities.

Regarding Japan's continued use of vague and discriminatory qualification and evaluation

criteria, the United States urges Japan to define the criteria used in particular procurements so as to maximize, rather than restrict, the number of firms that would be able to participate in the procurement. For many years, the United States has asked Japan to introduce Program Management (PM) and Construction Management (CM) into its public works market. PM and CM are advanced technologies used to maximize the efficiency of a project by saving time and money. In 2001, Japan's Ministry of Land, Infrastructure and Transport began issuing procurements that include CM technologies. The United States urges Japan to structure these procurements such that the increased efficiencies offered by CM technologies are fully utilized and that foreign firms with appropriate expertise are deemed eligible to compete.

In September 2001, Japan hosted the third U.S.-Japan Construction Cooperation Forum (CCF), which is designed to facilitate the formation of joint ventures between U.S. and Japanese firms and to make it possible for U.S. companies to participate more fully in Japan's public works market. (The CCF is a private sector meeting and not a substitute for government-to-government consultations.) The United States looks forward to tangible results from the CCF.

The United States is paying special attention to several major projects covered by the public works agreements of particular interest to U.S. companies including the Central Japan International Airport, Chitose Airport, Haneda Airport, Japan Railways procurements, Kansai International Airport, Kobe Airport, Kyushu University Relocation Project, New Kitakyushu Airport, and laboratory projects commissioned by the Ministry of Education, Culture, Sports, Science and Technology. Other projects of interest are major hospital projects, including health care facilities for elderly citizens, and urban revitalization projects. In addition, the United States is paying close attention to Private Finance Initiative (PFI) projects.

### Medical Technology

U.S. firms continue to be the world's leading producers of advanced medical technologies, and the 1994 Medical Technology Agreement provides an important step forward in enabling them, as well as other foreign firms, to more effectively sell medical technology products and services in Japan's public sector.

The most recent annual review of the agreement was held in March 2001. During this review Japan presented data for JFY 1999 that showed that foreign market share totaled 46.1 percent, down slightly form JFY 1998 levels of 46.9 percent. While the percentage of foreign products and services procured under the agreement remained essentially unchanged in JFY 1999, the total value of foreign medical technology procured declined from 38.4 billion yen in JFY 1998 to 30.5 billion yen in JFY 1999. Competition for medical technology tenders appeared to intensify in JFY 1999, with contracts awarded on the basis of single bidders valued at 2 billion yen, down from 4.7 billion yen in JFY 1998.

### Satellites

Under the 1990 U.S.-Japan Satellite Agreement, Japan agreed to open non-R&D satellite procurements to foreign satellite makers. To date, the agreement has been successful in opening the Japanese Government's procurement market to foreign competition. From 1990 through 2001, U.S. satellite makers – world leaders in this field – won seven out of eight contracts (with a combined value of nearly $2 billion) openly bid under the competitive procedures outlined in the agreement. The only contract not won outright by a non-U.S. firm

utilized a U.S. system. Given U.S. firms' strength in this area, the United States expects that this trend to continue. The U.S. Government will continue monitor Japan's adherence to the agreement and the application of the term "R&D satellite" by Japan.

**Telecommunications**

*NTT Arrangement*: The NTT Companies continue to be Japan's single largest purchaser of telecommunications equipment and, according to recent statistics, account for almost one-third of Japan's $36 billion telecommunication equipment market. As such, the "NTT market" has been and continues to be of keen interest to U.S. and other foreign telecommunications firms.

The last of seven successive U.S.-Japan Agreements on NTT procurement of foreign goods and services covering 20 years expired in July 2001. Figures provided by NTT for the final June 2001 review indicated that the share of products procured from foreign suppliers continued to increase, reaching levels well above $1 billion. At this level, foreign procurement was well above the negligible one percent that prevailed in 1980 when the first of the Agreements was negotiated.

The United States believes that the NTT Agreements have helped move NTT toward making procurement decisions based on market-driven factors and thus have contributed to a more competitive, fair, and transparent telecommunications equipment market in Japan. Nonetheless, the foreign share of equipment procurement by NTT remains at levels below that of the Japanese private sector telecommunications carriers (which have traditionally been far more open to foreign products) and telecommunications markets globally. The NTT companies procure over $10 billion in equipment and services annually and plan to increase procurement of data-related and Internet-related technologies, areas in which U.S. companies are particularly strong. Therefore, the United States expects that there will be continued growth in NTT companies' procurement of foreign equipment and that improved access to the NTT market should result in new opportunities for U.S. firms. The United States will consult with U.S. industry periodically to monitor NTT foreign procurement as well as NTT's efforts to make procurement opportunities available to all suppliers. Given the trends in the procurement environment toward shrinking lead times and increasingly narrow margins, adherence by NTT companies to information disclosure and other standards in the procurement guidelines is essential. The United States will discuss any future difficulties with the Government of Japan.

*Public Sector Procurement Agreement on Telecommunications Products and Services*: Pursuant to the 1994 U.S.-Japan Telecommunications Procurement Agreement, Japan has introduced procedures to eliminate barriers such as: unequal participation in pre-solicitation and specification drafting for large-scale telecommunications procurements; ambiguous award criteria; and excessive sole sourcing.

The United States and Japan held consultations under the Agreement in March 2001, during which JFY 1998 and JFY 1999 data were reviewed. The United States reiterated its longstanding concern over the continued low foreign share of Japanese Government procurement of telecommunications products and services, which Japanese Government data showed to be less than 6 percent. This stands in contrast to the 13 percent market share foreign firms achieved in the Japanese market overall, as well as the increases that foreign suppliers have made in selling to Japan's private sector and even to NTT.

The United States also noted that despite the fact that the agreement calls for a reduction in sole-source tendering, sole-sourcing rose six-fold between JFY1994 and JFY 1999, and the percentage of sole-source tendering in total government telecommunications procurements reached a record 27.4 percent in JFY 1999.

As Japan implements its "e-Japan" strategy to make the country a world leader in IT, telecommunications-related procurement by local and national government agencies will increase in order to meet the infrastructure requirements of this strategy. The United States expects that the electronic government component will also benefit foreign suppliers by permitting greater transparency in procurement. The United States will also raise and address future difficulties related to market access for foreign telecommunications products and services in Japan's public sector through various fora, including the Trade Forum under the Partnership.

## INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

The United States has continued to pursue its intellectual property rights protection agenda with Japan through close bilateral consultations and effective coordination in multilateral and regional fora.

Japan is a party to the Berne and Universal Copyright Conventions, the Paris Convention on Industrial Property, the Patent Cooperation Treaty, and the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Japan has ratified the World Intellectual Property Organization (WIPO) Copyright Treaty, which provides new protection for authors of works transmitted over the Internet. Japan has signed but not yet ratified the WIPO Performances and Phonograms Treaty. Japan was removed from the Special 301 Watch List on May 1, 2000. However, in the May 2001 Special 301 announcement, the United States expressed concern about some aspects of intellectual property rights protection in Japan and noted that it would continue to carefully monitor these aspects.

Japan has made progress in improving the protection of intellectual property rights and, relative to other countries, piracy is not a major problem, though several key issues, including the need to improve Japan's legal and administrative intellectual property framework to protect copyrights in the digital age, remain. The United States has identified a number of areas where further action by Japan is needed, including: (1) addressing persistent patent-related problems; (2) improving and expanding protection of copyrighted works particularly on the Internet; (3) providing effective protection for well-known trademarks; (4) providing protection for geographical indications; (5) affording greater protection of trade secret information; and (6) continuing to improve border enforcement mechanisms.

### Patents

The United States has focused particular attention on improving registration access and approvals, and reforming Japan's practice of affording only narrow patent claim interpretation. The United States remains concerned with several aspects of Japan's patent administration, including the relatively slow process of patent litigation in Japanese courts, the lack of an effective means to compel compliance with discovery procedures, and the lack of adequate protection for confidential information produced relative to discovery. The United States also is concerned about the lack of patent protection for business methods in Japan, particularly those related to the Internet. The WTO TRIPS Agreement requires member

countries to provide patents for inventions in all fields of technology, including business methods.

In recent years, Japan has taken a number of steps to address these issues. A revised patent law took effect on January 1, 2000. This law is designed to make it easier for plaintiffs to prove patent infringement in courts. Key provisions include increasing requirements on alleged violators to justify their actions, obligating alleged violators to cooperate with calculation experts, giving judges discretion over the amount of damages, increasing the penalty in cases where patents were obtained fraudulently, and allowing courts to seek technical advice from the Japan Patent Office (JPO). The United States will continue to monitor closely whether this revision reduces the burden of proof required by Japanese courts that has been particularly onerous to foreign patent owners in the past.

As part of the new law, the period between when a patent is applied for and when it must be pursued by an applicant has decreased from seven to three years. According to the JPO, the average "First Action Period" (the period from the date of patent application until the first response by JPO) was 21 months as of December 2000. A new law, which took effect on January 6, 2001, increased the number of patent lawyers and expanded their scope of permitted services. The United States is encouraged by such steps to improve the level of patent protection in Japan and will continue working with Japan to strengthen its patent laws in several fora.

**Copyrights**

The increasing use of the Internet and explosive growth of high-speed access in Japan has presented new challenges for protecting intellectual property rights, especially for copyrighted materials. The protection of this material is critical for electronic commerce to flourish and for the continued development of content-related industries such as games, music, film and software. The United States is particularly concerned about the recently passed Internet Service Provider (ISP) liability law, which in its current form does not provide adequate protection for the works of right holders on the Internet or the appropriate and necessary balance of interests among telecommunications carriers, service providers, right holders and website owners. The United States urges Japan to ensure clear-cut and balanced ISP liability rules through the implementation process for this new law.

The United States is also concerned about Japan's reluctance to clearly stipulate that temporary copies implicate the right holder's reproduction right. The United States' concerns about treatment of temporary copies in Japan are exacerbated by a Japanese court ruling in 2000 that a company airing music programs digitally in a program format designed to facilitate copying of those works does not constitute a copyright violation. According to the court, broadcasters have the right to duplicate copyrighted materials and subscribers can decide for themselves whether or not to copy the music. The court said that by offering such an opportunity to listeners, the broadcasting company was not encouraging them to make copies. Continued interpretations along similar lines could erode the ability to protect copyrighted materials. The United States is particularly concerned by the implications of such a position for copyrighted works.

In 2001 Japan raised the cap on punitive damages for copyright infringement from 3 million to 100 million yen, and in recent years it has made progress in combating computer software piracy. However, according to the most recent figures available, there was an increase in software piracy from 1999 to 2000. The United States continues to urge Japan to

take steps to reduce the piracy rate further, especially in light of the growing threat of online piracy. A notable step toward creating an effective deterrent against piracy would be amending Japan's Civil Procedures Act to award statutory damages rather than actual damages, and to provide for more effective procedures for collecting evidence. In addition, in order to set a model for the private sector, the United States urges Japan to issue a statement clarifying Japan's agreement to use only legitimately produced and licensed software in its government operations.

A revision of some aspects of the Copyright Law took effect in January 2000 in preparation for Japan's accession to the WIPO Copyright Treaty. Key provisions of the revised law included criminal penalties for producing and distributing devices designed to circumvent copyrights and for illegally revising copyright management information to make a profit. The United States is concerned that in the publicly available translation of the Copyright Law, the section on anti-circumvention states that the penalties for copyright circumvention devices will be applied only to devices whose "principal function" is circumvention. The law also expands the coverage of screening rights from motion pictures to still pictures and sets transfer rights so that the first sale doctrine covers films, books, and CDs.

In addition, the United States is concerned over the recent consideration by some in Japan's private sector and government to impose certain formalities as a precedent for copyright protection, especially for content on the Internet. The United States would like to underscore that any such shift would be a step away from the internationally accepted norms of copyright regimes and could cause significant problems for right holders, both foreign and domestic.

The United States will also continue to seek clarification of Japan's practices with respect to the treatment of songwriters who collaborate in the creation of musical compositions to ensure that they are provided the full term of copyright protection for their works.

**Trademarks**

Trademarks must be registered in Japan to ensure enforcement. Thus, any delays in the registration process make it difficult for foreign parties to enforce their marks. Legislation passed in preparation for Japan's ratification of the Madrid Protocol in March 2000 contains several useful provisions. Effective January 1, 2000, Japan began establishing a system to notify the public of trademark applications received. Effective March 14, 2000, trademark holders are entitled to compensation for damages for the period from application until registration of the trademark.

A 1997 revision to Japan's Trademark Law aimed to accelerate the granting of trademark rights, strengthen protection of well-known marks, address problems related to unused trademarks, and simplify trademark registration procedures in order to bring Japan into compliance with the Trademark Law Treaty. These measures also increase penalties for trademark infringement. Regrettably, in spite of the existence of provisions in Japan's Unfair Competition Law designed to afford greater protection to well-known marks, protection of such marks remains weak. Of particular concern is Japan's register of well-known marks, where employees of the Japan Patent Office make *ex officio* determinations whether a mark is well-known or not.

**Geographical Indications**

Articles 22 to 24 of the TRIPS Agreement set forth the obligations of WTO members with respect to geographical indications and their relationships to trademarks. It is unclear whether Japan currently provides interested parties with the legal means to prevent misuse of a geographical indication or whether Japan provides trademark owners with the legal means for resolving conflicts between trademarks and asserted geographical indications, as required by the TRIPS Agreement. The United States looks forward to receiving further information regarding the legal means by which Japan fulfills its TRIPS obligations under Articles 22 to 24.

### Trade Secrets

Although Japan amended its Civil Procedures Act to improve the protection of trade secrets in Japanese courts by excluding court records containing trade secrets from public access, the law is inadequate. Since Japan's Constitution prohibits closed trials, the owner of a trade secret seeking redress for misappropriation of that secret in a Japanese court is forced to disclose elements of the trade secret in seeking protection. Because of this, and the fact that court discussions of trade secrets remain open to the public with no attendant confidentiality obligation on either the parties or their attorneys, protection of trade secrets in Japan's courts will continue to be considerably weaker than in the courts of the United States and other developed countries. The United States continues to urge Japan to undertake further reform in this area.

### Border Enforcement

The United States remains concerned about the 1997 Japan Supreme Court decision to allow parallel imports of patented products and continues to monitor the Japan Customs and Tariff Bureau's (JCTB) implementation of this policy. Further, insofar as Japan provides *ex officio* border enforcement of trademarks and copyrights through the JCTB, efforts should be made to enhance such enforcement through aggressive interdiction of infringing articles. In an effort to bolster Japan's border control measures, the United States has urged Japan to improve its application, inspection and detention procedures to make it easier for foreign right holders to obtain effective protection against infringed intellectual property rights at the border. In response, Japan tightened its border enforcement in 2001. The United States is pleased with the steps Japan has taken, and urges Japan to continue to improve and tighten its border enforcement.

## SERVICES BARRIERS

This section includes the following subsections: Insurance and Professional Services. Energy services are discussed in the Sectoral Regulatory Reform section above.

### Insurance

Japan's private insurance market is the second largest in the world, after that of the United States, with direct net premiums of an estimated $450 billion in 2000. In addition to the offerings of Japanese and foreign private insurers, there is a large public sector provider of postal life insurance products (*Kampo*), the National Public Health Insurance System, and a web of mutual aid societies (*Kyosai*) that also provide significant amounts of insurance to Japanese consumers. The Japanese insurance sector, aside from *Kampo* and the *Kyosai*, is regulated by the Financial Services Agency (FSA), which was established in June 1998. The FSA is responsible for all aspects of financial regulation in Japan, including inspection, supervision, and surveillance of financial activities related to banking and securities business in addition to insurance.

Two bilateral Insurance Agreements, implemented in 1994 and 1996, are in effect. These agreements made significant contributions to the deregulation of the Japanese insurance market: their provisions committed Japan to introduce sweeping measures that resulted in significant improvements in the product approval process, greater use of direct sales of insurance products, and the introduction of risk-differentiated automobile insurance. Largely as a result of positive changes brought about by the agreements, foreign insurance companies have visibly and substantially increased their presence in both the life and non-life insurance sectors in Japan. While maintaining their strong third sector sales, U.S. and other foreign insurance companies have rapidly expanded their share in the primary sectors in recent years through product development and marketing innovations. Foreign insurers in Japan currently hold an estimated 5.4 percent share of the total non-life insurance market and 5 percent of the total life insurance market. In the third sector, foreign firms have captured approximately 69 percent of the health-related insurance market and about 19 percent of the non-life market. In addition, new business tie-ups and recent acquisitions in this sector involving foreign firms have significantly increased foreign presence in Japan.

Despite the noteworthy successes in this sector, as the market has changed and the Japanese Government has pursued further deregulation and liberalization in this sector, a number of issues have emerged which are of high priority to U.S. insurers. These include further liberalization and expansion of the insurance market, including the introduction of new products such as variable annuities and possible expansion of sales of such products by banks. The United States continues to urge Japan to adopt the goal of increasing competition as one of the basic principles of regulatory reform and to provide the foreign and domestic insurance industry meaningful opportunities to be informed of, comment on and exchange views with Japanese officials regarding the development or revision of guidelines or regulations through such means as public comment procedures and participation in government advisory groups.

The most recent bilateral consultations under the insurance agreements were held in Tokyo in July 2001. As in previous meetings, a U.S. regulator representing the National Association of Insurance Commissioners (NAIC), participated in the discussions. During the review, the United States and Japan discussed administrative and regulatory changes in Japan's insurance sector, including issues related to Japan's product approval process and the availability of needed resources and technology within FSA. The U.S. Government commended FSA for its efforts to seek public comment on the "Interim Report Concerning the Comprehensive Enquiry into the Issues in Life Insurance." During the consultations as well as in a written submission of comments to Japan on the interim report, the United States voiced support for many of the conclusions of this report. These included the need for FSA to shorten standard approval times and to move to a quicker, less-burdensome "file and use" system for certain insurance products. In light of the recent failures of prominent Japanese insurance companies, the United States and Japan also discussed recent changes related to the life and non-life Policyholder Protection Corporations, which are mandatory policyholder protection systems created by Japan in 1998 to provide capital and management support to insolvent insurers. Despite their strong and stable presence in the Japanese insurance market, U.S. insurers remain seriously concerned that they will be asked to make even higher contributions to these funds in the future. The United States also raised concerns regarding MPHPT's plans for the postal financial institutions as the Postal Services

Agency is transformed to a public corporation in 2003. The United States made several recommendations on how this transition should occur in its October 2001 recommendations to Japan under the Regulatory Reform Initiative. These included: increasing transparency in the Japanese Government's plans for the public corporation; prohibiting the postal financial institutions (*kampo* and *yucho*) from underwriting any new insurance products or originating any new non-principal-guaranteed investment products; and subjecting the postal financial institutions to the same standards of regulation as their private sector counterparts. As any modification to this system could have significant impact on competition in the Japanese insurance market, the U.S. Government also strongly urged that any decisions related to the future of the postal financial institutions, including possible privatization, be made and implemented in an open and transparent manner.

Discussions between the United States and Japan under the Regulatory Reform Initiative continue. The next annual consultations under the bilateral insurance agreements will be held in 2002, at which time the United States anticipates a full discussion of a wide range of issues.

**Professional Services**

The ability of foreign firms and individuals to provide professional services in Japan is hampered by a complex network of legal, regulatory and commercial practice barriers. U.S. professional services providers are highly competitive and their services are important, not only as U.S. exports, but as vehicles to facilitate access for U.S. exporters of other services and goods to the Japanese market. Moreover, U.S. services professionals often can contribute valuable expertise gained from broad experience in international markets and stimulate innovations for the economies they serve. Availability of such services can be a key factor in U.S. firms making decisions to invest in Japan, and thus is central to improving the environment for FDI in Japan.

*Accounting and Auditing Services:* U.S. providers of accounting and auditing services face a series of regulatory and market access barriers in Japan which impede their ability to serve this important market. Regulated accounting services may be provided only by individuals qualified as Certified Public Accountants (CPAs) under Japanese law or by an Audit Corporation (composed of five or more partners who are Japanese CPAs). To qualify as a CPA, a foreign accountant must pass a special examination for foreigners in order to obtain a professional certification. This examination was last offered in 1975. CPAs must also be registered as members of the Japanese Institute of Certified Public Accountants and pay membership fees.

Only individuals who are Japanese CPAs can establish, own or serve as directors of Audit Corporations. An Audit Corporation may employ foreign CPAs as staff, but foreign CPAs are not allowed to conduct audit activities. Furthermore, an Audit Corporation may engage in a partnership/association relationship with foreign CPAs only if the partnership/association does not provide audit services. Audit Corporations are prohibited from providing tax-related services, although the same individual may perform both functions as long as totally separate offices are maintained. Establishment is required for Audit Corporations, but not for firms supplying accountancy services other than audits. Branches and subsidiaries of foreign firms are not authorized to provide regulated accounting services. Nor can a foreign firm practice under its internationally recognized name; its official firm name must be in Japanese and is subject to approval by the Japanese Institute of Certified Public Accountants. The

United States will continue to urge Japan to remove these restrictions.

*Legal Services:* U.S. lawyers have sought greater access to Japan's legal services market and full freedom of association with Japanese lawyers (*bengoshi*) since the 1970s. However, strong opposition from the Japan Federation of Bar Associations (*Nichibenren*) and a reluctant Japanese bureaucracy have largely thwarted this objective. Since 1987, Japan has allowed foreign lawyers to establish offices and advise on matters concerning the law of their home jurisdictions in Japan as foreign legal consultants (*gaikokuho-jimu-bengoshi* or *gaiben*), subject to restrictions in the Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers (Law No. 66 of 1986, as amended, i.e. the Foreign Lawyers Law).

While Japan has liberalized several restrictions on foreign lawyers, the most critical structural deficiency in Japan's international legal services sector remains the severe limitations on the relationships permitted among Japanese lawyers and registered foreign legal consultants. In its October 2001 submission to Japan under the Regulatory Reform Initiative, the United States made the elimination of all prohibitions against freedom of association between Japanese and foreign lawyers a top priority and has urged the Japanese government to allow Japanese and foreign lawyers, as equal legal professionals, to determine their own forms of association that will enable them to best serve their clients' needs. The United States also emphasized that the "specified joint enterprises" (*tokutei kyodo jigyo*) system, which Japan established in 1995 instead of allowing *bengoshi* and foreign lawyers to form partnerships, does not provide the framework needed for effective teamwork between *bengoshi* and *gaiben*; nor will further adjustments of that system meet the needs of lawyers in Japan.

The United States also recommended that Japan allow foreign lawyers to hire Japanese lawyers, to provide advice on so-called "third country" law (that is, the law of a country other than the one that is a foreign lawyer's home jurisdiction) on the same basis as Japanese lawyers, and to establish professional corporations, limited liability partnerships (LLPs) and limited liability corporations. The United States also recommended improvements in Japan's foreign lawyers regulatory system, and specifically asked the Japanese government to ensure that the Nichibenren and the mandatory local bar associations provide *gaiben* with effective opportunities to participate in the development and enforcement of all laws and rules that affect them.

## INVESTMENT BARRIERS

Despite being the world's second largest economy, Japan continues to have the lowest inward FDI as a proportion of total output of any major OECD nation. In 2000, Japan's total cumulative stock of FDI totaled only 1.1 percent of GDP, compared with 12.5 percent for the United States and 29 percent for the United Kingdom. FDI in Japan has been rising rapidly, albeit from a small base, up 300 percent in JFY 2000 from the previous year's level. In JFY 2000, high growth sectors were banking and insurance, and telecommunications. However, FDI sharply declined in the first half of JFY 2001, down 18.7 percent from the previous year. U.S. direct investment for this period plunged 33.1 percent, but still accounted for 28.7 percent of all FDI in Japan. By contrast, European FDI in Japan increased significantly, and constituted 58.7 percentage of total investment for the period.

Although most direct legal restrictions on FDI have been eliminated, bureaucratic obstacles remain, including the occasional discriminatory use of bureaucratic discretion. While Japan's

foreign exchange laws currently require only *ex post* notification of planned investment in most cases, a number of sectors (e.g. agriculture, mining, forestry, fishing) still require prior notification to government ministries. More than government-related obstacles, however, Japan's low level of inward FDI flows reflects the impact of exclusionary business practices and high market entry costs.

Difficulty in acquiring existing Japanese firms – as well as doubts about whether such firms, once acquired, can continue normal business patterns with other Japanese companies – make investment access through mergers and acquisitions (M&As) more difficult in Japan than in other countries. However, the pressure of economic restructuring and the surge in M&As have weakened, to a degree, *keiretsu* relationships. U.S. investors cite the lack of financial transparency and disclosure and differing management techniques among the obstacles to M&A activity in Japan. The scarcity of qualified lawyers, auditors, and accountants needed for M&A activities also inhibits FDI.

The Investment Working Group was established under the Partnership to focus on needed changes in the basic operating rules of Japanese markets and to encourage policy changes that will help improve Japan's overall environment for foreign (and domestic) investment. More specifically, the United States urges Japan to consider measures that will assist with three key aspects of improving Japan's direct investment environment, including developing a more active and efficient market for M&As in order to enhance the productivity of capital in Japan; improving land market liquidity and foreign investors' access to land; and increasing the flexibility of Japan's labor markets.

In the area of M&As, U.S. proposals include: (1) allowing consolidated taxation in order to spur investment by lowering the post-tax cost to a parent firm of investing in new risk ventures; (2) taking steps to unwind extensive cross-shareholding in Japan; (3) improving corporate governance practices in order to mitigate senior management emphasis on firm loyalty over shareholder return, which can lead to premature rejection of M&A offers; (4) continuing with financial market regulatory reform, such as allowing stock-for-stock transactions and easing stock market listing requirements; (5) improving financial data disclosure to assist firms interested in pursuing M&A relationships with other firms; (6) increasing the availability of M&A-related services, including further easing of restrictions governing the accounting and legal professions; and (7) introducing smoother and more flexible bankruptcy procedures to make it easier for a corporation and its assets to be acquired or merged in a "rescue" format.

U.S. proposals addressing land and real estate transactions focus on improving land market liquidity, and include: (1) undertaking additional land tax relief measures and steps to further shift the burden of land taxation from acquisition taxes to holding taxes; (2) easing regulations on developing property in central urban districts as well as relaxing restrictions on the conversion of agricultural land; (3) changing leasing rules to allow new investors to make flexible use of acquired property; (4) making systematic disclosure of information on real estate transactions; and (5) making changes to the Special Purpose Corporation (SPC) Law and other related regulations to facilitate the creation of real estate investment trusts (REITs).

Finally, the United States stressed the need to improve labor mobility in Japan, recommending that Japan: (1) introduce defined contribution pension plans as a useful way to improve pension portability; (2) deregulate fee-charging employment agencies in order to assist foreign

investors in locating needed local talent; (3) liberalize Japan's labor dispatching business in order to help new investors find workers and cut costs, as well as help unemployed workers find work; and (4) ease excessively tight regulations that unnecessarily raise costs and lower the efficiency of corporate operations.

Japan has enacted new and revised legislation providing opportunities for foreign investors. For example, the Industrial Revitalization Law provides existing firms undergoing reorganization (both domestic and joint-venture) with tax and credit relief once the firm's business restructuring plan is approved by the Japanese Government. A new bankruptcy law (the Civil Reconstruction Law) also may provide investment opportunities as it encourages business reorganization, including spin-offs, rather than forced liquidation of assets. Other legislative changes now provide for stock options for employees, a key issue for foreign firms wishing to attract high quality employees. In addition, Japan prepared legislation on corporate divestiture that will facilitate companies' streamlining efforts. New accounting rules are bringing Japan closer to international standards and to a degree have helped reduce extensive cross-shareholding among firms, as the new accounting rules identify non-performing assets and liabilities. Further, Japan announced in April 2000 that it would undertake sweeping reforms of its Commercial Code, which can help investment. (For more details see the Commercial Code section under Structural Regulatory Reform.) While U.S. businesses have applauded these changes, they continue to urge that Japan's tax regulations be clarified and amended to facilitate use of these measures.

The Investment Working Group met three times in 2001 and participated in investment seminars in both Japan and the United States. Through these avenues, the two governments continue to explore ways to enhance the investment climate in Japan. The private sector participates actively in this process and has offered detailed suggestions on how to increase corporate governance and regulatory transparency, improve accounting and disclosure standards, and improve real estate liquidity and labor mobility.

## ANTI-COMPETITIVE PRACTICES

Anti-competitive practices are a cross-cutting issue in U.S.-Japan trade relations. In addition to this section, there is detailed discussion related to anti-competitive practices and AMA enforcement in several other sections, particularly under Sectoral Regulatory Reform.

*Exclusionary Business Practices:* U.S. firms trying to enter or participate in the Japanese market face a host of exclusionary Japanese business practices that block market access opportunities. These include:

- Anticompetitive private practices that violate the Antimonopoly Act (AMA) but go unpunished;
- Corporate alliances and exclusive buyer-supplier networks, often involving companies belonging to the same business grouping (*keiretsu*);
- Corporate practices that inhibit FDI and foreign acquisitions of Japanese firms (e.g., non-transparent accounting and financial disclosure, high levels of cross-shareholding among *keiretsu* member firms, a low percentage of publicly traded common stock relative to total capital in many companies, and the general absence of external directors);
- Industry associations and other business organizations that develop and enforce industry-specific rules limiting or

> regulating, among other things, fees, commissions, rebates, advertising, and labeling for the purpose of maintaining "orderly competition" among their members, and often among non-members.

Exclusionary business practices exact a heavy toll on the Japanese economy. By constraining market mechanisms, exclusionary business practices reduce the choices available to businesses and consumers, and raise the cost of goods and services. In addition, by discouraging competitors who seek to break into Japan's market with innovative products and services, these practices impede the development of new domestic industries and technologies. Such practices discourage potential foreign investors, whose market presence and technological innovation would stimulate the economy and provide critical channels for exports and sales by foreign firms.

*Law Against Unjustified Premiums and Misleading Representations:* The JFTC imposes overly restrictive limits on the use of premium offers (prizes) and other sales promotion techniques, and thereby discourages even legitimate cash lotteries and product giveaways used in such promotions. Foreign newcomers, who depend on innovative sales techniques to market their company names and products, are significantly impaired by the JFTC's restrictions on premiums. In addition, the JFTC allows "fair trade associations" (essentially, private trade associations) to set their own promotion standards through self-imposed "fair competition codes." Trade associations can, and often do, use the cover of these codes to adopt additional standards that are stricter than required by JFTC regulations under the Premiums Law and have the effect of restraining vigorous competition. The United States continues to urge Japan to review the necessity of §10-5 of the Premiums and Misrepresentations Law, which provides an exemption for fair trade associations from the AMA, with a view towards abolishing that provision. As of year end 2001, there are still 48 JFTC-authorized private premium codes. Moreover, five industries – real estate, household electrical appliances, newspapers, magazines, and hospital management – remain subject to specific stricter rules than the rest of the economy. Some steps were taken in the late 1990's to liberalize premium rules, but they fall short of the dramatic, pro-competitive liberalization measures requested by the United States.

## ELECTRONIC COMMERCE

Despite the recent slowdown in IT-related industries and the shakeout among dot-com companies, electronic commerce has become an established and key component of our two economies. As the second largest economy in the world, Japan is an important market for electronic commerce and a key player in international discussions regarding the regulatory framework for global electronic commerce and the Internet. Japan has, in its policy statements and its regulatory actions, endorsed an open, private sector-led and minimally regulated environment for the Internet and electronic commerce.

Nonetheless, the development of both the Internet and electronic commerce lags in Japan compared with other developed countries due to continued high phone rates for dial up access to the Internet. The IT Strategy Council (established by Prime Minister Mori in July 2000 and primarily comprised of Japanese business leaders) concluded that a key reason Japan has lagged in IT is because of high telecommunications fees. The cost of Internet access in Japan has been estimated by the OECD in 2001 to be double that of the United

States, New Zealand, and Canada and over four times more expensive than in Korea (for 30 hours, off peak). These charges are a result of the market access barriers to Japan's telecommunications sector (see the Sectoral Regulatory Reform section) and are currently being addressed by the United States and Japan. The threshold requirement for promoting electronic commerce is providing affordable access to conducting business online. Recent improvements in pricing for DSL services, for example, should help make e-commerce more economically feasible. However, a large number of consumers and businesses still access the Internet through dial up networks. The United States is working with Japan to ensure robust growth in this critical sector by targeting the high cost of dial up access to the Internet in Japan.

The United States continues to urge Japan to rely on the principles reflected in our Joint Statement on Electronic Commerce at the Birmingham Summit in May 1998, and reaffirmed in the July 2000 Okinawa Charter on Global Information Society as it moves towards spurring the growth of electronic commerce. Key among these principles are that: (1) the private sector should lead in the development of electronic commerce; (2) governments should encourage industry self-regulation; and (3) government regulation, where necessary, should be minimal, transparent, and predictable.

In addition, the United States made several recommendations and proposals in its October 2001 Regulatory Reform Initiative submission for increasing consumer confidence and promoting electronic commerce in the private sector. Specific areas addressed include online privacy, consumer protection, facilitating online transactions and electronic government. The United States is working with Japan on these and other electronic commerce issues through the IT Working Group in the Regulatory Reform Initiative. For more details see the Information Technologies section under Sectoral Regulatory Reform.

The United States will continue to monitor the development of electronic commerce and the Internet in Japan to ensure that Japanese Government-funded test-bed projects for electronic commerce will be fully open to participation by U.S. firms and that standards and technologies for electronic commerce and the Internet remain open and internationally interoperable. The United States will also monitor actions by regulators such as MPHPT (e.g. regarding licensing requirements and restrictions on new standards and technologies) to ensure that such actions promote a liberal environment for the growth and development of electronic commerce in Japan.

## OTHER BARRIERS

### Aerospace

Japan is the largest foreign market for U.S. aircraft and aerospace products. The United States accounted for approximately 83 percent of Japan's aerospace imports in 2001. Many Japanese firms have entered into long-term relationships with American aerospace firms.

The commercial aerospace market in Japan is generally open to foreign firms, but the United States is monitoring Japan's funding of feasibility studies for new projects and technologies and its important role in apportioning work among major Japanese aerospace companies. A recent proposal by METI to develop a 100-seat commercial aircraft, replacing the earlier YSX project, bears monitoring. Although U.S. firms have frequently won contracts to supply defense equipment to Japan, the Japan Defense Agency (JDA) has a general preference for licensing foreign technology for production in Japan to support domestic industry.

The United States is monitoring Japan's efforts to develop indigenous space systems which may limit the procurement of proven U.S. technology and products, and will continue to seek greater access in areas where Japan's preference for domestic space technologies has been most prominent.

**Autos and Auto Parts**

Further opening of the Japanese auto and auto parts markets remains an important objective of the United States. Access to Japan's automotive market continues to be inhibited by a variety of overly restrictive regulations, a lack of transparency in rule-making, and lackluster enforcement of antitrust laws. In recent years, Japan's lingering economic slump, limited market access, and weak competitive environment have disproportionately hurt foreign vehicle and auto parts manufacturers. Further, while there has been a trend toward closer integration and important technological advancements in the global automotive industry over the past several years, the effect these changes will have on market access and competition in this sector remain unclear.

The U.S. Government remains disappointed with falling sales of North American-made vehicles and parts in Japan and to the Japanese transplants. Sales in Japan of motor vehicles produced in the United States continued to decline in 2001, with combined sales decreasing by 20 percent (year-on-year) following a decline of 74 percent from 1995 to 2000. Today, American car makers sell only a quarter as many U.S.-made vehicles in Japan as they did in 1995, when the five-year, bilateral U.S.-Japan Automotive Agreement was concluded. Structural changes in the automotive industry have led U.S. companies to alter their distribution and marketing strategies in Japan. Nonetheless, foreign access to Japan's automotive distribution network has continued to be of concern to U.S. auto companies. Related to automotive parts, U.S. exports to Japan fell $1.2 billion in 2001, a decline of ten percent from the same period in 2000. The U.S. automotive trade imbalance with Japan – $42 billion in 2001 – is the equivalent of more than 60 percent of the overall U.S. trade deficit with Japan and makes up ten percent of the worldwide U.S. trade deficit.

In order to address barriers in and improve U.S. companies' access to the domestic Japanese automotive market and Japanese auto plants in the United States, the United States and Japan established a new Automotive Consultative Group (ACG) on October 24, 2001. The ACG will serve as the focal point for addressing lingering as well as emerging issues in this key sector of both countries' economies. More specifically, the group will assess trends in the industry based on a series of trade and economic data on autos and automotive parts to be provided by both countries and work to identify areas in which specific action can be taken by Japan to address U.S. concerns. This would include further deregulation (particularly with respect to the automotive parts aftermarket), increased transparency in rules and regulations governing this sector (including a proposed new recall system for automotive aftermarket parts), and more rigorous application of Japanese competition laws. The ACG will meet at least yearly and will be co-chaired by the Department of Commerce and USTR on the U.S. side, and METI and MLIT on the Japanese side. The first meeting is expected to take place in the first half of 2002.

In addition to meetings under the ACG, the United States is continuing to address cross-cutting issues impacting the automotive sector under the Partnership. This includes expanding opportunities for foreign investment, increasing transparency in governmental

rule-making, and promoting corporate restructuring in the Japanese economy.

### Civil Aviation

Market access for U.S. air carriers in Japan improved significantly with the 1998 bilateral civil aviation agreement, but carriers remain constrained by extremely high airport costs in Japan and by enduring restrictions on traffic rights, operational flexibility, and pricing.

In January 1998, the United States and Japan agreed to a new Memorandum of Understanding (MOU) which permitted "incumbent" carriers for the United States – United Airlines, Northwest Airlines, and Federal Express – to operate from any U.S. gateway point to any point in Japan and beyond Japan to third countries, without limitation on the number of flights. It also permitted two additional "non-incumbent" U.S. combination carriers (airlines that transport both passengers and cargo) to enter the Japanese market, and allowed non-incumbent carriers as a group to add up to 90 more weekly round-trip flights. Non-incumbent all-cargo carriers gained new opportunities to transport cargo to destinations beyond Japan. In 2002, another U.S. all-cargo carrier may enter the U.S.-Japan market (but with very restricted opportunities) and each party will be permitted 800 charter flights per year (up from 600 in 2001).

In October 2000, the New Tokyo Narita Airport Authority announced its intention to raise international flight landing fees (already 2 to 5 times higher than at other major airports in the world), while cutting fees for domestic flights that only Japanese carriers can operate. Plans by MLIT to effectively subsidize troubled Osaka-Kansai airport with Narita user fees, and to partially fund a costly new rail link to Narita with landing fees, would raise operating costs even further.

Limited slot availability at Narita airport – partly the result of artificial limits on movements – also prevents U.S. carriers from utilizing rights under existing agreements. Since 1998, U.S. non-incumbent combination carriers have been unable to operate several routes made available under the 1998 MOU. A second runway scheduled to open in April 2002 will provide additional slots, but at less than 2500 meters, the runway cannot accommodate most long-haul operations.

In the 1998 MOU, the two sides agreed to hold further negotiations by 2001 "with the objective of fully liberalizing the civil aviation relationship between Japan and the United States." The United States and Japan have held three rounds of civil aviation talks since November 2000. The United States will continue to pursue further liberalization consistent with its global policy to promote competition and market access in civil aviation.

### Electric Utilities

The cost of electric power in Japan remains the highest in the industrialized world. The United States believes that by introducing genuine competition into non-fuel procurement (valued at approximately $11 billion annually), Japan can effectively reduce costs in the electricity sector.

Many utilities have begun to increase imports and reduce costs. Some have increased the number of companies registered as potential suppliers and made procurement information accessible in Japanese and English through the Internet. While some firms have significantly improved procedures for international procurement, others continue to lag behind. Japan's utilities actively participate in the New Orleans Association (NOA), a U.S.

Embassy-sponsored forum that enhances communication between Japanese electric power firms and U.S. suppliers of non-fuel materials and equipment. The United States continues to urge Japanese utilities to further increase procurement of foreign products, which often prove more economical.

Foreign firms still face barriers due to standards and specifications used by Japanese utilities that often discriminate against or disproportionately burden foreign suppliers. Problems remain in the use of narrow, dimension-based technical standards rather than performance-based technical standards, and requirements that suppliers provide detailed information for spare parts originating from outside sources. Because each utility uses its own specifications, suppliers have to prepare ten production lines in order to sell to Japan's ten electric power companies. Although several utilities are moving to unify their specifications and comply with world standards, this remains a long-term project.

The United States continues to seek greater transparency and fairness in the procurement process. Costly and time-consuming procedures are generally required for a firm to be a designated supplier for a particular utility, including requests that suppliers submit detailed information on proprietary manufacturing processes. Access to procurement information is also a problem, and foreign firms often do not learn about procurements until after they have been awarded. To expand international procurement to reduce costs, it is important for the utilities to publish specifications in English and accept offer sheets, drawings, explanatory documents, and contract sheets in English.

U.S. exports currently account for approximately four percent of Japanese electric utility procurements, or around $440 million per year. Should barriers be lifted, that share could plausibly rise to six percent, or around $660 million per year.

**Flat Glass**

Despite efforts under the 1995 four-year bilateral Flat Glass Agreement to spur Japanese glass distributors to diversify supply sources and not to discriminate based on capital affiliation, Japan's three domestic flat glass producers (Asahi Flat Glass, Nippon Sheet, and Central Glass) have maintained largely constant market shares through informal coordination and tight control over distribution channels, restricting market access for U.S. manufacturers.

The 1995 agreement had some success, prompting Japan to adopt energy conservation standards for residential and commercial buildings and to feature American glass in high-profile public works projects.
However, U.S. and other foreign glass companies still have an artificially small share of Japan's flat glass market (about seven percent; import data are skewed by imports from foreign subsidiaries of Japanese manufacturers). In other major industrial markets, including the United States and the EU, the market share of foreign-owned companies (via imports and in-country production) is more than five times the level in Japan.

A JFTC survey of the flat glass market in May 1999 found no practices in violation of Japan's antitrust laws, but noted the dominant position of the three domestic firms, areas of possible serious concern, and the JFTC's intention to continue its surveillance of the industry. In December 1999, the JFTC sanctioned a Japanese auto glass association and a subsidiary of Japan's largest flat glass manufacturer for barring imports of auto glass, and issued warnings to three other industry associations.

After the expiration of the bilateral Flat Glass Agreement in December 1999, the United States engaged Japan in discussions under the Enhanced Initiative on Deregulation and Competition Policy, the outcome of which was contained in the Fourth Joint Status Report concluded in 2001. In that report, the Government of Japan recognized the economic benefits of competition in the distribution sector. It also confirmed that it would be detrimental to competition and a violation of Japan's Antimonopoly Act for distributors to reach agreements among themselves designed to exclude imported or other competitors' products from entering the market. In addition, the Government of Japan suggested that enterprises and foreign governments notify the JFTC of anti-competitive practices in the flat glass market and other highly oligopolistic markets. In the Fourth Joint Status Report, METI also agreed to continue to pursue economic reforms to ensure competition in the distribution sector.

The United States will continue to closely monitor developments in Japan's flat glass industry and will raise its concerns with Japan under the Partnership as appropriate. We urge Japan to take concrete steps to promote competition and eliminate unhealthy, oligopolistic behavior in this sector.

### Motorcycles

Japan's ban on tandem riding of motorcycles (carrying a passenger) on motorways is the only remaining restriction on motorcycling in Japan that the United States seeks to eliminate. The ban artificially limits Japan's market for large motorcycles, adversely affecting U.S. exports. More important, by forcing riders to use less-safe ordinary roads, the ban significantly reduces the safety of motorcycling in Japan. In March 1994, the United States first appealed to Japan to remove this burdensome restriction, and in June 1999 filed a formal petition to lift the ban with Japan's Office of Trade and Investment Ombudsman (OTO).

The OTO and Government of Japan continue to consider the U.S. petition. The Japan Automobile Manufacturers Association (JAMA) has recommended that Japan lift its ban on tandem riding of motorcycles on highways in Japan, and in February 2001, released a report summarizing a survey it conducted on motorcycle tandem riding on expressways in Europe (specifically, in Germany and Italy). It found that accidents involving tandem motorcycle riders on expressways are extremely rare, and for motorcycles, traveling on expressways is much safer than on public roadways. The report noted that the accident rate involving motorcycle tandem riders is below that of single riders, and no cases could be found in which tandem riding actually caused motorcycle accidents on expressways. These findings are similar to the findings of a U.S. research study of motorcycle tandem riding safety, which was given to the Government of Japan in 1999.

### Paper and Paper Products

In April 1992, the United States and Japan signed the "Measures to Increase Market Access for Paper Products," a five-year agreement aimed at substantially increasing access to Japan's market for paper products. Under the agreement, the Government of Japan agreed to encourage companies to increase imports of competitive foreign paper products; introduce transparent corporate procurement guidelines; encourage key end-user segments of the Japanese market to use foreign paper; and introduce Antimonopoly Act (AMA) compliance programs. Japan also promised to provide assistance to foreign paper suppliers in the form of market information and low-interest loans. The agreement expired in April 1997.

Through 2001, there has been no meaningful increase in Japanese imports of paper and paperboard products, and the level of import penetration for paper and paperboard products in Japan remains the lowest in the industrialized world. According to U.S. producers, exclusionary business practices remain a key problem. U.S. industry representatives estimate that the removal of systemic barriers to the Japanese paper market would result in at least a 10 percent share for U.S. suppliers, or approximately $5 billion, compared to the current level of $650 million.

**Sea Transport / Ports**

American carriers serving Japanese ports have long encountered a restrictive, inefficient, and discriminatory system of port transportation services. In 1997, the Federal Maritime Commission assessed a $100,000 fee on each ocean voyage to the United States by Japanese shipping lines, prompting Japan to agree in September 1997 to substantial regulatory reform of its ports sector. The U.S.-Japan understanding also noted side agreements designed to reduce the power of the Japan Harbor Transport Association (JHTA) from deterring competition in the sector. Japan amended its Port Transport Law (effective November 2000) to eliminate the need for new entrants to prove there is surplus demand. Also, fees no longer need to be approved by MLIT.

Since 1999, the United States has expressed its concern that reforms have not lessened JHTA's ability to deter new entry and restructuring in the ports sector. The United States has also noted that the revised Port Transport Law contains cumbersome administrative requirements, gives MLIT wide authority to intervene in pricing decisions of terminal operators, and increases minimum permanent staffing by 50 percent. MLIT has not addressed concerns about the prior consultation process nor about the apparent threat of illegal strikes.

The United States' concerns led the Federal Maritime Commission, in August 2001, to order major Japanese shipping lines and ocean carriers that provide substantial U.S.-Japan service to furnish detailed information on the effects of recent changes in Japanese port laws and ordinances. The United States will continue to closely monitor how these changes affect port operations and to urge faster regulatory reform in the port sector.

**Semiconductors**

An area in which the United States and Japan have made progress in addressing trade problems is semiconductors. After many years of effort by both Governments as well as their respective semiconductor industries, substantial progress has been achieved in both the level of industry cooperation and market access. Japanese purchases of foreign chips have been around 30 percent for several years. The 1996 Semiconductor Agreement expired in July 1999, and was replaced by a multilateral Joint Statement on Semiconductors announced by the United States, Japan, Korea, and the European Commission (Taiwan subsequently became a party). The new statement is designed to ensure fair and open global trade in semiconductors and includes the essential elements of the 1996 accord, such as regular meetings among governments and between government and industry representatives. The United States will, however, continue to monitor foreign market share in the Japanese market on a quarterly basis, and once a year will report the average foreign share in the Department of Commerce's "U.S. Industry and Trade Outlook." Governments and industries meet annually to review progress under the Joint Statement. Japan will host the next meeting in mid-2002.

### Steel

The U.S. steel industry endured tremendous hardship in 1998 as a sudden and substantial drop in demand for steel in Japan and the rest of Asia created a huge oversupply, much of which Japanese companies diverted to the U.S. market. Japan was the main source of imports to the U.S. market in 1998. While U.S. imports of steel from Japan are down significantly from 1998 crisis levels, the underlying causes of the surge should be addressed to ensure that this is not repeated in the future.

U.S. steel producers often have expressed concerns that Japanese steel companies may be engaging in anti-competitive practices. With respect to Japan's domestic market, it has been alleged that Japan's five integrated producers coordinate output, pricing, and market allocation goals – all with the knowledge of METI. In addition, it has been alleged that Japanese mills have entered into arrangements with foreign counterparts to regulate bilateral steel trade.

In June 2001 the U.S. Government launched the President's Multilateral Initiative on Steel. The Initiative is now proceeding on multiple tracks. Japan has participated constructively in bilateral consultations and in OECD High-Level Meetings on Steel in late 2001 aimed at reducing excess inefficient steelmaking capacity around the world. However, it is estimated that considerable uneconomic excess capacity in Japan still needs to be reduced or eliminated. The United States will continue to actively address anti-competitive activity, market access barriers, and/or market-distorting trade practices in the steel sector.