

# **JAPAN**

## **TRADE SUMMARY**

The U.S. trade deficit with Japan was \$75.2 billion in 2004, an increase of \$9.2 billion from \$66.0 billion in 2003. U.S. goods exports to Japan in 2004 were \$54.4 billion, up 4.6 percent from the previous year. Corresponding U.S. imports from Japan were \$129.6 billion, up 9.8 percent. Japan is currently the 3rd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Japan were \$29.8 billion in 2003 (latest data available) and U.S. imports were \$17.4 billion. Sales of services in Japan by majority U.S.-owned affiliates were \$38.3 billion in 2002 (latest data available), while sales of services in the United States by majority Japan-owned firms were \$22.3 billion.

The stock of U.S. foreign direct investment (FDI) in Japan in 2003 was \$73.4 billion, up from \$65.9 billion in 2002. U.S. FDI in Japan is concentrated largely in the finance, manufacturing, and wholesale sectors.

## **REGULATORY REFORM OVERVIEW**

Japan's efforts to achieve meaningful structural and regulatory reform have begun to bear concrete results. Broadband utilization in Japan has increased greatly and can now be enjoyed at some of the fastest speeds and lowest costs in the world. Energy sector reform is creating greater opportunities for competition and paving the way for more efficient use of electricity and natural gas in Japan. In the financial sector, Japan has made significant progress in dealing with its non-performing loans and deflation. And there are now hundreds of Special Zones for Structural Reform up and running throughout Japan, spurring growth and innovation at the local level. The United States welcomes all this reform activity and the growth it is generating to put the Japanese economy back on track.

If Japan is to sustain this growth, however, it must hold firm in its determination to continue its bold reform agenda. The United States therefore welcomes Prime Minister Koizumi's unwavering commitment to a meaningful structural and regulatory reform agenda. In particular, the United States welcomes the Prime Minister's decision to establish the Council for the Promotion of Regulatory Reform (CPRR) to carry on the important work of the Council for Regulatory Reform. Structural and regulatory reform not only contributes to growth, but also plays an enormous role in increasing market access opportunities for U.S. companies.

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

The Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) is one of six components of the U.S.-Japan Economic Partnership for Growth (Partnership), which President Bush and Prime Minister Koizumi launched in June 2001. The Initiative addresses key sectors, including telecommunications, information technologies, energy, medical devices and pharmaceuticals, financial services, and agriculture. It also addresses crosscutting sectoral issues, including competition policy, transparency, privatization, legal system reform, revision of Japan's commercial law, and distribution. Through the Regulatory Reform Initiative, the United States continues to advocate the reform of laws, regulations, administrative guidance and other measures, formal and informal, that impede access to the Japanese market for U.S. goods and services.

Progress achieved in the third year of this Initiative was detailed in the Third Report to the Leaders and presented to President Bush and Prime Minister Koizumi at the G-8 Summit in Sea Island, Georgia, in June 2004. Kicking off the fourth year of the Regulatory Reform Initiative, the United States submitted its recommendations to Japan in October 2004 in Washington. This was followed by a first round of Working Group meetings held in early December. After convening another round of Working Group meetings and a deputy-level meeting in the spring of 2005, the two Governments intend to conclude a Fourth Report to the Leaders on the margins of the next G-8 Summit in Perthshire, Scotland, in early July.

### **SECTORAL REGULATORY REFORM**

#### **Telecommunications**

Under the Regulatory Reform Initiative, the United States seeks regulatory changes to promote competition, innovation, and choice in Japan's telecommunications sector. The competitive and regulatory environment in this sector has evolved over the past several years, resulting in the rollout of numerous innovative technologies and competitively priced advanced services, including Digital Subscriber Line, Fiber-to-the-Home, and Voice Over Internet Protocol. Nevertheless, maintaining, and in some cases strengthening, dominant carrier regulation and competitive safeguards will be critical if competing carriers (both domestic and foreign-invested) are to offer viable alternatives to NTT's regional carriers and mobile operator.

Through its October 2004 Regulatory Reform submission and in bilateral consultations, the United States has asked Japan to take measures to address specific market access impediments related to a wide range of policies in this sector. If undertaken, these measures 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 committed to ensuring equitable opportunities for new entrants and unbiased treatment of all operators. The United States continues to request that Japan develop a plan to move regulatory functions outside the purview of a ministerial agency, where it is subject

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to direct political control, to a fully independent organization. It is also important for Japan to establish and exercise meaningful sanction authority by the regulator (imposition of fines, payments of damages, license restrictions) to punish anticompetitive behavior.

*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 for interconnection. In JFY 2003, the key interconnection rate was increased by 21 percent, and the revised rate for 2004 was increased an additional 6 percent in 2004. As a result, Japan continues to have some of the highest interconnections rates among OECD countries. The Ministry of Internal Affairs and Communications (MIC) is currently conducting another review to determine the rate system to be put in place from JFY 2005. The United States will continue to press Japan to correct the fundamental flaws of the methodology that caused the increased rates (primarily, inclusion of non-traffic sensitive costs in the rate calculation), as well as to address its lack of regulatory independence and accountability, which make it vulnerable to political influence throughout the rate-setting process.

*Dominant Carrier Regulation:* NTT has maintained its market dominance through a number of measures, such as denial of access to emergency services by interconnecting carriers and proposals for higher interconnection charges on carriers competing with alternative technologies (e.g., for DSL services). NTT also has been pressing MIC to remove fiber optic cable from the list of unbundled items they are required to make available to competitive carriers at non-discriminatory rates. The United States continues to monitor whether MIC is taking sufficient steps to ensure that NTT East and West will not take advantage of their dominant position to inhibit competition.

*Mobile Termination:* New entrants to Japan's telecommunications market have also expressed concern about the high access rates charged by NTT DoCoMo, the dominant wireless service provider. While DoCoMo reduced rates significantly in 2003, rate reduction in 2004 was barely four percent. Following reforms to the Telecommunications Business Law in 2001, DoCoMo was recognized as a dominant carrier in 2002, but MIC has not required DoCoMo to explain how its rates are calculated.

*New Mobile Wireless Licenses:* MIC's role in limiting the mobile wireless market to three main competitors, dominated by NTT DoCoMo with a market share of over 50 percent, is problematic – particularly given the high mobile rates prevalent in the market, evidence that operators are warehousing spectrum, and opposition by one incumbent to any new market entry (a position inconsistent with Japan's WTO commitments). MIC could greatly improve the competitive environment in the mobile wireless market by expanding market access opportunities through a more transparent and pro-competitive approach to spectrum allocation and assignment. Interest by U.S.-affiliated operators in new licenses makes this a priority issue.

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*Rights-of-Way:* New competitors in Japan find it time-consuming and expensive to build competing networks in Japan because of high costs and difficulties related to access to "rights-of-way." A labyrinth of restrictions reportedly increase construction costs by roughly ten times and can result in digging that takes six times longer than in other major markets. Japan's e-Japan Strategy, which is designed to make Japan a global information technologies leader by 2005, includes measures to relieve these problems on an experimental basis (in particular, relaxing certain restrictions on the laying of fiber optic cable). The United States continues to urge mandatory rights-of-way access for new competitors and has proposed that Japan establish pro-competitive rules to ensure non-discriminatory, transparent, timely, and cost-based access for telecommunications carriers and cable television operators.

### **Information Technologies**

Japan has made important progress over the last few years in removing numerous regulatory barriers as part of its efforts to become a world leader by 2005, a goal the Japanese government first outlined in a bold plan called the e-Japan Strategy. This progress has helped transform the landscape in Japan into one where broadband utilization is widespread and can be enjoyed at some of the fastest speeds available and at the lowest costs in the world. Japan has also increased the use of IT and online processes in the private and public sectors and is now one of the largest e-commerce markets in the world. The "e-Japan Priority Policy Program 2004" (2004 Priority Policies) reaffirms Japan's goals and prioritizes steps to achieve them, such as ensuring secure and reliable networks, focusing on IT adoption, protecting intellectual property, encouraging content development, and increasing use of e-government. The 2004 Priority Policies also acknowledge the private sector's leadership role in promoting IT usage, and the global nature of e-commerce.

The United States supports Japan's efforts to remove these barriers. The U.S. Government's recommendations in its October 2004 Regulatory Reform submission support Japan's goals by focusing on: 1) removing persistent legal and other barriers that hinder e-commerce; 2) allowing maximum private-sector flexibility, innovation, self-regulation, and leadership; 3) expanding private-sector input into the development of IT-related policy, regulations, and procurement reforms; 4) creating a legal structure that enhances efficiency and security and facilitates online transactions in all areas of the economy; 5) developing coordinated policies compatible with international practice; and 6) protecting and promoting intellectual property. The U.S. Government also urges Japan to ensure that new strategies, laws, ordinances, and guidelines to implement the 2004 Priority Policies do not promote, mandate, or unduly favor specific technologies (technological neutrality), in order to provide maximum flexibility and encourage innovation within the private sector.

*Regulatory and Other Barriers:* While Japan has made great strides in promoting e-commerce and increasing the use of online processes in the private and public sectors, legal and other regulatory barriers remain that prohibit Japan from fully realizing its IT potential. In its October 2004 Regulatory Reform submission, the United States is therefore urging Japan to: (1) remove

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barriers in existing laws and regulations that hinder e-commerce, such as permitting e-notification under the Money Lending Business Law and amending the Road Transportation Vehicle Law to allow registered owners of fleet vehicles to use online e-government systems to change fleet vehicle registrations; (2) create a flexible legal framework for digital storage and exchange of data in various sectors, including medical services, through the “e-Document Law” and its implementing regulations; and (3) implement measures to strengthen the ability of the IT Strategic Headquarters to produce coordinated, effective IT policymaking that meets the needs of the private sector.

*Personal Data Regulation (Privacy):* Since the Diet passed the Law on the Protection of Personal Information on May 23, 2003 (Privacy Law), several ministries and agencies have formulated implementation guidelines that must be finalized before the Law goes into effect in April 2005. The United States urges Japan to ensure the following: that any forthcoming privacy implementation guidelines are developed in a transparent and coordinated manner; that all final guidelines are consistent, complement existing international regulations, and not be overly burdensome; and that guidelines be enforced consistently and fairly. The United States suggests that implementing agencies issue authoritative government regulations and/or guidelines and examples for educational purposes, as had been discussed at the public/private privacy roundtable organized by the two Governments and held in Tokyo in May 2004. To further support Japan's efforts to establish privacy guidelines, the U.S. Government has been suggesting the co-sponsoring of a second privacy roundtable, where the ministries could further explain the implementation of their guidelines, as well as address industry's concerns regarding compliance and enforcement.

*Alternative Dispute Resolution:* Online dispute resolution is the only practical tool for consumers and online businesses to resolve the inevitable disputes that arise in business to consumer transactions. International practice allows for dispute resolution providers to be of the parties' choosing. Japan has been an outlier in this area as only members of Japan's bar have been permitted to profit from ADR services. This discouraged the development of online and offline dispute resolution in Japan. Late in 2004, Japan passed legislation to create a government certification system for ADR providers. This certification system, although voluntary, has the potential to actually discourage parties from choosing non-certified ADR providers. Given the impracticality of using an ADR provider certified by the Japanese government, the new legislation may not further the use of online dispute resolution in the cross-border context. (*See also Legal System Reform section in this chapter.*)

*Strengthening Intellectual Property Rights (IPR) Protection:* The October Regulatory Reform submission includes a number of recommendations to Japan intended to strengthen IPR, such as: (1) extending the term of copyright for sound recording and all other subject matter protected under Japan's Copyright Law; (2) adopting a statutory damages system that would act as a deterrent against infringing activities, ensure that right holders are fairly compensated for the losses suffered by infringement, and enhance judicial efficiency by eliminating the costly burden of having to establish and calculate actual damages and profits; and (3) actively working with the

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United States to develop ways to promote greater protection of intellectual property rights worldwide, especially in Asia. (*See also Intellectual Property Rights Protection in this chapter.*)

*Digital IPR:* Japan's liability rules for Internet Service Providers (ISPs) went into effect in May 2002 along with implementing guidelines drafted by a private sector-led working group. The United States remains concerned that the liability rules: remain unclear; do not provide the appropriate balance among the interests of telecommunication carriers, ISPs, right holders, and website owners; and fail to provide adequate protection for right holders. 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 audio-visual and game software industries, and may hinder the development of creative works and new products that could be subject to online piracy. The United States urges Japan to monitor compliance with the implementing guidelines for ISP liability rules and their effectiveness for ensuring that infringing materials are removed from websites quickly and adequate remedies are provided for any injuries suffered. The United States also continues to urge Japan to support the continued existence of the private sector working group, and any revisions of the guidelines and/or the law for ISP liability rules that may be necessary to ensure an effective "notice and take down system" and the appropriate balance of the rights and interests of all parties.

The Japanese government took a significant step forward in protecting temporary copies (e.g., digital copies made in the RAM of a computer) by recognizing that "temporary storage" implicates the reproduction right. However, the scope of protection for temporary copies remains vague, which could erode the ability to protect copyrighted materials in Japan. Given the importance of this new interpretation, the United States will continue to monitor developments in this area.

*Network Security:* Japan's Ministry of Economy, Trade and Industry (METI) issued network security guidelines in April 2003 for its own use. MIC released similar guidelines in late 2003 for use by local governments. In addition, the Cabinet Secretariat in conjunction with various ministries is currently developing central government-wide network security guidelines. Ministries are also scheduled to begin development of guidelines for key industrial sectors as well. The United States is urging Japan to ensure that any network security standards and guidelines developed for use by the Japanese government or the private sector be coordinated so as to provide predictability in the private sector, consistent to the extent practicable with standards developed by voluntary industry consensus standards bodies, developed in a transparent manner, and technology neutral and non-trade restrictive. The United States also urges Japan to take into account the input of all stakeholders on any forthcoming network security guidelines via a public comment process of at least 30 days.

*Information Systems Procurement:* The U.S. Government supports Japan's information systems procurement reforms. To ensure that these reforms are producing the intended results, the United States urges the Japanese government to monitor and evaluate the implementation and

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effectiveness of measures listed in the memorandum of agreement adopted by the ministries on March 30, 2004, and create additional measures to strengthen the reforms. The U.S. Government welcomes Japan's efforts to disclose more complete information about procurement awards by posting information to the electronic version of the government gazette (*kanpo*) and providing additional data, including Overall Greatest Value Method (OGVM) technical points and lifecycle costs, on the Internet. The United States encourages Japan to continue making procurement information even more accessible.

## **Energy**

As Japan moves to further liberalize its energy sector, the United States has viewed ongoing bilateral discussions as a key means of providing input into this process and to support Japan's goals of improved energy efficiency and lower energy costs, which are among the highest in the world. Japan has made important progress since both governments began to discuss this sector as part of their bilateral deregulation/regulatory reform work – in particular with the passage in June 2003 and subsequent steps to implement the Law for the Partial Revision of the Electricity Utility Industry Law and Gas Utility Industry Law.

*Electricity:* Key elements of the 2003 legislative reforms in the electricity sector include: (1) securing fairness and transparency of transmission and distribution systems through information firewalls, monitoring, and prevention of cross-subsidization; (2) abolishing the transmission pancaking system; (3) organizing and strengthening the governmental structure responsible for market monitoring and dispute resolution; and (4) establishing a plan and schedule for greater retail choice, with discussions on full liberalization to begin in April 2007. The reforms also paved the way for the planned launch in April 2005 of two new key institutions: a nationwide wholesale power exchange and a neutral transmission system organization (NSO) to set transmission and distribution rules.

To support Japan's electricity reform efforts, the United States continues to share its own experiences on reform of this sector and has made numerous recommendations under the Regulatory Reform Initiative. Among the recommendations discussed during Working Group talks in December 2004 were the establishment of procedures to supervise and enforce rules and fairness in the NSO; stronger steps to ensure reliable third-party access to the transmission grid; regulatory reforms to provide meaningful opportunities to operators of co-generation or other small-scale sources of excess power to sell electricity into the market; and securing sufficient resources to develop and implement effective regulatory and market monitoring functions.

*Natural Gas:* Japan's 2003 energy reform legislation also includes numerous important changes in the natural gas sector, such as: (1) special measures to increase incentives for pipeline investment and the promotion of pipeline interconnection; (2) steps to secure fair and transparent competition between the gas companies that maintain and operate the network and other companies that use the pipelines; (3) measures to separate accounts and prohibit discriminatory treatment towards certain businesses to which gas companies supply gas; (4) steps to promote

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third-party usage of liquefied natural gas (LNG) terminals by, for example, establishing rules for resolving disputes over negotiations; and (5) a plan and schedule for greater retail liberalization. As in the electricity sector, the United States continues to share its own experiences on reform of its natural gas sector and has made numerous recommendations to Japan under the Regulatory Reform Initiative. These include establishing a regulatory framework, including a tariff structure, that provides non-discriminatory, transparent, and reliable third-party access to LNG terminals and pipelines; ensuring adequate assessment and monitoring mechanisms to ensure gas liberalization is having a meaningful, pro-competitive impact on the market; establishing and strengthening a mechanism to conduct more rigorous rate approval examinations and audits; and conducting neutral and fair ex-post facto monitoring of the industry.

In addition to raising these and other recommendations during Working Group talks in December 2004, the United States stressed the importance of meaningful, reliable third-party access to LNG terminals and gas pipelines in Japan on the degree of competition and new market entry in the electricity and natural gas sectors. In order to give confidence to new entrants, the United States urged METI to take steps to ensure strong enforcement of the government's new conduct guidelines for third-party access to LNG terminals. The United States also highlighted the need for clear, disclosed tariffs for pipeline third-party access with standard terms and conditions that are enforceable as well as the clear separation of accounts. The United States welcomes steps Japan will take to achieve reform in this important sector in a manner that promotes efficiency, reduces energy costs through competition, and encourages market entry.

### **Medical Devices and Pharmaceuticals**

The United States and Japan address regulatory and reimbursement pricing issues in the medical device and pharmaceutical sectors through the Working Group on Medical Devices and Pharmaceuticals. The Working Group meets under the Regulatory Reform Initiative and the 1986 Market-Oriented, Sector-Selective (MOSS) Medical Equipment and Pharmaceutical Agreement. In these bilateral consultations, the United States focuses on ensuring that Japan's regulatory system provides faster approvals and that its reimbursement system appropriately values innovation.

The U.S. Government's top regulatory priority in the medical device and pharmaceutical sectors is faster product approvals. In this regard, the United States has welcomed the establishment of Japan's new regulatory agency, the Pharmaceuticals and Medical Devices Agency (PMDA), which is intended to speed approvals in part by the effective use of expanded resources provided through an increase in user fees paid by product applicants. The U.S. Government therefore urges PMDA to implement measures outlined in the June 2004 Third Report to the Leaders, such as meeting targets for faster product approvals and publishing annual progress reports. For example, Japan established a target of concluding its work on approvals for 90 percent of new medical device applications and 80 percent of new drug applications within one year by 2009 and set similarly specific shorter-term targets for gradual improvements in the intervening years. The United States has been urging Japan to attain those targets.

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Since the establishment of PMDA in April 2004, however, the U.S. medical device and pharmaceutical industries have reported that companies have faced significant delays in product reviews and approvals due in part to a backlog of old applications. U.S. companies have reported, for instance, that the time to schedule a meeting with regulators on the design of drug clinical trials has doubled to six months, delaying the introduction of useful new medicines. The U.S. Government has raised concerns with the Japanese government about the backlog's effect on the speed of reviews. The U.S. Government's October 2004 Regulatory Reform submission to the Japanese government urges Japan to develop in consultation with industry measures to evaluate PMDA's performance that enhance the detail and transparency of PMDA's annual report on its compliance with the performance targets. The U.S. submission also encourages Japan to develop a new pharmaceutical performance goal, adopt international standards for medical devices, and make the regulatory process more transparent. In 2005, the United States has been encouraging Japan to speed reviews and approvals.

PMDA's creation was a key part of a major reform of Japan's regulation of medical devices and pharmaceuticals through Pharmaceutical Affairs Law (PAL) amendments that were to be fully implemented by April 1, 2005. One effect of PAL reform will be an increase in PMDA's responsibilities for inspections of medical device and drug factories. The U.S. submission urges Japan to ensure that overseas audits or factory inspections not delay approvals of new products. PAL reform will also alter the licensing requirements for distributors and importers, requiring them to bear greater responsibilities for post-marketing safety. The U.S. submission therefore urges Japan to adopt measures to prevent the withdrawal of manufacturers from Japan's market because of this change.

As for pricing reform, the U.S. Government's top priority is to ensure that Japan's policies reward the development and introduction of innovative medical devices and pharmaceuticals. Japan has recognized that innovation can foster economic growth and improved healthcare, as noted in its "Visions" policy papers, which contain plans to improve the international competitiveness of its medical device and pharmaceutical industries and markets. The United States has urged Japan to implement the Visions quickly. Japan has taken recent steps to foster innovation that were noted in the Third Report to the Leaders, such as deciding more frequently whether to grant reimbursement prices to innovative medical devices and introducing two new premium pricing rules for particularly effective drugs. The U.S. Government has continued to encourage Japan to reform pricing rules to accurately assess the value of innovative products to Japan's healthcare system, and apply pricing premiums more fully to reward and stimulate advances in drug research and medical technology.

Regarding drug pricing, the United States has proposed that in setting reimbursement prices Japan consider manufacturers' suggested prices, which are based on data on factors such as the long-term cost savings for the healthcare system from use of a given drug. The United States also has proposed that when basing prices for new drugs on prices of existing drugs that Japan use the existing drug's original price level (before its price was cut). In addition, the U.S.

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Government has requested that Japan expand the data it uses to set prices and award premiums, and adopt a manufacturer's suggested price method for biologics.

Regarding medical device pricing, the U.S. Government has expressed concern about the "Foreign Price Adjustment" rule for devices that caps Japanese prices by linking them to lower prices abroad. The rule fails to consider the higher cost of doing business in Japan. The United States is urging Japan to review the Foreign Price Adjustment rule for devices and also proposing changes in Japan's method of setting prices for innovative devices.

Separately, Japan's 2002 Blood Law established a principle of "self-sufficiency" and included a Supply and Demand Plan that enables the Japanese government to manage supply and demand in the blood market. The United States has been urging Japan to ensure that the Plan does not discriminate against foreign blood plasma products and is consistent with Japan's international trade obligations. The United States has also been encouraging Japan to consult fully with industry on regulatory and reimbursement pricing matters related to blood products, and to apply policies and regulations in a fair and transparent manner.

## **Financial Services**

Japan's financial sector has become increasingly integrated into the global financial system in the past few years. Foreign financial institutions have made important acquisitions in securities brokerage, insurance, and banking. Consolidation among Japanese financial institutions has continued, 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, Japan must continue to move forward in establishing transparency in regulation and supervision of financial institutions in line with international standards and best practices.

The Japanese Diet took further steps to liberalize financial services and make regulation more transparent in 2004. Perhaps most significantly, the United States and Japan in March 2004 ratified a bilateral tax treaty that, among other things, completely eliminates source-country withholding taxes on certain income such as royalty income between the two countries. The key withholding provisions of the treaty went into effect July 1, 2004. Also significantly, the two Governments signed the Social Security Totalization Agreement in February 2004, which will prevent the double payment of social security contributions in the U.S. and Japan.

In addition, Japan revised its Securities and Exchange Law in December 2004 to allow private financial institutions, such as banks and insurance companies, to engage in securities businesses. Other amendments, which will go into effect April 1, 2005, introduce a system of fines to combat unfair trading practices and revise the law governing paperless stock transactions to permit companies to stop issuing physical stock certificates. In December 2004, the Diet passed legislation to allow foreign exchange trading on margin. The legislation, which will take effect

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in July 2005, is designed to protect investors by setting forth specific criteria for margin forex trading.

Japan also approved public pension reform legislation in 2004. The package calls for incrementally raising mandatory pension premiums and gradually reducing benefit payments, in order to cope with Japan's aging population and declining work force. Additionally, the legislation sets statutory limits on future pension premium rates, intended to wipe out concerns that premiums may go up indefinitely.

In December 2004, Japan enacted legislation to remove a ban on sales of mutual funds at post offices. Japan Post will start selling mutual funds in October 2005 at 550 of its 24,700 post offices. This development may create distribution opportunities for foreign firms operating in Japan.

## **Agriculture**

Agricultural issues were taken up in 2004 for the first time under the Regulatory Reform and Competition Policy Initiative. The main topic being addressed is the adoption by Japan of international plant health standards for the conduct of pest risk assessments and official control policy.

The Japanese government routinely requires that imported produce be fumigated for insect species that are already present in Japan. This practice is inconsistent with international practice and with the International Plant Protection Convention (IPPC). Japan claims these pests are under official control by MAFF in order to limit their spread within Japan. In practice, however, the Ministry of Agriculture, Forestry and Fisheries (MAFF) does not appear to have internationally recognized official control programs for domestically grown produce. The fumigation requirement is particularly detrimental to trade in fresh fruits and vegetables, including lettuce, citrus, and cut flowers. Fumigation adds unnecessary costs and results in produce deterioration, making products unmarketable. The U.S. lettuce industry estimates that exports would increase by at least \$100 million if this issue could be resolved.

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.

This issue was discussed in the first round of the Cross-Sectoral Working Group under the Regulatory Reform Initiative in Tokyo in December. In this meeting, U.S officials stressed the need for Japan to align its pest risk assessment procedures and official control practices with international standards. The United States also stressed the need for improved transparency and market predictability in Japan's phytosanitary enforcement procedures. The Japanese

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government acknowledged that it is working on the requests from the United States and other countries to shift some pests from quarantine to non-quarantine status. The United States will continue to urge Japan to adopt international standards, to develop a comprehensive list of non-quarantine pests, and to reduce excessive, unnecessary, trade-distorting fumigation.

A related issue was included in the Regulatory Reform and Competition Policy Initiative under the Special Zones section. (*See Special Zones section under Transparency and Other Government Practices.*) A proposal to import a limited amount of fresh potatoes directly to potato chip manufacturers under a special safety protocol has been submitted under the Special Zones initiative but has been repeatedly rejected on the basis of phytosanitary concerns raised by MAFF. The U.S. Government is working with U.S. industry to address MAFF's concerns and press for progress on the basis of this proposal.

## **STRUCTURAL REGULATORY REFORM**

### **Antimonopoly Law and Competition Policy**

Under the Regulatory Reform Initiative, the United States has been proposing a number of progressive measures to strengthen competition policy and enforcement of Japan's Antimonopoly Act (AMA) that would bolster competition and improve market access. One of the key problems in addressing anticompetitive practices in the Japanese market has been the historically weak status of the Japan Fair Trade Commission (JFTC) and its lack of sufficient enforcement powers and resources to implement the AMA effectively. Significant improvements may result from a bill to amend the AMA, the first significant revision of the AMA in over 25 years, which was submitted to the Diet in October 2004 but held over for consideration during the 2005 regular session.

*Strengthening the Effectiveness of Antimonopoly Enforcement.* Cartel activity, including widespread bid rigging, continues to be a serious problem in Japan. One important reason is that existing administrative and criminal sanctions do not constitute an adequate deterrent against companies and individuals engaging in unlawful anticompetitive practices. Administrative surcharges (fines) are too low to serve as a meaningful deterrent. The current maximum surcharge is six percent of the sales in question over a maximum of three years, but comparisons of prices before and after the JFTC has broken up cartels suggest that illicit profits from such arrangements in Japan average around 16 percent. Although the AMA provides for criminal sanctions against violators, criminal prosecutions have been sporadic, and prison sentences against corporate officials have been routinely suspended. The JFTC has initiated only seven criminal prosecutions of AMA violators since 1990 and only one since 1999. Where these cases have resulted in convictions, fines have been imposed, but all prison sentences were suspended, even for an individual convicted of a repeat offence in the most recent case.

A number of other factors limit the effectiveness of the JFTC's enforcement against egregious AMA violations. The JFTC does not have the powers enjoyed by other Japanese criminal

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investigation authorities, including the power to conduct compulsory searches and seizures. Nor does it have the authority to reduce or eliminate criminal sanctions and administrative surcharges for companies that come forward to expose illegal activities through a corporate leniency program for cartel whistleblowers.

The October 2004 legislative proposal to amend the AMA would increase administrative surcharges to a maximum of 10 percent of cartel sales for a first-time offense and 15 percent for a repeat offense, and expand the range of violations subject to surcharges and criminal prosecution. The bill also would introduce a corporate leniency program to eliminate administrative surcharges and criminal penalties for the first company to report to JFTC its participation in an unlawful cartel and cooperate with JFTC's investigation and reduce surcharges for up to two more companies applying for leniency. In addition, the bill provides criminal investigation powers for the JFTC, penalties for interfering with JFTC investigations or for non-compliance with JFTC cease and desist orders, streamlined hearing procedures, and an extension of the statute of limitations for AMA violations to three years after the conduct stopped.

The JFTC's ability to enforce the AMA also is hindered by insufficient personnel. Some progress has been made, as seen by the increase in the JFTC's staff levels from 474 in 1990 to 672 for 2004. More importantly, the number of the JFTC's investigative staff has increased from 154 in 1990 to 331 in 2004. Nonetheless, the JFTC remains understaffed, particularly in the areas of economic analysis and investigations, to adequately enforce the AMA. JFTC inaugurated a Competition Policy Research Center in 2003, staffed in part by visiting academic economists; however the assignment of economists to JFTC investigations still appears to be quite limited.

*Increasing the Procedural Fairness of JFTC Enforcement Activities:* Segments of Japan's business community have complained that JFTC procedures lack due process. In order to enhance the JFTC's authority and credibility with the business community, the United States is recommending an increase in the number of judges and lawyers acting as hearing examiners and procedural changes to allow companies subject to a proposed public warning by JFTC to make arguments as to why such a warning should not be issued.

*Prevention of Bid Rigging:* Japan has undertaken important steps in recent years to strengthen sanctions against bid rigging. In January 2003, the Diet enacted a law against bureaucrat-led bid rigging (so-called kansei dango). In September of 2003, the Ministry of Land, Infrastructure and Transport (MLIT) extended the maximum period of suspension of designation for companies engaging in bid rigging to one year. Nevertheless, concerns persist that debarment sanctions often are applied only in slow seasons and that sanctions against government officials complicit in bid rigging activities are weak or ineffective. The United States is recommending that Japan take further measures to address prolific bid rigging, including stronger penalties for government officials involved in bureaucrat-led bid rigging and consideration by MLIT of an administrative leniency program that exempts whistleblowers from administrative sanctions such as suspension

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of designation. The United States is also recommending the adoption of new measures by the Ministry of Internal Affairs and Communications (MIC) against bid rigging at the local level, improved transparency in sanctions against companies found to have engaged in bid rigging, and consideration of new bidding procedures to make bid rigging more difficult.

*Promoting Competition:* 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, not just through AMA enforcement actions, but also through advocating to other government agencies the adoption of pro-competitive regulations and measures. To this end, the United States has proposed that the JFTC actively participate in developing pro-competitive privatization policies and that JFTC monitor entities in the process of privatization to ensure they do not engage in anti-competitive activities. Furthermore, the United States is recommending that the JFTC actively participate in official study groups considering sectoral reforms.

### **Transparency and Other Government Practices**

Over the years, the United States has taken up a broad range of issues under “Transparency and Other Government Practices” with the aim of recommending ways for Japan to create a more transparent and participatory regulatory system that fosters accountability and ensures fairness and predictability for Japanese consumers as well as domestic and foreign firms. Japan has made some progress in expanding meaningful public participation, but additional measures are needed, and in its October 2004 Regulatory Reform submission, the United States urged Japan to increase transparency in the following areas:

*Public Comment Procedures:* While Japan’s Public Comment Procedures (PCP) have been in place since 1999, implementation of those procedures often fails to support the PCP’s central purpose of promoting transparency and a fairer and more open rule-making system. The Ministry of Internal Affairs and Communications (MIC) released another annual survey of PCP implementation in August of 2004, which demonstrated continuing problems with the PCP. That survey showed that in FY 2003, roughly half of the public comment periods for regulatory revisions requiring Cabinet decisions were shorter than 28 days – less than one percent of these comment periods were closer to a more reasonable 60-day period. Additionally, the survey showed that public comments were not incorporated into a vast majority of the final regulations. The United States urges Japan to eliminate inadequacies in PCP implementation so as to make it an effective and meaningful regulatory mechanism, most importantly by standardizing a 60-day comment period (or at minimum requiring the use of a minimum 30-day comment period, except in urgent cases), and incorporating the PCP into the Administrative Procedures Law.

*Special Zones for Structural Reform:* The U.S. Government continues to support regulatory reform in Japan through the establishment of the Special Zones for Structural Reform. The United States is pleased to note that since the approval of the first zones in April 2003, the total number has grown to almost 400, with 26 deregulation measures approved for application

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nationwide by the Cabinet in September 2004. To ensure this initiative continues to help revitalize local economies throughout Japan, the United States recommends that: transparency remain a centerpiece of all aspects of the zones initiative; a focus be placed on expanding market-entry opportunities; the Special Zones Headquarters continue to place a priority on expeditious nationwide application of successful measures and continue to work with U.S. and other foreign companies to submit zone ideas, participate in existing zones, and participate in the zones process at every stage; and foreign participation be encouraged by publishing in English on the Internet a comprehensive list of current zones, progress on zone applications, and updated zone information.

*No Action Letters:* The United States recommends that Japan take further steps to enhance the effectiveness and increase the usage of Japan's no-action letter system, which provides regulated firms with an opportunity to seek clarification of an administrative agency's interpretation of laws and regulations. Measures that would contribute to a more effective no-action letter system include giving Japan's no-action letter system – which was established under a Cabinet Decision – the force of law by incorporating its requirements into the Administrative Procedures Law (APL), and establishing both government-wide and agency-specific fora for seeking private sector input as to how to improve the no-action letter systems of the various government administrative agencies.

*Public Participation in the Development of Legislation:* The United States encourages Japan's ministries and agencies to accelerate the practice of providing greater opportunities for the public to comment on legislation in the early stages of its formation. Specifically, the United States urges Japan to fully utilize and implement the Public Comment Procedures and ensure that the insurance industry (both domestic and foreign) and all interested parties are provided meaningful opportunities to be informed of, comment on, and exchange views with officials on proposed amendments to the Insurance Business Law, the Life Insurance Policyholder Protection Corporation (Life PPC) reform legislation or other existing laws and regulations related to the Life PPC prior to their implementation and/or submission to the Diet.

*APEC Transparency Standards:* APEC leaders have agreed to a package of transparency standards for the range of trade and investment areas. The United States and Japan have worked closely to create these standards. Accordingly, the United States and Japan should work jointly to achieve full implementation of the APEC Transparency Standards in the domestic legal regimes of countries in the Asia-Pacific region.

## **Privatization**

Included in this year's October Regulatory Reform recommendations is a new, separate section on privatization, which underscores the importance the United States attaches to this ongoing process in Japan, particularly in regard to the privatization of Japan Post. Over the years, the United States has continued to take interest in Prime Minister Koizumi's efforts to restructure and privatize Japan's public corporations. The United States also recognizes that, if

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implemented vigorously, this reform initiative can have a major impact on the Japanese economy, stimulating competition and leading to a more productive use of resources. As reform of the public corporations advances, the United States has been urging Japan to: (1) conduct the restructuring and privatization in a transparent manner; and (2) ensure that domestic and foreign private sector entities that will or may be affected by the reform have meaningful opportunities to provide input in the privatization process, such as through use of the Public Comment Procedures.

In its October submission to Japan, the United States specifically recommends that privatization of Japan Post be ambitious and market-oriented to achieve maximum economic benefits for the Japanese economy. A truly market-oriented approach must include the establishment of undistorted competition in Japan's insurance, banking, and express delivery markets through, among other measures, the elimination of all advantages accorded to Japan Post over its private sector competitors. These advantages have long been of concern to U.S. and Japanese companies alike. (*For detailed discussion of Japan Post privatization, please see Insurance under Services Barriers section.*)

### **Commercial Law**

Japan has been making steady progress on its efforts to reform its commercial law, starting with the substantial revisions to its Commercial Code in 2002. Problems, however, still remain that impede foreign investment and corporate restructuring, and that hinder good corporate governance practices. In its October 2004 Regulatory Reform submission, the United States urged Japan to build on past reforms by further improving its commercial law and corporate governance. Specifically, the United States is recommending that Japan introduce modern merger techniques into its commercial law, and to provide appropriate tax treatment for such transactions. Japan is now set to submit to the regular 2005 Diet session legislation to permit certain modern merger techniques, including triangular mergers, cash mergers, and short form (squeeze-out) mergers, as part of its commercial law revision. The United States is also urging Japan to improve corporate governance by requiring pension fund and mutual fund managers to adopt active proxy-voting policies that are aimed at benefiting fund beneficiaries.

### **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. After more than 15 years of urging by the United States and the foreign legal community, Japan enacted legislation in 2003 that substantially eliminates restrictions on the freedom of association between foreign and Japanese lawyers, effectively permitting partnership and employment relationships between foreign and Japanese lawyers.

In its October 2004 Regulatory Reform submission, the United States again welcomed passage of the legislation regarding free association between Japanese and foreign lawyers and urged

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implementation by Nichibenren that upholds the spirit of the new law. The United States also calls on Japan to allow foreign lawyers to form professional corporations and establish branches throughout Japan, and to count all of the time foreign lawyers spend practicing law in Japan toward the three-year experience requirement for licensure as a foreign legal consultant.

In addition, the United States welcomed Japan's commitment to create a flexible and open legal environment that facilitates the development of Alternative Dispute Resolution (ADR) mechanisms in Japan. Japan enacted legislation in late 2004 creating a government certification system for ADR providers, but the legislation has the potential to impede, rather than facilitate, ADR processes in Japan. The United States is recommending that Japan ensure that its legal regime for ADR is consistent with international norms and practice, that foreign lawyers and non-lawyers will be permitted to act as neutrals in ADR processes without supervision from Japanese lawyers, and that the new law is not construed to cast doubt on the enforceability of ADR decisions and settlements in which non-certified ADR providers participated.

### **Distribution and Customs Clearance**

Japan has taken steps over the past year to improve customs clearance procedures and increase competitiveness at its international ports through the reduction of customs charges nationwide. More needs to be done, however, to facilitate the flow of goods for the benefit of Japanese consumers. In its October 2004 Regulatory Reform submission, the United States urged Japan to: (1) move from the Cost of Insurance and Freight (CIF) to the Free on Board (FOB) method for calculating duty on low-value goods at entry, which would more fairly represent the value of shipped goods and ease the work of Customs by decreasing the number of shipments over the 10,000-yen *de minimis* line; (2) increase the Customs Law *de minimis* limit from its current 10,000 yen in order to reduce the workload for both Customs and express carriers and streamline the customs clearance process; and (3) continue its pro-growth Customs policies by further reducing Customs overtime charges in International Physical Distribution Special Zones to zero.

Widespread use of credit, debit and ATM cards benefits consumers and provides for a more smoothly operating economy. In the United States, Europe, and Canada, 90 percent of all merchants accept credit or debit cards and over one-third of all purchases are made with these cards. Low card acceptance at both traditional merchants and ATMs in Japan, however, inconveniences Japanese residents and is also a common complaint of foreign visitors to Japan. The United States welcomes Japan's recent moves to boost card acceptance at some public hospitals, and urges Japan to: (1) further promote the use of credit and debit cards by businesses and as payment for government services; (2) mandate compliance with international PIN security and network encryption standards across ATM networks in Japan; and (3) strictly enforce laws and regulations relating to credit card fraud.

Another issue of significant importance to the United States is the high landing and user fees at Japan's Narita and Kansai International Airports. These fees, the highest in the world, increase

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the costs for cargo, mail delivery, and air travel, and are at odds with the region-wide trend of lowering landing fees. Announced fees for the new Central Japan International Airport in Nagoya are compatible to Narita or Kansai's. In its October 2004 Regulatory Reform submission, the United States is calling on Japan to reduce airport fees to improve the business and tourism climate and help boost the economy. As the Ministry of Land, Infrastructure and Transport (MLIT) sets financial terms for the private company airport, it is in a position to ensure reasonable fees are established in a transparent matter.

## **IMPORT POLICIES**

### **Rice Import System**

Although Japan has generally met import volume commitments made during the Uruguay Round and subsequent negotiations, Japan's highly regulated and non-transparent distribution system for imported rice assures that high quality U.S. rice does not enjoy meaningful access to Japanese consumers. U.S. rice exports to Japan in January-October of 2004 were valued at just over \$166 million, representing 361,200 metric tons of rice or over 50 percent of Japan's minimum access requirement. In 1999, Japan established a tariff rate quota (TRQ) that was to assure access to the Japanese market for 682,000 metric tons (milled basis) of imported rice annually. The Japan Food Department (JFD) of the Ministry of Agriculture, Forestry, and Fisheries (MAFF), manages imports within the TRQ through periodic minimum access (MA) tenders for imported rice and by imports through the simultaneous-buy-sell (SBS) system. In both programs, the activities of the JFD lack transparency. Moreover, less than one-half of one percent of rice imported from the United States reaches Japanese consumers as an identifiable product of the United States. Imports of U.S. rice under the periodic MA tenders, for example, are destined almost exclusively for government stocks or re-exported as food aid. A small share of U.S. rice imported under these tenders is released from JFD stocks and permitted to enter the industrial food-processing sector. Since Japan adopted a tariff system 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 a 400-1,000 percent *ad valorem* tariff, depending on the variety of rice. Through the MA tenders, the JFD imports roughly 582,000 metric tons of rice. The U.S. rice industry has been disappointed by the JFD's record of buying medium-quality rice for industrial use, food aid, and blending, rather than top quality rice for table use. The U.S. industry also faces barriers in moving rice imported under the JFD's MA tenders into the market place. The industry believes that medium-grain U.S. rice - the type of rice imported directly by the JFD - can be competitive in the non-table use market. However, lack of information on obtaining U.S. rice held in JFD stocks has made the development of this commercial market difficult.

Under the SBS system, also administered by the JFD, Japan imports the remaining 100,000 metric tons of its total MA commitment. The U.S. rice industry is particularly concerned over the operation of the SBS system, which was designed to allow exporters access to final consumers in Japan in order to engage in consumer market development. The SBS system, which provides a substantial mark-up to the JFD (equal to the difference between the import

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price of rice and the wholesale price in Japan), has not allowed U.S. exporters to develop markets in Japan for high-quality short grain U.S. rice used for the table market.

In June 2003, the Japanese Diet passed a law that included a comprehensive rice reform plan designed to cut government spending, curb surplus production, and make Japanese rice farmers more efficient. The reforms are scheduled to be fully implemented by 2008. Many areas of the plan, however, remain vague, and there is concern that parts of it may be undone before it is fully implemented. In the long term, the reforms would reduce the need for extremely high levels of protection for Japanese rice farmers.

Despite these reforms, Japan's position on market access for rice in ongoing WTO agricultural negotiations is to decrease Japan's Minimum Access commitment for rice, allegedly because of Japan's changing demographics and declining rice consumption. This proposal is counter to one of the principal aims of the Doha Development Agenda (DDA), which is to open agricultural markets and expand trade. Expanding market access for U.S. rice hinges on increasing Japan's market access commitment, reducing tariffs, changing the import system to make pricing and bidding more transparent, and revising the SBS system so the market can function freely. Currently, Japan's complex import system for rice makes it impossible to ensure price stability and a stable year-round supply of U.S. rice. Since the majority of U.S. rice imports sit in warehouses, importers of U.S. rice are denied the opportunity to establish direct relationships with Japanese consumers. The United States will seek great market access, particularly for direct access to Japanese consumers, for U.S. rice in the Doha Development Agenda.

### **Wheat Import System**

Japan requires that wheat be imported through the Ministry of Agriculture, Forestry and Fisheries' (MAFF's) Food Department, which then releases wheat to Japanese flour millers at prices that are substantially above import prices. These high wheat prices discourage wheat consumption by increasing the cost of wheat-based foods in Japan. The United States is seeking greater discipline on the trade distorting practices of state trading companies in the Doha Development Agenda agriculture negotiations.

### **Corn for Industrial Use**

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

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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 is seeking resolution of this issue in the Doha Development Agenda agriculture negotiations. In December 2004, Japan notified industry and the U.S. Government that it is considering abolishing the blending requirement by 2007 and moving to a tariff or levy regime instead. The decision should be made by March 2005.

### **Pork Import Regime**

U.S. pork exports to Japan, valued at approximately \$800 million annually, comprise more than 65 percent of the value of global U.S. pork exports. Japan's pork import system, however, is inflexible and fails to meet the needs of either Japan or the United States. The system includes a gate price and a safeguard negotiated during the Uruguay Round, which automatically raises tariffs if imports are 19 percent or more above the average level of imports during the previous three years.

The gate price system distorts pork trade by encouraging Japanese importers to buy mixed shipments of different cuts of pork (rather than the cuts the market would otherwise demand) to minimize tariffs by keeping the average CIF price of their shipments at or below the gate price.

Japan's pork safeguard, which was triggered for the fourth consecutive time in 2004, is also of concern because it results in erratic purchasing patterns. The safeguard system encourages increased imports when the safeguard is not in place, and these high levels of imports then tend to trigger the safeguard. Once the safeguard is triggered, importers tend to buy more expensive cuts of pork in order to raise the cost of their import shipments to the new, higher gate price.

In the Doha Development Agenda negotiations, the United States is seeking substantial reductions in pork tariffs, reform of the gate price system and safeguard, and greater transparency in Japan's import regime.

### **Beef Safeguard**

The United States has worked with like-minded parties to express opposition to Japan imposing a beef safeguard when Japanese consumption of beef fell due to Japan's first case of Bovine Spongiform Encephalopathy (BSE). Japan's beef safeguard was negotiated during the Uruguay Round to afford protection to domestic producers in the event of an import surge. The safeguard is triggered when imports increase by more than 17 percent from the previous Japanese Fiscal Year on a cumulative quarterly basis. Once triggered, the safeguard remains in place for the rest of the fiscal year. If triggered, tariffs on chilled beef increase from 38.5 percent to 50 percent. In 2002 and 2003, the United States pressed at the highest levels of the Japanese government to recognize the non-typical market conditions due to BSE in the application of the beef safeguard. The safeguard was lifted in March 2004 due to reduced imports resulting from Japan's ban on

U.S. beef after the discovery of a single case of BSE. The United States is intent on negotiating a change in the beef safeguard in the Doha Development Agenda.

### **Fish Products**

Japan is the most important export market for U.S. fish and seafood, accounting for over 40 percent of U.S. exports of such products in 2004. 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 government-to-government consultations on fish to discuss issues related to Japan's import quota system, including its administration, marine science, ecology and other bilateral and international fishery-related issues. The most recent consultations were held in January 2005 in Seattle, following consultations that were held in November 2003. U.S. exporters have been concerned about the quota application process and other administrative procedures. Over the past few years, however, 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. Although the requests of U.S. exporters for access to the Japanese market have been largely accommodated in recent years, the U.S. Government has urged the Japanese government to disband the import quota system on the grounds that it has outlived its usefulness.

As part of ongoing WTO discussions, a number of countries are working to resolve issues involving fish subsidies under the WTO Rules Committee. Japan provides numerous fishery subsidies but these and those of other countries have yet to be classified and addressed within the WTO context.

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

Japan maintains high tariffs 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 high tariffs generally apply to food products where Japan is protecting domestic producers.

High tariffs discourage the use of imported products, and in some cases keep Japanese prices so high that they reduce total consumption of certain products. Tariff reductions are therefore a high priority in the Doha Development Agenda agriculture negotiations.

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## **Wood Products, Housing, and Building Materials**

Japan is the second largest overseas export market for U.S. wood products, with U.S. exports totaling almost \$630 million in the first 10 months of 2004. With just under 1.2 million housing starts in 2003, Japan's home building materials market is second in size to only that of the United States. Estimates of the size of the home building and construction materials markets range upward of \$62 billion, not including materials going into the repair and remodeling market. Imports of wood and building materials from the United States fell 6.1 percent, to \$967 million in 2003, in large part due to the strength of the dollar and the high cost of U.S. wood and building materials, resulting from historic booms in the U.S. domestic housing market. New housing starts in Japan are not expected to strengthen appreciably in the foreseeable future but pent-up demand for wood and various building products from the repair and remodeling sector for the existing and outdated housing stock are expected to remain strong. Starts of North American style wood-frame housing increased by 3.2 percent in 2003 to 81,502 units, and this sector's starts from Jan-Oct of 2004 are up 11 percent from the same period in 2003.

Japan continues to restrict the import and use of U.S. manufactured wood products through tariff escalation (i.e., progressively higher tariffs on more processed wood products). The elimination of tariffs on wood products has been a long-standing U.S. objective, and the United States will continue to urge Japan to eliminate wood product tariffs. In 2001, the United States and Japan agreed that future discussions on wood/building products issues would be pursued under the government auspices of the Wood Products Subcommittee and its two technical committees, the Building Experts Committee (BEC) and JAS Technical Committee (JTC). The Wood Products Subcommittee met in Tokyo in April 2002, and the Building Experts Committee and the JAS Technical Committees last met in Vancouver in September 2004 to discuss a range of issues related to the newly instituted Japanese regulatory constraints on indoor air quality, fire performance requirements for wood products, and acceptance of overseas product testing and performance data and technical calculation methods. The discussions were generally productive but many technical issues remain unresolved. Japan gave information on upcoming changes to the Building Standards Law and agreed to work with the United States and Canada to promote harmonization of fire testing results.

## **Marine Craft**

Japan continues to maintain an inspection system for new boats and marine engines which is unique in the world in its severity and complexity and has the effect of seriously impeding market access for American manufacturers. Japan's regulations – administered by the Ministry of Land, Infrastructure and Transport (MLIT) and the Japan Craft Inspection Organization (JCI) – are vague and subject to arbitrary and inconsistent interpretation. Product testing requirements are expensive and documentation requirements are non-transparent and burdensome, forcing companies to disclose sensitive proprietary information about product design, material specifications, and manufacturing techniques. A fundamental problem with the inspection requirements is that they are applied to boats used for recreational purposes as well as to boats

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used for commercial fishing and other commercial uses. Fees are extremely high and bear no relationship to the actual costs of conducting the inspections. Moreover, considerable restrictions on the use of boat trailers, a principal means of transporting recreational boats, have significantly limited boating in Japan. In addition, a complicated small craft operator's licensing system accompanied by mandatory expensive and lengthy classes have restricted the ability of Japanese citizens to acquire an operator's license. Over-regulation has not improved boating safety in Japan compared to other major boating nations and has helped to keep the recreational boating industry (marinas, boats, engines, accessories, etc.) unusually small when compared to other developed nations.

The U.S. Government has made some inroads in encouraging Japan to deregulate this market under the Working Group Agreement reached on July 2, 2003. For example, in August 2004, MLIT agreed to further deregulate its license system by eliminating, effective November 1, 2004, the five-ton weight limit on pleasure boat operators' licenses. This limitation had been a major irritant for many years to U.S. industry, which has been a world leader in this segment of the market. In order to realize the full benefit of this deregulatory measure, other burdensome aspects of the Japanese inspection system must be addressed. The United States urges Japanese regulatory authorities to study how recreational boating is regulated in similar markets around the world and make major changes to their small craft inspection system to bring Japan's regulatory practices into line with international standards.

The Working Group, which includes participants from MLIT, JCI, the Japan Marine Importers Committee (JMIC), U.S. industry and the U.S. Department of Commerce, plans to meet for an additional year in order to discuss remaining outstanding issues.

### **Leather/Footwear**

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.

The process by which the Japanese government 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.

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 Japanese government Customs Tariff Schedule, the above-quota rates have declined to the higher duty of either 21.6 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.

U.S. industry has expressed concern that the quota on leather footwear imports effectively bars U.S. footwear manufacturers and U.S. brands from the Japanese market, one of the largest consumer markets in the world. According to the industry, the only way U.S. footwear companies can penetrate the Japanese market is through licensing arrangements where footwear is produced in Japan under a licensee. Many U.S. companies, however, have avoided this option because of the potential threat to the reputation of their brands by uncontrollable licensees that may not uphold the brand's quality or effectively market the brand's name.

## **STANDARDS, TESTING, LABELING AND CERTIFICATION**

Japan has many standards that limit trade in farm, forest, and industrial products. Japan has always been particularly conservative on questions involving food safety, human health, and the application of sanitary and phytosanitary standards. Recently, however, there appears to have been an increase in Japan's use of standards and other administrative requirements to limit agricultural and wood product imports in particular, and a greater tendency to deviate from scientific principles in setting new import policies and requirements.

### **Beef**

Reopening the Japanese market to U.S. beef is a top priority of the Administration on the bilateral trade front in 2004. Japan imposed a ban on U.S. beef after the December 2003 discovery of a single imported cow with BSE in Washington State. Before the ban, U.S. beef and beef product exports to Japan (the largest market for U.S. beef) totaled roughly \$1.7 billion annually. The U.S. Government immediately engaged Japan at a technical level and provided Japan with extensive documentation on the situation on the ground and the numerous additional measures that the United States implemented to further ensure the safety of U.S. beef for both domestic consumption as well as for export.

Since April 2004, while technical meetings continued to be held, the U.S. Government has also engaged the Japanese government in an extensive, high-level effort to reopen the Japanese market to U.S. beef. U.S. Government officials made numerous trips to Japan, organized visits of Japanese officials to Washington, D.C. as well as trips to feedlots, laboratories, and processing plants in the rest of the United States. President Bush and Prime Minister Koizumi also discussed this issue on several occasions.

After prolonged negotiations to determine the conditions under which the trade would be resumed, the two Governments agreed on a framework on October 23, 2004 designed to pave the way for resumption of beef trade between Japan and the United States. More specifically, that agreement was developed to enable U.S. beef trade to resume under a special marketing program pending an additional study on the correlation of the U.S. grading standards and age of cattle.

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After six months of operation of partial market opening, that program will then be reviewed, with a view toward returning trade to more normal patterns. The United States has addressed all questions related to science and consumer safety raised by Japan about U.S. beef. We are urging Japan promptly to reopen its market to U.S. beef. We will continue to press Japan on this important issue at all levels of the U.S. Government until U.S. beef exports resume.

### **Building Size, Designs, and Wood Products**

Restrictions on building size, designs, and wood products continue to constrain the use of some foreign building products and systems commonly used in the United States and elsewhere, thereby limiting choice for consumers and artificially inflating housing costs. The United States continues to have serious reservations about the transparency and basis of certain testing methodologies for evaluating fire resistance and formaldehyde emissions. The standard for testing fire resistance is inconsistent with international standards, and the testing criteria are such that test results (for the same product) can vary from one testing laboratory to another. As of late 2004, there were no testing bodies recognized outside of Japan to undertake the necessary testing for fire resistance.

The Japanese government has adopted and implemented regulations with respect to indoor air quality and the emission of certain volatile organic compounds, including formaldehyde, which are found in some building materials. Regulations on indoor air quality covering volatile organic compounds appear to be overly restrictive for some products such as wall coverings but are not applied to carpeting and interior furnishings, even though such products emit high levels of formaldehyde. The United States also has concerns about guidelines for other chemicals, especially if those guidelines become mandatory as well.

### **Fresh Apples Quarantine Requirements for Fireblight**

For years, Japan imposed 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. Japan's quarantine restrictions for fireblight included the prohibition of imports of U.S. apples from any orchard containing fireblight, three inspections of fireblight-free orchards at different times in the growing season, maintenance of a 500-meter fire-blight free buffer zone surrounding export orchards, and post-harvest treatment of apples with chlorine. These requirements were not scientifically based, significantly raised costs, and reduced the competitiveness of U.S. apples in Japan.

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 initiated WTO dispute settlement procedures. In its report of July 15, 2003, the dispute settlement panel agreed with the United States that Japan's inspection and buffer-zone requirements are inconsistent with Japan's obligations under the *WTO Agreement on the Application of Sanitary and Phytosanitary Measures*.

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In June 2004, Japan amended its quarantine restrictions arguing that the changes brought Japan into compliance with the WTO panel decision. In the view of the United States, Japan failed to come into compliance with the WTO rulings. In July 2004, therefore, the United States requested that a WTO compliance panel be convened to determine whether Japan's revised measures are consistent with its WTO obligations. The compliance review panel is scheduled to circulate a final report no earlier than spring of 2005.

### **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 limited imports of potatoes for use in the potato chip manufacturing industry under a strict safeguarding protocol. These issues were discussed at technical bilateral meetings in November 2004. In these meetings, Japan agreed to consolidate all of its concerns into one list and the United States agreed to respond to these questions, even though many of them may have already been addressed. The next technical bilateral meetings are scheduled to take place around May 2005.

### **Biotechnology**

While Japan has adopted a largely scientific approach in its approval process for agricultural biotechnology products, the United States is concerned with the recent changes in Japan's regulatory system, and seeks assurances that new requirements will be science-based, clearly stated, and will provide sufficient time for compliance as well as a smooth transition in order to reduce risk of trade disruption.

To date, MAFF and the MHLW, which regulate biotechnology products, have approved the importation of 59 biotechnology plant varieties for food, including corn, potatoes, cotton, and soybeans. In July 2003, Japan inaugurated a Food Safety Commission (FSC) with responsibility for performing food related risk evaluations. MAFF is requiring new mandatory environmental safety reviews for all biotech products, including those that have already gained approval, as part of their implementation of the Biosafety Protocol. It is still unclear what will be required for these mandatory environmental reviews.

The United States is also concerned by Japan's efforts to expand mandatory labeling of foods made from the products of biotechnology when no health risks exist, thereby potentially discouraging consumers from purchasing these foods. In 2002, MAFF included potato products,

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frozen potatoes, dried potato, and potato starch and potato snacks in the mandatory biotechnology-labeling scheme. 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 and respond to consumer and market demands. The United States is also concerned by MAFF's possible plans to expand mandatory labeling to feed and seed, which 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 share a common interest in working together to promote effective biotechnology approval and regulatory policies.

### **Restrictive Food Additive List**

Japan's overly restrictive list of food additives still limits imports of U.S. food products, especially processed foods. Japanese regulations, which limit the use of specific food additives on a product-by-product basis, are out of step with international practice. Japan refuses, for example, 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. Japan, however, allows its use in 36 other foods, most of which are traditional Japanese food products not normally produced outside of Japan. In 2002, Japan created a list of 46 food additives for expedited review. Since then, however, the United States and many of Japan's other trading partners have been very disappointed by the lack of progress to approve these or any other additives. In addition, Japan classifies post harvest fungicides as food additives, even though the international community, including Codex, classifies them as pesticides. The United States urged MHLW to begin regulating post harvest fungicides as pesticides as part of their revised positive list of Maximum Residue Levels (MRLs), but MHLW has indicated it will not consider this request. No post harvest fungicides have been approved since the 1970's.

## **Feed Additive Ban**

In August 2002, MAFF publicly announced its intent to ban 29 animal feed additives. After gathering additional information, MAFF decided in October 2003 to ban only those additives that could create a resistance problem for humans. Antibiotic animal feed additives have been in use for over 30 years. Many countries, including the United States, are in the process of reviewing regulations regarding the use of these antibiotics. In December 2002, the United States received conflicting reports that Japan had decided to move forward with a ban in advance of a report on the matter from a MAFF scientific committee, and seemingly in the absence of a science-based risk assessment. The Japanese Food Safety Committee set up detailed guidelines for risk assessment in September 2003, and although industry is relatively satisfied with the guidelines, the United States will continue to follow the issue closely to ensure that Japan follows through in a manner consistent with its WTO obligations.

## **Nutritional Supplements**

Although Japan has taken steps toward liberalization of its market for nutritional supplements, there are still restrictions or prohibitions on the use of many food additives and ingredients commonly used in markets outside Japan. Consequently, many U.S. nutritional supplements require a costly reformulation for the Japanese market. The U.S. Government's Regulatory Reform submission in October contained several proposals for liberalization of the market, including allowing educational and informational statements on labels and in advertising, reducing duties for nutritional supplements to the same level as duties for drugs containing the same ingredients, increasing Japan's participation in nutrition-related Codex activities, and basing potency limits on risk assessments. The United States has urged Japan to further liberalize this market.

## **Poultry**

Since 2002, Japan has imposed a number of national and statewide bans on U.S. poultry meat due to the detection of low pathogenic strains of avian influenza (AI) in limited areas in the United States. As a result, U.S. poultry meat exports to Japan have decreased substantially since then, from roughly \$81 million in 2001 to \$45 million in 2002, \$29 million in 2003, and \$31.1 million in 2004.

According to standards set by the international animal health organization, the Office of International Epizootics (OIE), quarantine procedures and some restrictions on imports are appropriate for highly pathogenic strains of AI, and not for low pathogenic strains. The OIE standards also provide for regionalization in the case of highly pathogenic AI (i.e., importing countries should limit bans to zones where highly pathogenic AI has occurred, while allowing imports from other regions in the exporting country, when the exporting country has effective control and surveillance measures in place to quarantine the affected region).

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Japan again prohibited all imports of U.S. poultry meat for several months in 2004 due to localized outbreaks of low pathogenic AI in some Northeastern and Atlantic states such as Delaware, Pennsylvania, and Maryland and a subsequent high pathogenic avian influenza outbreak in Texas. Despite the fact that the OIE declared the United States free of all types of AI in August 2004, Japan still is imposing bans on the states of Connecticut and New Jersey. The United States has repeatedly raised concerns with the Japanese government on its improper institution of these bans. The two Governments continue to work on revising the existing protocol for poultry meat and are also working towards finalizing new protocols for heat-treated poultry meat and heat-treated egg products.

## **GOVERNMENT PROCUREMENT**

### **Construction, Architecture and Engineering**

Although Japan has the second largest public works market in the world (\$190 billion for 2004), U.S. firms annually obtain far less than one percent of projects awarded. Two public works agreements are in effect: the 1988 U.S.-Japan Major Projects Arrangements (MPA) (updated in 1991) 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 Action Plan, Japan must use open and competitive procedures for procurements valued at or above the thresholds established in the WTO Agreement on Government Procurement.

Problematic practices continue to inhibit the full involvement of U.S. design/consulting and construction firms in Japan's public works sector. These practices include failure to address rampant bid rigging, use of arbitrary qualification and evaluation criteria to exclude U.S. firms, unreasonable restrictions on the formation of joint ventures, unclear or conflicting bid/contract procedures, and the structuring of individual procurements so they fall below thresholds established in international agreements. Public works issues are raised in the Trade Forum under the U.S.-Japan Economic Partnership for Growth. During the July 2004 Expert Level Meeting on Public Works under the Trade Forum (Expert Level Meeting), the United States urged Japan to eliminate the obstacles that prevent U.S. companies' full participation in this sector.

During the Expert Level Meeting, the United States also encouraged Japan to strengthen its efforts to eliminate bid-rigging practices (*dango*), under which companies consult and prearrange a bid winner. The United States also expressed concern about the practice of Japanese firms submitting bids on projects that are so low that they raise the question as to whether the work can be performed without a financial loss. This is hampering U.S. firms' abilities to offer quality services while remaining competitive.

The United States urged Japan to increase the number of Construction Management (CM) and Project Management (PM) projects commissioned during this fiscal year and structure procurements in such a way that foreign firms with appropriate expertise are able to compete.

## **FOREIGN TRADE BARRIERS**

(CM and PM are advanced project delivery and management systems that maximize the efficiency of a project.) The United States also urged Japan not to use ISO 9000 series registration with the effect of creating a barrier to international trade. Japan's Ministry of Land, Infrastructure, and Transport confirmed that it would not use ISO 9000 as a pre-qualification criterion for public projects. The United States urges other Japanese commissioning entities to follow suit.

The United States again urged Japan to abolish its three company joint venture rule (which limits to three the number of members in joint ventures for most construction projects), to increase use of the "mixed-type procurement" (which allows companies to decide whether to bid solo or as a joint venture), and to use Design Architect procurements to increase joint venture opportunities for firms specializing in architectural design. The United States also raised concerns regarding costly and unclear procedures for design proposals, including conflicting documentation requirements, and the lack of information on new bid/contract procedures that were not included in the Action Plan. The United States asked that steps be taken to make these procedures more fair, open, and transparent.

The United States is concerned that developments in Japan's public works market since the Action Plan was implemented have led to conditions that existing agreements do not fully address. The United States is promoting U.S. firms' participation in new types of public works projects in Japan such as Urban Renewal, Private Finance Initiative (PFI), and Local Area Renewal projects. During the Expert Level Meeting, the United States welcomed Japan's confirmation that Action Plan procedures would be used for Urban Renewal and PFI projects commissioned by Action Plan entities and above the specified thresholds. The United States also urged major municipalities in Japan to use Action Plan procedures for Urban Renewal projects. In November 2004, Japanese private sector organizations hosted the sixth U.S.-Japan Construction Cooperation Forum, which focused on facilitating the formation of joint ventures between U.S. and Japanese companies for Urban Renewal projects.

The United States is paying special attention to several major projects covered by the public works agreements of particular interest to U.S. companies. These projects include the New Kitakyushu Airport; Haneda Airport development and expansion; Kansai International Airport; Kobe Airport; Kyushu University Relocation Project; Okinawa Institute of Science and Technology; Okinawa Zukeran General Hospital Project; International Medical Center; laboratory projects commissioned by the Ministry of Education, Culture, Sports, Science and Technology; Japan Railways' procurements; major public buildings; urban development and redevelopment projects, including major PFI projects; and remaining MPA projects.

## **INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION**

The United States continues to pursue its intellectual property rights protection agenda with Japan through bilateral consultations and effective coordination in multilateral and regional fora. For its part, Japan continues to make progress in improving the protection of intellectual property

### **FOREIGN TRADE BARRIERS**

rights and, relative to other countries, piracy is not a major problem, though several key issues remain, including the need to improve Japan's legal and administrative intellectual property framework to protect copyrights in the digital age. 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 the processing and approval of patent applications, 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.

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 requiring defendants to justify their actions, obligating defendants 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 these revisions reduce the cost of access to Japanese courts that has been particularly onerous to foreign patent owners in the past. The United States welcomes these 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 therefore concerned that Japan's Internet Service Provider (ISP) liability law 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 use all the opportunities available to improve these shortcomings in the law. *(This issue is also taken up in the Information Technologies section under Sectoral Regulatory Reform.)*

The United States is also urging Japan to reduce the piracy rate, 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 an example for the private sector, the United States urges Japan to issue a decree forbidding any copyright infringement in its government operations. The United States is also concerned about the personal use exception both as it applies to the Internet and to students and book piracy. Japan should make its law crystal clear that the use of peer-to-peer networks to copyright and distribute copyrighted works without the right holder's authorization is not permitted under the personal use exception. The personal use exception appears to allow students to copy entire textbooks for personal use as long as they do not distribute copies. The United States urges Japan to explicitly incorporate the three-part test from international treaties into the Copyright Law to address both these problems.

In addition, the United States is concerned about the provision on anti-circumvention in the Copyright Law, which states that the penalties for technological protection measures (TPM) circumvention devices will be applied only to devices whose principal function is circumvention.

In a positive vein, Japan put into effect an extension of the term of copyright protection for cinematographic works, animation, and video games to 70 years to bring the term of protection closer to the growing international trend. The United States continues to urge the Japanese government to extend all copyright terms to life plus 70 years, or where the term of protection of a work (including a photographic work), performance or phonogram is to be calculated on a basis other than the life of a natural person, to 95 years.

## **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.

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. One defect of the "list" approach to well-known mark protection is that one can essentially pay one's way onto the list by requesting defensive registrations in many classes. A trademark committee is currently reviewing the scope of protection for well-known marks and the U.S. Government will continue to monitor its progress.

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## **Geographical Indications (GIs)**

Articles 22 to 24 of the TRIPS Agreement set forth the obligations of WTO Members with respect to GIs and their relationships to trademarks. It is unclear whether Japan currently provides interested parties with the legal means to prevent misuse of a GI or whether Japan provides trademark owners with the legal means for resolving conflicts between trademarks and asserted GIs, as required by the TRIPS Agreement. The United States understands the Japanese government is currently studying the issue of GI protection and fully supports that effort. Outstanding questions in this area remain of particular concern since it is unclear whether Japan maintains an undisclosed list of protected GIs against which applications for trademark registration are reviewed. The United States also understands the Japanese government is considering the use of GIs to protect the identity of traditional food products from well-known production areas in Japan but it is unclear how Japan would implement such protection. Japan has recently announced that it has three new Japanese terms which have been designated as GIs for wines and spirits by the Commissioner of the National Tax Agency through its Labeling Standard Concerning Geographical Indications, "to be protected in the territories of WTO members." The United States is concerned as to why the Japanese Tax Commissioner is designating GIs under the TRIPS Agreement – an intellectual property agreement, not a tax agreement – and whether foreign GIs are directly registrable under the Japanese GI system without intervention by a foreign government. The United States looks forward to receiving further information on these concerns.

## **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 Diet passed a bill to partially amend the Unfair Competition Prevention Law in May 2003. The bill contains a provision that states a person who illegally acquires, uses, and discloses corporate secrets is subject to criminal sanctions. The scope of the amendment, however, is limited. The United States continues to urge Japan to undertake further reform in this area.

## **Border Enforcement**

The United States continues to monitor the Japan Customs and Tariff Bureau's (JCTB) implementation of the policy to allow parallel imports of patented products based on a 1997 Japan Supreme Court. Further, insofar as Japan provides *ex officio* border enforcement of trademarks and copyrights through the JCTB, efforts should be made to enhance such

### **FOREIGN TRADE BARRIERS**

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. Although Japan increased the amount of resources devoted to enforcement during 2004, the United States urges Japan to continue to improve and tighten its border enforcement to ensure effective implementation of TRIPS obligations.

## **SERVICES BARRIERS**

### **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 \$335 billion in FY 2003. In addition to the offerings of Japanese and foreign private insurers, substantial amounts of insurance are provided to Japanese consumers by the large life insurance unit (Kampo) of government-owned Japan Post, the National Public Health Insurance System, and a web of mutual aid societies (Kyosai).

Given the size and importance of Japan's private insurance market, the United States continues to place a high priority on ensuring that Japan's regulatory framework fosters an open, fair, and competitive insurance market. Two bilateral Insurance Agreements, implemented in 1994 and 1996, are in effect and have contributed significantly to deregulating the Japanese insurance market. Largely as a result of positive changes brought about by these agreements, foreign insurance companies have substantially increased their presence in Japan's private sector insurance market (total market excluding Kampo/Kyosai), now holding an estimated 20 percent of the life insurance market (FY 2003) and a 5.5 percent share of the non-life insurance market (FY 2002). In the third sector, foreign firms have captured approximately 64 percent of the private sector life medical/nursing care insurance market (FY 2003) and about 24 percent of the private sector non-life medical/personal accident market (FY 2002).

Several issues of concern, however, continued throughout 2004, including the lack of a level playing field between private industry and Kampo/Kyosai, the introduction of new product offerings by Kampo and Kyosai, and uncertainty regarding future funding of the life and non-life insurance safety net systems or Policyholder Protection Corporations. The United States consistently raised its concerns and views about these and other key issues, such as plans to privatize the postal insurance system. Fora used to express these views included U.S.-Japan bilateral insurance consultations held in Tokyo on August 20, 2004, regularly scheduled Working Groups under the U.S.-Japan Regulatory Reform Initiative, and other regular contacts between U.S. and Japanese government officials.

Kampo is effectively the world's largest insurer and remains by far the largest player in Japan's insurance market. Kampo is bigger than the four largest private sector Japanese life insurers combined and is estimated to account for nearly 40 percent of all life insurance assets in Japan.

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In FY 2003, there were 76 million Kampo issued life insurance policies in force compared to 123 million for all private life insurance companies combined. In addition, according to the Japan Cooperative Insurance Association, Kyosai-issued policies amounted to more than 20 percent of all in-force life policies in the market and 35 percent of all in-force non-life policies in 2002.

Although Kampo and Kyosai compete with the private sector, they enjoy significant legal and regulatory advantages over private sector insurers. For example, both are exempt from Japan's Insurance Business Law and from contributing to Japan's insurance safety net systems. Kampo and Kyosai both possess advantageous tax status, which in Kampo's case exempts it from paying corporate and income taxes. Kampo insurance policies also are guaranteed by the Japanese government.

*Postal Insurance:* The United States has continuously voiced its Kampo-related concerns to the Japanese government, stressing the need for, *inter alia*, a prohibition on Kampo's ability to underwrite any new or altered insurance products until a level playing field with private companies is established, and for postal financial institutions to be subjected to the same legal, tax, and business requirements and supervision as their private sector counterparts. As any modification to the postal financial system could have significant impact on competition in the Japanese insurance market, the U.S. Government also strongly urged that decisions related to the future of the postal financial institutions, including possible privatization, be made and implemented in an open and transparent manner, in full consultation with domestic and foreign private insurers.

Japan Post introduced a new insurance product in January 2004 in spite of strong concerns voiced by the U.S. Government, Japanese and foreign companies, other foreign governments, industry analysts, and the media. The U.S. Government continues to closely monitor the performance of this product, which includes a rider providing for supplemental health coverage under a hybrid whole life and term life contract. The U.S. Government also continues to convey to the Japanese government its strong view that no additional Kampo products should be permitted until a level playing field is established.

The U.S. Government is also closely following developments related to the Japanese government's plan to privatize Japan Post, including its Kampo insurance business. The initiative has large potential implications for the conditions of competition in the insurance market between Japan Post and private companies. Prime Minister Koizumi made Japan Post privatization a priority issue during 2004, stating his aim of securing passage of privatization legislation by the Japanese Diet in 2005. To help achieve this goal, the Prime Minister established the Office for Privatization of Japan Post under the Cabinet Secretariat in the spring of 2004 to prepare legislation and also created the new post of Minister of State for Privatization of the Postal Services in September.

In September 2004, the Cabinet endorsed the "Basic Policy on the Privatization of the Japan Post" as a blueprint for privatization. The blueprint stated that "competitive conditions will be

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equalized with other private companies” and specifically called for the application of the same tax, legal, and safety net obligations for Japan Post that the private sector must meet. The blueprint also called for an end to government guarantees on postal insurance products. These proposed changes, long advocated by the United States, are welcome steps. The U.S. Government also continued to emphasize its long-standing concern about the timing for allowing the introduction of new Japan Post insurance products and raised other issues related to privatization reforms that, if left unaddressed, could undermine the potential for privatization to bring about a truly level playing field in Japan’s insurance market.

Dialogue between U.S. and Japanese government representatives on privatization issues remained active throughout 2004 and will continue as the privatization process proceeds. The U.S. Government also welcomed the transparent manner in which the Japanese government has undertaken the privatization process, including the opportunities provided to private sector interested parties to directly share their concerns and views with key Japanese government representatives, and urged that these efforts continue.

*Kyosai:* Kyosai operations have also received increased attention in 2004. Some Kyosai are regulated by their respective agencies of jurisdiction (Ministry of Agriculture, Forestry and Fisheries, or Ministry of Health, Labor and Welfare, for example), while others operate without any regulatory supervision. These separate regulatory schemes undermine the ability of the Japanese government to provide companies and policyholders a sound, transparent regulatory environment, and afford Kyosai critical business, regulatory, and tax advantages over their private sector competitors. The U.S. Government has stated its position that all Kyosai should be subject to the same regulatory standards and oversight as their private sector counterparts to ensure a level playing field and to protect Japanese consumers.

The U.S. Government welcomed a review of unregulated Kyosai undertaken during 2004 by a working group of the Japanese government’s Financial System Council (FSC). A working group report on its discussions was issued in October 2004 and opened to public comment, to which the U.S. Government submitted its views. The working group then issued a formal report with recommendations in December 2004, outlining steps to bring unregulated Kyosai under new government regulation and supervision. The U.S. Government also urged the Japanese government during 2004 to conduct a similar review of regulated Kyosai in the near future. The U.S. Government moreover expressed its concern over the introduction of new products by large regulated Kyosai during 2004, including a new whole life medical product from JA Kyosai and a new whole life medical product from Zenrosai.

*Policyholder Protection Corporations:* The life and non-life Policyholder Protection Corporations (PPCs) are mandatory policyholder protection systems created in 1998 to provide capital and management support to insolvent insurers. The Life PPC fund, in particular, had been nearly depleted as a result of industry failures. Private sector insurers have contributed considerable sums to the PPC systems, and U.S. industry, particularly life insurers, has expressed

## **FOREIGN TRADE BARRIERS**

serious concern at the prospect of additional contributions. The U.S. Government has stressed the need for a sustainable funding framework that did not unfairly burden the private sector.

Legislation was implemented in 2003 that assessed private sector life insurers an additional 100 billion yen to extend its funding guarantee to the Life PPC. The Japanese government also pledged to thoroughly review the PPC system and consider reforms long recommended by private insurers. U.S. insurers, although displeased with the additional levy, welcomed the review. The U.S. Government urged the Japanese government to ensure that the review is completed and necessary legislation enacted before the current Life PPC structure expires on March 31, 2006. A FSC working group conducted discussions on PPC review through much of 2004, issuing a report in December. The United States emphasized the need for transparency in subsequent government decision-making on the future of PPC funding and reform.

*Bank Sales:* Since April 2001, banks have been permitted to sell long-term fire insurance, debt repayment support insurance, credit life insurance, and overseas travel accident insurance. In October 2002, the list of permissible products was expanded to include individual annuities, maturity refund personal accident insurance with an annuity payout feature, *zaikei* (asset formation) insurance, and *zaikei* personal accident insurance. Although the U.S. Government welcomes these steps, the above list represents only a tiny fraction of the universe of private insurance products that could be made available to Japanese consumers through the bank sales channel.

In 2004, the U.S. Government continued to urge the Japanese government to promptly and completely liberalize the bank sales channel to allow banks to sell all types of insurance offered by any regulated private insurer and not specifically target third sector products by liberalizing only that sector first. In a March 2004 report, the FSC recommended full liberalization be accomplished within three years at the latest, and that partial liberalization within one year be carried out as a means to monitor the implementation and effectiveness of new anti-pressure sales rules. The U.S. Government expressed concern about a possible delay in the first stage of partial liberalization, and conveyed its view of the importance of meeting the FSC recommendation to complete liberalization no later than within three years. In order to promote bank sales of insurance in a manner that effectively serves the financial planning needs of consumers, the U.S. Government believes the Japanese government should promptly abolish or undertake appropriate revision of enforcement regulations that require banks to obtain customer consent in writing prior to the use of non-financial personal information in order to offer insurance products to customers.

The United States will continue to work closely with industry in following these issues and will urge the Japanese government to adequately resolve these concerns in an open and transparent manner.

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## **Professional Services**

U.S. and other foreign firms and individuals are hampered in providing professional services in Japan by a complex network of legal, regulatory, and commercial practice barriers. U.S. professional services providers are highly competitive. Their services also help facilitate access for U.S. exporters of other services and goods, and contribute valuable expertise to the economies they serve. The availability of such services can be a key factor in U.S. firms' decisions whether to invest, and thus is central to improving the environment for foreign direct investment in Japan.

*Accounting and Auditing Services:* U.S. providers of accounting and auditing services face regulatory and market access barriers in Japan that impede their ability to serve this important market. Only Certified Public Accountants (CPAs) or Audit Corporations (made up of five or more Japanese CPAs) can offer accounting services. Foreigners must pass a special examination to qualify, an examination last offered in 1975. The United States will continue to urge Japan to remove restrictions on accounting services.

*Legal Services:* As noted above in the Legal System Reform portion of the Regulatory Reform Initiative section, 2003 and 2004 brought sweeping reform in the area of association between Japanese and foreign lawyers, and the new system of Joint Law Firms (*kyodo jigyo*) is expected to be implemented by April 1, 2005.

*Medical Services:* Restrictive regulation limits foreign access to the medical services market. In the U.S.-Japan Investment Initiative, the United States has advocated allowing commercial entities to provide for-profit medical services and allowing more outsourcing of certain medical services, such as diagnostic and chronic care services (advanced imaging, maintenance dialysis, rehabilitation, etc.) to open this sector to foreign capital-affiliated providers.

*Educational Services:* Over-regulation also has discouraged foreign universities from operating branch campuses in Japan, presenting obstacles in the form of both administrative requirements and restrictions on pedagogical choices. The U.S.-Japan Investment Initiative has taken up these issues, and the Japanese government has announced the establishment of a new category for Foreign Branch Campuses of accredited institutions of higher education in the U.S. and elsewhere. The United States expects this designation will provide these campuses a number of important rights (such as student rail passes and the issuance of student visas) similar to those accorded Japanese educational institutions.

## **INVESTMENT BARRIERS**

Despite being the world's second largest economy, Japan continues to have the lowest inward foreign direct investment (FDI) as a proportion of total output in any major OECD nation. Foreign participation in mergers and acquisitions (M&A) activity, which accounts for some 80 percent of FDI in other OECD countries, also lags in Japan, although it is on an upward trend.

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This relative lack of foreign investment can act as a restraint on the expansion of imports. Much of the recent increase in FDI flows represents important opportunities and restructuring in the financial services and telecommunications sectors. The Japanese government has recognized the importance of FDI in revitalizing its economy. Prime Minister Koizumi, for example, vowed in January 2003 to double the stock of FDI in Japan in five years. Japan has since taken several steps to improve the FDI environment, including passage of legislation in 2003 to permit the use of triangular stock swaps for international M&A deals. U.S. businesses have applauded these steps, but continue to urge that tax rules be clarified and amended to facilitate use of modern merger techniques.

Cross-border M&As are more difficult in Japan than in other countries, partly because of conservative attitudes towards outside investors and partly because of the relative lack of financial transparency and disclosure and differing management techniques. The scarcity of qualified lawyers, auditors, and accountants is another impediment. Nevertheless, attitudes throughout Japan towards FDI have become considerably more positive, and some progress has been made through the introduction of consolidated taxation and revised bankruptcy procedures that make it easier for corporations and their assets to be acquired or merged in a "rescue" format.

The U.S.-Japan Investment Initiative co-chaired by the U.S. Department of State and Japan's Ministry of Economy, Trade and Industry (METI) was established in 2001 to focus on needed changes in the basic operating rules of Japanese markets and to encourage policy changes to improve the overall environment for foreign (and domestic) investment. The Investment Initiative has held a series of meetings and seminars. The first Working Group meeting of the Initiative in 2005 was held on January 26 in Tokyo, and Investment Seminars will be held in Nagoya and Chiba in May 2005. The private sector participates actively in this process and has offered detailed suggestions on how to increase transparency, as well as recommending the introduction of new financial instruments for international transactions.

## **ANTICOMPETITIVE PRACTICES**

There are detailed discussions related to anticompetitive practices and Antimonopoly Act (AMA) enforcement in several other parts of this report, particularly under the Regulatory Reform sections.

*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 often use the cover of these codes to adopt additional standards that are stricter than

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required by JFTC regulations under the Premiums Law and have the effect of restraining vigorous competition. As of December 31, 2004, there were still 40 JFTC-authorized premium codes.

## **ELECTRONIC COMMERCE**

The United States made numerous recommendations in its October 2004 Regulatory Reform submission for increasing consumer confidence and promoting electronic commerce in the private sector, including: removing regulatory and non-regulatory barriers, strengthening the protection of intellectual property rights, implementing new privacy legislation in a transparent and consistent manner, promoting alternative dispute resolution (ADR), and ensuring effective network security. The United States is urging Japan to support private sector self-regulatory mechanisms for privacy and ADR, as well as to ensure that laws governing electronic transactions are technology-neutral and that all final guidelines are consistent and complement existing international regulations. The United States will continue to work with Japan on these and other electronic commerce issues through the IT Working Group under the Regulatory Reform Initiative. (*For more details, see the Information Technologies section under Regulatory Reform.*)

## **OTHER BARRIERS**

### **Aerospace**

Japan is the largest foreign market for U.S. aircraft and aerospace products. The commercial aerospace market in Japan is generally open to foreign firms, and many Japanese firms have entered into long-term relationships with American aerospace firms. The U.S. Government continues to monitor METI's funding for the development of an indigenous small aircraft.

Military procurement by the Japan Defense Agency (JDA) accounts for over half of the domestic production for aircraft and aircraft parts, and continues to offer the largest source of demand in the aircraft industry. Japanese defense projects are carried out according to the current Mid-Term Defense Program (JFY 2001 - JFY 2005) with a projected budget of 25.16 trillion yen, or approximately \$206 billion, over this five-year period. The current Mid-Term Defense Program (MTDP) will end this JFY 2004 and a recently announced MTDP (JFY 2005-2009) will begin in April 2004. The projected budget is 24.24 trillion yen over this five-year period. Major projects include: ground and maritime ballistic missile defense systems, new maritime patrol aircraft, and new transport and tanker aircraft.

Although U.S. firms have frequently won contracts to supply defense equipment to Japan (over 90 percent of the annual foreign defense procurement is from the United States), the JDA has a general preference for domestic production or the licensing of U.S. technology for production in Japan to support the domestic defense industry. Also, European aviation competitors are starting to make inroads with some limited sales of aviation equipment for defense purposes.

## **FOREIGN TRADE BARRIERS**



Although Japan has considered its main space launch vehicle programs as indigenous for many years, in fact U.S. firms continue to participate actively in those space systems, including Japan's primary space launch vehicle, the H2-A. The U.S. Government has welcomed Japan's plans to develop a supplementary GPS navigation satellite constellation known as the "quasi-zenith" system, with the first launch scheduled for 2008. The United States is working very closely at the technical level with Japanese counterparts to ensure the Japanese system remains compatible with ours, and anticipates that U.S. companies will have the opportunity to supply major components of this system. The United States will continue to promote expanded access by American firms to commercial opportunities within Japan's domestic space programs as appropriate.

### **Autos and Auto Parts**

Further opening of the Japanese auto and auto parts markets remains an important objective of the United States, but access to Japan's automotive market continues to be impeded by a variety of overly restrictive regulations, a lack of transparency in rule making, and lackluster enforcement of antitrust laws. 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 remains unclear.

The U.S. Government remains disappointed with falling sales of North American-made vehicles and parts in Japan. Sales in Japan of motor vehicles produced in the United States declined in the first eleven months (January-November) of 2004, with sales decreasing by 30.5 percent following a decline of 15 percent in CY 2003. U.S. automakers sell less than a quarter as many U.S.-made vehicles in Japan as they did in 1995.

Even as American automakers have invested in Japanese auto manufacturers, foreign access to Japan's automotive distribution network remains troubling to U.S. auto companies. The U.S. automotive trade imbalance with Japan, \$44 billion in 2003 (\$32 billion deficit in autos and \$12 billion deficit in auto parts), is the equivalent of more than 66 percent of the overall U.S. trade deficit with Japan and made up eight percent of the 2003 worldwide U.S. trade deficit.

Auto and auto parts issues are addressed under our bilateral Automotive Consultative Group, which is co-chaired by USTR and the Department of Commerce on the U.S. side and METI and the Ministry of Land, Infrastructure, and Transport (MLIT) on the Japanese side. At its last meeting held in 2003, the group discussed industry trends based on a series of trade and economic data on autos and automotive parts provided by both countries and identified areas in which specific action can be taken by Japan to address U.S. concerns. This would include further deregulation (particularly in the automotive parts aftermarket), increased transparency in rules and regulations governing this sector, and more rigorous application of Japanese competition laws. The United States also continues to address crosscutting issues affecting the

## **FOREIGN TRADE BARRIERS**

automotive sector, such as expanding opportunities for foreign investment, increasing transparency in rule making, and promoting corporate restructuring in the Japanese economy under the Economic Partnership for Growth.

### **Civil Aviation**

Although market access for U.S. air carriers in Japan was improved significantly by an agreement reached in 1998, U.S. carriers remain constrained by extremely high airport costs in Japan and by enduring restrictions on traffic rights, operational flexibility, and pricing.

Several rounds of formal and informal talks aimed at further liberalization have taken place between the two sides since the 1998 agreement was signed, but without any success. As of the end of 2004, no further talks were scheduled. The U.S. Government continues to urge the Ministry of Land, Infrastructure and Transport (MLIT) to advance liberalization. Key U.S. concerns include passenger code carrier sharing limitations that further distort market inequities brought about by slot, designation and frequency restrictions; increased access to the Japanese market and additional “beyond Japan” service rights for non-incumbent cargo carriers; pricing liberalizations; and improvements in the regime for service between U.S. Pacific Islands and Japan.

In comparison to similar international airports in other countries, movements at Narita fall well below potential airport capacity, unnecessarily limiting slot availability. In periods of high demand, U.S. non-incumbent combination carriers have been unable to operate routes made available under the 1998 Memorandum of Understanding (MOU). A second runway opened in April 2002 provides additional slots, but at less than 2500 meters, the runway cannot accommodate most long-haul operations. The issue of excessively high landing fees at Narita and Kansai and the new Central Japan International Airport (Centrair) airports continues to be raised in the U.S.-Japan Regulatory Reform talks and in bilateral aviation discussions. (*See Regulatory Reform Initiative, Distribution Section.*)

The United States will continue to press hard for further liberalization consistent with its global policy to promote competition and market access in civil aviation.

### **Business Aviation**

Japan's over-regulated aviation system impedes the development of business aviation. Japanese firms cannot use business aircraft in an economical manner, and foreign users also find landing business planes difficult in Japan due to limited slots and commercial airline regulations that apply to charters and business aircraft. These regulations, which are administered by MLIT and the Japan Civil Aviation Bureau (JCAB), make costs prohibitive and are restrictive in particular for landing near Tokyo.

In Japan, the result of such regulatory burdens is that business aviation has yet to be used effectively as a tool for its global companies. Further, these burdens are a barrier to foreign direct investment since the investors cannot easily land; “Japan passing” is forced on CEOs even if they are inclined to stop due to “vampire hours” for late-night landings at Haneda as well as high fees for landing and other ground services. As a result, Japan has few landings and only about 25 dedicated commercial-use business aircraft, or less than a tenth of the 283 in Britain and an unusually small number when compared to other developed nations.

The Japanese government promises to improve the situation for landing slots at regional airports and, in the long run, in Tokyo. In central and western Japan, the Chubu and Kansai regions now have multiple airports that welcome such landings. By April 2005, regional airports (other than Type I) may accept landings of international charter and business aviation flights with only three days notice, a reduction from 10 days notice (provided that customs, immigration and quarantine or “CIQ” will be available). In the future, additional slots at Narita and Haneda may be available to ease access to Tokyo and to support both domestic and international business aircraft. Further, the additional runway at Haneda planned for 2009 should be a long-term target for significant improvement in the frequency and convenience of landing slots near Tokyo.

Growing needs among users (not to mention the renewed demands from U.S. firms and the U.S. Government) should force reexamination of these MLIT and JCAB regulations for business aviation. U.S. aircraft manufacturers believe that the regulatory situation has limited sales of their planes, and the U.S. Government has urged improvement. Bilateral initiatives for foreign investment, increased access and tourism, and long-term economic cooperation may also include means to ease use of business aircraft in Japan.

### **Electric Utilities**

The United States continues to stress that by introducing genuine competition into non-fuel procurement (valued at approximately \$10 billion annually), Japan can effectively reduce the costs of its electric power, which remain among the highest in the industrialized world. U.S. exports should rise significantly if barriers are lifted. U.S. exports currently account for approximately 3.5 percent of Japanese electric utility procurements, or around \$350 million per year.

Japan's utilities actively participate in the New Orleans Association (NOA), a U.S. Embassy-sponsored forum that enhances communication between Japanese electric power utilities and U.S. suppliers of non-fuel materials, equipment, and services. The United States continues to urge Japanese utilities to further increase procurement of foreign products and services (which often prove more economical) to seek greater transparency and fairness in the procurement process.

Nevertheless, foreign firms face barriers due to standards and specifications used by Japanese utilities that often discriminate against or disproportionately burden foreign suppliers. Problems

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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. In addition, because each utility uses its own specifications (in some cases, different departments of a utility use their own specifications), suppliers must prepare more than ten production lines in order to sell to Japan's ten electric power companies. Some Japanese utilities also require that foreign and domestic suppliers register with the utility, a process that can involve submission of product and test data and can be extraordinarily time consuming. In addition, there have been allegations that Japanese utilities rejected registration applications by foreign suppliers because the foreign companies are not consumers of electricity generated by Japanese utilities. Finally, good access to procurement information is difficult to obtain.

### **Motorcycles**

In 2004, the Diet finally eliminated Japan's ban on tandem riding of motorcycles (carrying a passenger) on Japanese motorways. This was followed by the Cabinet issuing a Cabinet Ordinance to allow motorcyclists aged 20 or higher with more than three years experience to tandem ride starting April 1, 2005. The previous prohibition of tandem riding ban artificially limited Japan's market for large motorcycles, adversely affecting U.S. exports. More importantly, by forcing riders to use less-safe ordinary roads, the ban significantly reduces the safety of motorcycling in Japan. The U.S. Government strongly supports this reform and will monitor its implementation.

### **Sea Transport/Ports**

U.S. carriers serving Japanese ports have long encountered a restrictive, inefficient, and discriminatory system of port transportation services. In October 1997, after repeated diplomatic efforts to remove these restrictions, the U.S. Federal Maritime Commission (FMC) assessed a \$100,000 fee on each ocean voyage to the United States by Japanese shipping lines. This prompted Japan to agree in October 1997 to substantial regulatory reform of its ports sector and the fees were suspended in November 1997. 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 Transportation Business Law (effective November 2000) to eliminate the need for new entrants to prove there is surplus demand. Charges for harbor services in nine large ports are subject to a prior notification requirement and there is an approval requirement for other ports by the Ministry of Land, Infrastructure and Transport (MLIT). The nine large ports are Keihin (Tokyo, Yokohama and Kawasaki), Chiba, Shimizu, Nagoya, Yokkaichi, Osaka, Kobe, Kanmon (Shimonoseki and Kitakyushu), and Hakata. In May 1999, the FMC removed its rule imposing the fees, and imposed a semi-annual reporting requirement on two U.S. and three Japanese shipping lines.

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 noted that

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the revised Port Transportation Business Law did eliminate the economic needs test and licensing requirement at the nine large ports, although the amended law still maintains a permission system for new entrants to port services operations in those ports. The Port Transportation Business Law introduces new requirements that run counter to the need of efficient port operations and discriminate against new entrants wishing to offer port services. For example, minimum manning levels for new entrants was set at 150 percent; new terminal operators are required to conduct all terminal operations as a joint venture or under a close ties relationship with established Japanese operators; a new licensing rule was introduced, requiring excessive and unnecessary information such as business plans; and the Japanese government now has the authority to disallow rates for port services found to be anticompetitive. In addition, MLIT has not addressed concerns about the prior consultation process conducted by the JHTA nor about the apparent threat of illegal strikes against foreign carriers who obtain permission to operate their own container terminals.

In August 2001, citing its continuing concern that these issues had not been resolved, the FMC ordered the five U.S. and Japanese carriers and several other major shipping lines serving the U.S.-Japan trade to report detailed information on the effects of recent changes in Japanese port laws and ordinances; the ongoing semi-annual reporting requirements continue only for the two U.S. carriers and the three Japanese lines named in the original proceeding. The United States will continue to closely monitor how these changes affect port operations and to urge faster regulatory reform in the port sector. Both the Japanese and U.S. positions, however, have solidified over the years. At the March 2004 High Level Regulatory Reform meeting, the U.S. Government reiterated its position that the Japanese government has failed to implement important aspects of the wide-ranging port deregulation promised in 1997.

## **Steel**

U.S. steel producers have previously expressed concerns that Japanese steel companies may be engaging in anticompetitive practices. With respect to Japan's domestic market, it has been alleged that Japan's integrated producers have coordinated output, pricing, and market allocation goals. In addition, it has been alleged that Japanese mills have entered into arrangements with foreign counterparts to regulate bilateral steel trade.

Japan participated constructively in bilateral consultations and in OECD High-Level Meetings on Steel during 2004 aimed at eliminating subsidies in the steel sector. In June 2004, the OECD High Level Group on Steel reaffirmed their commitment to the ultimate goal of stronger subsidy disciplines in the global steel sector, and decided to shift the focus of the talks to bilateral and plurilateral consultations to explore bridging the differences on the key issues. The High Level Group also agreed to reconvene in 2005 to evaluate prospects for a steel subsidies agreement.