

JAPAN

TRADE SUMMARY

The U.S. goods trade deficit with Japan was \$82.7 billion in 2005, an increase of \$7.1 billion from \$75.6 billion in 2004. U.S. goods exports in 2005 were \$55.4 billion, up 2.2 percent from the previous year. Corresponding U.S. imports from Japan were \$138.1 billion, up 6.4 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 \$35.2 billion in 2004 (latest data available), and U.S. imports were \$19.6 billion. Sales of services in Japan by majority U.S.-owned affiliates were \$43.7 billion in 2003 (latest data available), while sales of services in the United States by majority Japan-owned firms were \$22.7 billion.

The stock of U.S. foreign direct investment (FDI) in Japan in 2004 was \$80.2 billion, up from \$68.1 billion in 2003. U.S. FDI in Japan is concentrated largely in the finance, and manufacturing sectors.

REGULATORY REFORM OVERVIEW

While Japan has made significant progress on regulatory and structural reform over the years, more needs to be done to ensure Japan's economy remains on a growth trajectory and to expand opportunities for U.S. companies doing business in the Japanese marketplace. The United States therefore welcomes Prime Minister Koizumi's unwavering commitment to a meaningful economic reform agenda. Onerous regulations, however, continue to hamper commerce in Japan. The United States puts a high priority on efforts to achieve meaningful regulatory and structural reform.

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

The Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) is one of the chief vehicles the United States uses to engage Japan on economic reform. The 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 2001. This 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.

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The Fourth Report to the Leaders under the Regulatory Reform Initiative details progress achieved over the past year. Building on this progress, the United States kicked off the fifth year of the Initiative by submitting to Japan in December 2005 its recommendations to be discussed between the two governments in the coming months. The first such round of discussions occurred in Japan in late 2005 and early 2006 at the working group level. After convening another round of working group meetings and a high-level meeting in the spring of 2006, the two governments intend to conclude a Fifth Report to the Leaders in the summer of 2006.

SECTORAL REGULATORY REFORM

Telecommunications

Under the Regulatory Reform Initiative, the United States continues to seek 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. Through its December 2005 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. In addition, 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 to direct political control, to a more independent organization. It is also important for Japan to establish and exercise meaningful sanction authority by the regulator (e.g., imposition of fines, payments of damages, and license restrictions) to punish anticompetitive behavior.

Interconnection and Pricing: Japanese laws and regulations do not prevent NTT regional carriers from imposing high and onerous conditions on their competitors for interconnection. This is one of the most significant indications that Japan needs to improve its competitive safeguards with respect to dominant carriers. In 2005, the Ministry of Internal Affairs and Communications (MIC) implemented a more rational rate structure for wireline interconnection rates by phasing out certain fixed costs that MIC has permitted regional operators to charge competitors, a revision long sought by the United States. However, MIC's five-year transition period constitutes a disappointing delay in this much-needed rate reduction. MIC is expected to continue studying how to revise or replace the rate regime, and the United States will continue discussions with MIC to ensure that any changes will improve the competitive environment.

Dominant Carrier Regulation: NTT has worked to maintain its market dominance through a number of measures, such as denying interconnecting carriers access to emergency services and proposing higher interconnection charges for carriers competing with alternative technologies (e.g., DSL services). Despite being one of the most profitable companies in Asia, NTT is citing declining revenues as justification for an announced reorganization plan that, among other things, would consolidate wireline and wireless operations. Competitors have voiced concern that the plan would rollback the "breakup" of NTT companies in 1999 that was intended to foster competition within the NTT group.

Universal Service Program: Japan's universal service fund mechanism, which has been inactive since it was established in 2003, was revised in 2005. Doubts remain as to whether the revised fund can be considered "competitively neutral" as it is expected to benefit only the NTT regional carriers in specific high-cost areas. The United States continues to monitor whether MIC is taking sufficient steps to ensure that NTT East and NTT West will not take advantage of their dominant position to inhibit competition. This will become increasingly important as MIC reviews its competition policy in upcoming years to facilitate both wireline/wireless and broadcast/telecommunications convergence.

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, its rate reduction in 2005 was only 3.4 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: For the past twelve years, MIC limited the mobile wireless market to three main operators, including NTT DoCoMo with a market share of over 50 percent. In 2005, MIC took a significant step forward by making substantial blocks of spectrum available primarily for new wireless entrants, thereby creating opportunities not only for telecommunications companies wanting to expand into the wireless business in Japan, but also equipment suppliers to those companies. MIC pre-approved licenses for three new market entrants in October 2005, which have already attracted substantial U.S. investment to deploy new facilities. However, much work remains to be done to create a level playing field for the new market entrants, including "roaming" on incumbent networks at reasonable rates, sufficient access to towers and tower sites, and analyzing incumbents' unused spectrum to eliminate "warehousing."

Information Technologies (IT)

Since 2001, e-Japan Strategies and Programs have promoted the use of IT and e-commerce in Japan by removing regulatory barriers and increasingly emphasizing private-sector input and leadership in the development and implementation of IT and e-commerce policies. After focusing on IT infrastructure build-out earlier this decade, Japan's strategies have shifted to highlighting IT and e-commerce use. Notably, the IT Policy Package 2005 promoted the use of IT and e-commerce in areas closely related to the welfare of individual citizens and prioritized areas such as information security and e-government.

As Japan responds to the challenges that lie ahead in this pivotal sector, the U.S. Government is urging Japan to establish a regulatory framework that ensures competition, promotes innovation, protects users, allows private sector-led regulation where appropriate, and protects intellectual property rights in the digital age. The U.S. Government's recommendations in its December 2005 Regulatory Reform submission support Japan's goals by focusing on: protecting intellectual property; removing regulatory and non-regulatory barriers to e-commerce; promoting e-commerce via private-sector self-regulatory mechanisms and technologically neutral, market-driven solutions; and expanding IT procurement opportunities.

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Legal and Other Regulatory 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 prevent Japan from fully realizing its IT potential. In its December 2005 Regulatory Reform submission, the United States urged Japan to: (1) implement its new IT Strategy in a manner that promotes private-sector leadership and self-regulation in IT and e-commerce by ensuring that any Cabinet orders, ministerial ordinances, guidelines, or other measures prepared to implement the Strategy or its policy goals also are open to public comments, a minimum period of 30 days is provided for comments, and comments received are seriously considered and reflected as appropriate in the final measures and actions that are implemented; (2) seek out a diverse range of views in any IT- and e-commerce-related government-organized study groups; (3) reaffirm the importance of private-sector leadership in IT-related standards setting; (4) ensure adherence to technology neutrality as Japan pursues implementation of proposals and policies laid out in the IT Strategic Headquarters' September 2004 "Basic Concept on IT International Policy Centered on Asia" and related sections of the IT Policy Package 2005; and (5) ensure that Japan's IT and e-commerce policies and regulations are compatible with international practice.

Personal Data Regulation (Privacy): Japan's Law on the Protection of Personal Information (Privacy Law) went into effect in April 2005. Ministries and agencies have subsequently formulated implementation guidelines to ensure the Law's effectiveness. In March 2005, Ministries from the Government of Japan participated in a seminar for U.S. and Japanese enterprises on the Privacy Law, educating over 300 participants on how to comply with the Law. In its regulatory reform recommendations this year, the United States urges Japan to ensure that: the Privacy Law is implemented in a transparent and coordinated manner; guidelines are clearly defined as mandatory or voluntary; a system is established to publish information about violations and corrective actions; and guidelines are enforced consistently and fairly. The United States commends the Ministry of Economy, Trade and Industry (METI) for conducting annual reviews of its implementation guidelines, and recommends that all Ministries conduct similar annual reviews. To further support Japan's efforts to ensure the effective implementation of the Privacy Law, the U.S. Government has recommended collaborating to ensure a successful third privacy roundtable, where the Ministries could further explain the implementation of their guidelines, as well as address industry's concerns regarding compliance and enforcement.

Online Nuisance, Deceptive Practices, and Fraud: Japan has recognized the growth and impact of malicious activity and fraud propagated on the Internet, and their corresponding threat to online behavior. The United States commends the Japanese government for amending the Law on Regulation of Transmission of Specified Electronic Mail (Anti-Spam Law) to include direct penalties, for actively analyzing issues such as spam and phishing, and for the Information Security Policy Council's (ISPC) calls to address new online threats. The United States urges Japan to: work closely with the private sector in combating spam, phishing, and other online fraud; vigorously enforce the amended Anti-Spam Law; implement any online fraud-related laws, regulations, and guidelines in a manner that strives not to unduly promote, mandate, or favor specific technologies; and work closely with the Government of the United States to share information and collaborate to best address rising issues of online fraud.

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This includes cooperating with the United States to ensure a successful anti-phishing, spam, and online fraud conference with relevant stakeholders in April 2006 to raise awareness, highlight best practices, and promote public-private partnerships to counter online hazards.

Strengthening Intellectual Property Rights (IPR) Protection: The U.S. Government's 2005 Regulatory Reform Initiative 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; and (3) actively working with the 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 sectorled working group. The United States remains concerned the liability rules are unclear, do not provide the appropriate balance among the interests of telecommunication carriers, ISPs, rights holders, and website owners, and fail to provide adequate protection for rights holders. The United States continues to urge 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. In regard to temporary copies, the scope of protection for such copies remains vague in Japan, which could erode the ability to protect copyrighted materials. The United States will continue to monitor developments in this area.

Network Security: The United States continues to welcome Japan's efforts to improve and ensure the security and reliability of government information systems. Japan's new National Information Security Center (NISC) affirmed the importance of private sector input in the development of new information security standards for central government entities by holding a public comment period on a draft of these standards in fall 2005 and subsequently making publicly available a summary of the main issues raised in the comments received, as well as an indication of NISC's response or actions taken. In its December 2005 Regulatory Reform submission, the United States recommended that NISC solicit input from the public on all government computer security requirements it issues, whenever possible; promote consistent implementation of minimum information security requirements by all Ministries; and ensure that procurement of IT products or services to meet Japan's government information security requirements is fair and transparent for all domestic and foreign vendors. The United States also suggested that if Japan decides to provide guidance to local governments regarding their information security standards, that Japan encourage them to use those security requirements issued by NISC for the central government to promote consistency.

Japan has also taken significant steps regarding information security in the private sector. In the Regulatory Reform Initiative Fourth Report to the Leaders, the Government of Japan recognized that voluntary best practices can be more easily revised and, therefore, it would work in conjunction with the private sector to develop and disseminate voluntary best practices for information security in the private sector during FY2005 and beyond.

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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 continue to monitor and evaluate the implementation and effectiveness of measures listed in the memorandum of agreement adopted by the Ministries in 2002 (and revised most recently in 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 on the Internet, review rules for participation in bidding and adopt changes that increase flexibility and promote competition, and renovate government "legacy" computer systems to reduce costs and increase performance. In its December 2005 Regulatory Reform submission, the United States also encouraged Japan to enhance efforts to set clear limits on liability in procurement contracts, promote wider dissemination of the benefits of new intellectual property (IP) created through government-sponsored projects, protect rights to IP incorporated into procurement deliverables, and increase IP training for procurement officers.

Energy

Important progress continues in Japan's efforts to liberalize its electricity and natural gas markets. The United States has worked with Japan through bilateral consultations, including by sharing its own experiences, to help Japan foster improved energy efficiency, lower energy costs, and boost competition through the enhancement of new market opportunities. As of the end of 2005, approximately 63 percent of Japan's electricity market and approximately 50 percent of its natural gas market have been opened to competition. As reform and liberalization proceeds, it remains important that Japan pay careful attention to the actual market-based impacts of these reforms and that further reforms or adjustments are implemented whenever necessary to ensure that Japan's energy markets are truly competitive, efficient, and open to new market participants. The United States has also emphasized the importance of transparency, urging Japan to ensure that its regulatory processes are sufficiently open to engender the confidence of market participants and consumers alike.

Electricity: The further liberalization of Japan's electricity market in 2005 was complemented with the operational launch in the same year of two potentially important institutions: a nationwide wholesale power exchange, and a neutral transmission system organization (NSO) to set transmission and distribution rules. Japan has continued to carry through on implementing key elements of legislative reforms passed in 2003, including the abolition of the transmission rate "pancaking system" along with the introduction of a new framework for network users to pay uniform transmission rates. The United States will monitor these new developments, including the growth and vigor of participation in the new wholesale power exchange. The United States will also continue to monitor the broader evolution of Japan's reforms in this sector, including as Japan prepares to consider from 2007 further liberalization in Japan's electricity market down to smaller users (including the household level).

Natural Gas: Japan will expand the scope of competition by taking its next step in 2007 to liberalize the natural gas market to customers with an annual demand of 100,000 cubic meters. At this time, however, Japan has not yet committed to expanding retail choice down to the household level. In addition to further liberalization, Japan has taken other steps to help enhance

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the transparency and fairness of third party access to gas pipelines, including improvements in the information disclosure that companies provide to make the process for approving rates more transparent. The United States has urged Japan to take a variety of additional measures to ensure truly meaningful third-party access to Japan's natural gas infrastructure is achieved to enable smooth market entry, including measures that enhance the certainty of third-party access to liquefied natural gas (LNG) terminals.

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 in 2004 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 has urged PMDA to implement measures outlined in the November 2005 Fourth Report to the Leaders, such as meeting targets for faster product approvals. Japan has established a target of concluding by 2009 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 continues to urge Japan to attain those targets.

Since the establishment of PMDA, 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 shortage of qualified PDMA staff. The U.S. Government urges Japan to implement plans contained in the 2005 Report to the Leaders to ensure PMDA increases its resources and expertise, including recruiting qualified PDMA staff, to facilitate product reviews and safety. In its December 2005 Regulatory Reform Initiative recommendation, the United States urged Japan to take steps to enhance PMDA's ability to perform reviews.

Regarding drugs, the United States urged Japan to use performance metrics agreed upon by PMDA and the U.S. drug industry to facilitate faster drug reviews and discussions with industry on improving the review system. The United States also urged Japan to take steps to facilitate consultations with industry on drug clinical trials. Regarding medical devices, the United States recommended that Japan improve reviews of products that have undergone "partial changes" by clarifying approval procedures. The U.S. Government also is concerned about Japan's unreasonable requirements for clinical trial data provided in support of medical device applications. The United States urged Japan to require only relevant clinical trial data for medical devices.

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The U.S. Government also is concerned about the effect of revisions to Japan's Pharmaceutical Affairs Law (PAL) that took effect on April 1, 2005. One effect of the PAL revision is an increase in PMDA's responsibilities for inspections of medical device and drug factories. In the 2005 Report to the Leaders, Japan noted that overseas inspections will generally not delay the review process for approvals of new devices and drugs. The U.S. Government has urged Japan to take steps to ensure that overseas audits or factory inspections not delay approvals of new products.

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 so-called "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. In 2006, the Japanese Government is expected to discuss and approve changes in its healthcare system to remedy financial problems caused by the aging of its population. The U.S. Government has been encouraging Japan to implement changes that result in both long-run cost savings and improved health. The United States has recommended that Japan fix inefficiencies in its healthcare system such as its excessively long hospital stays, which are triple the average of countries in the Organization for Economic Cooperation and Development. The U.S. Government also is urging Japan to consider the long-term benefits of reimbursement pricing systems that foster the development of innovative drugs and devices. Such policies will promote the speedy introduction of advanced products that not only help save and improve lives but help make Japan's healthcare system more efficient by precluding the need for surgeries and reducing the lengths of hospital stays.

Regarding drug reimbursement, in the 2005 Regulatory Reform Initiative Report to the Leaders, Japan noted it will allow manufacturers to make presentations on their products' effectiveness and usefulness at certain key advisory body meetings, consider all data provided by firms about their drugs when the drugs' reimbursement levels are under consideration, and recognize the differences between biologics and chemical-based drugs. In the 2005 Regulatory Reform Initiative submission, the United States urged Japan to provide industry with meaningful opportunities to express its views on changes to the reimbursement pricing system and implement on a trial basis a pricing method for new drugs that ensures the full scope of their value can be evaluated based upon data from manufacturers.

Regarding medical device reimbursement, in the 2005 Report to the Leaders, Japan noted it will recognize the value of diagnostic products when determining reimbursement pricing. In its 2005 Regulatory Reform Initiative submission, the U.S. Government proposed that Japan consult with companies affected by the "Foreign Average Price" rule for medical devices, which caps Japanese prices by linking them to lower prices abroad. That rule fails to consider the higher cost of doing business in Japan. The United States is urging Japan to use a medical device reimbursement mechanism based on market factors in Japan and to consult with companies that would be affected by the reimbursement mechanism.

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 the Plan does not discriminate against foreign blood plasma products and is consistent with Japan's international trade obligations. The United States is also urging Japan to develop a reimbursement pricing system for blood products that accounts for the unique characteristics of that industry and that is not based on the pharmaceutical model. In addition, the U.S. Government has 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 recent 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. In 2005, the Government of Japan took the following steps to liberalize financial services and make regulation more transparent.

Securities and Exchange Law: Under a revised Securities and Exchange Law (SEL), Japan in 2005 began to allow private financial institutions, such as banks and insurance companies, to engage in securities businesses. SEL amendments, which went into force April 1, 2005, include the introduction of a system of fines to combat unfair trading practices and revisions of the law governing paperless stock transactions to permit companies to stop issuing physical stock certificates. Legislation to allow foreign exchange trading on margin took effect in July 2005. The new rule was designed to protect investors by setting forth specific criteria for margin foreign exchange trading.

On June 22, 2005, the Diet approved additional revisions to the SEL. The revised law has three provisions: (1) companies that seek to acquire more than one-third of the outstanding shares in a listed company in after-hours transactions are subject to takeover bid regulations (this revision was triggered by Livedoor's early 2005 purchase of a large amount of shares in Nippon Broadcasting System in after-hours trading); (2) parent firms of companies listed in Japan, if not under a continuous disclosure obligation, must disclose a certain level of parent company information; and (3) non-Japanese firms may disclose their financial statements in English, with an attached summary in Japanese.

Japan Post Distribution of Mutual Funds: Following the December 2004 legislation removing a ban on sales of mutual funds at post offices, Japan Post in 2005 chose three private financial firms to produce mutual funds for sale at 550 of its 24,700 post offices in its first phase of mutual fund sales. One U.S. firm and two Japanese firms were selected. Other foreign financial firms operating mutual funds in Japan plan to compete for Japan Post distribution in the future.

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Banking Law: On October 26, 2005, the Diet approved a bill revising the Banking Law. The approved bill allows non-financial companies to handle such banking services as taking deposits and providing loans as bank agents, with the approval of the Financial Services Agency. Retailers, such as convenience store chain operators, supermarkets, and automobile dealers, are expected to launch banking services as bank agents from April 2006.

Agriculture

Agricultural issues made progress under the Regulatory Reform and Competition Policy Initiative in 2005. The main topic addressed was the need for Japan to be consistent with international plant health standards on official control and pest risk assessment.

The Japanese government routinely required that imported produce be fumigated for insect species that are already present in Japan and not officially controlled. This practice is inconsistent with international practice and with the International Plant Protection Convention (IPPC). The fumigation requirement is particularly detrimental to trade in fresh fruits and vegetables, primarily lettuce and citrus. 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.

In December 2004, at the first round of the Cross-Sectoral Working Group under the Regulatory Reform Initiative in Tokyo, the United States proposed that Japan harmonize its risk assessment and official control practices with International Plant Protection Convention standards. The United States also stressed the need for improved transparency and market predictability in Japan's phytosanitary enforcement procedures. As a follow-on to the December 2004 meeting, the United States and Japan held a plant health workshop in April 2005 to discuss in detail the application of IPPC standards for risk assessment and official control. The Japanese government acknowledged it would review official control practices and shift some pests from quarantine to non-quarantine status, based on the outcome of risk assessments. As a result, for example, Japan agreed to review the quarantine status of a number of pests, primarily of lettuce, that are present in Japan and not officially controlled. In addition, Japanese scientists visited the United States to consult with U.S. scientists on risk assessment policies and procedures. The United States will continue to urge Japan to adopt international standards, develop a comprehensive list of non-quarantine pests, and reduce excessive, unnecessary, and trade-distorting fumigation.

STRUCTURAL REGULATORY REFORM

Antimonopoly Law and Competition Policy

Under the Regulatory Reform Initiative, the United States continues to propose 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 should result from April 2005 amendments to the AMA, the first significant revision of the AMA in over 25 years.

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Strengthening the Effectiveness of Antimonopoly Enforcement: Cartel activity, including widespread bid rigging, continues to be a serious problem in Japan. One important reason is administrative and criminal sanctions did not constitute an adequate deterrent against companies and individuals engaging in unlawful anticompetitive practices. Administrative surcharges (fines) were too low to serve as a meaningful deterrent, with a maximum six percent surcharge of the sales in question over a maximum of three years. 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 nine criminal prosecutions of AMA violators since 1990, including two in 2005. Where these cases have resulted in convictions, fines have been imposed. All prison sentences were suspended, however, even for an individual convicted of a repeat offense in a recent case.

A number of other factors limited the effectiveness of the JFTC's enforcement against egregious AMA violations. The JFTC did not have the powers enjoyed by other Japanese criminal investigation authorities, including the power to conduct compulsory searches and seizures. Nor did it have the authority to reduce administrative surcharges or promise not to bring criminal charges against companies that come forward to expose illegal activities through a corporate leniency program for cartel whistleblowers.

The April 2005 amendments to the AMA, however, address many of these problems. Administrative surcharges increased to 10 percent of cartel sales for large manufacturers and service providers that are first-time AMA offenders, and to 15 percent for repeat offenders. The amendments authorize the JFTC to introduce a corporate leniency program that eliminates administrative surcharges for the first company to report its participation in an unlawful cartel and cooperate with the JFTC's investigation and reduces surcharges for up to two more companies applying for leniency. The JFTC introduced such a leniency program in January 2006, and undertook not to file a criminal accusation against the first company (and its officers and employees) that enters the leniency program for a given cartel. In addition, the amendments provided the JFTC with criminal investigation powers; increased penalties for interference with JFTC investigations or for non-compliance with the JFTC cease and desist orders, streamlined hearing procedures, and extended the statute of limitations for AMA violations to three years after the conduct stopped. The United States is recommending that the JFTC take steps to maximize the effectiveness of its leniency program and to heighten compliance with the AMA.

The JFTC's ability to enforce the AMA has also been 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 706 in 2005. More importantly, the number of JFTC investigative staff has increased from 154 in 1990 to 360 as of March 2006. Nonetheless, the JFTC remains understaffed, particularly in the areas of economic analysis and investigations, to enforce the AMA adequately. The 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 JFTC undertook to introduce a system in January 2006 to allow companies subject to a proposed public warning by the JFTC to submit evidence and make arguments as to why such a warning should not be issued. The JFTC also added two hearing examiners who are qualified attorneys, so that three out of seven hearing examiners are now attorneys or judges. The United States is recommending that the JFTC implement additional measures to improve the reliability and fairness of JFTC investigatory and administrative procedures.

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 July 2005, the Ministry of Land, Infrastructure and Transport (MLIT) clarified that companies engaging in serious bid rigging would be subject to suspension from bidding for up to two years. 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 bid rigging, including implementation of an administrative leniency program that exempts whistleblowers from administrative sanctions such as suspension of designation, an increase in the minimum suspension from bidding for bid-rigging recidivists, and strengthening measures to address conflicts of interests created by the *amakurari* system.

Transparency and Other Government Practices

The United States continues to raise a broad range of issues under “Transparency and Other Government Practices” with the aim of urging 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 December 2005 Regulatory Reform submission, the United States urged Japan to increase transparency in the following areas.

Public Comment Procedures: The effectiveness of Japan's Public Comment Procedures (PCP), in place since 1999, remains uncertain. The September 2005 annual survey of PCP implementation released by the Ministry of Internal Affairs and Communications (MIC) reflects many of the inadequacies of Japan's PCP implementation prior to its recent incorporation into the Administrative Procedure Law. In FY2004, over half of the public comment periods for regulatory revisions requiring Cabinet decisions were shorter than 30 days. While the recent amendment of the Administrative Procedure Law has strengthened the PCP, the United States urges Japan to evaluate and eliminate remaining inadequacies in PCP implementation to make it more effective in promoting a more transparent and fair rulemaking system. Specifically, the United States recommends that Japan compel ministries and agencies to provide minimum 30-day public comment periods and commit to making further revisions to the PCP if recent reforms still provide insufficient opportunities for meaningful public input into the policymaking process.

Special Zones for Structural Reform: The U.S. Government continues to support Japan's efforts to promote regulatory reform through the Special Zones for Structural Reform and lauds Japan's continued expansion of this program since the approval of the first zones in April 2003. The number of zones grew by 224 over the past year, bringing the total to 548 by the end of 2005. To ensure that this initiative continues to promote local and national economic revitalization, as well as opportunities for both domestic and foreign companies to operate in a deregulated environment, the United States urges Japan to continue transparent implementation and expeditious nationwide application of zone measures. In keeping with the focus on expanding market entry opportunities, the United States also recommends that Japan continue to encourage foreign participation in the zones initiative by publishing in English on the Internet a comprehensive list of current zones, progress on zone applications, and updated information.

No Action Letters: The Financial Services Agency (FSA) is studying measures to enhance its No-Action Letter (NAL) system and develop other means of expanding the body of written interpretations of Japanese financial law and regulations as a key element of its Program for Further Financial Reform. The number of NALs published by the FSA is increasing. The FSA has issued 9 No-Action Letters since April 2004, up from six issued in the previous 12 months and four during the first 21 months after the NAL system was introduced in July 2001. Under the Program for Further Financial Reform, the FSA has encouraged more active use of its NAL system by publishing in February 2005 "Detail of the No-Action Letter System" (an English-language version of the bylaws of the NAL system) and distributing in June 2005 a detailed questionnaire to the general public (including regulated firms) on the NAL system and suggestions for improvement of the FSA's implementation of the NAL system and its laws and bylaws.

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 continue to work jointly to achieve full implementation of the APEC Transparency Standards in the domestic legal regimes of countries in the Asia-Pacific region.

Privatization

Prime Minister Koizumi's efforts to restructure and privatize Japan's public corporations continue to make important progress. The U.S. Government recognizes that these reforms, if implemented in a fully market-oriented manner, can have an important impact on the Japanese economy by stimulating competition and leading to a more productive use of resources.

The U.S. Government has a particular interest in the Prime Minister's initiative to reform and privatize Japan Post, which has large banking and insurance businesses in addition to its mail and parcel delivery operations. The U.S. Government has long called on the Japanese government to eliminate the tax, regulatory, and other advantages Japan Post has over U.S. and other private companies. With the passage of related legislation by the Diet in October 2005, Japan has established a framework to make important progress in this direction. As Japan moves forward with its implementation of these reforms, the U.S. Government, through the Regulatory Reform Initiative and in other fora, continues to urge the Japanese government to ensure that all necessary measures are taken to achieve a truly level playing field between Japan Post and the private sector in Japan's banking, insurance, and express delivery markets at the earliest possible date. In this regard, the U.S. Government welcomes inclusion in the legislation of the principle that equivalent conditions of competition will be established. The U.S. Government also continues to call on Japan to ensure that a level playing field is in fact created before the postal financial institutions are permitted to introduce new lending services, underwrite new or altered insurance products, or originate non-principal-guaranteed investment products. The U.S. Government also is urging Japan to ensure that the process by which this reform proceeds is made fully transparent and inclusive, including full and meaningful use of Public Comment Procedures and opportunities for interested parties to express views to related officials and advisory bodies before decisions are made. (*For additional detailed discussion of Japan Post privatization and postal financial institutions, please see "Insurance" under the Services Barriers section.*)

Commercial Law

Japan has been making steady progress on reforming its commercial law. In 2005, it enacted legislation aimed at modernizing its Corporate Code, including provisions that, when they come into effect, will permit the use of modern merger techniques, such as triangular mergers, in cross-border merger and acquisition transactions. Problems, however, still remain that impede foreign investment and corporate restructuring and that hinder good corporate governance practices. Of particular concern are efforts by some parts of the Japanese business community to erect barriers to beneficial foreign investment in Japan.

In its December 2005 Regulatory Reform submission, the United States urged Japan to build on past reforms by further improving its commercial law and corporate governance and rejecting efforts to protect entrenched management and impede foreign investment in Japan. Specifically, the United States is recommending that Japan implement the new triangular merger provisions promptly in a manner that does not impose significant restrictions on the use of foreign company shares in cross-border transactions and that facilitates tax deferral benefits in such transactions in appropriate cases.

FOREIGN TRADE BARRIERS

The United States is also recommending that Japan take measures to facilitate efficient tender offer bids as well as to improve corporate governance by adopting mechanisms that encourage and facilitate the active exercise of shareholder rights by both institutional and small investors, while providing legal mechanisms to ensure oversight of management and shareholder decisions.

The United States has also urged Japan to make revisions to its Company Law before it comes into effect in 2006 to remove all legal liability that a new provision has created for legitimate branches of foreign corporations in Japan. Article 821, which was included in the new Company Law that passed Japan's Diet in 2005, has created great uncertainty among foreign corporations, including U.S. corporations that conduct their primary business through their company branches in Japan's market. As written, Article 821 appears to prohibit such branches of foreign corporations from engaging in transactions in Japan on a continuous basis. While supplementary steps were taken in Japan's Diet prior to passage of the new Company Law to assure companies that the Japanese government would not apply Article 821 to legitimate entities, legal uncertainty has remained for these branches, particularly with respect to private litigation that could be brought against their directors and officers.

Legal System Reform

Reform of the Japanese legal system is essential to the establishment of an 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 them.

In its December 2005 Regulatory Reform submission, the United States again welcomed passage of the legislation regarding free association between Japanese and foreign lawyers and urged implementation by both the Ministry of Justice and the relevant bar associations in a manner that upholds the liberalization. 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.

Distribution and Customs Clearance

The efficiency of Japan's distribution system is hampered by high airport user fees, relatively inefficient and costly customs procedures, low credit card acceptance at traditional merchants and ATMs, burdensome regulations on operators of fleet vehicles, and excessive rules on the activities of private express delivery companies. In addition, at the end of 2005, the Ministry of Land, Infrastructure, and Transportation (MLIT) announced proposals for changes to Japan's city planning laws that would, if enacted, restrict retailers' ability to meet Japanese consumers' needs by opening larger stores offering cheaper and more varied goods.

In its 2005 Regulatory Reform recommendations, the United States continued its focus on seeking improvements in Japan's distribution sector. Reform recommendations included urging Japan to: continue to reduce airport fees and assure transparency in the setting of those fees at Japan's international airports; take additional steps to streamline customs procedures; further increase acceptance of credit and debit cards as payment for goods and services; mandate compliance with international standards for retail banking and ATM security; streamline changing fleet vehicle registrations and registering title transfers; and ensure new regulations or other measures are not implemented that would limit the ability of large-scale retailers to open stores in Japan.

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 2005 were valued at just under \$118 million, representing 340,966 metric tons of rice or about 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 through the simultaneous-buy-sell (SBS) system. Under 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 percent to 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 exporter's 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 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. Because 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 is seeking greater 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.

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 corn starch production must be matched by purchases of domestic potato and sweet potato starch in the ratio of one part of potato starch for 12 parts of corn starch. 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.

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.

Pork Import Regime

Japan is the world's largest importer of pork, importing a record 868,000 tons in Japanese Fiscal Year (JFY) 2004. U.S. pork exports to Japan in JFY 2004 were valued at over \$1 billion. In 2004 and 2005, restrictions on beef and poultry and favorable exchange rates contributed to demand for pork products.

Japan's pork import 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.

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

Once Japan fully opens its beef market, there will be a high probability that Japan's beef safeguards will be triggered, hampering the United States' ability to fully regain historical export levels. When Japan first applied its beef safeguard in 2003, the United States pressed the Japanese government at the highest levels to recognize the non-typical market conditions caused by Japan's first case of Bovine Spongiform Encephalopathy (BSE). Similarly, the United States has expressed to Japan its opposition to any re-imposition of the beef safeguards based on the unusual market conditions caused by the ban on U.S. beef in December 2003.

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 and frozen 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 United States is intent on negotiating a change in the beef safeguard in the Doha Development Agenda. Based on the current Japanese safeguard methodology and current import levels, if Japan triggers the safeguard, U.S. exports will be subject to a higher import duty, which will negatively impact exports.

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 Seattle in January 2005, 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 a 38 percent tariff on beef, a 32 percent tariff on oranges, a 40 percent tariff on processed cheese, and a 30 percent tariff 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.

FOREIGN TRADE BARRIERS

Wood Products, Housing, and Building Materials

Japan is the second largest overseas export market for U.S. wood products, with U.S. exports to Japan for the first 11 months of 2005 at \$653 million, a drop of 9.4 percent from the \$721 million in exports during the first 11 months of 2004. 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. 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. During the period of January through September 2005, total housing starts stood at 911,435, a 3 percent increase from the same time period of 2004 (885,494). As for North American 2x4 frame housing starts, the January-September 2005 time frame witnessed 68,178 new units, a 3 percent increase from the 66,269 units built in the same time period in 2004.

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 Building Experts Committee and the JAS Technical Committees last met in Chicago in September 2005 to discuss a range of issues related to indoor air quality regulations, 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 recent 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 that 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. 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. For example, in 2004, MLIT agreed to further deregulate its license system by eliminating the five-ton weight limit on pleasure boat operators' licenses. Japan has also increased its acceptance of plastic fuel tanks and has eased its marine engine requirements. In order to realize the full benefits of these deregulatory measures, 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. Other countries, including the United States, have put in place systems to ensure an extremely high level of boater safety without imposing burdensome requirements on manufacturers and importers. In the United States, the National Marine Manufacturers Association (NMMA) operates a certification program following the standards of the independent American Boat and Yacht Council, which exceed U.S. Coast Guard requirements. The CE program used throughout Europe and increasingly throughout the world is another example of an acceptable approach. The U.S. looks forward to refocusing future marine craft meetings to discussion of Japan's overall regulatory approach and the potential benefits of harmonizing Japan's system with accepted international practices.

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 imports in particular, and a greater tendency to deviate from scientific principles in setting new import policies and requirements.

Beef

On December 12, 2005, Japan partially reopened its market to U.S. beef after a nearly two-year ban resulting from the December 2003 discovery of a single imported cow with Bovine Spongiform Encephalopathy in Washington State. Achieving a reopening of the Japanese market to U.S. beef was a top priority of the Administration throughout 2005. Japan's partial market reopening in December 2005 enabled U.S. exporters, under a special export verification program with Japan, to export beef from cattle 20 months of age and younger. Before the ban, U.S. beef and beef product exports to the Japanese market (the largest export market for U.S. beef) totaled roughly \$1.3 billion annually.

Japan effectively closed its market again, however, on January 20, 2006, after suspending import inspection procedures for U.S. beef when one shipment of veal from a single U.S. meat packing company was discovered by Japanese authorities to not meet the terms of the export verification program. In response, the U.S. Department of Agriculture conducted a thorough review of the incident, presented the results of this review to the Japanese government on February 17, and announced additional safeguard measures to prevent further incidents from occurring. Although certain products in this veal shipment were not allowed under the export verification program with Japan, the U.S. Government emphasized that the contents of the shipment were nevertheless completely safe for consumption and as such did not pose a health risk.

The U.S. Government remains engaged with Japan in an intensive, high-level effort to reopen its market which involves numerous meetings between officials and technical experts from both governments. During those exchanges, the United States continues to provide all the necessary data and assurances to the Japanese government and its citizens to demonstrate the safety of U.S. beef. In addition, to further ensure that potentially infected material cannot enter the food chain, the United States continued to implement changes it made in the previous year to slaughter and feed processes.

In addition to pressing Japan to reopen its market, the United States is also urging Japan to take the next step to bring its measures in line with international guidelines of the World Animal Health Organization (OIE) by allowing imports of all ruminant and ruminant products deemed safe. The United States will aggressively work toward achieving this important objective.

SPS in Regulatory Reform

SPS issues were taken up in 2004-2005 for the first time under the Regulatory Reform and Competition Policy Initiative. The main topic addressed was the adoption by Japan of international plant health standards for the conduct of pest risk assessments and official control policy. Through talks conducted under the Regulatory Reform Initiative, Japan made several positive steps to revise its fumigation policy. First, and most importantly, Japan agreed to change its official control policy to become consistent with international standards. Japan also agreed to assess certain pests of lettuce, with the aim of removing fumigation requirements for them. Second, Japan confirmed that it is now conducting a pest risk assessment for Western Flower Thrips, one of the most frequently intercepted pests on lettuce. The United States hopes this process will lead to significant market expansion for U.S. produced lettuce.

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 United States is pleased to see positive developments in fire testing recognition. U.S. organizations now have the option of seeking and obtaining Overseas Recognized Performance Evaluation Body status in order to conduct fires tests and seek Japanese government approval.

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. 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 were inconsistent with Japan's obligations under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures.

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 were consistent with its WTO obligations. The compliance review panel released its final report in June 2005. Japan has stated that it will comply with the panel's findings and remove the quarantine restrictions for fireblight on U.S. apple exports.

Ban on Fresh Potatoes

Japan's Ministry of Agriculture, Forestry and Fisheries (MAFF) prohibits the entry of all fresh potatoes from the United States due to phytosanitary concerns, primarily over Golden Nematode and potato wart, despite efforts by the U.S. potato industry and the USDA to remove the import restriction. United States has long argued that Golden Nematode only exists under quarantine in New York, and that potato wart no longer exists in the United States. In an effort to resolve this issue, the United States successfully gained entry approval specifically for chipping potatoes from January to June, during Japan's off-season. USDA was able to negotiate with Japan a safeguarding procedure that allows potatoes to be shipped to chipping plants in Japan under strict controls to prevent the importation of potential pests. Through these efforts, U.S. chipping potatoes gained market access to Japan in early 2006.

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 biotechnology 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, 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 many of these or any other additives. In addition, Japan classifies post-harvest fungicides as food additives (involving a separate registration process), 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 1970s.

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 Commission 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 Japan follows through in a manner consistent with its WTO obligations.

Nutritional Supplements

Although Japan has taken steps toward liberalization of its nutritional supplements market, many restrictions remain. The approval process for “Foods with Health Claims” (FHC) remains costly, time-consuming, and burdensome. In addition, health claims are prohibited for supplements that do not qualify for the FHC category, which include over half of this \$10.7 billion market. To address these concerns, the United States has urged Japan in its recommendations under the Regulatory Reform Initiative to increase transparency of its system for regulating supplements, to allow educational and informational statements on labels and in advertising (provided such statements are accurate and verifiable), and to reduce duties for nutritional supplements to the same level as duties for drugs containing the same ingredients.

Cosmetics and Quasi-Drugs

Japan’s regulation of cosmetics and quasi-drugs (a category defined under Japan’s Pharmaceutical Affairs Law) includes unnecessary and burdensome requirements that do not enhance product safety, quality, or efficacy. These requirements and a lack of transparency in the regulatory system serve to impede the ability of U.S. companies and products to compete in the Japanese market. In addition, certain advertising claims for cosmetics and quasi-drugs may not be made in Japan even though these claims are based on verifiable data. Allowing these claims would enable companies to provide consumers with information that would help them make sound choices and would improve consumer access to innovative products. The United States has urged Japan in its recommendations under the Regulatory Reform Initiative to work with industry to identify and eliminate unnecessary requirements, to improve transparency in the regulatory process, and to permit the use of efficacy claims based on verifiable data.

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, \$31 million in 2004, and \$30 million in 2005.

Japan's periodic nationwide trade restrictions are unwarranted under international guidelines and have unnecessarily disrupted millions of dollars of U.S. poultry product exports. 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).

Japan continues to prohibit imports of poultry products from New York and Connecticut due to past findings of AI. USDA will continue to encourage Japan to remove these unnecessary restrictions.

GOVERNMENT PROCUREMENT

Construction, Architecture and Engineering

Although Japan has the second largest public works market in the world (\$180 billion for 2005), U.S. firms annually obtain far less than one percent of projects awarded. Japan's procurement of construction services, above certain thresholds, is subject to the WTO Government Procurement Agreement (GPA). In addition, 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 GPA thresholds.

Problematic practices continue to inhibit the full involvement of U.S. design/consulting and construction firms in Japan's public works sector. A major problem in Japan's market is bid-rigging (*dango*), under which companies consult and prearrange a bid winner. High-profile bid-rigging scandals in 2005 brought to light the prevalence of this practice. Other problematic practices include use of arbitrary qualification and evaluation criteria that 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.

FOREIGN TRADE BARRIERS

Public works issues are raised in the Trade Forum under the U.S.-Japan Economic Partnership for Growth. During the December 2005 Expert-Level Meeting on Public Works (Expert-Level Meeting) under the Trade Forum, the United States urged Japan to eliminate the obstacles that prevent U.S. companies' full participation in this sector. The United States also encouraged Japan to strengthen its efforts to eliminate bid-rigging and asked Japan to continue to address the problem of firms submitting bids so low that they raise questions as to whether the work can be reliably performed.

The United States asked Japan not to use qualifying and evaluation criteria that excluded U.S. firms from procurements. The United States encouraged Action Plan entities to be flexible in their interpretation of a company's experience in cases where the qualifying conditions are unique to Japan and to allow qualifying conditions to be satisfied based on similar work experiences. The United States also urged Japan not to use ISO 9000 series registration with the effect of creating a barrier to international trade.

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 and city landscaping procurements to increase joint venture opportunities for firms specializing in architectural design. The United States also expressed concern about the lack of information on new bid/contract procedures that were not included in the Action Plan.

The United States asked for increased monitoring of the introduction of these procedures and asked Japan to ensure the new procedures are consistent with the Action Plan and the GPA. The United States also asked Japan to disseminate information on the streamlining of documentation requirements for design proposals to all Action Plan entities.

The United States welcomed the first Project Management (PM) procurement issued in the history of Japan's public works market. During the Expert-Level Meeting, the United States urged Japan to increase the number of PM and Construction Management (CM) projects commissioned during this fiscal year and structure procurements in such a way that foreign firms with appropriate expertise are able to compete. (CM and PM are advanced project delivery and management systems that maximize the efficiency of a project.)

Under its GPA market access coverage, Japan has an exemption for procurement relating to the operational safety of transportation for certain entities. The United States has raised concerns with the appropriateness of Japan's use of this exemption.

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 asked Japan to provide contact points and early information for these projects. The United States is encouraged by increased communication between U.S. and Japanese construction industry representatives, through which firms can directly share their interests and concerns related to Japan's market.

FOREIGN TRADE BARRIERS

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: Okinawa Institute of Science and Technology; National Institute projects commissioned by the Ministry of Education, Culture, Sports, Science and Technology; Haneda Airport development and expansion; Kansai International Airport; Central Japan International Airport; Kyushu University Relocation Project; International Medical Center Project; Okinawa Zukeran General Hospital Project; Japan Railways' procurements; major public buildings, urban development and redevelopment projects; 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 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 continues to be concerned that Japan's Internet Service Provider (ISP) liability law does not provide adequate protection for the works of rights holders on the Internet or the appropriate and necessary balance of interests among telecommunications carriers, service providers, rights 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, providing compensation to rights holders, and improving the efficiency of copyright cases in Japan's courts would be amending Japan's Civil Procedures Act to provide for an award of statutory damages at the election of the rights holders as an alternative to actual damages. 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 clear that the use of peer-to-peer networks to download and copy copyrighted works without the rights holder's authorization is not permitted under the personal use exception. The personal use exception also 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.

The United States is concerned about the provision on anti-circumvention in Japan's Copyright Act, which applies only to devices whose principal function is circumvention and which does not protect access controls against circumvention.

In a positive vein, in recent years Japan put into effect an extension of the term of copyright protection for cinematographic works, animation, and video games to bring the term of protection closer to the growing international trend. The United States continues to urge the Japanese government to extend the term of protection for all the subject matter of copyright and related rights 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.

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. The United States understands the Japanese government is currently studying the issue of GI protection and fully supports that effort. Outstanding concerns remain, since it is unclear whether Japan maintains an undisclosed list of protected GIs against which applications for trademark registration are reviewed. Reports have indicated that 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 to be protected outside of Japan, 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. Because 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.

FOREIGN TRADE BARRIERS

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 that 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 ruling. Further, insofar as Japan provides *ex officio* border enforcement of trademarks and copyrights through the JCTB, efforts should be made to enhance such enforcement through aggressive interdiction of infringing articles. In an effort to bolster Japan's border control measures, the United States has urged Japan to improve its application, inspection, and detention procedures to make it easier for foreign rights 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 its 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 36.1 trillion yen (approximately \$335 billion) in JFY 2004. In addition to the offerings of Japanese and foreign private insurers, substantial amounts of insurance are also 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 insurance cooperatives (*kyosai*).

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 continued to increase their presence in Japan's private sector insurance market (total market excluding Kampo and *kyosai*). Foreign insurers now hold an estimated 25.1 percent of the private life insurance market (JFY 2004) and a 4.4 percent share of the private non-life insurance market (JFY 2004). In the third sector, foreign firms have approximately 60 percent of the private sector life medical/nursing care insurance market (JFY 2004) and about 11 percent of the private sector non-life medical/personal accident market (JFY 2004).

FOREIGN TRADE BARRIERS

Given the size and importance of Japan's private insurance market as well as the scope of the obstacles that remain, the U.S. Government continues to place a high priority on working with the Japanese government to ensure that its regulatory framework fosters an open, fair, and competitive insurance market. Several important issues and concerns remain to be addressed in order to achieve this.

Postal Insurance: Japan Post's insurance business, or 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. In FY 2004, there were 73 million Kampo-issued life insurance policies in force compared to 124 million for all private life insurance companies combined.

The U.S. Government has long-standing concerns about tax, regulatory, and other advantages given to Kampo over its private sector competitors as well as over the impact these advantages have had on competition in Japan's insurance market. It remains important that Japan eliminate these advantages and create a level playing field. In this regard, the U.S. Government has taken particular interest in Prime Minister Koizumi's initiative to privatize and reform Japan Post. The reform framework established under legislation passed by Japan's Diet in 2005 includes a number of key measures that, if implemented fully, will represent long-awaited progress in areas of concern to U.S. and other insurers in the market. Importantly, the legislation also included the establishment of equivalent conditions of competition between Japan Post and the private sector as a basic principle of the reforms. In addition to eliminating Japan Post's tax and regulatory advantages and ensuring equal supervisory treatment, the U.S. Government continues to look to Japan to take other steps necessary to achieve a level playing field.

These steps include measures to both ensure and demonstrate that cross-subsidization does not occur among the new Japan Post corporations to be created under the new laws, such as by requiring Japan Post's strict adherence to the arms-length rule under the Insurance Business Law and adequate financial disclosures.

The U.S. Government also continues to call on Japan's government to ensure that a level playing field is actually created between the postal insurance institutions (both the existing Kampo business and, from October 2007, the new postal insurance business) and private insurers before the postal insurance institutions are permitted to underwrite and introduce new or altered insurance products. Approval of any proposed new products by the new postal insurance company, according to the new laws, will shift in October 2007 from Diet approval to a new process whereby decisions are made by the Prime Minister (with the Commissioner of the Financial Services Agency acting as proxy) and Minister of Internal Affairs and Communications, after hearing the opinion of an appointed government advisory body. It is important that this new process be fair and open to all parties. It is also critical that this process include careful analysis of, and full consideration given to, actual competitive conditions in the market, and that private sector views are actively solicited and considered.

As any modification to the postal financial system could have a significant impact on competition in Japan's insurance market, adequate transparency in the process of implementing the reforms passed by the Diet remains key, both prior to the start of the privatization process in October 2007 and after. The U.S. Government has recommended that Japan take a variety of steps to ensure transparency and inclusiveness, including: (1) providing meaningful opportunities for interested parties to exchange views with related government officials as well as members of government-commissioned advisory committees and groups before decisions, including those on products, are made; and (2) fully utilizing Public Comment Procedures with respect to implementing regulations, guidelines, Cabinet and other orders, and other measures.

The U.S. Government will continue to carefully monitor developments as the Japan Post reform process unfolds and express its views through regularly scheduled Working Groups under the U.S.-Japan Regulatory Reform Initiative, bilateral insurance consultations, and at other opportunities. The U.S. Government will also continue to closely monitor the performance of a new Kampo insurance product (including a rider providing for supplemental health coverage) which the U.S. Government and others strongly objected to when introduced in January 2004.

Kyosai. Insurance businesses run by cooperatives, or *kyosai*, have occupied a substantial presence in Japan's insurance market. 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, the last year for which statistics are available.

Some *kyosai* are regulated by their respective agencies of jurisdiction (the Ministry of Agriculture, Forestry and Fisheries, or the Ministry of Health, Labor and Welfare, for example) instead of by the Financial Services Agency (FSA), while others have been allowed to operate without any regulatory supervision at all. 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 Japanese government took some important steps in 2005 to bring more oversight scrutiny to unregulated *kyosai*. Under changes to take effect from 2006, a new "small-amount, short-term" *kyosai* provider category will be created. Previously unregulated *kyosai* that meet the criteria for selling small-amount and short-term insurance policies to customers will be supervised by the FSA and held to some of the same regulatory standards as private sector insurers. Previously unregulated *kyosai* that do not meet these criteria will be required to meet the same license requirements as private insurers. Other *kyosai*, however, will continue to be allowed to operate with a minimum of regulatory supervision, including public welfare cooperatives and cooperatives run by workers within private corporations. As the Japanese government implements this new system and reviews its operation as required under the amended law, the U.S. Government urges that additional steps be taken to hold all *kyosai* to the same regulations and FSA supervision as are applied to private companies.

FOREIGN TRADE BARRIERS

With respect to *kyosai* regulated by ministries and agencies other than the FSA, the U.S. Government remains concerned by their continued expansion in Japan's insurance market. This is particularly the case in light of the differences in regulatory treatment and other requirements that continue to give these *kyosai* inherent advantages over private sector companies. The U.S. Government continues to call on Japan to bring all regulated *kyosai* under the same regulatory obligations and FSA supervision as that applied to the private sector.

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. As a result of subsequent industry failures, private sector insurers have been called upon to contribute considerable sums to the PPC since that time. U.S. industry, particularly life insurers, has expressed serious concern over the burden of these contributions. The U.S. Government has stressed the need for a sustainable funding framework that does not unfairly burden private companies.

Japan's Diet passed legislation in 2005 to renew the PPC system starting in April 2006. While some improvements were made on the previous system under the legislation, the PPC system nonetheless continues to rely upon pre-funding by its members, instead of adopting a system of funding to follow an insolvency that results in a draw of funds from the PPC (post-funding). The U.S. Government continues to urge Japan to adopt more fundamental changes in the PPC systems, including the post-funding approach, when the next renewal of the system is enacted. Ensuring adequate transparency is also important as the new system is reviewed and as preparations are made to renew it, including providing opportunities for interested parties to express views to related government officials and government-appointed advisory groups.

Bank Sales. Initial steps taken in 2001 and in 2002 to allow for limited sales of insurance products through banks were augmented with a new step, effective December 2005, to further liberalize this sales channel.

Although these steps are welcome, the range of products now available through banks nonetheless represents a small percentage of the universe of private insurance products that could be made available to Japanese consumers through banks.

A key advisory body to the Japanese government, in its 2004 report, recommended that full liberalization of bank sales of insurance be accomplished within three years at the latest. The U.S. Government continues to urge the Japanese government to completely liberalize the bank sales channel, within a time period no later than the period identified by this advisory body, to allow banks to sell all types of insurance offered by any regulated private insurer.

The United States will continue to work closely with U.S. industry to follow these issues and will urge the Japan to adequately resolve these concerns in an open and transparent manner.

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*) was implemented on 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 established a new category for Foreign Branch Campuses of accredited institutions of higher education in the United States and elsewhere. Three U.S. universities were granted this status in 2005. 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. However, the new status for foreign universities does not yet grant the tax benefits enjoyed by Japanese institutions and their students.

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. This relative lack of foreign investment can act as a restraint on the expansion of imports.

FOREIGN TRADE BARRIERS

Much of the recent increase in FDI flows reflects 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 revision of the Corporate Code in June 2005 to permit the use of triangular stock swaps for international M&A deals, although implementation has been postponed until a year after the rest of the new Corporate Code takes effect in April 2006. 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 differing management techniques and the relative lack of financial transparency and disclosure. The scarcity of qualified lawyers, auditors, and accountants is another impediment. Although negative media coverage of a recent high-visibility takeover attempt and efforts by some parts of the Japanese business community to erect barriers to beneficial investment still reflect traditional antipathy toward FDI, Japanese attitudes toward inward investment have become 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 Working Group of the Initiative met in Tokyo in January, May and December 2005, and Investment Seminars were held in Nagoya and Chiba in May 2005 and in New York and San Jose in December 2005. The Working Group will meet again in spring 2006, and seminars are tentatively planned for October 2006 in Sendai and the Tokyo region. 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 section.

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."

FOREIGN TRADE BARRIERS

Trade associations often use the cover of these codes to adopt additional standards that are stricter than required by JFTC regulations under the Premiums Law and have the effect of restraining vigorous competition. As of December 31, 2005, there were still 40 JFTC-authorized premium codes.

ELECTRONIC COMMERCE

The United States made numerous recommendations in its December 2005 Regulatory Reform submission for maximizing the adoption and use of information technology (IT) and electronic commerce, including: removing regulatory and non-regulatory barriers; strengthening the protection of intellectual property rights; implementing the new Privacy Law in a transparent, coordinated and consistent manner; expanding IT procurement opportunities; and ensuring effective network and online security. The United States is urging Japan to ensure that laws governing electronic transactions are technology-neutral and are compatible with international practice. 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 Japan'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 of aircraft and aircraft parts and continues to offer the largest source of demand in the aircraft industry. 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.

Japanese defense projects are carried out according to the Mid-Term Defense Program (JFY2005-2009), which began in April 2004, and has a projected budget of \$224 billion 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 Japan has considered its main space launch vehicle programs as indigenous for many years, 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.

FOREIGN TRADE BARRIERS

The United States is working very closely at the technical level with Japanese counterparts to ensure the Japanese system remains compatible with the U.S. system 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 in 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 overall flat sales of North American-made vehicles and parts in Japan. Sales in Japan of motor vehicles produced in the United States increased slightly by 3.1 percent in 2005, following a decline of 8 percent in 2004. U.S. automakers currently sell less than 12 percent 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, \$50.2 billion in 2005 (\$35.2 billion deficit in autos and \$15.0 billion deficit in auto parts), is the equivalent of more than 60 percent of the overall U.S. trade deficit with Japan and made up 6.5 percent of the 2005 worldwide U.S. trade deficit.

The United States continues to work with Japan to address crosscutting issues affecting the 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 enduring restrictions on traffic rights, operational flexibility, and pricing and by extremely high airport costs in Japan.

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. The two sides met in July 2005, and the result was an informal proposal which would have benefited only one U.S. carrier. The U.S. Government's attempt to expand the scope of that offer in bilateral talks in January 2006 was to no avail. In light of Japan's position, the United States is considering how best to move forward.

Key U.S. concerns include restrictions on operating rights for non-incumbent cargo carriers, limitations on same country carrier code-sharing, change of gauge limitations, and restrictive pricing practice.

Due to its geographic location as the closest landing point in Asia from the United States, several U.S. carriers maintain large hub operations at Narita International Airport. Nonetheless, 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. An extension project to allow use of this runway for long-haul routes is underway, but this project is bundled with other capital upgrades and the overall budget tops 33 billion yen. At this point it is not clear this project will be able to pay for itself, and it is possible an increase in the already high user-fees will be used to finance it. Recently lowered landing fees at Narita were offset in part by raising other fees and introducing new ones. The issue of excessively high landing fees at 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 the "Regulatory Reform Initiative" in the Distribution Section.*)

The international business and tourism sector in Japan is constrained by high landing and users fees at Narita, Kansai and Centrair Airports. Opening the formula used to calculate landing fees at Japan's international airports to public comment and ensuring the landing fee calculation at all airports is transparent both for domestic and international flights would benefit both Japanese consumers and the civil aviation industry.

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

Business Aviation

Japan's regulatory framework impedes the development of business aviation. The regulations for commercial airline safety, maintenance, and repair regulations administered by the Japan Civil Aviation Bureau (JCAB) of the Ministry of Land, Infrastructure, and Transport (MLIT) also apply to business aircraft, thus raising the costs of qualification, operation, and maintenance. Landing business planes is difficult due to limited slots and local rules that hamper flexible scheduling, especially near Tokyo. The result of such regulatory burdens is that Japanese companies, foreign companies in Japan, and foreign companies interested in doing business with Japan currently cannot use business aviation effectively and economically. Further, these burdens are a barrier to foreign direct investment since investors cannot easily land at Japanese airports. U.S. aircraft manufacturers believe that the regulatory burden has limited sales of their planes to Japanese companies that would greatly benefit from their use.

Multiple airports in the Chubu and Kansai regions now welcome business aircraft, providing many of the same services that business aircraft operators receive in the United States and Europe. Since April 2005, regional (non-designated) airports may also accept landings of international charter and business aviation flights with only three days notice, provided that customs, immigration and quarantine (CIQ) is available. But airports in the Tokyo metropolitan area, namely Narita and Haneda, remain extremely difficult to use for business flights. Moreover, severely restricted hours for landings and take-offs and the lack of services significantly limit travel on business aircraft to and within Japan.

Based on the growing needs of business aircraft owners and operators, the United States recommends that JCAB reexamine the application of these civil aviation regulations to business aviation and develop appropriate regulations specific to the business aviation industry. The United States encourages JCAB to consider the regulatory reform requests submitted by U.S. and Japanese industry. In advance of the opening of the additional runway at Haneda planned for 2009, the United States urges Japan to make immediate improvements in the overall regulatory framework.

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 cost of its electric power, which remains 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) and to seek greater transparency and fairness in the procurement process.

Foreign firms face barriers due to standards and specifications used by Japanese utilities that often discriminate against or disproportionately burden foreign suppliers. Problems remain in the use of narrow, dimension-based technical standards rather than performance-based technical standards, and requirements that suppliers provide detailed information for spare parts originating from outside sources. 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, sufficient access to procurement information is difficult to obtain.

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 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 for 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 2005 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.