JAPAN

In 1996, the U.S. trade deficit with Japan was $47.7 billion, a decrease of $11.6 billion from the U.S. trade deficit of $59.3 billion in 1995. U.S. merchandise exports to Japan were $67.5 billion, an increase of $3.2 billion (5.0 percent) from the level of U.S. exports to Japan in 1995. Japan was the United States' second largest export market in 1996. U.S. imports from Japan were $115.2 billion in 1996, a decrease of $8.4 billion (6.8 percent) from the level of imports in 1995.

The stock of U.S. foreign direct investment (FDI) in Japan in 1995 was $39.2 billion, an increase of 6.9 percent from the level of U.S. FDI in 1994. U.S. FDI in Japan is concentrated largely in the manufacturing, wholesale, and finance sectors.

Overview

The Administration continued in 1996 to place the elimination of trade barriers and improved market access at the center of the U.S.-Japan economic relationship. Although trade issues did not dominate media perceptions of bilateral relations in 1996 as they have in years past, the Administration continued, with considerable success, to use complementary policy approaches to reduce Japanese market access barriers. By the end of 1996, agreements had been reached and disputes had been resolved in many important sectors which will offer significantly expanded opportunities for American businesses in Japan. The United States also clearly indicated those areas where market access problems warrant further attention, and continued to monitor closely the implementation of past agreements. The Administration will continue to employ, as appropriate, a mix of bilateral negotiations, multilateral negotiations, and the application of relevant U.S. trade laws to pursue aggressively the elimination of remaining or emerging trade barriers in Japan.

In February 1996, the United States brought the first intellectual property case in the World Trade Organization (WTO) by initiating proceedings against Japan for its failure to implement retroactive copyright obligations for pre-existing sound recordings under the new Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). The Japanese Diet passed legislation in December 1996 providing the required protection. As a result, in January 1997 the United States withdrew its case against Japan at the WTO.

In March 1996, the United States reached a new agreement with Japan on all-cargo aviation services which will create new opportunities in the cargo sector by introducing additional flights, additional carriers, and greater operational flexibility.

In April 1996, USTR placed Japan on the "Priority Watch List" under the "Special 301" provisions of the 1988 Trade Act, for insufficient protection of intellectual property rights. Japan was cited for patent practices, protection of trademarks and trade secrets, end-use software piracy, and the sound recordings dispute, which were subject to WTO consultations.

Japan

In April 1996, USTR placed Japan on the Title VII “Watch List” for construction.

In June 1996, USTR invoked the WTO dispute settlement provisions to seek elimination of Government of Japan practices with respect to the sale and distribution of consumer photographic materials in Japan which appear to contravene Japan’s obligations under the General Agreement on Tariffs and Trade. The WTO established a panel in December 1996 to decide the dispute. The panel’s decision is anticipated in October 1997.

In July 1996, a WTO panel established under the Dispute Settlement Understanding ruled in favor of the United States, Canada, and the European Union (EU) in finding that Japan’s tax system for distilled spirits discriminates against imported products. This ruling was upheld on appeal, and the reports of the panel and the WTO Appellate Body were adopted on November 1, 1996. On December 24, the United States requested arbitration of the reasonable period of time to be given Japan to implement fully the rulings when it became apparent that Japan intended to take five years to bring the offending measures into compliance. In his decision of February 14, 1997, the arbitrator ruled that Japan should be given no more than 15 months to comply fully.

In July 1996, USTR removed the wood products sector from the “Super 301 Watch List” after the Government of Japan made commitments in key technical areas and for reporting future market trends so U.S. market penetration can be more fully evaluated. In particular the Japanese Government agreed to approve construction of 3-story apartments in suburban areas, recognize the U.S. grading system as satisfying Japan’s quality standards, move toward a performance-based system and away from its prescriptive system, and provide technical data to promote U.S. companies’ understanding of the Japanese market.

In August 1996, the United States reached a new semiconductor arrangement with Japan, succeeding the 1991 arrangement. The new arrangement seeks to preserve the gains U.S. and other foreign semiconductor firms have made in penetrating the Japanese market and to continue cooperative activities between suppliers and users in key market segments, and will involve the United States, Japan, and other semiconductor producing nations in monitoring market access and policy issues in this important sector.

In October 1996, USTR, in its annual "Super 301" review, identified Japanese practices in the insurance, telecommunications, and paper/paper products areas as "bilateral priorities that may warrant identification as priority foreign country practices in the future." USTR also identified the implementation of the bilateral auto/auto parts agreement with Japan as an area where the Administration was pursuing a policy of "strategic enforcement."

In November 1996, the Federal Maritime Commission (FMC) voted to propose sanctions against Japanese ocean freight operators in response to restrictions and requirements on the use of Japanese ports, and requested comments on the proposed sanctions within 60 days. On February 26, 1997, the FMC announced sanctions of $100,000 per entry on ships owned and operated by three Japanese companies, effective April 14, 1997, if the issue is not resolved prior to that date.

In December 1996, the United States and Japan reached agreement on a package of "supplementary measures" to augment the 1994 agreement on insurance. These measures will lead to substantial deregulation of the primary sectors of the Japanese insurance market, especially auto and fire insurance, and will ensure that there will be no radical change in the third sector markets important to foreign insurers until 2001.

The Framework

When President Clinton took office in 1993, he pledged to take a new, results-oriented approach to trade with Japan. Even though the U.S. Government had previously reached bilateral and multilateral agreements with Japan, long term access to Japan's market for foreign goods and services remained elusive. While Japan has reduced its formal tariff rates on imports to very low levels, it has maintained non-tariff barriers -- such as non-transparency, discriminatory standards, and exclusionary business practices -- and a business environment that protects domestic companies and restricts the free flow of competitive foreign goods into the Japanese market.

Determined to crack the structural obstacles to market access in Japan, President Clinton and then-Prime Minister Miyazawa signed in July 1993 the U.S.-Japan Framework for a New Economic Partnership (the Framework), a new vehicle for addressing the myriad of barriers that foreign companies encounter when doing business in Japan. Under the Framework, the Administration has sought agreements with distinctly defined commitments from Japan that can be measured using objective criteria, both quantitative and qualitative.

This approach, which assesses the implementation and success of agreements through "tangible progress," has been successful in creating and expanding opportunities for imported products in the Japanese market. Under the Framework, Japan committed to address major barriers in five sectoral and structural "baskets":

Government Procurement: Japan committed to establish and implement measures significantly expanding Japanese Government procurement of competitive foreign goods and services. Under this basket, the United States and Japan reached agreements in the telecommunications and medical technology sectors in 1994.

Japanese Regulatory Reform and Competitiveness: To reduce the pervasive regulations that both burden foreign and domestic firms and minimize competitiveness, Japan pledged to reform its regulatory regime. The two countries negotiated the financial services and insurance agreements under this basket, and the Deregulation and Competition Policy Working Group is addressing key structural issues within the context of this basket, including deregulation, administrative reform, and competition policy.

Other Major Sectors: In 1995, the United States and Japan completed negotiations in the automotive sector -- the key sector under this basket -- and reached an agreement which is beginning to substantially open Japan's market to foreign autos and auto parts.

Economic Harmonization: To address the outstanding structural barriers to Japan's marketplace, especially Japan's low receptivity to foreign direct investment, negotiations under this basket resulted in the

conclusion of a bilateral arrangement aimed at increasing foreign direct investment in Japan. In addition, the United States and Japan reached two intellectual property agreements in 1994 under this basket.

Implementation of Existing Arrangements and Measures: Under this basket, all existing bilateral agreements are being monitored -- and in some cases have been renegotiated, as in the case of flat glass -- to ensure full implementation and market access for U.S. companies. Ongoing monitoring and enforcement of existing arrangements and measures are essential to achieving the tangible results in market access that this Administration seeks with Japan.

In addition to these sectoral and structural initiatives, Japan also committed under the Framework to address the fundamental economic asymmetries that have afflicted Japan's international economic relations. In particular, Japan agreed to work toward reducing its current account surplus as a percentage of its GDP. While in 1992 Japan's current account surplus was 3.2 percent of GDP, by 1996 it had dropped to around 1.5 percent ($66 billion) despite minimal economic growth in Japan over the past three years. Additionally, in 1996, U.S. exports to Japan reached an historic high of $67.5 billion, nearly 26 percent greater than in 1994 and 41 percent more than in 1992. More specifically, in those sectors covered by recent trade agreements with Japan, exports have grown by more than 85 percent since President Clinton took office, and 3 times as fast as other U.S. exports to Japan.

IMPORT POLICIES

In the Uruguay Round, Japan agreed to "zero for zero" tariff eliminations on pharmaceuticals, paper and printed products, beer, whisky, and brandy, agricultural equipment, medical equipment, construction equipment, furniture, steel, and toys. These tariff concessions are being phased in over six years, and will be complete on January 2, 2000. Japan also adopted the chemical harmonization initiative. Japan cut tariffs on copper and aluminum, with the top rate reduced from 12.8 percent to 7.5 percent. At the Singapore WTO Ministerial meeting in December 1996, Japan committed, as part of the Information Technology Agreement (ITA), to eliminate remaining tariffs on computers and telecommunications goods, services, components, and equipment. Japan's remaining high tariffs affect primarily agricultural and food products, including white distilled spirits, corn grits, wood and wood products, and leather and leather products**.**

General Food Products

In the Uruguay Round, Japan agreed to bind tariffs on all agricultural products and to reduce bound rates by an average of 36 percent during the six-year period 1995-2000, with a minimum 15 percent reduction on each tariff line. Japan also agreed to gradually reduce tariffs on imports of beef, pork, fresh oranges, cheese, confectionery, vegetable oils, and various other items. Even after the Uruguay Round cuts, however, imports of many intermediate and consumer-oriented food and beverage products will still face relatively high tariffs, including: beef, fresh oranges, fresh apples, citrus and other fruit juices, corn grits, confectionery, snack foods, ice cream, and processed tomato products.

Japan also agreed in the Uruguay Round to convert all import bans and quotas (except for rice) to tariffs, which would be reduced between 1995 and 2000. Strict import quotas for wheat, barley, starches, peanuts,

and dairy products were replaced by tariff rate quotas. However, Japan retains state trading authority and price stabilization schemes.

The United States is closely monitoring Japan's implementation of the Uruguay Round measures for agriculture, particularly rice imports (and exports of imported rice) and safeguard measures for beef and pork. Bilateral efforts have also focused on countering any technical or food safety-related measures that threaten to impede imports, including product standards and labeling issues.

Leather and Leather Products

In March 1991, Japan liberalized treatment of footwear imports, setting a footwear quota of 2.4 million pairs per year. In 1994, Japan raised the quota to 8.34 million pairs. The Japanese Fiscal Year (JFY, April 1 - March 30) 1996 quota was roughly 12 million pairs. MITI will not confirm whether it will continue to expand the quota in the future, but U.S. industry expects continued annual quota increases of about 20 percent. The U.S. Government and U.S. leather and leather footwear industries have been pushing for elimination or further liberalization of the quotas.

In the Uruguay Round, Japan undertook to reduce tariffs over an eight-year period: on under-quota leather footwear (from 27 percent to 21.6 percent); on the tariff category that includes crust leather (from 20 percent to 13 percent); and on other leather categories (from 20 percent to 16 percent). Footwear imported above tariff rate quota levels face a tariff of 52.3 percent or 4,675 yen, whichever is higher. By 2002, this will drop to 30 percent or 4,300 yen, whichever is higher. In principle, the over-quota tariff rate was reduced 50 percent from the 1994 rate, and the yen minimum alternative rate will be reduced by 10 percent over the eight-year phase-in period. In practice, the yen minimum alternative rate is applied in a manner which negates the effect of the significant over-quota tariff rate reduction.

As a result of the quota, high quality and high fashion manufacturers in France and Italy have taken a large percentage of Japan's leather shoe import market. The American share of the leather shoe market has fallen. Leather shoe manufacturing continues to decline slowly in Japan, while imports of leather uppers grew by 30 percent to 18.3 million pairs in JFY 95. Finally, it should be noted that 48 million pairs of athletic shoes were imported into Japan in 1995. Most of these were American-branded products manufactured in Asia.

Wood Products

Japan is the United States' largest export market for wood products. U.S. exports to Japan totaled $3.31 billion in calendar year 1996, up just over one percent from the level in 1995. However, raw logs still constitute more than half of this trade flow.

The 1990 U.S.-Japan Measures Affecting Wood Products addresses: tariff reduction, tariff reclassification, consistency of subsidies with international agreements, improvements in product standards and JAS certification procedures, and liberalization of building codes/standards -- particularly for regulations that are not performance-based.

Japan

Japan was placed on the Super 301 "Watch List" in 1994 and 1995 for its failure to fully implement certain measures and the spirit of the 1990 agreement. Discussions over the past two years, under the auspices of the U.S.-Japan Wood Products subcommittee, culminated in an exchange of letters in July 1996. In this exchange of letters, Japan agreed to specific steps which will improve access for U.S. value-added products including oriented strand board, structural glue laminated lumber, and veneer lumber. Agreements were reached on: elements of an annual data exchange to assess effectiveness of the agreement, import procedures for tariff classification of laminated lumber products, and future expert-level exchanges on codes/standards issues. In recognition of this progress and related deregulatory steps, USTR removed Japan's wood products sector from the Super 301 “watch list” in 1996.

In February 1996, Prime Minister Hashimoto announced, during a meeting with President Clinton, that Japan would accelerate efforts to reduce housing costs by one-third by the year 2000 through increased importation of housing products and reform of regulatory obstacles to woodframe housing construction. This announcement has aided U.S. efforts to improve export opportunities for wood products over the past year. Subsequent approvals by the Ministry of Construction of U.S. softwood lumber grademarks for 2x4 construction in April 1996 and January 1997 are among a series of promising deregulatory measures. Further efforts are underway to gain recognition of other U.S. wood products, including structural panel and finger-jointed lumber.

U.S. agencies will monitor closely Japan’s ongoing efforts to make their standards performance based and to ensure that they do not discriminate against imported wood products. This includes efforts to allow multi-story wood frame construction in semi-fire protection zones. A dialogue will continue under the Wood Products Subcommittee and through informal expert-level contacts.

Tariffs, although slated for further reduction as part of the Uruguay Round, remain an impediment to expansion of U.S. value-added exports.

Fresh Horticultural Products

Japan continues to restrict, for phytosanitary reasons, the entry of numerous U.S. fresh fruits, vegetables and other horticultural products. Some U.S. products, like tomatoes, potatoes, and plums, are banned outright due to Japanese concerns about entry of pests or plant diseases. Elimination of the prohibition on imports of tomatoes has been discussed intensively over the past year, with approval of 25 U.S. tomato varieties expected in mid-1997.

Phytosanitary protocols for several other horticultural products, such as apples, cherries, and nectarines, include only specific limited product varieties, excluding other almost identical varieties. This has occurred despite presentation of scientific evidence that effective treatments against pests of one variety can be extended easily to new varieties. Under the current system, new varieties must undergo costly and time-consuming additional scientific research and testing to be allowed entry under a phytosanitary protocol. U.S. experts contend these requirements are unfounded scientifically and are a barrier to trade. Bilateral technical discussions continue on approval of new apple, cherry, and nectarine varieties.

The United States also is seeking systemic reform, including elimination of Japan's variety-by-variety approval policy. Under the current policy, Japan requires that an imported product be treated in accordance with an approved phytosanitary treatment; it further requires inspection at the exporting country production site by Japanese Government inspectors, even if the Ministry of Agriculture, Forestry and Fisheries cannot provide enough inspectors to accomplish the job expeditiously and at reasonable cost. In annual bilateral discussions and under the auspices of Japan's own deregulation initiative, the U.S. Government has requested that Japan allow U.S. authorities to perform the work under Japanese Government supervision. Significant progress has been made on these requests over the past year, particularly for the cherry program. The issue will continue to be discussed, however, as additional liberalization is warranted.

Another area of major, ongoing concern is the lack of transparency in Japan's fumigation policy. Japanese plant quarantine regulations require fumigation of imported fresh horticultural products if, upon import inspection, a shipment is found to be infested with live insects, regardless of whether or not such pests are already present in Japan. In addition to the added expense and delays in import clearance, this requirement has proven particularly detrimental for maintaining the quality of delicate fresh produce such as leafy vegetables, strawberries, some citrus, and avocados after import.

In 1996, largely in response to U.S. and foreign pressure for deregulation, the Government of Japan announced its intention to amend the Plant Quarantine Law effective April 1, 1997, to exclude a number of pests (both insects and plant diseases) from plant quarantine authority. While this appears to be an important positive step, the list of non-quarantine pests proposed does not include various commonplace pests of interest for U.S. horticultural product exports. The U.S. Government will continue to press the Government of Japan in all available technical and deregulatory fora to develop a comprehensive list of non-quarantine pests and transparent inspection procedures in an effort to reduce excessive fumigation.

Low-Malt Beer

Since 1994, two major Japanese brewers have been marketing low-malt beers called “happoshu” or "sparkling brew" in Japan. One purpose for producing this beer was to take advantage of a lower domestic liquor tax (excise tax). The excise tax on beer in Japan is divided into three categories according to malt content, with lower rates applying to beverages with lower malt contents. Under the 1994 Liquor Tax Law "beer" was categorized as a beverage with malt content of 67 percent or more, and sparkling brew was categorized as “miscellaneous liquor,” with a lower excise tax than regular beer. Some imported malt beverages (beer) were categorized in the same, lower-tax sparkling brew category. However, for imports, this favorable tax treatment is negated by a tariff rate for sparkling brew that is nearly seven times higher than the duty charged for regular beer.

This discriminatory tariff treatment is compounded by the lack of transparency in determining classification criteria for sparkling brews. Unlike the excise tax categorization, which is determined by a set percentage of malt content, the criteria applied to distinguish between beer and sparkling brews is not clearly established.

In October 1996, the Ministry of Finance redefined the categories of malt beverages to reduce the significant tax advantage enjoyed by the sparkling brews. As a result, some U.S. exporters of lower-malt

content beer had to reformulate their products to retain the lower tax treatment and remain competitive with domestic sparkling brews. However, reformulation to the lower malt content (49 percent or less) apparently results in a customs classification as "other fermented beverages," with approximately seven times higher duty than beer.

The net effect has been a near-halt in U.S. export sales of low-malt beer in Japan. The prohibitive tariff rate levied on imports has also given the two major Japanese companies producing sparkling brews a major advantage in a growing product category for which retail sales total nearly $100 million.

Fish Products

Japan maintains seven global and two bilateral import quotas on fish products. U.S. fishery exports to Japan subject to import quotas include: pollock surimi, pollock roe, herring, cod, mackerel, whiting, squid, and several other fish products. These quota-controlled imports into Japan account for hundreds of millions of dollars in sales annually, approximately one-fourth of total fishery exports to Japan. In the past several years, there has been a downward trend in sales of these import-quota controlled items, largely due to the economic recession in Japan.

In 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. (Because the Uruguay Round agricultural negotiations did not require commitments on fish, Japan has no obligation to convert non-tariff measures to tariff rate quotas.) While Japan has taken steps to improve its administration of the import quotas, especially the application procedures, the lack of transparency still causes concern for U.S. exporters. At the January 1996 session of the annual fishery trade consultations, the United States and Japan agreed to continue formal discussions to identify solutions to these import quota issues at the 1997 session. The two governments also are exchanging papers on these issues.

Distilled Spirits

In July 1996, a WTO panel ruled against Japan in the dispute settlement proceeding initiated in 1995 by the United States, Canada, and the European Union regarding the discriminatory effects of Japan's excise tax system on imported distilled spirits. In October 1996, the WTO Appellate Body upheld the panel’s ruling and reaffirmed that the Government of Japan's unequal taxation of domestic and imported distilled spirits is discriminatory and violates Japan’s GATT obligations. The ruling requires that Japan bring its liquor tax laws into conformity with GATT standards. Japan's proposed solution maintains a three percent difference between domestic shochu and imported spirits and calls for a 23-month and five year implementation period for high grade and low grade shochu, respectively. The United States requested WTO arbitration, and the arbitrator ruled that Japan has 15 months to come into full WTO compliance. The United States fully expects Japan to implement tax law changes in 1997 which will bring it into full compliance with the WTO DSB ruling.

Racehorses

The Japan Racing Association (JRA) restricts participation of foreign horses in Japanese races. In addition, only Japanese residents may register with the JRA as racehorse owners in Japan. The United States and other interested countries have pressed Japan to liberalize access for foreign horses, with modest success. By 1996, seven JRA races have been opened to foreign racehorses with race experience outside Japan. The JRA has announced that it will increase this number to twelve by 1999. The United States will continue to press Japan for further liberalization.

Rice

Under the WTO Agriculture Agreement, Japan committed to provide market access concessions for imported rice. Specifically, Japan agreed to increase the amount of imported rice to eight percent of domestic consumption by JFY 2000. For JFY 1996, Japan agreed to import 454,800 tons (milled rice basis). Within this import commitment, Japan also has established a simultaneous-buy-sell (SBS) system for some imported rice, allowing importers and exporters to set quality and other requirements, subject to Food Agency approval.

During JFY 1996, Japan imported 465,650 tons of rice (actual tonnage basis). Of this amount, 215,134 tons (46.2 percent) originated in the United States. Of the total, 201,000 tons of rice entered under the food agency's "ordinary import" system (U.S. share: 45.3 percent), and 14,134 tons were imported under the SBS system (U.S. share: 64.2 percent). Japan also imported rice flour for use in textile dyeing and bumped rice for the manufacture of breakfast cereal.

The U.S. Government protested strongly when Japan decided to imported rice for food donations because this policy prevents imported rice from reaching Japanese consumers, contrary to the spirit of Japan’s WTO market access commitments.

Import Clearance Procedures

Despite progress in recent years, Japanese import clearance procedures remain slow and cumbersome by industrial country standards, raising costs for U.S. cargo companies and Japanese consumers. The U.S. and Japanese Governments have been working to improve import clearance, first through the Working Group on Import Procedures set up under the Structural Impediments Initiative, and subsequently in the Deregulation and Competition Policy Working Group established under the U.S.-Japan Framework and regular bilateral consultations between customs agencies.

These discussions have helped promote changes in Japan's import processing procedures, including the elimination of the requirement to process all air cargo through a separate cargo holding area (Baraki-cargo area) 30 kilometers from Narita airport, the institution of a computerized customs processing system, integration of that computer system with inspection authorities from the Ministry of Health and Welfare and the Ministry of Agriculture, Forestries and Fisheries, and establishment of a pre-arrival approval customs clearance procedure.

As a result of these changes, the cargo directly cleared at the Narita Airport has increased from 51 percent to 76 percent and customs clearance is less time-consuming. However, overall import clearance time has

improved only slightly. This is in part due to slow processing by inspection authorities other than Customs; the U.S. Government hopes this problem will be addressed when the computer connection between Customs and other inspection agencies is completed in April 1997. Other remaining problems include high user fees at the Narita and Kansai Airports, non-uniform application of customs regulations and rulings throughout Japan, and the need for smoother implementation of the pre-arrival clearance system to encourage importers to use this procedure on more routine basis. The Japanese Government should take all possible steps to realize its goal of reducing processing time to less than 24 hours.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

Certification problems hamper market access in Japan. In some cases, advances in technology make Japanese standards outdated and restrictive. Japanese industry often supports safety and other standards that are unique and restrict competition. In some areas, however, the Government of Japan has simplified, harmonized, and eliminated restrictive standards to follow international practices.

The principal organization that adjudicates standards and certification disputes between foreign companies and the Government of Japan is the Office of the Trade and Investment Ombudsman (OTO). In 1994, the OTO was transferred to the Prime Minister's office and authorized to recommend actions to appropriate ministries. However, this transfer has not resulted in greater success for U.S. firms taking cases to the OTO, because it has no enforcement authority and its recommendations do not have the force of law.

For example, in October 1996, the U.S. Government submitted a request to the OTO urging further deregulation of nutritional food supplements and vitamins, in line with the OTO's March 1996 directive supporting significant deregulation of these products. The OTO's market access ombudsman council recommended, among other things, that products that are normally distributed and marketed overseas as foods -- such as nutritional supplements, vitamins, and herbs -- should be treated as foods, and not as pharmaceuticals. However, the Ministry of Health and Welfare has been reluctant to adopt the OTO's recommendations. The Ministry is currently considering some incremental deregulation measures, but appears inclined to maintain its excessive controls on the manufacturing, packaging, and sale of vitamins and food supplements. The U.S. Government also continues to press for meaningful deregulatory steps through the U.S.-Japan Deregulation and Competition Policy Working Group and other bilateral channels.

Pharmaceuticals/Medical Devices

The Administration continues to pursue improved medical and pharmaceutical product market access in the context of the Market-Oriented Sector-Selective (MOSS) Medical Equipment and Pharmaceutical talks. One issue of regular discussion is the reimbursement process and schedule under Japan's national health insurance system for U.S. medical equipment and pharmaceutical products. Reimbursement prices in Japan often do not adequately, or in a timely fashion, compensate firms for the costs inherent in developing and marketing new, innovative equipment and pharmaceutical products in Japan. The United States is monitoring this issue through consultations with industry and through the MOSS.

At the February 1997 MOSS meeting, Japan announced a possible reduction of the “R zone” for medical devices from the current 15 percent. If implemented, this action will make it even more difficult for U.S.

firms to sell their products in Japan at reasonable prices. At present, the U.S. Government is working to resolve this issue. In addition, the U.S. Government is concerned with a variety of other obstacles facing U.S. pharmaceutical and medical equipment manufacturers when they seek to market their products in Japan. These range from a slow and sometimes non-transparent approval process to regulations that prevent certain products from being sold in hard gelatin capsules in Japan. In addition, the U.S. Government advocates greater industry access to policy-making councils from which they are presently excluded.

The U.S. medical products industries continue to support Japan's deregulation initiatives. For the third year in a row, these industries, and the U.S. Government, provided the Government of Japan with a list of regulations that inhibit the ability of health care firms to do business in Japan and raise costs to the end-user and the health care system. Several of these issues also have been raised in the MOSS process.

Food Additives

Processed food imports into Japan often are hampered by Japanese "use" standards for additives that are generally recognized as safe in every other part of the world. As part of an ongoing general revision of the Food Sanitation Law, Japan is conforming its positive list for food additives to the WTO's Sanitary and Phyto-Sanitary (SPS) measures, but its regulation of chemically-synthesized food additives remains unusually strict. The U.S. Government encourages U.S. firms and industry associations to file applications with Japan's Ministry of Health and Welfare to initiate approval processes for new food additive approvals. The subject has also been taken up in bilateral talks on deregulation.

Pesticide Residues

The Ministry of Health and Welfare continues to establish new residue standards for pesticides, including full notification to the WTO and provision for comment and review. The Ministry is providing full notification to the WTO and allowing for comment and review. The U.S. Government is providing scientific data pertaining to relevant U.S. and international standards for the chemicals concerned.

Japan is currently in the process of adding residue standards for an additional eleven chemicals to its pesticide registration list. Once these chemicals are subjected to the WTO notification/comment procedures, they are expected to be finalized and become effective in Japan later in 1997.

While the Government of Japan has made progress in establishing residue standards in line with internationally recognized tolerance levels, further government action remains necessary to help counter misleading information regarding the safety of imported food and agricultural products (see the fresh horticultural products entry in the “Import Policies” section of this chapter).

GOVERNMENT PROCUREMENT

The United States has negotiated bilateral agreements with Japan to help improve foreign firms' access to six Japanese public sector markets; computers, telecommunications equipment and services, medical technologies products and services, satellites, public works, and supercomputers. Structural problems and

an entrenched legacy of restrictive "domestic" purchasing practices, especially at the local level, still hamper foreign firms from gaining market access.

The lack of uniform, centralized procurement processes and the difficulty in establishing long-term relationships with Japanese Government procurement officials hurt foreign firms in Japan. Japanese law, cabinet orders, and MOF ministerial ordinances specify general government contracting procedures, but many details are governed by ministry and agency regulations, including administrative guidance (informal internal notices). The Government of Japan is developing a standardized bid format for all ministries.

The WTO Government Procurement Agreement (GPA) took effect January 1, 1996. Japan extended coverage bilaterally to central government entities, certain subcentral governments (prefectures and 12 designated cities) and 84 government related entities. Until the GPA entered into effect, prefectures and other local governments were not subject to international procurement disciplines. As a result, complying with the GPA has been difficult for some sub-central governments because of their unfamiliarity with the new obligations. In addition, local governments have long posed challenges to foreign suppliers, in part because their own procurement procedures often limit access to information on planned projects and hinder foreign firms' participation in early development of systems. For example, in the first half of 1996, the U.S. Embassy in Tokyo observed that certain municipal and other non-central government authorities were engaging in procurement practices for helicopters that raised concerns with Japan's compliance with its obligations under the GPA. Dialogue with the central government and the local entities themselves brought about a number of corrective actions, including establishment by local governments of GPA-mandated grievance procedures. Monitoring will be necessary to ensure compliance with the GPA and in particular that public sector procurement is not shielded from open bidding by inappropriate use of GATT and bilateral agreement exceptions. In addition, under the 1994 Framework Procurement Agreements, the Japanese Government has agreed to urge local and prefectural governments to adopt more transparent procedures and to give full consideration to foreign suppliers.

Because Japan did not extend coverage of its National Space Development Agency and its electrical power generation entities to the United States, the United States did not extend coverage of NASA and U.S. Government-owned power generation entities with respect to Japan. Quasi-governmental entities and third sector projects (Japanese Government and private sector joint ventures) are not covered by Japan's WTO Procurement Code commitments or Action Plans, but they increasingly purchase services and goods that formerly were the responsibility of national and local governments. Official Japanese data show that there are 6,659 quasi-government entities with more than 25 percent local government equity. (The figure would be higher if entities with central government equity were included.) Because most of these entities are not covered by the GPA, bilateral agreements, or Japanese action plans, and thus are not required to use fair, open and transparent procurement procedures, the United States remains concerned that a large amount of potential procurements of U.S. goods and services by quasi-governmental entities and third sector projects will be lost.

Computers

The United States and Japan signed a government procurement agreement on computers in January 1992, which commits Japan to use non-discriminatory and transparent procurement procedures to expand

government purchases of competitive foreign computer products and services. Under this agreement, Japan made major commitments designed to improve the procedures used in the public procurement of computer products and services, and addressed the various stages of the procurement process, including the following:

- All potential bidders are to be granted equal access to pre-solicitation information and equal opportunities to participate in that stage of the procurement;

- Specifications are to be formulated in an impartial manner, and any supplier involved in the development of specifications for a procurement may not bid on that procurement if doing so would result in an unfair competitive advantage;

- All potential suppliers are to be accorded fair and equal opportunities to submit bids, and sole sourcing is used only in exceptional cases justified under the GATT Code/WTO GPA; and

- Evaluation of bids is to be conducted based on evaluation factors set forth in the tender documentation.

The agreement also establishes a complaint mechanism. In addition, it provides that bidders submitting unjustly low bids in violation of Antimonopoly Act rules on fair competition will be excluded from bidding on the procurement, and that information regarding such unfair bids will be provided by the procuring entity to the Japan Fair Trade Commission. The procedural provisions of the computer procurement agreement apply to both national government and quasi-governmental entities. With regard to local and prefectural governments, the Japanese Government committed to inform these entities of the measures and seeks their cooperation in following procurement policies and procedures consistent with the computer agreement.

While the foreign share of the Japanese Government computer market increased somewhat from the signing of the agreement through 1994, preliminary indications suggest slippage in all sectors in 1995. Foreign computer manufacturers' (FCM) share of the national government market (excluding personal computers) increased from nine percent in 1992 to 14 percent in 1994 but declined in 1995. Furthermore, FCM's share of the national government market still lags far behind the FCM share of Japan's private sector computer market, which was estimated at 37 percent in 1994. The FCM share of the national central government market has, however, tripled since 1992, though the FCM share of the growing local sector decreased from 6.2 percent in 1991 to 3.5 percent in 1995.

Although some progress has been made in opening Japanese Government procurement of computers to foreign suppliers, it is clear that more work remains to be done. The "greatest overall value" evaluation system for public procurement, introduced as part of the Government of Japan's action plan on government procurement of March 1994, is not being implemented in a sufficiently transparent manner, with the relative weighting of factors in the evaluation left to procuring agencies. Moreover, there continue to be problems with deep discounting of personal computers and related equipment by Japanese computer makers -- in some cases reportedly as high as 90 percent. This not only restrains fair competition in the procurement market, it also leads to greater follow-on costs as successful bidders seek to offset losses on

the initial procurement with inflated costs on subsequent equipment and service procurements. The Government of Japan also could take additional measures to improve access to information by potential bidders.

The two governments conduct annual reviews to assess implementation, and the U.S. Government raised these issues with the Government of Japan in the February 1996 review. Owing to these concerns, particularly to reports of continued discounting practices in government procurement, on April 30, 1996, USTR highlighted Japanese Government procurement of computers as a problem trade area, but did not "identify" this area under Title VII. The Administration is strongly committed to ensuring that the 1992 computer agreement is fully implemented and that U.S. computer makers have fair access to Japan's government procurement market. The next annual review is scheduled to take place in the spring of 1997.

Major Projects Arrangement

The United States-Japan Major Projects Arrangement (MPA), signed in 1991, is discussed under the title "Construction, Architectural, and Engineering Services" in the section of this chapter entitled "Services Barriers."

Medical Technology

The United States concluded an agreement on medical technology with Japan on October 1, 1994, under the Framework to improve market access and transparency for U.S. medical device manufacturers in the government procurement market. The agreement also contains both a comprehensive complaint mechanism and procedures for dealing with unfair bids. The agreement and accompanying exchange of letters represent an important step forward in the ability of foreign firms to sell medical technology products and services to Japan's public sector. The agreement establishes fair and transparent procedures that must be used by national medical institutions in procuring major medical equipment and services for Japan's $2.6 billion government procurement sector. Also, for the first time, the agreement requires government hospitals in Japan to make procurement information public, regardless of value. Each hospital will publish, on an annual basis, information on the top ten medical technology products it plans to purchase during the upcoming year. Previously, this important information had not been readily available.

U.S. firms are highly competitive in medical technology, and hold a global market share of 52 percent. In the Japanese market, however, the U.S. industry' share is 26 percent, reflecting the existence of substantial market access barriers in this sector. The 1994 agreement calls for the Framework goal of a "substantial" increase in access and sales of foreign competitive products and services. It specifies a set of five quantitative and five qualitative criteria to assess the implementation of this agreement, including: yearly measurement of the number of Japanese entities procuring foreign products and services; the number and value of contracts awarded each year as a result of a decrease in single tendering; and the results of reviews conducted by the procurement review board.

A key element of the agreement is the requirement that procurement decisions for certain procurements, including purchases above a specified threshold be made on the basis of the overall greatest value method (OGVM), instead of the current minimum price system. The threshold will be reduced in value over a

three-year period from 800,000 Special Drawing Rights (SDRs) on April 1, 1996, to 385,000 SDRs on April 1, 1998. For the first time, equipment costs of these items will be calculated on a life-cycle basis. This means that the highly sophisticated medical technology products manufactured by U.S. and foreign firms will not be excluded automatically because of initial price. The technical excellence of those products, and the value they provide over the long term, will now be taken into account.

The U.S. Government is pleased that the national government hospitals are using OGVM in selecting medical equipment valued above the established thresholds, and that they have found the methodology to be very effective in procuring the kinds of equipment they need to provide quality medical care to their patients. U.S. firms are concerned, however, that prefectural and municipal hospitals continue to use the lowest-bid procedure of evaluation in procurement of advanced technology products. Under the medical technology agreement, the Japanese Government is required to encourage prefectural and local/municipal governments to utilize measures similar to those adopted by the central government entities. The fact these entities do not use OGVM hinders the ability of U.S. companies to sell in this significant portion of the market, as U.S. equipment is usually innovative and/or high-end equipment offering special features or extraordinary performance. This equipment may have a higher initial price, but provides significant cost savings over the life of the product. The United States continues to actively encourage the Japanese Government to have local and prefectural governments adopt this methodology.

The terms of the measures went into effect on November 1, 1994. The two countries held the second annual review of the agreement in October 1996 to assess market share data and progress in the implementation of procedures to establish more transparent tendering practices. The Japanese Government calculated a foreign market share of the government procurement market covered by the agreement (equipment procurements above the threshold for the agreement's procedures) of 38.5 percent. This figure includes sales of all foreign products including those by Japanese distributors, all imports from overseas Japanese production facilities, and all products sold under foreign brand-name regardless of location of manufacture or capital affiliation. The U.S. Government could clearly identify only 21 percent of the market as being held by foreign firms, although this figure almost certainly undercounts the foreign share since sales of U.S. products by Japanese distributors are particularly difficult to track.

The review also found that the Japanese Government had made good progress toward implementing the transparent and open procurement procedures called for in the agreement. Almost no procedural concerns were identified by U.S. firms, and the issues that have been raised were satisfactorily addressed during the reviews.

Satellites

The 1990 U.S.-Japan satellite procurement agreement binds the Japanese Government to open non-R&D satellite procurements to foreign satellite makers. Coverage includes procurement for broadcast satellites by the NTT and NHK, the government-owned television/radio service.

U.S. satellite makers won all five contracts (with a combined value exceeding $1 billion) openly bid under this agreement from 1990 through 1995. The most recent contract was a $100 million weather/navigation satellite procured by the Ministry of Transport in 1995, which was won by Space Systems Loral.

Despite U.S. firms' success under the agreement, the United States continues to be concerned about the National Space Development Agency's (NASDA) categorization and exclusion of certain satellite procurements from the agreement as "R&D" satellites. The United States recognizes that R&D satellites can be excluded from open bidding under the agreement, but it is concerned that an overly-broad definition of R&D could unfairly deny U.S. and other foreign satellite companies legitimate procurement opportunities.

In October 1996, NASDA awarded a $350 million contract to a Japanese firm for two data relay satellites outside the open bidding procedures. The United States will closely monitor this and subsequent Government of Japan procurements to ensure that such R&D procurements are consistent with the terms of the agreement -- namely that they incorporate technology new to Japan, and are not intended for the provision of regular services.

Supercomputers

Following the failure of the 1987 U.S.-Japan Agreement on Government Procurement of Supercomputers to improve access to Japanese Government procurement of supercomputers, the United States and Japan concluded a second supercomputer arrangement in June 1990. Under the arrangement, the Government of Japan committed to implement a fair, transparent, and non-discriminatory public procurement process. The provisions of the arrangement called for procuring entities establish and apply objective criteria for evaluating bids, and to subject supercomputers under consideration to identical benchmark tests of forecasted workload problems (rather than theoretical maximum speeds). To address unlawful discount pricing by Japanese supercomputer makers, the agreement specified that contract awards would be made based not only on price but also on performance. The arrangement also stipulated that bids so low as to constitute unfair competition would not be permitted, and a protest mechanism was established.

Results of the 1990 supercomputer arrangement have been mixed. The U.S. share of Japanese supercomputer procurements has varied considerably from year to year. U.S. supercomputer makers won only 27 percent of the procurements in the first three years of the arrangement, then received roughly 40-45 percent of procurements in JFY 1993 and 1994. This positive trend was reversed in 1995, when U.S. firms won only 9 percent of the procurements. In 1996, U.S. firms won two of eight Government of Japan supercomputer bids and lost to a Japanese firm in the only head-to-head competition between U.S. and Japanese firms.

Notwithstanding year-to-year fluctuations in market share, several persistent market access barriers have emerged. U.S. share of the public procurement market has remained well below the U.S. makers' roughly 50-percent share of the Japanese private sector supercomputer market. Moreover, the majority of recent U.S. sales to Japanese government entities have augmented or replaced an existing U.S. supercomputer installation; the U.S. share of "new" Government of Japan installations is even lower than its share of total procurement. Deep discounting of pricing remains a problem, and procuring entities continue to give insufficient weight to non-price factors. The agreement allows for new supercomputers to be bid based on forecasted performance provided performance standards are met after installation, there have been concerns that some installed supercomputers have been unable to meet the forecasted performance standards.

The U.S. Government will continue to vigorously monitor this arrangement and, as necessary, take steps to ensure Japanese compliance with its measures.

Telecommunications

NTT Arrangement: In 1994, the NTT procurement agreement was renewed for the fifth time since 1980. The renewed agreement contained improved NTT procurement procedures, designed to increase procurement transparency, increase reliance on international standards, and reduce sole sourcing of telecommunications equipment by NTT. NTT, Japan's single largest purchaser of telecommunications equipment, accounts for almost one half of Japan's $30 billion telecommunication equipment market. Three NTT subsidiaries (NTT Data Communications, NTT Mobile Communications, and NTT Power and Building Facilities) agreed to voluntarily adopt the procedural improvements. The current agreement is due to expire in September 1997.

NTT's procurement of all foreign products increased from 135 billion yen in JFY 1994 to 152 billion yen in JFY 1995 (approximately $1.5 billion, at 100 yen/dollar). While NTT's purchases of foreign telecommunications equipment also increased, the increase in market share for these products was minimal. Considering U.S. firms' competitiveness -- evidenced by favorable exchange rates, worldwide export growth of over 20 percent, and significantly better results in the Japanese private sector market -- these results are disappointing.

The poor results U.S. companies have achieved with NTT compared with the private Japanese telecommunications sector suggests that NTT is still captive to its monopoly legacy and not fully responsive to market principles in its procurement. NTT's favoring of its "family companies" for the bulk of its telecommunications equipment, its tendency to over-engineer and under-document specifications -- often based on Japan-specific or NTT-specific standards -- and its allocation of supplier market share for products based on non-transparent criteria raise costs to NTT and its customers and pose significant market access barriers.

NTT's practices hamper competition not only in the market for equipment, but for services as well. In many categories of equipment, telecommunication service companies competing against NTT are required to use NTT-family developed equipment at higher costs than comparable equipment. To support a truly multi-vendor market for such equipment, and thus encourage cost-effective facilities-based competition, the standards, specifications, and interfaces for equipment connecting to the public switched network should not be determined solely by NTT and its family-companies. Rather, a neutral, open organization, to which any vendor or service supplier can belong, should be mandated.

These issues all point to the need to closely monitor procurements under the NTT agreement and to continue to seek ways to improve implementation of this agreement. Until vigorous competition is introduced in both the equipment and service markets, such oversight is vital. These issues will be the subject of review in mid-1997.

Public Sector Procurement Agreement on Telecommunications Products and Services: The 1994 U.S.-Japan Public Sector Procurement Agreement on telecommunications products and services was

intended to improve access and sales for foreign telecommunications firms selling to Japan's public sector. Pursuant to the agreement, Japan has introduced procedures to eliminate barriers such as: obstacles to participation in pre-solicitation and specification-drafting for large-scale telecommunications procurements; ambiguous award criteria; excessive sole sourcing; and the absence of an effective bid protest mechanism. The public sector procurement agreement also includes quantitative and qualitative criteria for measuring progress such as: annual value and share of foreign products; annual numbers of entities buying foreign products and services; annual numbers and values for contracts awarded as a result of single tendering; and new subcontracting opportunities for foreign suppliers.

The United States and Japan held the second annual bilateral review of this agreement in October 1996. While Japanese data showed that foreign share of Japanese government procurement of telecommunications products and services increased from 7 percent in 1994 to 13 percent in 1995, the United States questions the Government of Japan's estimates of the size of the market covered by this agreement. (1995 data show the agreement covering a market of only 88 billion yen, or about $880 million at 100 yen to the dollar.)

The United States also has continuing concerns about the high number of contracts awarded through single tendering in 1995. The agreement calls for a reduction in sole sourcing and the U.S. Government has asked the Japanese Government to take steps to remedy this.

One particular case falling under this agreement is of serious concern. In April 1996, a U.S. company was excluded from the specifications-development for a major wireless telecommunications system to be procured by the National Police Agency. This exclusion appears to violate provisions of this procurement agreement and efforts to resolve this issue continue.

LACK OF INTELLECTUAL PROPERTY PROTECTION

Since 1994, Japan has been placed on the Special 301 "Priority Watch List" of countries from which the United States sought stronger intellectual property rights (IPR) protection. IPR has been the focus of U.S.-Japan discussions in a number of multilateral and bilateral fora.

In February 1996, the United States initiated the first intellectual property case at the WTO by invoking dispute settlement proceedings against Japan for its failure to provide full "retroactive" protection to pre-existing sound recordings in accordance with the TRIPs Agreement. Although the TRIPs Agreement required developed countries as of January 1996 to protect sound recordings produced in other WTO countries within the past 50-years (i.e., produced in 1946 or later), Japan only protected foreign sound recordings produced in 1971 or later. Japan ultimately agreed to provide such protection and did so through legislation adopted in December 1996 that will come into effect in March 1997. In January 1997, the United States and Japan jointly notified the WTO that the matter had been resolved.

In April 1996, USTR placed Japan on the Special 301 "Priority Watch List" under the provisions of the Trade Act of 1988, for its failure to provide adequate and effective protection for intellectual property rights. Japan was cited for problematic patent practices, inadequate protection of trademarks and trade secrets, high levels of end-use software piracy, and the sound recordings dispute, which at the time was

under discussion at the WTO. Another major concern is the practice of Japanese courts interpreting patents very narrowly, allowing competitors to conduct activity that would be considered infringing in the United States and in most other countries.

Copyrights

U.S. computer software groups remain concerned about the significant problem of end-user piracy in Japan. U.S. and some Japanese software developers seek much stronger legal and procedural provisions to allow the prosecution of end-user pirates, including the establishment of a more effective system of applying for and receiving ex parte provisional relief on a timely basis.

Patents

IPR Agreements: During 1994, two bilateral agreements on IPR were concluded under the Framework. The first agreement, signed on January 20, 1994, addressed a number of outstanding issues, including permission to file patent applications with the Japanese Patent Office (JPO) in English, correction of translation errors after patent issuance (as long as it does not substantially expand the scope of protection), and changes in the U.S. patent term from 17 years-from-grant to 20 years-from-filing. Japan and the United States have implemented these commitments.

On August 16, 1994, a second agreement was signed in which the JPO agreed: to end the practice of allowing third parties to oppose a competitor's patent before it is granted and to hear all opposition claims at the same time; to establish an accelerated patent examination procedure that will enable applicants to obtain disposition of their patent applications within 36 months, upon request; and to end the practice of awarding dependent-patent compulsory licenses in cases other than where anticompetitive practices have been found. The threat of the imposition of dependent-patent compulsory licenses had been used in the past to force patent holders to license the use of their technology to competitors, effectively limiting their exclusive rights in their inventions. Japan has fully implemented these commitments.

Remaining Problems: Even with Japan’s implementation of the 1994 agreements, significant problems with the Japanese patent system remain. Two important examples are narrow patent claim interpretation before the JPO and narrow patent claim interpretation in the courts.

During 1995, Japan modified its patent examination guidelines in a manner that appears to alleviate U.S. concerns about narrow patent issuances by the JPO. In the past, Japan limited the scope of patent claims to cover only what had been specifically "reduced to practice" and described in the application; i.e., a claim could be no broader than the specific examples actually made and listed in the application. In contrast, the United States and most other countries permit claims to be broader than the actual examples provided if: (1) the applicant clearly describes how one skilled in the art can make the products described by the "prophetic example;" and (2) that these examples are not otherwise known to the public. The ability to base claims on prophetic examples is particularly important in the chemical area, where thousands of variations are possible and it is impractical to list each example after reducing it to practice. The Government of Japan has confirmed: (1) the issuance of revised guidelines to JPO examiners, directing them to grant patents based on prophetic as well as working examples; and, importantly, (2) application of the new guidelines

to outstanding patent applications, some of which have been pending for many years. Some U.S. companies have hundreds of such pending applications with the JPO.

Concerns remain about the narrow patent interpretation practices in Japanese courts. As a general practice, Japanese courts impose liability based only on the literal infringement of patents; as a result, competitors can avoid liability by changing an element of the invention even if the resulting product is substantially similar to the patented product. In contrast, courts in the United States and in most other countries, as a general practice, will find infringement if the defendant has either literally or substantially infringed the patent. That is, infringement will be found even if the infringer has deviated from the patent in certain marginal and unimportant ways. This latter practice is known as the "doctrine of equivalents." This doctrine has been used by Japanese courts only in rare instances.

Another problem has been the occurrence of "patent flooding" in which companies in Japan will flood the JPO with applications that deviate marginally from a particular previous filing, thereby adding to JPO's already considerable backlog and creating uncertainty in the marketplace by making it difficult for foreign parties to determine what applications are likely to mature into patents.

Trademarks

The trademark registration process remains slow, requiring approximately 36 months to register a trademark in Japan versus 16-18 months in the United States. Trademarks must be registered in Japan to ensure enforcement so that delays make it difficult for foreign parties to enforce their marks. Protection of well known marks also remains weak.

Trade Secrets

Japan's protection of trade secrets is inadequate because Japanese courts require disclosure of trade secrets when a case is brought to them. This puts the owner of a trade secret in the untenable position of being unable to protect the trade secret without disclosing it publicly. An amendment to Japan's Civil Procedures Act (which was pending before the Diet in 1996), should be enacted by the Diet later this year, should improve the protection of trade secrets in Japanese courts by excluding court records containing trade secrets from public access. However, this legislation does not adequately address the problem. Court discussions of trade secrets will remain open to the public and there are no confidentiality obligations on the part of parties to the case or their attorneys. Thus protection of trade secrets in Japan's courts will continue to be considerably weaker than in the courts of the United States and other countries.

SERVICES BARRIERS

Construction, Architectural, and Engineering Services

For the past three years, the Government of Japan has made efforts to reform its public works bidding system in accordance with its "action plan on reform of the bidding and contracting procedures for public works." This action plan, coupled with additional understandings in an exchange of letters between then Commerce Secretary Ronald Brown and Japanese Ambassador Takakazu Kuriyama, constitutes the 1994

U.S.-Japan Public Works Arrangement. Under this arrangement, Japan must use open and competitive procedures on procurements valued at or above WTO threshold levels. As part of the arrangement, Japan re-affirmed its commitments under the 1991 Major Projects Arrangement (MPA) which will remain in effect until all projects covered by the MPA are completed.

Since the 1994 arrangement was signed, the Department of Commerce has held two annual reviews to assess the impact of the reform measures on Japan's public works market. At the first review, the U.S. Government acknowledged that 1994 was a transition period, but expressed dissatisfaction with the limited business awarded to foreign firms, and voiced an expectation of increased future business for U.S. and other foreign firms. In addition, the United States offered numerous procedural recommendations to facilitate greater foreign participation in Japan's public works market at the central and local government levels.

Although Japan's Ministry of Construction (MOC) has taken some steps to accommodate the U.S. Government's procedural recommendations, there has been little real impact on foreign firms' access to the overall Japanese public works market. The limited success of U.S. firms has resulted in part from implementation problems in both the 1994 arrangement and the 1991 MPA. Furthermore, U.S. firms have described specific instances where the Japanese Government and industry either have been uncooperative or unforthcoming in allowing foreign participation in the bidding process. Consequently on April 30, 1996, Japan was placed on the Title VII "Watch List" due to continued concern over the implementation of the 1991 MPA and the 1994 arrangement.

Against this backdrop, the U.S. Government held the second annual review of the arrangements in June 1996. Despite the fact that JFY 1995 marked the first year in which the new open and competitive procedures were fully implemented, the number of real opportunities available for foreign firms to bid on contracts in accordance with the agreement, particularly in the area of design contracts, was limited. Market access barriers resulting from a combination of procedural requirements, such as restrictions on the size and scope of joint venture consortia, and exclusive business practices, continued to frustrate foreign firms in their efforts to bid on contracts. In particular, the U.S. Government made clear its concerns regarding the lack of genuine market access for foreign firms on projects covered by the 1991 MPA -- notably the Chubu New International Airport in Nagoya (CNIA) and the Kansai International Airport near Osaka.

The CNIA is an "if and when" project identified under the 1991 MPA. As such, Japan is obligated to add CNIA to the list of MPA projects as soon as the Government of Japan decides to proceed with the development of the project. The Government of Japan has indicated that coverage will not begin until a formal decision on the development of the airport is made, and that this decision is not expected until 1998. However, the U.S. Government was pleased to learn recently that Japan's Ministry of Transport (MOT) has decided to begin voluntary use of the MPA procedures for CNIA as soon as the budget for JFY 1997 is approved. In addition, the Japanese Government recently informed the U.S. Government that the commissioning entities for the Kansai International Airport are using MPA procedures, as required by the agreement.

Although these actions represent a step forward, the U.S. Government continues to monitor developments closely. It is important that by the beginning of JFY 1997 (April 1, 1997), that the data collected show a significant increase in the level of foreign participation in the Japanese public works market.

Financial Services

Japanese financial markets traditionally have been highly segmented and strictly regulated, and as such, have restricted the entry of foreign financial services firms and discouraged the introduction of innovative products in which foreign firms may have enjoyed a competitive advantage. Some of the restrictions that have impeded access include the use of administrative guidance, “keiretsu” (interlocking business relationships), lack of transparency, inadequate disclosure, the use of a positive list to define a security, and lengthy processing of applications for new products. These restrictions have hindered the emergence of a fully competitive market for financial services in Japan.

With a view to eliminating or reducing these barriers, on February 13, 1995, the United States and Japan concluded a comprehensive financial services agreement, "Measures by the Government of Japan and the Government of the United States Regarding Financial Services." This agreement features an extensive package of market-opening actions in the key areas of asset management, corporate securities, and cross-border financial transactions.

In the two years since the agreement was signed, the Japanese Government has implemented the vast majority of the commitments made within the specified time frame. In some instances, the timetable for implementation was accelerated. In a few areas, the Japanese Government has taken or announced additional actions for future implementation to improve the liberalization of Japanese financial markets.

The U.S. Government is currently monitoring the agreement to ensure that implementation remains on schedule and to assess the impact of the actions undertaken using the qualitative and quantitative criteria included in the agreement. At the March 1997 review, the U.S. Government emphasized the need for further improvements in financial disclosure and transparency.

In an announcement on November 11, 1996, Prime Minister Ryutaro Hashimoto committed the Japanese Government to conducting broad-based deregulation of Japan's financial sector, aimed at making Tokyo's financial markets comparable to those of New York and London by 2001. The Japanese Government's plans, while still very preliminary, indicate the possibility of such major changes as allowing mutual entry across financial sectors, tax changes, liberalization of commissions, liberalization of foreign exchange transactions, tightened disclosure rules, and further liberalization of asset management regulations. These changes could create important new business opportunities for U.S. financial services providers. The U.S. Government will watch developments closely.

Insurance

Japan is the world's second largest market for insurance with annual premium revenues of $410 billion in JFY 1995. It is also one of the most heavily regulated of all major insurance markets, with Ministry of Finance regulations, informal guidance, and industry associations all serving to limit competition in the

market. While foreign market shares of other G-7 countries' domestic insurance markets ranged from 10 to 33 percent, foreign firms' share of the Japanese market is only 3.5 percent. Foreign firms have only a 1.5 percent share of the primary life insurance market and a 2.8 percent share of the primary non-life market (mostly auto, fire and marine insurance). Together these two primary sectors account for roughly 95 percent of Japan's entire insurance market. Foreign firms have played an important role in developing new products and sales channels in the remaining five percent of the market, the so-called third sector, as reflected in their roughly 40 percent share of this sector.

On October 11, 1994, a U.S.-Japan insurance agreement was concluded as one of four priority areas for negotiation under the U.S.-Japan Framework. Negotiations resumed in the fall of 1995, when it became apparent that Japan intended to allow Japanese insurance subsidiaries to operate in the third sector in a manner contrary to key provisions of the 1994 agreement. Following a year of difficult negotiations, on December 24, 1996, the United States and Japan reached agreement on a package of "supplementary measures" which will significantly deregulate Japan's market. The Administration is committed to monitoring the implementation of these agreements closely to ensure that the anticipated opportunities materialize.

1994 Insurance Agreement: The October 1994 insurance agreement commits Japan to enhance regulatory transparency, strengthen antitrust enforcement, introduce a "notification system" for approval of insurance rates and products, and undertake specific liberalization measures. The Ministry of Finance (MOF) has, to varying degrees, implemented these provisions. The agreement also sets forth MOF's intention to allow insurance brokers to operate in Japan; while MOF has established the framework for a broker system, continued inability to differentiate product form and type has limited opportunities for brokers.

The agreement calls for five government corporations with large annual insurance requirements to use fair, transparent, non-discriminatory, and competitive criteria in their annual allocation of insurance premium shares. This remains a key concern: only one of those five government corporations (the Housing Loan Corporation) has disclosed its premium allocation criteria; and for all five corporations, the foreign share of premiums remains negligible, even relative to foreign insurers' small share of the private sector Japanese insurance market. The agreement also calls for Japanese and foreign insurers in Japan to complete by March 1995 a study of the impact of "keiretsu" business relationships and case agents on insurance purchasing patterns in Japan, and for the Japan Fair Trade Commission to conduct its own study of the same issues. As of February 1997 work on neither of those studies has begun.

Finally, the 1994 agreement contains a provision related to "mutual entry" of life insurers into non-life markets and of non-life insurers into life insurance markets. Until enactment of a new Insurance Business Law (IBL) on April 1, 1996, life and non-life insurance firms were strictly prohibited from doing business in their counterpart sectors. The new IBL allows such activity in the form of subsidiaries and the specific parameters under which these subsidiaries will operate was addressed at length in bilateral negotiations throughout 1996.

1996 Insurance Agreement: Under the 1994 agreement, the Government of Japan committed to avoid "radical change" in the third sector until foreign, small and mid-sized insurers (which have a greater degree of dependence on the third sector markets) have had a reasonable period to compete in significantly

deregulated primary life and non-life sectors. The “supplementary measures" agreed to in December 1996 define the extent and timing of primary sector deregulation by MOF. These measures also define the scope of business activities of the Japanese insurance subsidiaries in the third sector consistent with the commitment to avoid radical change.

Under the 1996 agreement, the Government of Japan committed to approve by September 1997 applications for automobile insurance with differentiated rates based on a range of risk criteria, e.g., age, gender, driving history, geography, and vehicle usage. It also committed to obtain Diet passage and implement legislation amending the Rating Organizations Law to eliminate the rating organizations’ authority to set industry-wide rates for automobile and fire insurance. Currently, the rating organizations, comprised of all non-life insurers, operate as rate-setting cartels exempt from Japan’s Antimonoply Act. The reforms Japan committed to will introduce significant new competition into Japan’s insurance sector.

In addition, Japan committed to expanding the list of products to be included under the "notification system." This is anticipated to accelerate the introduction of innovative products, including several important liability lines. MOF also will reduce the threshold above which insurers will be permitted to offer flexible rates for commercial fire insurance from the current 30 billion yen (contract value) to seven billion yen in several stages by April 1998.

With respect to the third sector, the 1996 agreement commits the Government of Japan to prohibit or substantially limit the Japanese insurers' new subsidiaries from marketing certain third sector products of particular importance to foreign insurers, e.g., cancer, hospitalization, and personal accident insurance, until foreign firms have had sufficient time to establish a presence in the deregulated primary sectors. The agreement envisions completion of primary sector deregulation by July 1998. If completed on schedule, restrictions on the activities of the subsidiaries in the third sector will be lifted in two-and-a-half years, i.e., by January 2001, consistent with Prime Minister Hashimoto's "Big Bang" financial services deregulation initiative.

In the 1996 agreement Japan committed to significantly deregulate Japan's insurance market. This will result in far greater competitive opportunities for American insurers and choice for Japanese consumers. Both countries will review implementation of these agreements semiannually.

Legal Services

The U.S. Government's Deregulation and Competition Policy Working Group under the Framework has repeatedly requested that the Government of Japan eliminate or drastically reduce its severe restrictions on foreign lawyers working in Japan. Since the 1970s, U.S. lawyers have sought greater access to the Japanese legal services market and full freedom of association in employment arrangements with Japanese lawyers. However, strong opposition from the "Nichibenren" (Japan Federation of Bar Associations) and an unwilling bureaucracy have consistently refused to redress all of the U.S. concerns. Of particular concern are the prohibition on Japanese lawyers and quasi-legal professionals joining foreign law firms either as partners or employees, restrictions on the scope of practice with respect to the law of third countries, as well as the small number of Japanese lawyers capable of handling international business

transactions which constrains the ability of foreign companies to obtain proper legal advice on doing business in Japan.

Under the current 3-year (JFY 1995-97) Government of Japan Deregulation Action Plan, the Ministry of Justice (MOJ) has taken incremental steps to ease some restrictions on partnerships in 1995 and to allow qualified foreign lawyers to represent parties in international arbitration proceedings in Japan starting in JFY 1996. However, the MOJ has rejected other key U.S. deregulation requests, including: (1) lifting the prohibition against foreign lawyers licensed in Japan ("gaikokuho jimu bengoshi") employing, or entering into partnerships or other fee-sharing arrangements with, Japanese lawyers and quasi-legal professionals; and (2) easing the restrictions on legal experience that can be counted toward satisfying the five-year requirement. In its January 1997 interim deregulation report, the MOJ reiterated its weak 1996 pledge to complete a "study" of foreign lawyer issues by the end of JFY 1997, but rejected the U.S. request to consider allowing foreign lawyers and law firms in Japan to enter into full partnerships with Japanese lawyers and quasi-legal professionals. Combined with the overall insufficient number of qualified lawyers, the Government of Japan's restrictions will continue to place a burden on the operations of foreign firms in Japan.

Telecommunications Services

Japan has made significant progress in formulating mandatory interconnection rules, the lack of which had posed a major barrier to entering the local telecommunications service market dominated by the monopoly supplier NTT. Such rules are key to making the WTO telecommunications agreement meaningful.

The development of these rules proved a major step forward in transparent rulemaking, providing all interested parties an opportunity to participate in the process. The United States has urged the Ministry of Posts and Telecommunications (MPT) to ensure that the maximum incentives for encouraging competition are provided, by introducing long run incremental costing (LRIC) as the price standard for access to monopoly-controlled facilities.

Since the new rules are not expected to come into effect until late 1998, the United States has urged that the MPT take intermediary steps to ensure fair, cost-based interconnection with NTT. Two unresolved issues of immediate concern are access by competing service providers to all NTT services, and the costs NTT is asking competing service providers to bear for network modification. The U.S. Government also remains concerned about restrictions on foreign investment in direct broadcasting services (DBS), and in NTT and KDD, Japan's two dominant telephone carriers.

In the recently concluded WTO negotiations on basic telecommunications services, Japan made commitments on all basic telecom services. It adopted the reference paper on regulatory commitments. Japan retained a 20 percent foreign investment limit in KDD and NTT. The United States will monitor these and other telecommunications issues to help ensure that new entrants, including U.S.-affiliated carriers, benefit from pro-competitive treatment.

Although the 1990 and 1991 International Value-Added Network Services (IVANS) agreements have been successful and have permitted foreign companies to introduce a wide variety of enhanced services in Japan,

certain issues remain. As with Type I carriers, IVANS providers should benefit from inter-connection rules applying to NTT, and any interim measure the MPT undertakes to ensure a competitive market. MPT has indicated that it will extend interconnection obligations to cover Type II carriers.

MPT has expanded the scope of carriers eligible for the less burdensome designation "general Type II" carriers. Unfortunately, all services involving international telecommunications face the more burdensome requirements applicable to "special" Type II carriers. The United States has recommended that the MPT eliminate this distinction, and treat all resellers as general Type II carriers. As Japan opens up the market for international services using leased lines connecting to the public switched network (scheduled for 1997), these issues may become more important.

Japan proposed deregulatory measures in the DBS sector in 1996, but failed to liberalize two key areas: restrictions on the transponder bandwidth a single company can control, and limits on both foreign investment and corporate board representation. The United States has urged that such restrictions, which stifle the development of a competitive, technically progressive market, be relaxed.

INVESTMENT BARRIERS

Japan's stock of inward foreign direct investment (FDI), relative to the overall size of the Japanese economy, is minuscule compared to that of other advanced industrialized countries. In 1995, for example, the value of Japan's stock of inward FDI totaled only 0.7 percent of the nation's 1995 gross domestic product, as compared to 7.0 percent for the United States. Japan's outward investment flows, on the other hand, dwarf investment into Japan: the ratio of outward-to-inward FDI was roughly 19-to-1 from 1990 to 1994. In 1995, Japanese overseas FDI was $51 billion; Japan's inward FDI was only $4 billion. The scarcity of foreign investment into Japan contributes to large external trade imbalances and helps block market access to competitive foreign companies. The legacy created by the Government of Japan actively discouraging foreign investment during the high growth periods of the 1950s to the 1980s, combined with still negative attitudes and a high-cost, over-regulated environment, leads to extremely low participation by foreign firms in Japan, which remains a barrier to trade.

Acknowledging that inward investment lags far behind that of other industrialized economies, the Japanese Government has taken some limited steps to address the problem, aimed at making the environment for foreign investment in Japan more attractive. In July 1994, the Government of Japan established the Japan Investment Council (JIC), chaired by the prime minister and charged with identifying measures to improve Japan's investment climate, coordinating policies of ministries and agencies concerned with investment, and disseminating information on investment-promotion measures. In June 1995, the JIC released a statement on investment that encouraged FDI and listed a few useful policy measures.

Although many direct legal restrictions on foreign direct investment have been eliminated, bureaucratic obstacles remain. Japan's low level of inward FDI flows in recent years also reflects the impact of exclusionary business practices, high market entry costs, and discriminatory use of bureaucratic discretion. While Japan's foreign exchange laws currently require only ex-post notification of planned investment in most cases, a number of sectors (e.g., agriculture, mining, forestry, fishing) still require prior notification

to government ministries. Restriction on foreign investment in direct broadcasting services (DBS), and the NTT and KDD telephone carriers remain a concern.

Difficulty in acquiring existing Japanese firms -- as well as doubts about whether such firms, once acquired, can continue productive business relations with other Japanese companies -- make investment access through mergers and acquisitions much more difficult in Japan than in other countries. Foreign companies have little access to mergers and acquisitions (M&A) in Japan, the major avenue for FDI (some 80 percent) in the rest of the Organization for Economic Cooperation and Development (OECD). Extensive cross-shareholding among allied companies and difficulties foreign firms encounter in hiring employees also works to inhibit direct foreign investment.

Japan's Antimonopoly Act provides that "no entrepreneur shall enter into an international agreement or an international contract which contains such matters as constitute unreasonable restraint of trade or unfair trade practices." This language has allowed the Japan Fair Trade Commission (JFTC) to require that it be notified of and be allowed to review certain types of international contracts, in a manner that disadvantages the foreign parties since it results in greater scrutiny of contracts involving foreign parties than of contracts solely between Japanese parties. In 1992, the JFTC revised but did not eliminate its regulations specifying types of international contracts subject to notification, resulting in substantial decreases in the numbers of notifications. In its January 1997 interim deregulation report, the Government of Japan indicated its intention to amend the Antimonopoly Act to eliminate this notification requirement.

Investment Arrangement: In July 1995, the United States and Japan agreed to "Policies and Measures Regarding Inward Direct Investment and Buyer-Supplier Relationships." This arrangement lays out the inward FDI promotion policies instituted by the Japanese Government during the course of the Framework agreement investment negotiations, and commits Japan to: expand efforts to inform foreign firms about FDI-related financial and tax incentives, and broaden lending and eligibility criteria under these programs; make low-interest loans and provide tax incentives under the 1992 Inward Investment Law available to foreign investors; propose measures to improve the climate for foreign participation in mergers and acquisitions; and strengthen the FDI promotion roles of such organizations as the Japan Investment Council, Office of the Trade Ombudsman, Japan External Trade Organization (JETRO), and the Foreign Investment in Japan Development Corporation. Subsequently, the Inward Investment Law was extended from May 1996 to May 2006. In addition, MITI has lowered the interest rate charged by the Japan Development Bank (JDB) to foreign investors in high-technology projects, and as of April 1996, foreign firms' eligibility for tax incentives was extended from the first five years to the first eight years of operation of a foreign firm in Japan.

In reality, however, Japan's FDI promotion policies are mostly grafted onto domestic regional development promotion programs. They are small in scale and inflexible, and far from able to offset major impediments to create an attractive climate able to reverse low foreign investment levels in the near term.

ANTICOMPETITIVE PRACTICES

Exclusionary Business Practices

Japan

American firms trying to enter or participate in the Japanese market face exclusionary Japanese business practices and close government-to-industry relations that give domestic insiders an unfair advantage in the market. These include the following:

- Anticompetitive private practices -- such as bid-rigging, price-fixing, and refusals to deal -- which may violate the Antimonopoly Act and other Japanese laws, but often go unpunished;

- Corporate alliances and exclusive buyer-supplier networks often involving companies belonging to the same business grouping (or "keiretsu") that work to protect "market stability" (i.e., stable market shares and profit margins);

- Problematic corporate practices that inhibit foreign direct investment and foreign acquisitions of Japanese firms (e.g., nontransparent accounting and financial disclosure, cross-holding of shares among "keiretsu" member firms, low percentage of publicly traded common stock relative to total capital in many companies, and restrictions on foreigners serving on corporate boards);

- Industry associations and other business organizations that develop and enforce industry-specific rules that limit or regulate, inter alia, fees, commissions, rebates, advertising, and labeling for the purpose of maintaining “orderly competition” among their members, and often also applying to non-members.

Exclusionary Japanese business practices exact a heavy toll on the Japanese economy. By constraining market mechanisms, such practices reduce the choices available to businesses and consumers, and raise the cost of goods and services, as reflected in Japan's large internal-external price gap. Many products and services cost substantially more, often two to three times more, in Tokyo than in other international cities. In addition, by discouraging competitors that seek to break into the market with innovative products and services, these practices impede the development of new domestic industries and technologies (e.g., in software, multimedia, and telecommunications). Moreover, exclusionary business practices discourage potential foreign investors, whose market presence and technological innovation would stimulate the economy, as well as provide critical channels for exports and sales by foreign firms.

Cartels can pose serious barriers for foreign exporters and foreign companies that seek to invest in Japan. The Japan Fair Trade Commission (JFTC) is responsible for deterring and punishing illegal cartel behavior, but is an uneven enforcer with limited resources and strength to use its prosecutorial powers. (See also the sections below on the JFTC’s enforcement record; consumer photographic film and paper; and sea transport and freight.)

Japanese regulators view their role not simply as neutral arbiters of a legal rule-based system, but as active players in the control and guidance of their respective industries. Two aspects of this particularly disadvantage new domestic and foreign entrants to the market: the high degree of discretionary authority regulators maintain at both the national and local levels, and the regulator's tendency to rely on incumbent industry players to develop and self-enforce consensus on policy and regulatory changes**.**

Government-Industry Relationship

The close government-industry relationship in Japan often works to the disadvantage of foreign firms trying to participate in the Japanese market because the relationship favors domestic companies. Several aspects of the relationship are of particular concern.

Privatization of Regulations: The Government of Japan delegates, both formally and informally, governmental or public policy functions, such as industry standard development, product certifications, and entry authorizations, to industry associations and other business-related organizations that are generally not under any obligation to conduct their operations in an open, transparent, and non-discriminatory manner or to include foreign firms in their operations.

Informal Management of Industry: Business in Japan is more heavily regulated than in the United States, with much of the regulation taking place through cooperative consultations between the government ministry or agency and the affected industry, industry association, or other business-related organization; the issuance of "administrative guidance" to Japanese companies; or the placement of retired bureaucrats in companies and trade associations in a practice called "amakudari" (literally, "descent from heaven").

Lack of Transparency in Administrative Practices

Foreign firms are disadvantaged by the lack of transparency in Japanese administrative practices, in particular with regard to the following.

Lack of Rulemaking Process: Japanese ministries and agencies prepare regulations in a "black box" with participation generally limited to bureaucrats, former bureaucrats and special interests. Others with an interest in the regulation are denied the opportunity to take part in the process.

Use of Administrative Guidance: The lack of transparency in the Government of Japan's extensive use of informal directives or "administrative guidance" remains a serious concern despite requirements in the 1994 Administration Procedure Law (APL) that oral administrative guidance must be put in writing upon request and administrative guidance issued to multiple persons must be issued in written form.

Use of Advisory Councils: The Government of Japan often relies upon advisory councils ("shingikai"), established by ministries and agencies, to formulate policies and recommendations which give an appearance of objectivity and independence from the bureaucracy, when in fact the members include former bureaucrats, and the councils are essentially expected to endorse policies developed or advocated by the ministry.

Absence of an Information Disclosure Law: To date, Japan has not enacted an information disclosure law, analogous to the U.S. Freedom of Information Law, that would provide foreign firms, as well as the Japanese public, with access to records and other information in the control of governmental entities. (However, based upon a recommendation by the Administrative Reform Council, the Government of Japan is expected to submit information disclosure legislation to the Diet by March 1998.)

Japan Fair Trade Commission's Enforcement Record

Japan

A key reason for the prevalence of anticompetitive business practices is the JFTC's historically weak antitrust enforcement record. The JFTC routinely faces domestic criticism for its lack of bureaucratic clout and reluctance to exercise its enforcement powers aggressively. While there have been some improvements in recent years due to sustained U.S. efforts under the 1989-91 Structural Impediments Initiative, the U.S.-Japan Framework, and annual bilateral antitrust consultations, which have helped the JFTC muster domestic support for its gradual strengthening, the JFTC's enforcement efforts fall far short of those needed to ensure that Japanese markets are open to fair competition from U.S. and other foreign companies.

The JFTC's ability to enforce Japan's fair competition laws is hindered by its historically weak stature among Japanese ministries, shortage of personnel, and perceived lack of autonomy. The JFTC was "upgraded" last year to allow the formation of an administrative general affairs bureau, an economic bureau, investigations bureau, and a new special investigation division to handle major cases. Previously, the JFTC only had departments, which relegated JFTC officials to a lower status relative to ministry officials. However, the JFTC failed to gain approval for the creation of a competition policy bureau and did not achieve the substantial gains it needs in antitrust enforcement personnel. The JFTC currently has a total of about 540 staff personnel, of which about 236 work in the investigation bureau. There are 46 investigators in the special investigation department -- a number too small to handle more than one or two major cases at a time. The United States has actively supported the JFTC and encouraged the commission to continue pressuring Government of Japan leaders for more investigative resources. However, the JFTC has few real allies on budgetary matters, and, in the current tight fiscal environment, JFTC personnel expansion will likely proceed incrementally.

Over the past five years, the JFTC has improved its enforcement performance, but not enough to shed its public image as an ineffective watchdog. For example, after maintaining surcharge orders for cartel practices at very low levels during the 1980s, since 1990, the JFTC has steadily increased its penalties, imposing 6.4 billion yen in surcharges against 741 companies in JFY 1995. However, the JFTC still rarely criminally prosecutes antimonopoly violators -- on average, tackling one case every two years -- and actual imprisonment for antimonopoly violations is unheard of. The JFTC's infrequent use of the AML's criminal provisions undermines deterrence of illegal business practices.

Although the JFTC is nominally an "independent" commission with "independent" enforcement authority, its leaders are often drawn from other ministries, raising doubts about the commission's autonomy. Indeed, the JFTC's chairman and commissioners always include some former senior officials from trade-related ministries -- notably, from the Ministries of Finance, International Trade and Industry, and Foreign Affairs. Historically, the vast majority of JFTC chairmen have been former top career officials of the powerful Finance Ministry. Japanese economic observers agree that as long as these "ex" ministry officials are involved in JFTC decisionmaking, the commission cannot be considered truly "independent." The JFTC's current chairman is a former public prosecutor and ex-official (Ministry of Justice) who has raised some public expectations of a more activist JFTC enforcement role. The United States has yet to see whether a 1996 amendment raising the mandatory retirement age of the JFTC chairman from 65 to 70 will facilitate the candidacy of non-bureaucrats for the top JFTC job, and thus questions about the JFTC's independence remain.

The JFTC itself administers a number of laws and regulations that have an anticompetitive effect or include inappropriate exemptions.

Law Against Unjustified Premiums and Misleading Representations: The JFTC imposes unrealistic limits on the use of premium offers (prizes), and thereby discourages even legitimate cash lotteries and product giveaways used in sales promotions. Foreign newcomers, who depend on innovative sales techniques to market their company names and products, are severely impaired by the JFTC's restrictions on premiums. In addition, the law aims to deter misleading or fraudulent advertising and labeling -- in itself, a worthy policy. However, the JFTC's practice of allowing "fair trade associations" (essentially, private trade associations) to set their own promotion, advertising and labeling standards through self-imposed "fair competition codes" creates difficulties, especially for newcomers who are unfamiliar with local guidelines. Trade associations can and often do use the cover of these codes to set additional standards that are stricter than the JFTC's regulations under the Premiums Law. Indeed, at least 27 such premium codes have been authorized. Recently the JFTC has incrementally liberalized its rules on premiums and other sales promotions, among other steps, by raising the maximum value of "open" cash lotteries (not requiring a purchase) to ten million yen; repealing restrictions on premiums offered by department stores; and eliminating the 50,000 yen ceiling on consumer premiums (while retaining price caps as a percentage of the transaction value). However, these changes fall short of the dramatic liberalization measures requested by the U.S. Government in Framework discussions and in the November 1996 deregulation submission to the Government of Japan.

Resale Price Maintenance (RPM): The Antimonopoly Act exempts resale price maintenance (RPM) in the distribution of selected products, such as cosmetics, pharmaceuticals, and copyrighted products (books, magazines, newspapers, and CDs). There is no reason that retail price maintenance should be treated any differently under the Antimonopoly Act than any other practice. The JFTC has recently announced that it will terminate the RPM exemption for cosmetics and pharmaceuticals and is considering limiting or eliminating the RPM exemption for copyrighted products.

International Contract Notification: Under the Antimonopoly Act, the JFTC is authorized to screen certain notifiable international contracts -- such as joint ventures involving foreigners -- and to prohibit specific contracts that, in the JFTC's judgment, might cause unreasonable restraints on trade or involve the use of unfair trade practices. Any Japanese entrepreneur who enters into an international contract that is notifiable under JFTC rules must file with the commission within 30 days of concluding such an agreement. Recognizing that this practice needlessly burdens business operators, the JFTC has pledged to submit draft legislation by the end of March 1997 calling for, in principle, the elimination of the current notification system.

Abolition of Cartels: The JFTC's planned elimination of 33 antitrust-exempted cartels by the end of JFY 1998 is a positive step, but most of the under-used cartels targeted for abolition -- such as the price cartel for cultured pearls and silk cocoons -- will not significantly affect U.S. trade interests. Some mainly Japanese firms will benefit from the abolition of cartels in coastal shipping and import/export enterprises. However, these measures do not address more important U.S. concerns, such as Japan's monopolistic port practices by the Japan Harbor Transport Association. The JFTC should implement additional deregulation measures to remedy these serious problems.

Japan

OTHER BARRIERS

Aerospace

The Government of Japan offers Japanese firms incentives, such as interest rate subsidies and preferential loans, for aircraft and engine development. Policy and regulations allow MITI to nurture the Japanese aerospace industry by importing, developing, and distributing new technology and by apportioning work among Japanese manufacturers. Despite the focus on development, long term prospects for Japan's aerospace industry are far from certain. Nonetheless, Japan has become a major supplier to foreign aircraft assemblers by supplying fuselage sections for large civil aircraft.

The lack of a dynamic general aviation (i.e., neither airline nor government) industry in Japan severely restricts development of aviation-related infrastructure and the purchase of business or general aviation aircraft. Sales of U.S. business jets, light aircraft, air traffic technology and equipment, airport-use equipment, and services remain far below that generally expected in a nation with an economy as developed as Japan's. Japanese demand for helicopters is also stifled by restrictive flight rules and lack of heliports.

U.S. manufacturers of business jets have reported that the limited landing slots for business aircraft at airports near Tokyo have inhibited the use and sales of these aircraft to both Japanese and foreign businesses. In 1996, two additional slots per day at Tokyo's Narita airport were made available to business jets. Reports from operators indicate that the system operates more smoothly now, but that additional access is still needed.

Motor Vehicles

Japan's domestic motor vehicle sales were approximately 7.08 million units in 1996, valued at about 13.5 trillion yen. Imported motor vehicle sales reached a record 427,525 units in 1996, up 10.2 percent from 1995. The sales growth in 1996 is due in large part to the sustained sales and marketing efforts of U.S. and other foreign auto makers which has led to the increasing acceptance of their products by Japanese consumers.

Although sales of imported motor vehicles have increased four years in a row and set records during the last three years, import penetration is still only six percent of total sales, far below the level of other industrialized nations. Sales of U.S.-made motor vehicles were 147,683 units in 1996, or 2.1 percent of the market. If vehicles produced by the U.S. subsidiaries of the Japanese auto makers are subtracted, import penetration decreases to 1.1 percent. Sales in Japan of Big Three vehicles originating in North America were only 78,105 units. Since announcement of the auto agreement in August 1995, the Big Three auto makers have obtained 113 (as of February 21, 1997) new sales outlets, up from 19 new sales outlets they had obtained a year ago, but far below the industry’s expectation of obtaining 200 new sales outlets by the end of 1996. U.S. Big Three auto makers began selling several new right hand drive cars and recreation vehicles in Japan in 1996 and several more right hand drive products are scheduled to go on sale in Japan during 1997. At the same time, the Big Three are following through with major investments in expanded distribution networks and research facilities in Japan.

U.S. access to the motor vehicle market is restricted primarily through Japanese auto manufacturers' informal control over dealer networks. In many respects, dealers function as captive distributors of vehicle manufacturers rather than independent businesses. This system tends to keep dealers marginally profitable and highly dependent on a single manufacturer. Improving foreign access to Japan's auto dealer network will remain a high priority in the monitoring of the agreement.

Automotive Parts: In 1996, Japan's automotive parts market was valued at an estimated $140 billion; of which aftermarket parts accounted for an estimated $65 billion. The U.S. share of the total Japanese parts market was estimated to have been less than 1.5 percent, while U.S. parts makers sales to aftermarket repair were well under 0.5 percent.

The reason for the small presence of foreign parts sales in Japan is that close Japanese intercorporate relationships make it difficult for foreign automotive parts suppliers to compete with Japanese-owned suppliers for original equipment (OE) sales to Japanese motor vehicle makers. On the aftermarket side, complex, strict, and often nontransparent regulations governing vehicle inspections, modifications and repairs continue to limit foreign suppliers' access to this segment of the market. These regulations encourage consumers to have their vehicles repaired at auto dealerships or other designated/certified garages that use almost exclusively Japanese origin, or "genuine," replacement parts. Because parts distributors, wholesalers, and jobbers seldom stock non-OE parts, even the independent garages have no choice but to use genuine parts. Parts price surveys have shown that these OE parts can cost three times as much as similar parts sold in the United States, creating windfall profits for OE parts suppliers at an enormous cost to Japanese consumers.

Regulations limiting where and by whom repairs may be made further restrict creation of a competitive, independent parts aftermarket. For example, parts deemed essential to vehicle safety ("critical parts") cannot be replaced without inspection by a Ministry of Transport (MOT) Land Office official, unless repairs are done at a certified garage. A noncertified garage cannot perform any safety related repairs. Consumers may replace critical parts themselves, but must then take the vehicle to a MOT Land Office for a time consuming inspection.

These regulations create strong incentives for consumers to use only dealerships or other designated garages, simply for convenience's sake. These garages depend heavily on vehicle manufacturers and their OE suppliers for their business and, as a rule, do not use foreign aftermarket parts. In addition, in order to sell to the manufacturer or its distribution channel, a foreign supplier must be accepted by each Japanese vehicle manufacturer as a potential supplier for a given vehicle model, and then must go through an expensive and lengthy approval process.

Market Opening Negotiations: In 1993, the United States and Japan agreed to include motor vehicles and parts under the Framework talks. In August 1995, after nearly two years of intensive negotiations, the United States and Japan signed a market opening agreement with the following provisions under which the Japanese Government:

- and industry will help develop dealer networks in Japan by promoting business connections among dealers and manufacturers, by publicly informing dealers of their options to distribute more than

the manufacturer's product, and by establishing key contacts in both government and industry for problem resolution.

- will conduct a study to see if any "critical parts" could be eliminated from the disassembly repair, and establish a procedure to allow requests to eliminate additional parts from the disassembly repair regulations.

- will relax regulations for the number of mechanics, amount of floor space, and machinery and tool requirements for certified garages.

- will authorize more than one certified garage to pool resources in order to perform repairs for required vehicle inspections and allow a new type of garage, called a "specialized certified" garage, to perform repairs on one or more systems, such as brakes or transmissions, without having to meet the costly requirements for repairing the entire vehicle.

- no longer will require a MOT inspection for a minor modification on a vehicle.

- will deregulate 23 standards and certification barriers and streamline the type design system.

- will allow equal access to data registration information which will allow U.S. vehicle makers to analyze competitors' customer bases and, thus, target their marketing efforts.

Government of Japan and Industry Actions Since Signing of Agreement: As a result of the automotive agreement with Japan, in the fall of 1995 MOT eliminated most restrictions on minor modification of vehicles (for example, the addition of side mirrors, air dams, etc.), and eliminated four parts from the "critical parts lists" (shock absorbers, struts, power steering equipment, and trailer hitches). It also issued regulations decreasing the amount of floor space, the number of tools, and the number of mechanics required for certified garages. MOT undertook a year long study of further deregulation of "critical parts," as specified by the agreement. In August 1996, MOT removed from the "critical parts" list four additional categories of parts: stabilizers, torque rods, torsion bar springs, and clutches for motorcycles, but did not revise the overall regulation.

The regulation by MOT of critical parts items such as brake parts constitutes an important barrier to the sale of American auto parts in Japan. Deregulation of these critical parts will be very important for expanded participation of American suppliers in the Japanese aftermarket. For this reason, the four major U.S. parts associations (Automotive Parts and Accessories Association, Automotive Service Industry Association, Motor and Equipment Manufacturers Association, and Specialty and Equipment Market Association) filed a petition January 6, 1997, to have brake parts removed from the disassembly repair regulations (i.e., the "critical parts list"). MOT denied the petition on February 5, citing safety considerations as the principal reason.

Equally significant to American auto parts suppliers will be the conditions under which the Japanese garage system is opened to independent participation. By limiting the ability to conduct compulsory inspections

to garages that are closely linked to Japanese automobile manufacturers, MOT regulations have been an important deterrent to foreign participation in the huge Japanese replacement parts market.

MOT took a potentially important step towards liberalization with the February 20 announcement of regulations permitting the new special garages called for in the auto agreement. MOT will now allow garages, called Specialized Certified Garages, to perform repairs on one or more of the seven "critical parts" assemblies (brake systems, transmissions, engines, etc.). Prior to this announcement, a certified garage had to have the capability of fixing a vehicle bumper-to-bumper -- and only a fully certified garage could fix any of the critical parts.

To facilitate this, MOT has reduced space and tool requirements and tailored these to specific needs of each of the seven new types of specialized garage. For example, a fully certified garage is required to have 72 square meters of floor space and 30 necessary machines and tools. A specialized certified brake shop will now need only 53 meters and 16 tools. These reductions will make it easier and cheaper for small independent garages (who will have an incentive to seek competitively priced parts) to enter into one or more of the specialty repair markets.

The new regulations also created Special Designated Garages, which will make it possible for repairs related to the periodic *shaken* inspections to be performed at smaller certified garages that have not earned the rating of "designated" certified garages. Prior to this announcement, *shaken* repairs made at certified garages had to be taken to MOT for time-consuming inspections, while those made at designated garages (mostly dealerships) could be self inspected by the garage. Now, a group of independent local certified garages can pool resources and form a joint inspection facility that can perform *shaken* inspections.

The auto agreement has been, and will continue to be, closely monitored by an interagency team headed by Commerce and USTR. The team has issued two semiannual reports on progress achieved under the agreement. The first annual consultation on the agreement was held in San Francisco in September 1996, and was attended by observers from the EU, Canada, and Australia.

Progress in opening the Japanese automotive market has generally been good. As a result of the agreement, significant inroads have been made in deregulating the parts aftermarket and increasing access to the vehicle distribution system in Japan. These structural changes have resulted in increased sales of U.S.-made vehicles and U.S.-made parts, particularly those that have been directly deregulated.

Much more, however, needs to be done to fully open the Japanese market to competitive U.S. and other foreign automotive vehicle and parts manufacturers. The U.S. Government has expressed disappointment in the slow pace of progress in three key areas: the reluctance of existing Japanese dealers to sign franchise agreements with U.S. automakers, the lack of additional progress in eliminating high market value components from the "critical parts list," and a slowing in the rate of increase in the purchases of U.S.-made parts by the Japanese automakers. Progress in these areas will provide important indications of the commitment of the Government of Japan to an open and competitive automotive market.

Civil Aviation

Japan

In 1995, roughly 13 million passengers traveled by air between the United States and Japan. U.S. airlines carried almost two-thirds of them. U.S. carriers also are highly competitive in the cargo sector, holding a market share of about 55 percent. With nearly 40 percent of U.S. exports to Japan moving by air, Japan is by far the largest air freight market for U.S. carriers. A 1996 private study estimated that the U.S. economy could gain $100 billion in new economic activity, over 2,000 jobs, and nearly $20 billion in trade receipts under a more liberalized civil aviation agreement.

For many years, Japan has maintained that U.S. carriers carry an excessive amount of Asia traffic. Japan claims that the 1952 agreement is outdated and unbalanced in favor of the United States because there are three “incumbent” U.S. carriers (Northwest, United, and Federal Express) serving Japan with broad rights to fly passenger and cargo routes, while Japan has only one such carrier (Japan Air Lines). The United States strongly disagrees with this argument.

In July 1995, the United States and Japan agreed to begin all-cargo negotiations to liberalize air cargo transport and expand opportunities for both countries. In March 1996, an agreement was reached which created significant new commercial opportunities in the cargo sector. United Parcel Service (UPS) can now serve Osaka's Kansai International Airport with 12 additional flights a week; six of those have "beyond" rights. Another U.S. all-cargo carrier (Polar Air) has been designated to serve Japan for the first time, and Northwest, United, and Federal Express gained new operational flexibility and the right to serve three additional Japanese airports. Japanese carriers obtained comparable opportunities to serve new U.S. destinations and new operating flexibility, and a new Japanese all-cargo carrier (not yet designated by Japan) has the right to fly to the United States.

The Japanese Government advocates restraining the growth of U.S. carriers' services, both in the bilateral market and "beyond" Japan, while gaining expanded rights for Japanese carriers to and beyond the United States. In an apparent effort to pressure the United States into a revision of the 1952 agreement, Japan periodically refuses to grant rights to U.S. carriers that the United States believes are authorized in the agreement. In mid-1996, Japan declined to approve certain new routes for Federal Express that included beyond rights to the Philippines and Indonesia. Requests to start Northwest and United service from Osaka to Jakarta have not been approved. In response, the Department of Transportation proposed to restrict certain all-cargo service by Japan Air Lines. In turn, Japan threatened to block Federal Express and Northwest from flying U.S. cargos via Japan to several Asian destinations, including the Philippines and Singapore.

This potential cycle of sanctions-counter sanctions was put on hold when President Clinton and Prime Minister Hashimoto met at the Manila APEC summit in November and authorized the start of high-level civil aviation discussions in early 1997 to explore prospects for comprehensive passenger negotiations. The President has called upon Japan to negotiate an "open skies" agreement which would provide full and equal opportunities for Japanese and U.S. passenger and cargo carriers to compete in each other's markets. High-level meetings took place in Tokyo in January 1997 and in Washington in March 1997.

Deregulation

Japan's recent government deregulation efforts notwithstanding, the Japanese economy remains clogged with excessive and often outdated regulations, which constrain economic growth and contribute to trade frictions by impeding imports, limiting foreign investment opportunities, raising business costs, and hampering employment mobility and business formation.

As established by the 1993 U.S.-Japan Framework, the bilateral Deregulation and Competition Policy Working Group holds consultations on deregulation, competition policy, and administrative reform issues. Since 1994, the focus of this group has been Japan's efforts to formulate and implement a three-year Deregulation Action Plan which will conclude in 1997. Each year the United States has submitted extensive recommendations to the Japanese Government for consideration in that process.

The United States continues to press Japan to implement meaningful deregulation and to emphasize that deregulation must be regarded as a dynamic process if it is to be responsive to changing circumstances. Combined with stronger antitrust enforcement and administrative reforms to increase the transparency and objectivity of regulatory regimes, effective deregulation in Japan will enhance competition and provide greater market access for foreign goods, services and investment. The enhanced economic efficiencies and competition that deregulation would bring will, over the long run, benefit the Japanese economy as a whole by lowering production, distribution, and retail costs; strengthening industrial competitiveness; and expanding product and service choices in the marketplace.

The Government of Japan issued the second revision of its Deregulation Action Plan in March 1996 which included significant deregulation measures in housing, financial services, and telecommunications. Included in the revision was a housing promotion initiative that will change building and building material regulations that limit market access for U.S. construction products and services, further opening of the private pension fund market to foreign investment advisory companies, liberalization of foreign exchange controls, and some relaxation of the Ministry of Posts and Telecommunications' control over telecommunications market entry and introduction of pro-competition interconnection rules. However, the revised 1996 Deregulation Action Plan failed to address adequately many issues, including: competition policy, distribution, transportation, legal services, labor, and administrative reform.

Over the past two years, an increasing number of Japanese and other foreign government and business organizations have spoken out in favor of deregulation. In 1996, the Japanese Economic Planning Agency (EPA) issued two reports that underscored the need for deregulation: (1) a January report which estimated that failure to deregulate costs Japan about 1.25 percentage points in real economic growth per year; and (2) a September 1996 report which concluded that the economic impact of deregulation in major industries -- such as distribution and telecommunications -- has equaled, on average, 1.69 percent of Japan's annual GDP over the last five years, with over one million new jobs created. In addition, the Economic Council, an advisory council to the EPA, issued a report in December 1996 that emphasized the need for structural reform in six major areas: advanced telecommunications, physical distribution, financial system, land and housing, employment and labor, and medical care and welfare.

Japan

In November 1996, Prime Minister Hashimoto publicly announced his commitment to implement a "Big Bang" liberalization initiative of the financial services sector to revitalize Tokyo financial markets through dramatic deregulation and structural reform.

In December 1996, the government Administrative Reform Council (ARC) issued policy recommendations for inclusion in the second and final revision of the Three-year Deregulation Action Plan. The ARC proposed useful measures in 13 areas including financial services -- an area where deregulation has gained momentum recently due to the Prime Minister's "Big Bang" initiative, Government of Japan commitments made under the U.S.-Japan Financial Services Agreement, and domestic pressures for change.

Despite these calls for reform, opposition to specific deregulation proposals remains strong among vested interests in Japan. In particular, Japanese regulators are often reluctant to relinquish their discretionary authority over formal and informal rules. While many Japanese businessmen perceive that over-regulation impedes the critical changes necessary to adapt Japanese business to the demands of international competition, some are unwilling to challenge the status quo.

In January 1997, Japanese ministries issued their interim reports on how they planned to address the numerous proposals they had received from the United States, the EU, and other countries, as well as business groups. Other than areas such as telecommunications and housing which showed promise, most of the interim reports were disappointing. While the United States has been encouraged by Prime Minister Hashimoto's strong statements of support for deregulation, competition policy, and administrative reform, the United States continues to believe that deregulation must remain a priority until meaningful deregulation becomes a reality.

Distribution

Japan's highly regulated, inefficient distribution system is widely recognized as a significant trade and investment barrier. In its November 1996 "Submission by the Government of the United States to the Government of Japan regarding Deregulation, Administrative Reform and Competition Policy in Japan," the United States requested the implementation of significant deregulation measures to address key distribution problems faced by foreign firms. Among other items, the United States asked that Japan:

- liberalize entry into the warehousing industry to reduce shortages of storage space, reduce costs, and minimize burdens for foreign firms related to the distribution of their products;

- eliminate the Large Stores Law by JFY 2000, including all adjustment provisions concerning store approval, floor space reductions, closing days, and hours of operation; and

- review all laws and regulations affecting distribution services in Japan, with the goal of eliminating all regulatory barriers which impede the approval, construction, licensing, and business operations of retail establishments.

Large Stores Law: The Large Stores Law continues to challenge foreign investors and exporters by limiting the establishment, expansion, and business operations of large stores in Japan which are most likely to serve

as distributors of imported products. Large retailers, both domestic and foreign, continue to face serious problems advancing into the market. Under the Large Stores Law, Japanese consumers also lose. By impeding the business operations of large stores, the law reduces productivity in merchandise retailing, raises costs, discourages new domestic capital investment and ultimately decreases the selection and quality of goods and services.

In June 1996, as part of its consumer photographic film and paper dispute, the United States requested bilateral consultations at the WTO under the General Agreement on Trade in Services (GATS) on the Large Stores Law and other Japanese retail laws which constitute a barrier to foreign suppliers and to Japanese importers and distributors of foreign consumer products. The United States is now examining Japan's responses to these consultations, which were held on November 7-8, 1996, and is considering next steps. (See section below on consumer photographic film and paper.)

Electrical Utility Companies' Procurement

Japan's electric utilities are among the largest and most profitable companies in Japan. Although private sector enterprises, the ten generating companies enjoy regional monopolies in their service areas and are regulated closely by MITI's Natural Resources and Energy Agency in accordance with the Electric Utilities Industry Law. The MITI administered electricity rates have virtually guaranteed profits despite the utilities' very heavy capital investment programs (the industry accounts for about ten percent of Japan's total industrial investment). A number of the larger utilities are periodically ranked by the financial press as among the most profitable companies in Japan, a glaring contradiction for a regulated public service monopoly.

Japan is said to have the most expensive electric power of any industrialized nation. The high cost of electricity is of obvious concern to a nation like Japan, which relies so heavily on exports of electricity-intensive manufactured goods. This has motivated the MITI Minister recently to call for a 20 percent reduction in electricity rates within the next five years. This also was one of the concerns which prompted revision of the Electric Utilities Industry Law, effective December 1995, to introduce a limited degree of competition into the industry, including the establishment of a framework for independent power producers (IPPs). As a result, 3,047 megawatts of annual supply was secured by six utilities in the first round of bidding (1996). Although the IPPs will only be permitted to sell to the utilities handling their respective service areas, the bids by prospective IPPs to date suggest that these newcomers are prepared to produce electricity at markedly lower rates than the "avoided costs" indicated by the utilities as ceiling prices for bids. This in turn should increase the already formidable pressure on the utilities to cut power costs. In order to cut costs, however, the utilities need to introduce real competition in to their non-fuel procurement practices. The introduction of substantial and varied foreign products would provide real cost saving and drive down the prices of domestically produced equipment and materials through greater competition. To date, efforts by utility companies have varied across Japan, with some utilities making notable progress and others lagging behind.

In recent years, the annual non-fuel procurement requirements of the Japanese electric power utility industry have totaled around $25 billion. Purchases from foreign suppliers comprise only a small fraction of this enormous market, despite the fact that many overseas firms can offer high quality goods and services

at very competitive prices. Barriers which foreign suppliers face in doing business with the utilities include the following:

- Expensive and time consuming procedures to become a designated supplier to a given utility, and a lack of standardization among the utilities, which requires prospective vendors to repeat the process for each utility to which they wish to market;
- Lack of uniform technical standards and specifications among the utilities;
- Lack of harmonization between MITI technical standards and international standards; and
- A bias against the introduction of foreign products, which discourages initiatives to seek lower priced foreign goods.

In addition to addressing the foregoing problems, the following measures should be taken to improve the openness and transparency of utility company procurement and increase imports:

- Sharply increase the number of foreign companies on the product category lists from which utilities solicit estimates under the "competitive cost estimates method" (“kyoso mitsumori hoshiki”);
- Increase the proportion of procurements using the “competitive cost estimates method;”
- Minimize the number of documents required from new suppliers to apply for type approval or registration;
- Shorten the time required for type approval of equipment; and
- Increase procurements of non-power related foreign goods and services.

In July 1995, the Japanese utility industry took a positive step toward international cooperation by agreeing to participate with U.S. suppliers in the New Orleans Association (NOA), a forum for U.S. suppliers of power generation, transmission, and distribution equipment to promote awareness of their products among Japanese utilities while also learning about the procurement procedures and business practices of the latter. NOA has held a number of meetings and is being watched with interest.

Despite several encouraging procurements by individual utilities, the percentage of overseas procurement by Japan’s power companies remains low. While some companies have set up large integrated procurement divisions which actively seek foreign products, others lag far behind in this regard. American and other foreign products are sweeping other electrical equipment markets in Asia and demand is increasing throughout the region. Japan remains the most notable exception where foreign market share remains low. Middle market goods can be shipped in bulk for just in time delivery to Japanese utilities at competitive prices. Many of the goods need little or no after sale service and could be easily integrated into the utilities procurement systems. But unreasonable and unnecessary products specifications often pose barriers to these products. Japanese utilities have advertised that they are searching the world for competitively priced

products but knowledge of the middle market in the United States and other foreign countries is minimal and real initiatives to seek out such cost-cutting products are lacking.

This is the fourth year that utility company procurement has been identified as posing significant barriers to American goods and services. While some progress has been made, there is no question that Japanese utility companies could go further. The United States will continue to maintain strong interest in individual utilities' efforts to achieve fair and open access, and will evaluate progress in providing real opportunities to foreign suppliers.

Flat Glass

Japan's $4.5 billion flat glass market, the second largest in the world, is an oligopoly dominated by three manufacturers: Asahi Glass, which controls about 50 percent of the market; Nippon Sheet Glass, which controls about 30 percent; and Central Glass, with about 20 percent. Foreign suppliers accounted for only approximately 3 percent of the Japanese market (by value) in 1994 and 5 percent in the first half of 1995.

With few exceptions, wholesalers and distributors in Japan have represented only one Japanese glass manufacturer, thereby significantly restricting competition. Japanese flat glass makers also have controlled many of the 15,000 retail glass stores in Japan. By controlling the distribution system, Japanese manufacturers have been able to limit the use of imported glass throughout Japan.

In January 1995, the United States and Japan signed an agreement to open the Japanese flat glass market to foreign suppliers. Pursuant to the agreement, Japanese glass distributors publicly stated that they will diversify supply sources to include competitive foreign glass suppliers and that they will not discriminate among suppliers based on capital affiliation. Japanese glass makers also voiced support for diversifying their *de facto* exclusive distribution networks. The Government of Japan committed to promote increased competition in glass procurement for construction projects based on nondiscriminatory technical and performance specifications and competitive commercial terms.

The agreement includes qualitative and quantitative criteria for measuring progress. The United States is monitoring implementation of all phases of the agreement, especially to ensure that Japanese distributors begin to procure glass from several different manufacturers. Consultations to assess implementation of the agreement are held at six month intervals. The two governments conducted the first review of the glass agreement in the fall of 1995 and the first annual review in April 1996.

Although trade statistics for 1995 showed a small increase in imports, updates from industry suggest 1996 sales were weak. The Government of Japan is gathering new survey data on recent trends in the flat glass market. This data will be considered in March at a government-to-government review. The data also will be reviewed by the private sector as part of an ongoing industry-to-industry dialogue conducted under the auspices of the U.S.-Japan Business Council. The United States strongly supports this private sector dialogue as a forum for addressing issues that arise under the agreement.

Much more remains to be done to open the Japanese retail/wholesale distribution system to competitive foreign glass products; improve access for U.S. glass products such as mirrors and automotive glass; and

promote the use of energy efficient insulating glass, where foreign glass companies have a strong competitive advantage. The U.S. Government hopes to see an increase in foreign suppliers' market shares and looks to the Government of Japan to continue its efforts to open further the retail/wholesale distribution system. Access to public sector procurement in Japan is also a key part of the agreement, which the U.S. Government is monitoring closely.

Paper and Paper Products

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

There has been no meaningful increase in Japanese imports of paper products. In 1995 the U.S. share of the Japanese paper market stood at 1.8 percent, only one-tenth of one percent higher than in 1991, the year before the agreement was concluded. Japan's paper and paperboard imports from all sources accounted for just 4.2 percent of the country's consumption in 1995, only slightly higher than the 1991 total import share of 3.7 percent and the 1994 total import share of 3.9 percent. This is still the smallest such ratio of any major industrialized country.

While the agreement has failed to produce anticipated results, U.S. paper companies point to some areas where it has led to improved market access. The paper agreement has led to virtual elimination of the practice of "post-purchase price adjustment," and has made industry selling practices more transparent. U.S. industry believes the agreement also provided useful political cover to Japanese customers inclined to purchase imported paper, but fearful of retaliation from Japanese suppliers.

The U.S. Government and the Government of Japan continue to hold semi-annual reviews of the implementation of the agreement. At the eight, and final, review meeting, in March 1997, the U.S. Government stated that the agreement had not addressed the agreed-upon goal of substantially increasing market access for foreign paper, and stated that further efforts would be needed. The lack of progress in this sector prompted the U.S. Government to list market access for paper and paper products as a practice that may warrant future identification as a "priority" foreign country practice under the provisions of "Super 301" for the third consecutive year in September 1996.

Consumer Photographic Film and Paper

Foreign film manufacturers face a variety of barriers that restrict access and sale of foreign-produced photographic film and paper in the Japanese market, the second largest film market in the world. These include barriers that prevent foreign firms from obtaining adequate access to the Japanese film distribution network and retail outlets.

On July 2, 1995, in response to a petition by Eastman Kodak, the USTR initiated an investigation under Section 302(a) of the 1988 Trade Act of barriers to access to the Japanese market for consumer photographic film and paper. At that time, the United States requested bilateral consultations with the Government of Japan. Consultations were held in October 1995, but failed to resolve the issue.

On June 13, 1996, after an extensive investigation which included careful examination of voluminous evidence submitted by interested parties and an independent inquiry by the U.S. Government, and in the absence of rebuttal from the Government of Japan, USTR made a determination of unreasonable practices by the Government of Japan with respect to the sale and distribution of consumer photographic materials in Japan. The investigation showed that the Government of Japan built, supported, and tolerated a market structure that impedes U.S. exports of consumer photographic materials to Japan, and in which practices occur that also impede U.S. exports of these products to Japan, thereby denying fair and equitable market opportunities.

The USTR also concluded that Japanese Government liberalization countermeasures, including measures to restructure the distribution system for photographic products, as well as the Premiums Law, and the Large Stores Law and related measures, appear to contravene Japan's WTO obligations, and nullify or impair benefits accruing to the United States under the WTO Agreements. Therefore, the United States made three separate requests for consultations under WTO auspices on the broad range of market access barriers in the consumer photographic materials sector in Japan. These included consultations under: (1) the General Agreement on Tariffs and Trade (GATT), (2) the General Agreement on Trade in Services, and (3) a GATT contracting parties' decision on restrictive business practices.

The first set of consultations was held on July 10-11, 1996, and addressed GATT violations and nullification and impairment of GATT benefits. When those consultations failed to resolve the issue, the U.S. Government formally requested the formation of a WTO panel to hear the U.S. complaint. The panel was established at the October 16, 1996, meeting of the WTO Dispute Settlement Body. The European Union and Mexico requested to join as third parties to the case.

On February 20, 1997, the United States submitted its opening brief to the WTO dispute settlement panel. The submission describes the extensive array of measures put in place by the Government of Japan over the past 30 years to offset the effects of tariff, import, and foreign investment liberalization and limit the sale of imported consumer photographic film and paper in the Japanese market. Beginning with the Kennedy Round and continuing to the present, Japan has imposed laws, regulations, and administrative actions to strengthen the dominant position of domestic consumer photographic material manufacturers and curtail opportunities for imports that otherwise should have been available. Through these "liberalization countermeasures," Japan deliberately restructured its market to discriminate against imports and systematically nullified and impaired benefits that trading partners expected from Japan's tariff concessions while discriminating against imported photographic film and paper.

Distribution Countermeasures: Japan's Ministry of International Trade and Industry (MITI) consolidated wholesale operations in the photographic materials sector, changing what formerly had been a dynamic and open system to one with narrow distribution channels under the control of domestic manufacturers. As a

result of these Japanese Government measures, less than three percent of film that flows through Japanese wholesale channels is foreign.

Restrictions on Large Retail Stores: In addition to denying foreign manufacturers of photographic film and paper access to the primary distribution network, Japan has restricted the next best available alternative: large retail stores. Whereas wholesalers are needed to reach Japan's multitude of photospecialty retailers, large retail stores have sufficient economies of scale to make direct-to-retail sales efficient. Moreover, the greater amount of shelf space in large stores increases the likelihood that imports will be displayed beside domestic brands. Japan, however, has established a highly restrictive regulatory system limiting the expansion and operation of large retail stores.

Promotion Countermeasures: Japan has reinforced the foregoing measures affecting wholesalers and retailers by limiting the extent to which foreign producers might rely upon their marketing strength to promote sales through the use of economic inducements, or "premiums," and other marketing techniques. Such promotions stimulate demand for products and thereby serve as incentives for wholesalers and retailers to carry them. Japan adopted a series of "promotion countermeasures" restricting the ability of suppliers to use certain discounts, coupons, lotteries, give-aways or other economic incentives, and particular representations in advertising, especially where price or price discounts are discussed.

The panel will hear the first round of arguments on April 16, after both the United States and Japan have submitted their opening briefs. The final panel report is due in October 1997.

On November 7-8, 1996, the United States held consultations with Japan on possible violations of the GATS arising from the Large Stores Law and related measures. The United States is examining Japanese Government responses to questions it raised during the consultations and considering next steps.

The United States also requested consultations pursuant to the GATT contracting parties' "Decision on Restrictive Business Practices: Arrangements for Consultations" to discuss with the Government of Japan significant evidence of anticompetitive activities in the Japanese photographic materials sector, and to ask it to take appropriate action. The Japanese Government has refused the U.S. request unless the United States agrees to consult on alleged restrictive business practices in the U.S. photographic materials market. The United States has made it clear that such linkage is contrary to longstanding GATT principles and therefore is unacceptable. The European Union requested to join in these consultations on July 5, 1996, and the United States accepted this request on August 15, 1996.

Japan's photographic film and paper market is valued at about $4.0 billion per year. The leading U.S. producer, Eastman Kodak Company, estimates that the barriers in this market have cost it at least $5.6 billion in lost revenues since 1975.

Semiconductors

On August 2, 1996, the United States and Japan announced new measures to replace the 1991 semiconductor arrangement, which expired on July 31, 1996. The new measures, like the preceding 1991 and 1986 semiconductor arrangements, were negotiated to address persistent problems of market access

for U.S. manufacturers of semiconductors. The new measures represent an innovative, four-dimensional approach to a sector in which market access is promoted not only through government-level discussion, but through concrete industry-level discussion.

The cornerstone is a new industry-to-industry agreement under which industries have established a "Semiconductor Council" to promote cooperative activities, discuss market access concerns, and expand international cooperation. Included within its scope are both a continuation of existing user/supplier cooperative activities as well as new supplier/supplier cooperative activities in such areas as standards, intellectual property, environmental and safety issues, market development, and trade and investment liberalization. Industry experts also will collect and analyze data on the situation and outlook for the market and report this quarterly to governments. The intention is to provide a complete picture of the market situation in the Japanese and other key markets. Industry organizations may join the Council if the countries where they are headquartered have either eliminated tariffs, committed to eliminate tariffs expeditiously, or suspended tariffs pending their formal elimination.

Second, the measures, through a bilateral government statement, establish a multilateral government consultative mechanism, essentially to oversee and interact with the Semiconductor Council. Governments whose industries have joined the Council may participate in these consultations. Such consultations will occur at least once per year for the purpose of reviewing the reports prepared by industry, the cooperative activities of the Council, and market trends and developments in Japan and other major markets.

Third, the measures, also through the bilateral government statement, establish the "Global Governmental Forum" (GGF). Governments of all major semiconductor-producing countries are invited to participate without precondition. This multilateral forum also will meet at least once per year to discuss policy issues of interest to the semiconductor industry, including: trade and investment liberalization, legal regimes, environmental issues, worker health and safety, standardization, intellectual property rights, approaches to basic scientific research, and promotion of the information society.

Fourth, in December 1996, the Semiconductor Industry Association (SIA) and the Electronics Industries Association of Japan (EIAJ) announced an industry-level agreement on antidumping consistent with the August 2 industry agreement and government statement reaffirming the need to avoid injurious dumping through effective and expeditious antidumping measures consistent with the GATT and WTO Antidumping Agreement. Individual semiconductor producing companies will continue to collect and maintain specified data on a voluntary basis which can be produced in an antidumping investigation on an expedited basis.

The first meeting of the Global Governmental Forum was held in Tokyo on December 16, 1996, with the Governments of Japan, the United States, the European Union (represented by European Commission) and the Republic of Korea participating. The United States will host the next session in the latter half of 1997. Industry is planning to hold the first Semiconductor Council meeting in April 1997, and is planning for one user-supplier symposia in the spring in telecommunications and emerging applications. While Japanese industry has committed under the new agreement to continue the cooperative activities that existed under the 1991 agreement, it has not yet agreed to a full schedule of activities. The Administration is concerned about Japanese industry's commitment to sustain the level of cooperation attained under the previous

agreement, and will be working closely with U.S. industry and the Japanese Government to ensure that the commitments made in the new semiconductor agreement are fully and successfully implemented.

Progress under the 1991 agreement was limited in its first year, with foreign market share stalled at around 16 percent through September 1992. However, in the fourth quarter of 1992, foreign market share jumped to 20.2 percent. Due to the concerted efforts made by all parties to the agreement, foreign market share reached an average 22.4 percent market share in 1994, a 25.4 percent market share in 1995, and 26.8 percent market share in January-September 1996.

Sea Transport and Freight

American carriers serving Japanese ports encounter a highly restrictive, inefficient and discriminatory system of port services. The Japan Harbor Transport Association (JHTA), a trade association of stevedoring companies, uses a system of "prior consultations" (the requirement that carriers submit to the JHTA 60 days in advance notification of any new request or change in operational plans) to control competition, allocate harbor work among JHTA member stevedores and terminal operators, and frustrate the implementation of any cost-cutting by carriers. Other restrictive JHTA practices include the mandatory weighing and measuring of cargo regardless of commercial necessity and restrictions on the provision of harbor work on Sundays. The MOT protects the JHTA's position by refusing to license new entrants into port service businesses and by supporting the requirement that lines submit their plans to JHTA to prior consultation.

On November 6, 1996, the Federal Maritime Commission (FMC) proposed sanctions against Japanese ocean freight operators in response to restrictions and requirements on the use of Japanese ports. The FMC determined that the Government of Japan appears to be discriminating against U.S. carriers by refusing to issue licenses to non-Japanese companies to perform stevedoring or terminal operating services. The FMC also determined that the Government of Japan through its licensing and support of the prior consultation system appears to protect the Japan Harbor Transport Association. Effective April 14, 1997, if the issue is not resolved prior to that date, the FMC announced sanctions of $100,000 each time a liner vessel owned or operated by Mitsui-OSK Line, Nippon Yusen Kaisha (NYK Line), and Kawasaki Kisen Kaisha (K Line) entered the United States from abroad. Government-to-government discussions on the prior consultation system were held in Washington D.C. in early 1997, with no resolution.