

JAPAN

TRADE SUMMARY

The U.S. goods trade deficit with Japan was \$62.6 billion in 2011, up \$2.6 billion from 2010. U.S. goods exports in 2011 were \$66.2 billion, up 9.4 percent from the previous year. Corresponding U.S. imports from Japan were \$128.8 billion, up 6.9 percent. Japan is currently the 4th largest export market for U.S. goods.

U.S. exports of private commercial services (*i.e.*, excluding military and government) to Japan were \$44.8 billion in 2010 (latest data available), and U.S. imports were \$23.5 billion. Sales of services in Japan by majority U.S.-owned affiliates were \$65.6 billion in 2009 (latest data available), while sales of services in the United States by majority Japan-owned firms were \$87.1 billion.

The stock of U.S. foreign direct investment (FDI) in Japan was \$113.3 billion in 2010 (latest data available), up from \$96.0 billion in 2009. U.S. FDI in Japan is mostly in the finance/insurance, manufacturing, nonbank holding companies, and wholesale sectors.

OVERVIEW

The U.S. Government continues close engagement with the Japanese government to urge the removal of a range of trade barriers. This engagement takes place through several means, including the United States-Japan Economic Harmonization Initiative and the United States-Japan Trade Forum. The U.S. Government will continue to address trade and trade-related concerns through these as well as other fora.

IMPORT POLICIES

Beef Import System

Japan continues to restrict access for U.S. beef and beef products by limiting imports to beef and beef products from animals aged 20 months or younger. Reopening Japan's beef market consistent with science and international standards as well as in a commercially viable manner is an important priority. This issue is discussed in detail in USTR's 2012 Report on Sanitary and Phytosanitary Measures.

Rice Import System

Japan's highly regulated and nontransparent importation and distribution system for imported rice limits meaningful access to Japanese consumers. In 1999, Japan established a tariff-rate quota (TRQ) of approximately 682,000 metric tons (milled basis) for imported rice. The Staple Food Department of the Ministry of Agriculture, Forestry and Fisheries (MAFF) manages imports of rice within the TRQ through periodic ordinary minimum access (OMA) tenders and through simultaneous buy-sell tenders. Imports of U.S. rice under the OMA tenders are destined almost exclusively for government stocks. MAFF releases these stocks exclusively for non-table rice users in the industrial food processing or feed sector and for re-export as food aid. In calendar year 2011, U.S. rice exports to Japan were valued at \$293 million, representing approximately 363,000 metric tons of rice. Only a small fraction of this rice reaches Japanese consumers identified as U.S. rice, despite industry research showing Japanese consumers would buy U.S. high quality rice if it were more readily available. The United States looks to Japan to continue meeting its WTO import volume commitments.

Wheat Import System

Japan requires wheat to be imported through MAFF's Food Department, which then resells the wheat to Japanese flour millers at prices substantially above import prices. These high prices discourage wheat consumption by increasing the cost of wheat-based foods in Japan. In 2007, MAFF revised the wheat import regime to allow more frequent adjustment to the resale price so that prices more closely reflect international price movements. The U.S. Government, however, remains concerned by Japan's operation of a state trading entity for wheat and its potential to distort trade.

Pork Import Regime

Japan is the largest export market for U.S. pork on both a volume and a value basis, importing 478,000 metric tons in 2011, worth \$1.94 billion. The import tariff for pork is established by a gate price system that applies a 4.3 percent *ad valorem* tariff when the import value is greater than or equal to the administratively established reference price. Imports whose value falls below the reference price pay an additional duty equal to the difference between the import value and the reference price.

Beef Safeguard

Japan negotiated a beef safeguard during the Uruguay Round of multilateral trade negotiations to protect domestic producers in the event of an import surge. The safeguard is triggered when the import volume of beef increases by more than 17 percent from the level of the previous Japanese fiscal year on a cumulative quarterly basis. When triggered, beef tariffs would rise to 50 percent from 38.5 percent for the rest of the Japanese fiscal year.

Fish and Seafood Products

U.S. fish and seafood exports to Japan were valued at \$796 million in 2011, ranking Japan as the third largest export destination with 15 percent of U.S. fish and seafood exports.

While Japan's tariffs on seafood imports are generally low, tariffs on several products remain an impediment to U.S. exports. Other market access issues also remain. For example, Japan maintains import quotas on Alaska pollock, Pacific cod, Pacific whiting, mackerel, sardines, squid, and herring as well as specific products such as pollock and cod roe and surimi. Although Japan cut tariffs as a result of the Uruguay Round, it did not change its import quotas at that time. Administration of the quota system has improved considerably since then. Japan has eased administrative burdens, and is expected to continue to reduce obstacles to U.S. exports of fish and seafood.

High Tariffs on Beef, Citrus, Dairy, Processed Food, and Other Agricultural Products

Japan maintains high tariffs on a number of food products that are important exports for the United States, including red meat, citrus, wine, dairy, and a variety of processed foods. Examples of double digit import tariffs include 38.5 percent on beef, 32 percent on oranges during winter months (16 percent in the summer), 40 percent on processed cheese, 29.8 percent on natural cheese, 22.4 percent on shredded mozzarella cheese, 20 percent on dehydrated potato flakes, 17 percent on apples, 10.5 percent on frozen sweet corn, 20.4 percent on cookies, up to 17 percent on table grapes depending on the season of the year, and 15 percent to 57.7 percent on wine depending on the Harmonized Tariff System classification. These high tariffs generally apply to food products where Japan has domestic production. Tariff reductions on these and other products continue to be a high priority for the U.S. Government.

Wood Products and Building Materials

Japan continues to restrict imports of certain manufactured wood products through tariff escalation (*i.e.*, progressively higher tariffs based on the level of processing of the wood product). The elimination of tariffs on wood products remains a long-standing U.S. Government objective.

Leather/Footwear

Japan continues to apply a TRQ on leather footwear that substantially limits imports into Japan's market, and it sets these quotas in a nontransparent manner. The U.S. Government continues to seek elimination of these quotas.

SERVICES BARRIERS

Japan Post

The U.S. Government remains neutral as to whether Japan Post should be privatized. However, as modifications to the postal financial institutions and network subsidiary could have serious ramifications for competition in Japan's financial market, the U.S. Government continues to monitor carefully the Japanese government's postal reform efforts and to call on the Japanese government to ensure that all necessary measures are taken to achieve a level playing field between the Japan Post companies and private sector participants in Japan's banking, insurance, and express delivery markets.

In the area of express carrier services, the U.S. Government remains concerned by unequal conditions of competition between Japan Post Service and international express delivery providers. The U.S. Government urges Japan to enhance fair competition, including by ensuring that Japan Post Service is subject to customs clearance procedures and costs for competitive services similar to those of other international express delivery service suppliers, and by preventing subsidization of Japan Post Service's international express service with revenue from monopoly postal services. (*For discussion of Japan Post and postal insurance, see "Insurance" under the Services Barriers section.*)

The U.S. Government also continues to emphasize the importance of transparency and disclosure as Japan considers reforms to Japan Post. As a result, the U.S. Government has continued to urge the Japanese government to ensure that the postal reform process is fully transparent, including by providing full and meaningful use of public comment procedures and opportunities for interested parties to express views to government officials and advisory bodies before decisions are made. Timely and accurate disclosure of financial statements and related notes is a key element in the postal reform process, as is the continued public release of meeting agendas, meeting minutes, and other relevant documents.

Insurance

Japan's private insurance market is the second largest in the world, after that of the United States, with direct net premiums of approximately 35,348 billion yen (\$425.3 billion) in Japanese fiscal year 2010. In addition to the offerings of Japanese and foreign private insurers, insurance cooperatives (*kyosai*) and the Japan Post Insurance, a wholly government-owned entity of the Japan Post Group, also provide substantial amounts of insurance to Japanese consumers. Given the size and importance of Japan's private insurance market as well as the scope of the obstacles that remain, the U.S. Government continues to place a high priority on ensuring that the Japanese government's regulatory framework fosters an open and competitive insurance market.

Postal Insurance: Japan's postal life insurance system remains a dominant force in Japan's insurance market. At the end of Japanese fiscal year 2010, there were approximately 47.2 million postal life and postal annuity insurance policies in force. In comparison, 134 million life and annuity policies were in force with all other life insurance companies combined. The U.S. Government has long standing concerns about the postal insurance company's negative impact on competition in Japan's insurance market and continues to monitor the implementation of reforms closely. A critical objective, from the U.S. Government perspective, is to establish equivalent conditions of competition between the Japan Post companies and the private sector, consistent with Japan's international obligations. It is also important for Japan to ensure full transparency in implementation of laws and regulations related to Japan Post.

The U.S. Government continues to urge Japan to take a number of steps to address these concerns. For example, Japan should ensure equal supervisory treatment between Japan Post's financial institutions and private sector companies. Also, Japan Post Network, the company established to manage Japan's post offices, should provide private companies access to its network comparable to that given to Japan Post entities, and select and distribute financial products of private providers through its network transparently and without discrimination. In addition, Japan should implement measures to prevent cross-subsidization among the Japan Post businesses and related entities, such as ensuring the Japan Post companies' strict compliance with the Insurance Business Law's arm's length rule and requiring adequate financial disclosures to demonstrate that cross-subsidization is in fact not occurring.

The U.S. Government continues to urge Japan not to allow Japan Post to expand the scope of operations for its financial services companies before a level playing field is established. The current restraints on the scope of these operations, including the cap on the amount of insurance coverage and limits to the types of financial activities and products Japan Post could pursue, have helped to limit the extent to which the uneven playing field harms private insurance companies. The U.S. Government is concerned about a March 2010 Japanese cabinet proposal that would weaken these restraints by agreeing to pursue a nearly doubling of the per-person caps on Japan Post Insurance coverage from 13 million yen to 25 million yen. In addition, before final decisions are made, it is vital that Japan's process for approving new products be transparent and open to all parties, including active solicitation and consideration of private sector views, and include careful analysis and full consideration of actual competitive conditions in the market.

The U.S. Government continues to monitor legislative developments that would roll back certain aspects of Japan's postal reforms that went into effect in 2007 and has expressed concern regarding draft legislation that would give additional competitive advantages to the Japan Post group companies, such as preferential regulatory and tax treatment. The U.S. Government has urged the Japanese government as it proceeds with its legislative process fully to address long-standing level playing field concerns, consistent with Japan's WTO obligations, and to ensure full transparency in the policymaking process, including by providing meaningful opportunities for comments from U.S. companies.

Kyosai: Insurance businesses run by cooperatives, or *kyosai*, hold a substantial share of insurance business in Japan. Some *kyosai* are regulated by their respective agencies of jurisdiction (the Ministry of Agriculture, Forestry and Fisheries or the Ministry of Health, Labor and Welfare, for example) instead of by the Financial Services Agency (FSA), which regulates all private sector insurance companies. These separate regulatory schemes create a nontransparent regulatory environment and afford *kyosai* critical business, regulatory, and tax advantages over their private sector competitors. The U.S. Government urges that *kyosai* must be subject to the same regulatory standards and oversight as their private sector counterparts, including being brought under the supervision of the FSA, to ensure a level playing field.

The U.S. Government also remains concerned about the reversal of progress toward giving FSA supervisory authority over *kyosai* that have insurance operations that are neither regulated by the FSA nor any other government agency. The 2005 Insurance Business Law revisions would have achieved this by

requiring these unregulated *kyosai* to come under FSA supervision, either by becoming full-fledged insurance companies or opting to fall under the Small Amount Short Term Insurance Providers system, which would limit their product range and size. However, in November 2010, the Japanese government passed legislation to allow certain existing types of public interest corporations to continue operating *kyosai* businesses for the time being under a new category called “authorized specified insurance providers,” under which the ministry or agency that currently supervises the parent public interest corporations, rather than the FSA, would regulate these *kyosai*. In addition, the Japanese government passed legislation in May 2010 that provided an exemption for certain unregulated *kyosai*, such as the Parent and Teacher Association *kyosai*, to remain outside the jurisdiction of the FSA.

Policyholder Protection Corporations: The Life and Non-life Policyholder Protection Corporations (PPCs) are mandatory policyholder protection systems created to provide capital and management support to insolvent insurers. The current system relies on pre-funding of the PPC by its members and a government “fiscal commitment” in the event that industry funding is insufficient, instead of adopting a system where an insolvency would result in members contributing funds to the PPC as needed (post-funding). The Japanese government introduced legislation to extend government funding of the PPC for an additional five years, until March 2017, keeping the current system. The U.S. Government continues to urge Japan to consider more fundamental changes in the PPC systems, including through full and meaningful deliberations with interested parties, before renewing these measures again.

Bank Sales: In December 2007, the Japanese government fully liberalized the range of insurance products eligible for sale through banks. As a follow-up, the U.S. Government asked Japan to review market conduct rules, including the limits on sales of first and third sector products and treatment of customer data, to ensure they do not limit the effectiveness of bank sales of insurance or impede consumer convenience and choice. FSA committed to conduct a review of market conduct rules three years after liberalizing the bank sales channel and published a report in July 2011 announcing minor revisions to the market conduct rules along with the results of the monitoring process. The revisions, effective April 2012, were relatively limited in their commercial impact, as the easing of the restrictions on the sale of insurance products was narrow in its scope. Although the Japanese government has not committed to another review by a certain date, the U.S. Government continues to call for Japan to conduct a fact-based and transparent review of the bank sales channel in the near term with meaningful opportunities for input from interested stakeholders and taking into account global best practices to further enhance policyholder protection and improve consumer choice.

Domestication of Foreign Insurance Operations: The U.S. Government has recommended that Japan take steps to improve the process for foreign incorporated companies operating branches in Japan that seek to transfer business operations to a Japan-incorporated entity in a seamless manner that protects policyholders and creditors while ensuring business continuity. The U.S. Government continues to urge that the portfolio and transfer provisions of the IBL be revised accordingly. Currently, the IBL limits foreign insurance companies’ ability to use certain forms of corporate transactions, while allowing domestic insurance companies to choose from a wider range of procedures that are often less complicated and costly.

Financial Services

While improvements have been made in Japan’s financial services sector, such as the Financial Services Agency’s continued commitment to its Better Markets Initiative, the U.S. Government continues to urge reforms in the areas of online financial services, defined contribution pensions, credit bureaus, and sharing of customer information. In addition, more improvement in this sector is needed, particularly with respect to transparent practices such as enhancing the effectiveness of the no-action letter and related

systems, providing written interpretations of Japan's financial laws, and soliciting input from all interested parties on concerns and potential improvements related to the inspection process.

Distribution Services

The U.S. Government continues to urge Japan to take a variety of steps to improve customs processing and to facilitate other faster and lower-cost solutions in the distribution sector. In this regard, the U.S. Government welcomes Japan's work to formulate an Authorized Economic Operator (AEO) system, which allows exporters with good compliance records to process goods more expeditiously through customs. Exempting AEO exporters from paying the five percent consumption tax for cleared cargo would help facilitate more efficient cargo flows. Currently, Japan customs refunds this tax, but an exemption would reduce the administrative burden of filing for a refund. The U.S. Government also has encouraged Japan to raise the Customs Law *de minimis* ceiling from 10,000 yen to a higher level. The customs clearance process and clearance times could also be further facilitated by, for example, allowing all users of Nippon Automated Cargo and Port Consolidated System to select the Customs Office for declaration, and by allowing customs officials to be co-located at the bonded premises of private companies handling shipments. Strengthening Japan's system for advanced rulings would also improve transparency and predictability for U.S. exporters.

Telecommunications

The U.S. Government continues to urge Japan to ensure fair market opportunities for emerging technologies and business models; ensure a regulatory framework appropriate for addressing converged and Internet-enabled services; and strengthen competitive safeguards on dominant carriers. The U.S. Government also continues to urge Japan to improve transparency in rulemaking and ensure the impartiality of its regulatory decision making. In January 2012, Japan agreed with the United States on a set of common trade principles for information and communications technology (ICT) services, a positive step toward addressing many of these issues.

Fixed-line Interconnection: In March 2011, Japan's Ministry of Internal Affairs and Communications (MIC) approved both Nippon Telegraph and Telephone (NTT) East and NTT West's interconnection rates based on the Long Run Incremental Cost Method through Japanese fiscal year 2012. In June 2010, MIC also authorized Japanese fiscal year 2010 connection fees for the Ethernet data transmission of the "Next Generation Network" (NGN) operated by NTT East and NTT West, but interconnecting operators have sought further rate reductions.

Dominant Carrier Regulation: NTT continues to dominate Japan's fixed line market through its control over almost all "last-mile" connections. As Japan's broadband users transition from digital subscriber line (DSL) (where competition, ensured through regulation, was vibrant) to optical fiber, competitors have raised concerns that the more lightly-regulated fiber-based services will allow NTT to expand its dominant position through control of the fiber-to-the-home (FTTH) market, where it holds a market share of about 75 percent as of September 2011. NTT's ability to bundle its fixed-line services with NTT DOCOMO's mobile service is another cause of concern, as it appears to undermine the rationale for structurally separating the companies. While NTT asserts that there is adequate competition in FTTH service and that consequently unbundling rules should be relaxed, NTT's share of that market has steadily increased over the past few years. The U.S. Government has urged Japan to remain committed to ensuring competition in the telecommunications market, in light of Japan's ongoing review of the overall legal structure of NTT, which affects all players participating in markets for converged services.

Universal Service Program: Current cross-subsidization of NTT West by NTT East using interconnection revenue (ostensibly to address NTT West's higher network costs resulting from the higher number of

rural subscribers) appears redundant given the existence of the universal service fund. The U.S. Government has urged the abolition of this cross-subsidy. A Ministry of Internal Affairs and Communications (MIC) panel reviewed the universal service system as part of MIC's New Broadband Superhighway plan. Under the present universal service system, NTT East and NTT West are required to maintain subscribers' copper lines. Nonetheless, the panel recognized a need to avoid letting this requirement become an impediment to development of fiber optic lines. In December 2011, the panel recommended that the universal service system allow fiber optic Internet Protocol telephony, which is equivalent in voice quality, reliability, and other factors, to subscribers' existing wireline telephony.

Mobile Termination: Like most countries, Japan uses the "Calling Party Pays" system, imposing the entire cost of termination on the calling party (enabling mobile subscribers to benefit from free incoming calls). Mobile interconnection rates still remain high by international standards and particularly compared to fixed-line rates in Japan. However, following new guidelines from MIC on calculating interconnection rates, NTT DOCOMO, the dominant incumbent mobile carrier, announced in February 2010, that it would lower its termination rates by over 10 percent, continuing incremental rate reductions implemented over the past 10 years. In January 2011, NTT DOCOMO announced a decision to cut connection fees for calls to other wireless service operators by up to 35.6 percent retroactive to April 2010. MIC is encouraging all wireless carriers to follow the new guidelines. In contrast to NTT DOCOMO, though, other mobile operators' termination rates remain high, and mediation efforts to reduce these rates have not borne fruit. With new entrants now in the mobile sector, the U.S. Government has continued to monitor actions and to urge MIC to consider the advantages of moving to a "bill-and-keep" system that is more economically efficient and where interconnection payments are not exchanged between carriers.

New Mobile Wireless Licenses: Starting in 2005, MIC began opening the market to new mobile providers beyond the three main incumbents by assigning blocks of spectrum to a limited number of new wireless entrants. In September 2010, MIC awarded only one license for mobile multimedia broadcasting services, even though the subject spectrum band was able to support two operators. The complexity of the factors MIC used to determine how to evaluate applications raised questions about whether it achieved its stated goal of awarding these licenses based on objective criteria. Given the scarcity of spectrum and high demand for new technologies, the U.S. Government continues to urge MIC to consider alternative mechanisms, including auctions, that assign commercial spectrum in a timely, transparent, objective, and nondiscriminatory manner that adheres to principles of technology neutrality, particularly for spectrum that became available as a result of broadcasters' switch to digital television in July 2011. In December 2011, MIC announced that it plans to introduce a system by 2015 that allows for auctions as an option to assign commercial spectrum, a positive development that the U.S. Government will monitor.

Information Technologies

The Japanese government took a positive step by agreeing with the U.S. Government on a set of common trade principles for information and communications technology services in January 2012 that cover a range of topics including regulatory transparency, open access to networks and applications, free flow of information across borders, non-discriminatory treatment of digital products, and foreign investment in ICT services. However, the U.S. Government continues to urge the Japanese government to address concerns related to cloud computing, health information technology (IT), privacy, and IT and electronic commerce policymaking.

Cloud Computing: Cloud computing has the potential to increase efficiency and reduce costs in the public and private sectors. Cloud computing and the Internet economy can flourish only if governments permit the free flow of data across borders. The U.S. Government, therefore, has urged Japan to adopt the principle of nondiscrimination between data services offered inside and outside of Japan. The U.S.

Government also has urged the Japanese government to ensure full transparency and consult foreign and domestic industry as rules on data centers and cloud computing are formulated and implemented.

Health IT: Government policies that fail to encourage interoperability, technology neutrality, and international harmonization, in addition to providing insufficient reimbursement incentives, inhibit the expansion of Japan's health IT services sector, an important market for U.S. companies. The U.S. Government has urged Japan to improve the quality and efficiency of healthcare by rapidly implementing health IT that is based on international standards, promotes technology neutrality and interoperability, and allows patients greater access to their own health records.

Privacy: Separate and inconsistent privacy guidelines among Japanese ministries have created an unnecessarily burdensome regulatory environment with regard to the storage and general treatment of personally identifiable information in Japan. The U.S. Government has urged Japan to introduce greater uniformity in the enforcement of the Privacy Act across the central government through policy standardization and consistent implementation of guidelines. The U.S. Government also has urged the Japanese government to reexamine the provisions and application of the Privacy Act, so as to foster appropriate sharing of data, and to ensure full transparency and consult widely as privacy guidelines for online advertising are developed.

IT and Electronic Commerce Policymaking: Insufficient transparency in Japan's policymaking process for IT and electronic commerce has stifled innovation and competitiveness in Japan and constrained U.S. company access. The U.S. Government has urged Japan to improve its policymaking process by seeking and considering industry input at all stages of policymaking. This will help foster development of programs that promote technology neutrality, facilitate private sector participation in government-appointed advisory groups, and provide companies with adequate time to offer public comments and adjust to rule changes.

Legal Services

Japan imposes restrictions on the ability of foreign lawyers to provide international legal services in Japan in an efficient manner. The U.S. Government continues to urge Japan to liberalize the legal services market further. Legislation was submitted to the Diet in March 2012 that would allow foreign lawyers to form Japanese professional corporations that are permitted to establish branch offices within Japan. Another important step would be to allow foreign lawyers to establish multiple branch offices in Japan, whether or not they have established a professional corporation. The U.S. Government continues to urge Japan to take other important measures, including ensuring that no legal or Bar Association impediments exist to Japanese lawyers becoming members of international legal partnerships, and accelerating the registration process for new foreign legal consultants.

Educational Services

The U.S. Government continues to urge the Japanese government to work with foreign universities to find a nationwide solution that grants tax benefits comparable to Japanese schools and allows them to continue to provide their unique contributions to Japan's educational environment.

INTELLECTUAL PROPERTY RIGHTS PROTECTION AND ENFORCEMENT

Japan generally provides strong intellectual property rights (IPR) protection and enforcement. However, the U.S. Government continues to urge Japan to improve IPR protection and enforcement in specific areas through bilateral consultations and cooperation, as well as in multilateral and regional fora.

Japan's signing of the Anti-Counterfeiting Trade Agreement (ACTA) in October 2011 was a positive step. The ACTA establishes an international framework that will assist parties in their efforts to effectively combat the infringement of intellectual property rights, in particular the proliferation of counterfeiting and piracy, which undermines legitimate trade and the sustainable development of the world economy.

The U.S. Government also has urged Japan to continue to reduce piracy rates, including adopting methods to protect against piracy in the digital environment. Police and prosecutors lack *ex officio* authority to prosecute IPR crimes on their own initiative, without a rights holder's complaint. In addition, the U.S. Government has pressed for improvements to Japan's Internet Service Provider liability law to provide adequate protection for rights holder's works on the Internet. In addition, while Japan took steps to revise its Customs Law and Unfair Competition Law in 2011, it should continue to strengthen its laws to provide effective criminal and civil remedies against unauthorized circumvention of technological protection measures used by rights holders to protect their works, trafficking in tools used to circumvent them, and providing circumvention services.

In other areas, although Japan provides a 70 year term of protection for cinematographic works, it only provides a 50 year term for all other works protected by copyright and related rights. The U.S. Government continues to urge Japan to extend the term of protection for all subject matter of copyright and related rights in line with emerging international trends. In addition, amendments to the Copyright Law came into effect in 2010 which, among other things, clarified that the statutory private use exception does not apply in cases where a downloaded musical work or a motion picture is knowingly obtained from an infringing source. The U.S. Government continues to urge the Japanese government to expand this limitation on the private use exception to cover all works protected by copyright and related rights.

In addition, the U.S. Government continues to monitor developments related to Japan's announcement in October 2011 of plans to introduce a *sui generis* system for the protection of geographical indications within five years.

GOVERNMENT PROCUREMENT

Japan is a signatory to the WTO Agreement on Government Procurement (GPA). For procurement of construction services by sub-central entities and government enterprises covered under the GPA, Japan applies a threshold of 15 million SDRs (\$23.7 million), which is 3 times the threshold applied by the United States.

Construction, Architecture, and Engineering

U.S. companies annually obtain far less than one percent of projects awarded in Japan's massive public works market, estimated at \$189 billion in 2011. Two bilateral public works agreements are in effect: the 1988 United States-Japan Major Projects Arrangements (MPA) (updated in 1991) and the 1994 United States-Japan Public Works Agreement, which includes the Action Plan on Reform of the Bidding and Contracting Procedures for Public Works (Action Plan). The MPA includes a list of 42 projects in which international participation is encouraged. Under the Action Plan, Japan must use open and competitive procedures for procurements valued at or above the thresholds established in the GPA. The U.S. Government raises public works issues in the Expert-Level Meetings on Public Works under the United States-Japan Trade Forum.

Problematic practices continue to limit the participation of U.S. design/consulting and construction firms in Japan's public works sector, including bid rigging (*dango*), under which companies consult and prearrange a bid winner. (*For more, see "Broadening Measures to Combat Bid Rigging" under the*

Anticompetitive Practices section.) The U.S. Government continues to press Japan to take more effective action to address this pervasive problem. The U.S. Government continues to monitor Japan's public works sector.

Specifically, the U.S. Government is paying special attention to certain major projects covered by the public works agreements that are of particular interest to U.S. companies. These include major expressway projects; major public buildings, railroad procurements, urban development and redevelopment projects; planned port facilities expansion projects; major Private Finance Initiative (PFI) projects; and the MPA projects still to be undertaken or completed. The U.S. Government is also monitoring developments related to "green" building, design, and procurement.

Procurement of Information Technology

Lack of transparency, excessive reliance on sole-source contracting, and restrictions on intellectual property ownership, among other factors, hinder the participation of U.S. companies in Japanese government IT procurement. The U.S. Government therefore has urged Japan to introduce greater competition, transparency, and fairness in government procurement of IT through steps such as implementation of national government-wide policies that reflect international technology trends and standards and that follow principles of technology neutrality and interoperability. The U.S. Government is urging that Japanese government procurement of cloud computing services be neutral with respect to the technology used by cloud service providers.

INVESTMENT BARRIERS

Despite being the world's third largest economy, Japan continues to have the lowest inward foreign direct investment (FDI) as a proportion of total output of any major OECD country. Inward foreign merger and acquisition (M&A) activity, which accounts for up to 80 percent of FDI in other OECD countries, also lags in Japan.

While the Japanese government has previously recognized the importance of FDI to revitalizing the country's economy, its performance in implementing domestic regulatory reforms to encourage a sustained increase in FDI has been uneven. In September 2006, the Japanese government set a goal of doubling the stock of FDI in Japan by 2010 to the equivalent of five percent of Gross Domestic Product (GDP). During the period Japan's stock of FDI remained below four percent. Since 2009, Japan has ceased to use FDI stock to set policy targets or measure progress toward them, or to explicitly encourage inward investment through mergers and acquisitions (M&A) as a policy priority. Even before the financial crisis of 2008 and 2009, questions existed regarding the adequacy of measures taken to promote a level of cross border M&A necessary to achieve the government's target. A variety of factors make cross border M&A difficult in Japan. These include attitudes toward outside investors; inadequate corporate governance mechanisms that protect entrenched management over the interest of shareholders; aspects of Japan's commercial law regime (*see section titled "Commercial Law"*); and a relative lack of financial transparency and disclosure. Japan's Foreign Exchange and Foreign Trade Act governs investment in sectors deemed to have national sovereignty or national security implications.

ANTICOMPETITIVE PRACTICES

Japan has taken significant positive steps in recent years to bolster its competition regime, including increasing fines and penalties, extending the statute of limitations, and strengthening aspects of the Japan Fair Trade Commission's (JFTC) enforcement mechanisms and tools. At the same time, particular concern persists regarding whether the present system for enforcing the Antimonopoly Act (AMA) affords sufficient due process protections. Additional measures to combat anticompetitive behavior and

provide for basic due process protections would improve the business environment and ensure that enforcement procedures are fair and transparent.

Improving Anti-Monopoly Compliance and Deterrence

The AMA provides for both administrative and criminal sanctions against cartels. Criminal prosecutions, which should have the strongest deterrent effect against anticompetitive behavior, have been few, and penalties against convicted company officials have been weak. The U.S. Government has continually urged Japan to take steps to maximize the effectiveness of enforcement against hard-core violations of the AMA. The Japanese government has taken certain steps to address these concerns, particularly through AMA amendments enacted in June 2009 that, for the most part, came into effect in January 2010. These amendments increased administrative penalty (surcharge) rates for enterprises that played a leading role in cartel activities by 50 percent, extended the statute of limitations to five years, increased maximum prison sentences for criminal cartel and bid-rigging violations to five years, and improved the leniency program to encourage reporting of unlawful cartels. The 2009 AMA amendments also provide for mandatory surcharges on enterprises that engage in exclusionary private monopolization, abuse of superior bargaining position, and repeat violations of certain “unfair trade practices.” The JFTC issued guidelines on exclusionary private monopolization on October 28, 2009, after considering public comments. The JFTC’s ability to enforce the AMA effectively continues to be hindered by an insufficient number of employees with post-graduate economics training, a factor that undermines JFTC ability to engage in the careful economic analysis necessary to properly evaluate non-cartel behavior. The U.S. Government continues to urge the JFTC to improve its economic analysis capabilities.

Improving Fairness and Transparency of JFTC Procedures

Japan introduced a system in January 2006 that empowered the JFTC to make determinations of AMA violations without a prior formal administrative hearing. Respondents are only afforded the right to seek administrative review of the JFTC decision after the decision is put into place. Although the JFTC allows companies subject to a proposed cease-and-desist or surcharge payment order to review the evidence relied upon by JFTC staff and to submit evidence and make arguments in their defense prior to issuance of a final order, questions have arisen as to whether the current system provides sufficient due process protections. In December 2009, the Japanese government announced its intention to eliminate the *ex post* hearing system and to allow appeals of JFTC orders directly to the Tokyo District Court. Although legislation for those purposes was submitted to the Diet, it has not yet been enacted. The U.S. Government continues to raise concerns about certain procedural fairness questions related to the JFTC’s investigative, pre-decisional, and appeals processes.

Broadening Measures to Combat Bid Rigging

Japanese officials have implemented a series of measures to address the problem of bid rigging. In recent years, the Ministry of Land, Infrastructure, Transport, and Tourism (MLIT) has strengthened administrative sanctions against companies found by JFTC to have engaged in unlawful bid rigging. Administrative leniency programs have also been introduced to encourage companies and individuals to report illegal acts. As of April 2009, MLIT and 13 other central government entities are administering an administrative leniency program to complement the JFTC leniency program, which is designed to help encourage individuals and companies to report anticompetitive acts. In addition, Japan has put in place a series of measures aimed at ensuring a competitive bidding process for project contracts tendered at the central and local government levels. The U.S. Government continues to raise concerns that further measures are needed to prevent conflicts of interest in government procurement, improve efforts to eliminate involvement in bid rigging by government officials, and expand administrative leniency programs.

OTHER SECTORAL AND CROSS-SECTORAL BARRIERS

Transparency

Transparency issues remain a top concern of U.S. companies operating in Japan's market. The U.S. Government has strongly urged Japan to adopt new measures to achieve a higher degree of transparency in governmental regulatory and policy-making processes.

Advisory Groups: Although advisory councils and other government-commissioned study groups are accorded a significant role in the development of regulations and policies in Japan, the process of forming these groups can be opaque and nonmembers are too often not uniformly offered meaningful opportunities to provide input into these groups' deliberations. The U.S. Government continues to urge Japan to ensure the transparency of advisory councils and other groups convened by the government by adopting new requirements to ensure ample and meaningful opportunities are provided for all interested parties, as appropriate, to participate in, and directly provide input to, these councils and groups.

Public Comment Procedure (PCP): Many U.S. companies remain concerned by inadequate implementation of the PCP by Japanese ministries and agencies. Examples include cases where comment periods appear unnecessarily short, as well as cases suggesting comments are not adequately considered given the brief time between the end of the comment period and the issuance of a final rule or policy. The U.S. Government has stressed the need for Japan to ensure its existing PCP is being fully implemented and to make additional revisions to further improve the system, such as doubling the public comment period for rulemaking to 60 days in principle.

Transparency in Regulation and Regulatory Enforcement: To ensure the private sector has sufficient information about regulations and official interpretations of those regulations that require compliance, the U.S. Government is urging Japan specifically to require its ministries and agencies to make public their regulations and any statements of policy of generally applicable interpretation of those regulations.

Commercial Law

A 2006 reform of Japan's commercial law permitted the use of certain modern merger techniques, including domestic and cross-border (forward) triangular mergers (*i.e.*, mergers structured so that a Japanese company is acquired by a Japanese subsidiary of a foreign parent company, with the shareholders of the target company receiving shares in the foreign parent company as compensation). These new provisions did not prove as effective as had been hoped in facilitating foreign investment into Japan, which has been constrained by the limited range of tax-advantaged merger tools available for inward-bound investment to Japan and by corporate governance systems that do not adequately reflect the interests of shareholders, among other possible issues.

The U.S. Government continues to urge Japan to identify and eliminate impediments to cross-border mergers and acquisitions, including the availability of reasonable and clear incentives for many such transactions, and to take measures to ensure that shareholder interests are adequately protected when Japanese companies adopt anti-takeover measures or engage in cross-shareholding arrangements. The U.S. Government has also continued to urge Japan to improve further its commercial law and corporate governance systems to promote efficient business practices and management accountability to shareholders in accordance with international best practices, such as by facilitating and encouraging active and appropriate proxy voting, ensuring the independence of outside directors and augmenting their role on corporate boards, strengthening protection of minority shareholders by clarifying fiduciary duties of directors and controlling shareholders, and encouraging the stock exchanges to adopt listing rules and

guidelines that will improve the corporate governance of listed companies and ensure that the interests of minority shareholders are protected. While the Japanese government has convened study groups to examine some of these matters, necessary reforms in this area have not yet been adopted.

Automotive

A variety of nontariff barriers have traditionally impeded access to Japan's automotive market. Overall sales of U.S. made vehicles and automotive parts in Japan remain low, which is a serious concern.

The U.S. Government has expressed concern with the overall lack of access to Japan's automotive market for U.S. automotive companies. For example, U.S. automakers seeking to introduce, for testing and demonstration purposes, automobiles using new technology (*i.e.*, fuel cell vehicles) have faced a lack of transparency and other barriers to certifying these new products in a timely and efficient manner. Beyond emerging issues related to new types of vehicles, additional issues include, but are not limited to, standards and certification issues, lack of sufficient opportunities for stakeholder input in the development of standards and regulations, as well as barriers that hinder the development of distribution and service networks. The U.S. Government urges Japan to address the full range of barriers in Japan's automotive market.

Medical Devices and Pharmaceuticals

Japan's market for medical devices and pharmaceuticals continues to be one of the most important for U.S. medical device and pharmaceutical exports. In 2010, the Japanese market for medical devices and materials was just over \$26.4 billion. Japan's total imports of U.S. medical devices exceeded \$6.1 billion in 2010, a 23 percent market share. The pharmaceuticals market in Japan was valued at \$101.9 billion in 2010, and U.S. pharmaceutical firms have achieved a market share approaching 20 percent, or total sales worth \$20 billion.

Despite the size of these markets, many globally available pharmaceuticals and medical devices have not yet been introduced in Japan. One issue is the average lag time of about two years between the introduction of pharmaceuticals in the United States and their introduction in Japan. Similarly, only about half of all European and American medical devices are available in Japan. Recognizing the need to address this drug and device "lag," which prevents timely patient access to innovative and life-saving technologies, Japan has taken various measures such as improving the clinical trials environment and accelerating the review process. Also, Japan has set specific goals to improve access to innovative pharmaceuticals and medical devices such as reducing total review times for new products to 12 months for new drugs by April 1, 2012, and to 14 months, for new medical devices by April 1, 2014. The Pharmaceutical and Medical Device Agency reported that it exceeded its goals of reducing review times for new drugs and new medical devices in Japanese fiscal year 2010, although target review times have not been met for me-too devices and improved devices that do not require clinical data. The U.S. Government continues to urge Japan to meet the goals in the future and take additional steps as the Japanese government moves forward with changes to the Pharmaceutical Affairs Law.

Japan's reimbursement policies for medical devices also hinder the introduction of innovative medical technology to the market. Of specific concern has been Japan's application of and changes to the Foreign Average Price rule. The U.S. Government continues to urge Japan to implement predictable and stable reimbursement policies that reward innovation and provide incentives for companies to invest in the research and development of advanced healthcare products.

With regard to pharmaceuticals, the U.S. Government welcomes Japan's decision to implement, on a trial basis, a new premium system that minimizes downward price revisions on new drugs for which there are

no corresponding generics. The new premium system has considerably promoted the development of both drugs and indications with unmet needs that had not previously been approved in Japan. In the biennial price revision of April 1, 2012, the Japanese government decided to continue the new premium system trial for an additional two years starting from April 1, 2012. Making this new system permanent would help increase the predictability and attractiveness of the Japanese market, reduce the drug lag, and promote investment in Japanese life sciences discovery over the long term. The U.S. Government continues to urge Japan to make the new premium system permanent and to refrain from implementing other aspects of reimbursement policies that hinder the development and introduction of innovative pharmaceuticals such as re-pricing based on market expansion.

The level of transparency in Japan's drug and medical device reimbursement decision-making processes, including potential additional systemic changes, remains an issue. The U.S. Government is urging Japan to build further on recent improvements in this area to foster a more open and predictable market.

Nutritional Supplements

Japan has taken steps to streamline import procedures and to open its 1,150 billion yen, or \$14.4 billion, nutritional supplements market, although many significant market access barriers remain. Burdensome restrictions on health claims are a major concern. Only those products approved as Foods for Specified Health Uses (FOSHU) or Foods with Nutrient Function Claims (FNFC) are allowed to have health or structure/function claims. Producers of most nutritional supplements, however, are unable to obtain FOSHU or FNFC approval due to FOSHU's costly and time-consuming approval process and due to the limited range of vitamins and minerals that qualify for FNFC. These processes apply to both imported and domestic products. Other concerns include long lead times for food additive applications; inability to use food ingredients and food additives, including organic solvents for processing ingredients to be used in nutritional supplements; high import duties for nutritional supplements compared to duties on pharmaceuticals containing the same ingredient(s); lack of transparency in new ingredient classifications; and lack of transparency in the development of health-food regulations. The U.S. Government continues to discuss these issues with the Japanese government.

Cosmetics and Quasi-Drugs

Japan is the world's second largest market for cosmetics and quasi-drugs after the United States. In 2011, U.S. exports of cosmetics and personal care products to Japan were estimated at \$373 million, second only to France. Despite this market presence by U.S. products, regulatory barriers continue to limit timely consumer access to safe and innovative products without unnecessary costs. Unlike the over-the-counter drug monograph system in the United States, Japan requires premarket approval for certain products, such as a category called "medicated cosmetics" that are classified as quasi-drugs under the Pharmaceutical Affairs Law. The approval process of the quasi drugs includes requirements that are burdensome, lack transparency, and do not appear to enhance product safety, quality, or efficacy. In addition, restrictions on advertising claims for cosmetics and quasi-drugs prevent companies from informing customers of product benefits so consumers can make an informed choice. Enhanced communication between both the U.S. and Japanese governments and industries has led to some improvements in the Japanese regulatory system. For example, in the fall of 2009, the Japanese government agreed to reduce the amount of paperwork required to import cosmetic products. In the summer of 2011, the Japanese government agreed to allow a new advertising claim for "the appearance of reduced fine lines" for cosmetics. The U.S. Government continues to urge Japan to address pending issues of concern.

Proprietary Ingredient Disclosure Requirement for Food and Dietary Supplements

As part of its product classification process for new-to-market food and dietary supplement products, Japan mandates that all ingredients and food additives be listed by name, along with content percentages, and include a description of the manufacturing process. In addition to being burdensome, this process risks the release of proprietary information to competitors.

Aerospace

Japan is among the largest foreign markets for U.S. civil aerospace products. The civil aerospace market in Japan is generally open to foreign firms, and some Japanese firms have entered into long-term relationships with U.S. aerospace firms. The U.S. Government continues to monitor Japan's development of indigenous aircraft.

Military procurement by the Ministry of Defense (MOD) accounts for approximately half of the domestic production of aircraft and aircraft parts and continues to offer the largest source of demand in the aircraft industry. Although U.S. firms have frequently won contracts to supply defense equipment to Japan (over 90 percent of the annual foreign defense procurement is from the United States), the MOD has a general preference for domestic production or the licensing of U.S. technology for production in Japan to support the domestic defense industry.

Although Japan has considered its main space launch vehicle programs as indigenous for many years, U.S. firms continue to participate actively in those space systems. Japan is also developing a Global Positioning System (GPS) navigation satellite constellation known as the "quasi-zenith" system. At the conclusion of the June 21, 2011, United States-Japan Consultative Committee meeting, the governments of the United States and Japan released a joint statement in which our two nations recognized recent progress to deepen our bilateral space security partnership through the United States-Japan Space Security Dialogue, and possible future cooperation in areas such as space situational awareness, a satellite navigation system, space-based maritime domain awareness, and the utilization of dual use sensors. In line with this statement, the U.S. Government is working to ensure U.S. companies have full opportunities to participate in Japan's satellite market.

Business Aviation

The U.S. Government has continued to urge the Japan Civil Aviation Bureau (JCAB) of the MLIT to reexamine the application of civil aviation regulations specific to commercial airlines to business aviation and to develop appropriate regulations specific to the business aviation industry that are consistent with the treatment of business aviation in North America, Europe, and other developed economies. The issues identified include severely restricted hours for landings and take-offs at Haneda Airport in Tokyo (the top preferred business destination for overseas business jets) and the lack of services for private business aircraft at both Narita and Haneda. These conditions continue to significantly limit travel by business aircraft to, from, and within Japan.

In October 2010, the JCAB executed important liberalization of the rules regarding the use of business aviation at Haneda Airport. Following committee discussions under the JCAB on promoting the business jet industry, some important steps were taken (focusing on Narita Airport) that include the creation of a business jet terminal with Customs, Immigration, and Quarantine functions by the end of Japanese fiscal year 2011; abolition of the ceiling on the number of landing/take-off slots for business jets; and an increase in parking spots for business jets. Availability of these landing/take-off slots and parking spots can be monitored on the Narita Airport webpage. Although these are important steps forward, the U.S.

Government will continue to work with the JCAB to promote greater liberalization in the business aviation sector.

Civil Aviation

Japan is the United States' largest aviation partner in the Asia-Pacific region. Consistent with its longstanding policy to promote competition and market access in civil aviation, the U.S. Government signed an Open Skies Memorandum of Understanding with Japan on October 25, 2010.

The U.S. Government welcomed the Japanese government's willingness to negotiate an Open Skies agreement and the planned expansion of landing and take-off slots at Tokyo's Narita and Haneda airports. The agreement provides assured opportunities for growth of U.S. airline operations at Narita airport and ensures fair competition for U.S. airlines at Tokyo's Haneda airport, which opened to limited scheduled international air service in October 2010. The U.S. Government has begun working with the Japanese government to allow for more non-stop flights with fewer time restrictions between Haneda airport and the United States. The U.S. Government is urging Japan to continue to take further steps to increase capacity and reduce overall congestion at these airports.

Transport and Ports

The U.S. Government has had longstanding concerns about barriers to entry to, and the lack of competitiveness in, Japanese ports. Long-term relationships, a lack of transparency, licensing requirements, and other practices and requirements have had the effect of greatly limiting the ability of foreign shipping companies to do business in Japan. On January 26, 2011, the Federal Maritime Commission (FMC) issued an Order terminating a proceeding that it had opened in 1995 to investigate these practices. In its 2011 Order, the FMC stated that concerns about practices and requirements in Japan had not been completely eliminated, and that it will remain watchful for unfavorable conditions in the U.S.-foreign ocean-borne trade.