

JAPAN

TRADE SUMMARY

The U.S. goods trade deficit with Japan was \$88.4 billion in 2006, an increase of \$5.9 billion from \$82.5 billion in 2005. U.S. goods exports in 2006 were \$59.6 billion, up 7.5 percent from the previous year. Corresponding U.S. imports from Japan were \$148.1 billion, up 7.3 percent. Japan is currently the 3rd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Japan were \$41.8 billion in 2005 (latest data available), and U.S. imports were \$22.3 billion. Sales of services in Japan by majority U.S.-owned affiliates were \$48.4 billion in 2004 (latest data available), while sales of services in the United States by majority Japan-owned firms were \$26.0 billion.

The stock of U.S. foreign direct investment (FDI) in Japan in 2005 was \$75.5 billion (latest data available), up from \$68.1 billion in 2004. U.S. FDI in Japan is concentrated largely in the finance, manufacturing, wholesale trade, and professional, scientific, and technical services sectors.

REGULATORY REFORM OVERVIEW

The United States-Japan Regulatory Reform and Competition Policy Initiative

Launched in 2001, the Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) remains a key forum by which the U.S. Government seeks changes to Japan's practices that create barriers to market access, limit competition in the marketplace, or otherwise contribute to difficulties that U.S. companies face in the Japanese market. As a result of this broad focus, the Regulatory Reform Initiative addresses practices in multiple industry sectors, including telecommunications, pharmaceuticals/medical devices, information technologies, agriculture, and distribution services. Through this initiative, the United States also urges improvements in practices that cut across numerous industry sectors, including in competition policy, commercial law, and transparency in regulatory and policy making processes. The Regulatory Reform Initiative is one component of the overarching United States-Japan Economic Partnership for Growth.

In June 2006, the U.S. and Japanese governments concluded their fifth annual Report to the Leaders which identified progress made under the Regulatory Reform Initiative over the previous seven months. The U.S. Government presented new detailed recommendations to Japan in December 2006 to urge further sectoral and structural regulatory reform. These recommendations will be discussed through the first half of 2007 with the aim of concluding the sixth Report to the Leaders in mid-2007 to reflect progress achieved across all areas.

SECTORAL REGULATORY REFORM

Telecommunications

Under the Regulatory Reform Initiative, the United States continues to seek regulatory changes to promote competition, innovation, and choice in Japan's telecommunications sector. Through its December 2006 Regulatory Reform submission and in bilateral consultations, the United States has asked

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Japan to take measures to ensure market-based technology decisions, strengthen competitive safeguards on dominant carriers and streamline certification processes for telecommunications equipment. In addition, the United States continues to request that Japan develop a plan to move regulatory functions from a ministerial agency, where it is subject to direct political control, to an independent regulatory agency. It is also important for Japan to continue to foster greater transparency in rulemaking (particularly rules or decisions originating from informal study groups) and allow wider participation of interested stakeholders.

Interconnection: Japanese laws and regulations do not prevent Nippon Telegraph and Telephone (NTT) regional carriers from imposing high rates and onerous conditions on their competitors for interconnection. This is one of the most significant indications that Japan needs to improve its competitive safeguards with respect to dominant carriers. In 2005, the Ministry of Internal Affairs and Communications (MIC) implemented a more rational rate structure for wireline interconnection rates by phasing out certain fixed costs that MIC has permitted regional operators to charge competitors, a revision long sought by the United States. However, MIC's five-year transition period (until 2010) constitutes a disappointing delay in this much-needed rate reduction. MIC is expected to continue studying how to revise or replace the rate regime and the United States will continue discussions with MIC to ensure that any changes will improve the competitive environment.

Dominant Carrier Regulation: NTT, one of the most profitable companies in Asia, continues to dominate the fixed-line market and controls 95 percent of Japan's wireline infrastructure. The Government of Japan has reduced its stock in NTT to the one-third share minimum it is required by law to hold and stated its intention to consider reorganizing NTT to improve the competitive environment. A decision on this issue, however, was delayed until 2010. As Japan's broadband users turn from digital subscriber line (DSL) to optical fiber, NTT's competitors fear that NTT is trying to extend its monopoly power through domination of the FTTH (fiber-to-the-home) market and by bundling NTT fixed services with those of NTT DoCoMo, the dominant wireless operator. In September 2006, MIC published its "New Competition Promotion Program 2010" to address competition concerns as suppliers increasingly offer telecommunications services over Internet Protocol-based networks. The United States will continue to monitor developments as MIC implements the program to ensure that competitive safeguards remain strong.

Universal Service Program: In March 2006, Japan designated the NTT regional carriers, East and West, as eligible to receive funds under a universal service program. Japan approved a scheme beginning in January 2007 for major carriers to collect a universal service fee of seven yen per month for subscribers of voice services. This money is then contributed to the universal service fund, which the NTT regional carriers use to offset the cost of rural services. Doubts remain as to whether this universal service program can be considered "competitively neutral" since it effectively benefits only NTT and limits fund eligibility to wireline carriers. The United States remains concerned that NTT East's cross-subsidization of NTT West through interconnection revenue (since 2003) is a potentially anticompetitive practice. NTT's use of funds from the universal service program would appear to obviate Japan's alleged justification for this practice.

Mobile Termination: New entrants to Japan's telecommunications market have also expressed concern about the high access rates charged by NTT DoCoMo, the dominant wireless service provider. While DoCoMo reduced rates significantly in 2003, its rate reduction in 2006 was only 2.6 percent. Following reforms to the Telecommunications Business Law in 2001, DoCoMo was recognized as a dominant carrier in 2002, but MIC has not required DoCoMo to explain how its rates are calculated. The government of Japan has maintained that the introduction of mobile number portability (which started in

October 2006) will put competitive pressure on these rates and the United States will monitor this carefully.

New Mobile Wireless Licenses: For the past twelve years, MIC limited the mobile wireless market to three main operators, including NTT DoCoMo with a market share of 55 percent. In 2005, MIC took a significant step forward by making substantial blocks of spectrum available primarily for new wireless entrants, thereby creating opportunities not only for telecommunications companies wanting to expand into the wireless business in Japan, but also equipment suppliers to those companies. MIC approved licenses for three new market entrants in October 2005, although one of the companies opted to buy out the third-largest carrier rather than take up the new license. However, much work remains to be done to create a level playing field for the new market entrants, including “roaming” on incumbent networks at reasonable rates, access to towers and tower sites, and analyzing incumbents’ unused spectrum to eliminate “warehousing.”

Information Technologies (IT)

Since 2001, the Japanese Government has promoted the use of IT and electronic commerce in Japan in large part through the creation and implementation of successive e-Japan Strategies and Programs. Japan continues to push forward with its work in this important sector, as evidenced by the completion in 2006 of several new plans for IT-related policies, including the New IT Reform Strategy, Priority Policy Program 2006, and e-Government Promotion Plan. In addition, Japan is conducting an extensive review of its Copyright Law and continuing efforts to achieve numerous other goals related to the creation, protection, and enforcement of intellectual property rights (IPR).

The U.S. Government’s December 2006 Regulatory Reform Initiative recommendations encouraged Japan to ensure its regulatory framework for IT and electronic commerce promotes competition and innovation, enhances transparency, protects users, and fosters active private sector participation in policymaking processes. The recommendations also identified steps Japan should take to effectively protect IPR in the face of challenges posed by globalization, new technologies and the digital era.

General Themes for IT and Electronic Commerce Policymaking: Japan has made considerable progress in promoting and supporting the use of IT and electronic commerce in the private and public sectors. To ensure this progress continues, the United States included recommendations on IT and electronic commerce policymaking in its 2006 Regulatory Reform Initiative submission that urged Japan to: (1) implement its plans and policies in a manner that fosters private sector leadership, self regulation, and active participation in policymaking process; (2) provide meaningful opportunities for interested parties in the private sector, both domestic and foreign, to submit views on draft rules and policies and obtain information about, and participate in, government advisory groups; (3) adhere to the principle of technology neutrality in policymaking and cooperate with the private sector in standards development activities; and (4) ensure its policies and rules are compatible with international practice.

Privacy: Japan’s Law on the Protection of Personal Information (Privacy Law) went into effect in April 2005. Ministries and agencies subsequently formulated implementation guidelines to ensure the Privacy Law’s effectiveness. The Cabinet Office started a process to review the implementation of the Privacy Law and will draft a report based on this review, potentially recommending revisions to improve implementation. In its 2006 Regulatory Reform Initiative recommendations, the United States urged Japan to ensure that: (1) this review, and implementation in general, be transparent; (2) the Privacy Law and implementing guidelines clearly differentiate between publicly available information and sensitive personal information; (3) implementing guidelines are standardized across Ministries except when necessary for specific sectors; and (4) any Cabinet Office recommendations regarding cross-border

transfers not unduly restrict data flows, while recommending due diligence in protecting personal information.

Online Nuisance, Deceptive Practices, and Fraud: Japan has recognized the growth and impact of malicious activity and fraud propagated on the Internet, and their corresponding threat to legitimate online pursuits. In its 2006 Regulatory Reform Initiative submission, the United States urged Japan to: (1) continue to work closely with the private sector to address online fraud; (2) help U.S. entities understand Japanese laws and regulations impacting spam-filtering and blocking; and (3) implement any online fraud-related laws, regulations, and guidelines in a manner that strives not to unduly promote, mandate, or favor specific technologies. The United States also encouraged Japan to work closely to share information and collaborate to best address issues of online fraud.

Strengthening Intellectual Property Rights (IPR) Protection: The U.S. Government's 2006 Regulatory Reform Initiative submission includes a number of recommendations to Japan intended to strengthen IPR, such as: (1) extending the term of copyright for sound recording and all other subject matter protected under Japan's Copyright Law; (2) adopting a statutory damages system that would act as a deterrent against infringing activities; (3) providing for patent procedures that improve the efficacy of the application process; and (4) actively working with the United States to develop ways to promote greater protection of intellectual property rights worldwide, especially in Asia. (*See also "Intellectual Property Rights Protection" in this chapter.*)

Government IT Procurement: The United States supports Japan's efforts to reform its procedures for government IT procurements to accomplish goals such as acquiring high-quality IT systems at reasonable costs, promoting transparency and fairness, and stimulating innovation and competition. While significant progress has been made in many of these areas, much work remains. A "follow-up survey" released by the Inter-Ministerial Task Force for Information Systems Procurement (Task Force) in January 2006 indicated that many items in the Task Force's 2002 memorandum on government IT procurement reform (revised most recently in 2004) have not yet been implemented. In its study of central government computer systems released in October 2006, the Board of Audit of Japan recommended that central government procuring entities work to enhance the competitiveness and transparency of their IT procurements. In the e-Government Promotion Plan it released in August 2006, Japan's Chief Information Officers Council similarly directed ministries to vigorously promote the taking of concrete actions to move from sole source contracts to competitive contracting in procurements for IT systems.

The United States continues to urge Japan to implement all of the Task Force memorandum's reforms without delay. In particular, in its December 2006 Regulatory Reform Initiative submission, the United States encouraged Japan to: (1) clearly define and set appropriate limits on liability in all IT procurement contracts; (2) follow through on plans to submit legislation to the Diet in fiscal year (FY) 2007 that will make it possible for contractors to possess ownership rights to intellectual property created through government-sponsored development of IT systems; (3) ensure that the Japanese government's online database for IT procurements is an effective tool to enhance transparency and fairness; (4) reduce significantly the use of sole source contracting in IT procurements; (5) sign IT procurement contracts as soon as possible after winning bidders are chosen and refrain from backdating contracts; and (6) provide meaningful opportunities for interested parties to participate in the formulation of government IT procurement policies.

Medical Devices and Pharmaceuticals

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

The U.S. Government's top regulatory priority in the medical device and pharmaceutical sectors is ensuring that Japan's regulatory system facilitates the introduction of innovative products. In 2006, the Japanese government announced plans to expedite the introduction of medical devices and drugs in response to concerns that such products typically are introduced in the United States and Europe long before their introduction in Japan. The lag in the introduction of drugs and devices in Japan is a concern of both the U.S. and Japanese governments.

The U.S. Government's December 2006 Regulatory Reform Initiative recommendations urged Japan to reform regulations and practices that impede the development and introduction of devices and drugs in Japan. Those recommendations include substantial increases in the staff of the Pharmaceuticals and Medical Devices Agency (PMDA), the regulatory authority created in 2004 to review applications for new drugs and medical technology. The United States believes PMDA must expand its staff and increase its expertise to attain its goal (to be implemented in 2009) of completing within one year the review of 90 percent of device applications and 80 percent of drug applications.

Regarding drugs, in the 2006 Regulatory Reform Initiative Report to the Leaders, the Ministry of Health, Labor and Welfare (MHLW) noted it would ensure PMDA uses performance metrics to facilitate product reviews and work with PMDA to foster the ability of companies to conduct clinical trials in Japan. The U.S. Government's December 2006 recommendations on pharmaceuticals urged Japan to facilitate the simultaneous global development of new medicines, improve the environment for clinical trials, and speed reviews. Regarding medical devices, in the 2006 Report to the Leaders, MHLW said it would ensure that it clarifies its requirements for clinical trials and that PMDA eliminates a backlog of product applications. The U.S. Government's December 2006 recommendations on devices urged Japan to eliminate a backlog of product applications by March 2007, further clarify Japan's policies on clinical trial data, and expedite approvals of minor changes in products.

As for pricing reform, the U.S. Government's top priority is to ensure that Japan's policies reward the development and introduction of innovative medical devices and pharmaceuticals. Japan has recognized that innovation can foster economic growth and improved healthcare, as noted in its so-called "Visions" policy papers, which contain plans to improve the international competitiveness of its medical device and pharmaceutical industries and markets. The United States has urged Japan to implement the Visions quickly. The U.S. Government has been encouraging Japan to ensure that any changes to its overall healthcare system result in both long-run cost savings and improved health. The United States has recommended that Japan fix inefficiencies in its healthcare system such as its excessively long hospital stays, which are triple the average of countries in the Organization for Economic Cooperation and Development. The U.S. Government also is urging Japan to consider the long-term benefits of reimbursement pricing systems that foster the development of innovative drugs and devices. Such policies will promote the speedy introduction of advanced products that not only help save and improve lives but make Japan's healthcare system more efficient by precluding the need for surgeries and reducing the lengths of hospital stays.

Regarding drug reimbursement, in the 2006 Report to the Leaders, MHLW noted that it relaxed the qualification requirements for the pricing premium for drugs that are particularly “useful” and raised the rates for several other pricing premiums. MHLW also increased industry’s opportunities to provide input at certain key advisory board meetings. The U.S. Government’s December 2006 recommendations on pharmaceuticals urged Japan to continue to improve transparency and industry’s ability to provide input, to reverse the April 2006 revisions to the Foreign Price Adjustment rule for drugs, and to refrain from moving to annual price revisions.

Regarding medical device reimbursement, in the 2006 Report to the Leaders, MHLW noted it will study the impact of Japan’s regulatory and distribution systems on the cost of medical devices in Japan and will review industry studies on the cost of doing business in that sector. MHLW also noted it increased the frequency of health insurance listings of devices classified as C2 to four times a year. The U.S. Government’s December 2006 recommendations on medical devices urged Japan to replace the Foreign Average Price rule for devices by April 2008 with a system that fully reflects the value of advanced medical devices to Japan and work with industry to increase functional categories to reflect differences among products in the current functional categories.

Separately, Japan’s 2002 Blood Law established a principle of “self-sufficiency” and included a Supply and Demand Plan that enables the Japanese government to manage supply and demand in the blood market. The United States has been urging Japan to ensure the Plan does not discriminate against foreign blood plasma products and is consistent with Japan’s international trade obligations. The United States is also urging Japan to develop a reimbursement pricing system for blood products that accounts for the characteristics of that industry and that is not based on the pharmaceutical model.

Financial Services

Japan's financial sector has become increasingly integrated into the global financial system in recent years as Japan has strengthened its accounting and financial reporting standards and removed regulatory barriers to domestic and foreign competition. As a result, foreign financial institutions have gained market share – including through acquisitions in some cases – in securities brokerage, asset management, insurance, and banking.

Financial Instruments and Exchanges Law: On June 14, 2006, the Diet approved the Financial Instruments and Exchanges Law (FIEL), amending 89 financial laws and consolidating the remainder into a cohesive text, aimed at enhancing investor protection and the promotion of movement of financial assets into securities markets, through cross-sectoral rules for investment product sales, management, and disclosure. Given the hundreds of pages of statutes comprising the FIEL, the overall impact of the law will not be discernable until FIEL implementing regulations, interpretation and enforcement are evident, consistent, and predictable.

The transparency and predictability of Japan’s financial regulatory system have improved, but further progress is needed. In particular, Japan’s Financial Services Agency (FSA) could limit the scope for uncertainty as to what is legally permissible by expanding the body of written interpretations of Japan’s financial laws. While supervision and disclosure have improved, Japan must continue to move forward in establishing transparency in regulation and supervision of financial institutions in line with international standards and best practices.

No Action Letters and Written Interpretations: The FSA has been making some efforts to enhance the effectiveness of the no-action letter system, including the active solicitation of input from U.S. and other foreign firms on how best to improve the system, however, the use of the system has not materially

increased. The United States recommends that the FSA explore ways to expand use of the no-action letter system. The FSA should also expand the written interpretations it provides through other means, including through active use of its new “interpretive letter” system and increasing the number of “reference cases” published on the FSA web site.

Agriculture

Japan maintains many tariff and non-tariff barriers that remain obstacles to trade in the agricultural sector. The U.S. Government’s December 2006 Regulatory Reform Initiative submission includes a number of recommendations to enhance the efficiency of the trading environment and the transparency of related rules and regulations. These recommendations include: 1) adopting science-based international standards in animal health and related measures; 2) completing the review of food additives recognized as safe by a Joint Food and Agriculture Organization/World Health Organization Evaluation Committee; and 3) implementing international standards in plant quarantine. (*See also “Standards, Testing, Labeling and Certification” in this chapter.*)

Plant Quarantine Issues: Japan’s animal and plant quarantine system is one of the most restrictive in the world. One main impediment to trade is that Japan imposes nationwide bans instead of recognizing regions or zones. For example, when a disease or pest outbreak is reported in the United States, Japan often imposes nationwide bans on all associated U.S. animal or plant products. This is not necessary since the United States takes strict quarantine measures to control the spread of disease. A second aspect is Japan’s failure to use of international standards as a basis for pest risk analysis.

Japan's Ministry of Agriculture, Forestry and Fisheries (MAFF) prohibits the entry of various fresh plant products due to the presence of pests, although some of these pests are also present in Japan. Japan has a pest forecast system that monitors certain domestic pests and alerts producers to potential increased pest damage. For decades, the Japanese government has contended that this constitutes official control under the International Plant Protection Convention (IPPC), the international standards setting body for plant protection. Japan therefore required imported commodities to have an equivalent system. Recently the Japanese government took initial steps to harmonize with international standards. In December 2004, Japan notified the World Trade Organization of its intent to relax quarantine measures for several plant pests and diseases and then again in May 2006 five additional cosmopolitan pests were added to the list. The United States welcomes these actions and urges Japan to continue regular efforts to harmonize the classification of plant pests and diseases with international standards, since there are dozens more pests that could be added to the list of cosmopolitan pests which would provide relief to U.S. exporters.

STRUCTURAL REGULATORY REFORM

Antimonopoly Law and Competition Policy

A more robust competition policy and enforcement regime that would bolster competition and improve market access would reinforce Japan's economic recovery. In particular, cartel activity, including widespread bid rigging, has been a serious problem in Japan.

Strengthening the Effectiveness of Antimonopoly Enforcement: Japan passed a critical milestone in the effort to improve its competition enforcement with the implementation in 2006 of the first significant amendments to the Antimonopoly Act (AMA) – Japan's main competition legislation – in over 25 years. Administrative surcharges increased to 10 percent of cartel sales for large manufacturers and service providers, and to 15 percent for repeat offenders. The Japan Fair Trade Commission (JFTC) introduced a corporate leniency program that eliminates administrative surcharges for the first company to report its

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participation in an unlawful cartel and cooperate with JFTC's investigation and reduces surcharges for up to two more companies applying for leniency. The AMA amendments also provided JFTC with criminal investigation powers, increased penalties for interference with JFTC investigations or for non-compliance with JFTC cease and desist orders, streamlined hearing procedures, and extended the statute of limitations for AMA violations to three years after the conduct stopped.

Initial indications are that the amendments to the AMA are having an effect on bid rigging activity in Japan. According to a variety of press reports, winning bids on government-tendered projects are often only 60 percent to 70 percent of the targeted maximum price, whereas previously they routinely exceeded 90 percent or more. It has been reported that JFTC received approximately 60 leniency applications – including from a number of major corporations – in the first year of the program.

Effective deterrence against hard-core cartel conduct depends on strong sanctions against both the companies and their executives that engage in that unlawful behavior. Although the AMA provides for criminal sanctions against violators, criminal prosecutions have been sporadic. The JFTC has initiated only ten criminal prosecutions of AMA violators since 1990. The United States expects that JFTC's new criminal investigation powers and the creation of a specialized criminal investigation department within JFTC will substantially increase the number of criminal AMA prosecutions. On the other hand, even when successful criminal AMA prosecutions occur, criminal penalties imposed by the courts against culpable individuals have been weak. Convicted executives have in all cases received suspended prison sentences, without fines, even for repeat offenders. The United States continues to urge Japan to take steps to maximize the effectiveness of AMA enforcement against hard-core violations of that Act, including by increasing the number of criminal prosecutions, strengthening criminal sentences of convicted individuals and maintaining the system of imposing both administrative surcharges and criminal sanctions on corporate participants in cartel and bid rigging conspiracies.

The JFTC's ability to enforce the AMA effectively has also been hindered by insufficient personnel. JFTC's total staff is expected to reach 737 by March 31, 2007, and, although further progress is needed, there has been steady improvement in the number of staff assigned to JFTC's Investigation Bureau, having increased from 154 in 1990 to 360 as of March 2006. JFTC is particularly weak, however, in the number of staff with post-graduate economics training which hurts JFTC's ability to engage in the careful economic analysis necessary to properly evaluate non-cartel behavior such as mergers, monopolization and distribution and licensing practices. The United States continues to urge JFTC to improve its economic analysis capabilities.

Increasing the Procedural Fairness of JFTC Enforcement Activities: The Japanese and foreign business community continue to raise concerns over the fairness and transparency of JFTC's investigative and hearing procedures. The JFTC introduced a system in January 2006 to allow 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 an order being issued. A similar system was implemented for proposed recipients of public warnings for suspected violations of the AMA or the Premiums and Misrepresentations Act. Nonetheless, companies still complain that JFTC procedures lack standards of proof or a neutral arbiter to protect the rights of the firm targeted by the JFTC investigation. As a result, the United States is pressing JFTC to implement additional measures to enhance the fairness and transparency of JFTC investigatory and administrative procedures, including by establishing clear standards for granting stays of JFTC orders pending appeal, ensuring that at least a majority of JFTC hearing examiners are non-JFTC career employees, extending due process rights to recipients of recommendations and public warnings under the Subcontract Act, and introducing procedures to increase certainty in stock acquisition transactions.

Prevention of Bid Rigging: Despite the continued prevalence of bid rigging, Japanese authorities have recently been stepping up measures to address the problem. The JFTC has invoked the 2003 law against bureaucrat led bid rigging (so-called *kansei dango*) in several cases, and Japanese prosecutors have arrested and convicted several current and former officials of the Defense Facilities Administrative Agency (DFAA) involved in a bid rigging conspiracy. (One former DFAA official received an 18-month prison term, which was not suspended.) In 2006, the Ministry of Land, Infrastructure, and Transport (MLIT) strengthened administrative sanctions against companies found by JFTC to have engaged in unlawful bid rigging, doubling to 12 months the minimum period that companies that are repeat offenders will be barred from bidding on public works projects. MLIT also introduced an administrative leniency program to complement the JFTC leniency program by reducing by half the period of suspension from bidding for firms admitted to the JFTC program. In addition, following a number of high-profile bid rigging cases in 2005 and 2006, the Ministry announced a series of measures aimed at ensuring a competitive bidding process for project contracts tendered by the Ministry.

On the other hand, Japan continues to shy away from tough steps to limit or to control post-retirement employment by its officials, the so-called "descent from Heaven" (*amakudari*), which has underpinned many bid rigging conspiracies. The United States continues to urge Japan to take additional measures to combat bid rigging, including strengthening laws and rules against *amakudari* and other conflicts of interest to ensure that such practices do not facilitate government-led bid rigging, expanding MLIT's administrative leniency program to other government agencies and public corporations, and further improving procurement rules to prevent bid rigging practices.

Transparency

The United States continues to urge Japan to strengthen measures that achieve a high degree of transparency in governmental regulatory and policy making processes. Improving regulatory predictability, ensuring access to information about pending policy changes, and allowing greater participation by interested parties as changes to regulations and policies are planned helps ensure fairness and accountability and greatly contributes to fostering a positive business climate. Japan has made some progress in expanding meaningful public participation, but additional measures are needed. The United States also looks to Japan to act as a strong partner in promoting similar practices in the Asia-Pacific region. In its December 2006 Regulatory Reform submission, the United States urged Japan to take additional steps to increase transparency.

Public Comment Procedures: Japan's Public Comment Procedures (PCP) were strengthened with the amendment to the Administrative Procedure Law which came into effect in April 2006. According to a May 2006 survey of PCP implementation released by the Ministry of Internal Affairs and Communications, 65 percent of the public comment periods for regulatory revisions requiring Cabinet decisions were longer than 30 days, an improvement over Japan FY 2005. The report, however, does not identify how often ministries incorporated comments provided by interested parties into their decision making process. The United States recommends that Japan fully implement the PCP and commit to making further revisions to the system to provide truly meaningful opportunities for public input into policy-making and regulatory reform processes.

Public Participation in the Development of Legislation: The United States encourages Japan's ministries and agencies to accelerate the practice of providing greater opportunities for the public to comment on legislation in the early stages of its formation.

Advisory Groups: Advisory councils and other government-commissioned study groups are often accorded a significant role in Japanese policy development. While membership lists and meeting minutes

may be publicly available, the process of creating these councils and study groups remains opaque and non-members are not uniformly offered meaningful opportunities to provide input into these groups' decision-making processes. The United States urges Japan to increase the transparency of advisory councils and other government-sponsored working groups by openly publishing lists of these councils and their members and by allowing ample and meaningful opportunities for all interested parties, as appropriate, to participate in and provide input to these councils' policymaking formulations.

Privatization

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

The U.S. Government has a particular interest in the initiative to reform and privatize Japan Post, which has large banking and insurance businesses in addition to its mail and parcel delivery operations. The U.S. Government has long called on the Japanese government to eliminate the tax, regulatory, and other advantages Japan Post has over U.S. and other private companies. With the passage of related legislation by the Diet in October 2005, Japan established a framework to make important progress in this direction. As the scheduled beginning of the privatization process in October 2007 approaches, the U.S. Government continues to carefully monitor the implementation of these reforms and continues to call on the Japanese government to ensure all necessary measures are taken to achieve a truly level playing field between Japan Post and the private sector in Japan's banking, insurance, and express delivery markets. The U.S. Government also continues to look to Japan to ensure that a level playing field is in fact created before the postal financial institutions are permitted to introduce new lending services, underwrite new or altered insurance products, or originate non-principal-guaranteed investment products. The U.S. Government also urges the Japanese government to ensure that the process by which this reform proceeds is made fully transparent, including by full and meaningful use of Public Comment Procedures and through opportunities for interested parties to express views to related officials and advisory bodies before decisions are made. (*For detailed discussion of Japan Post privatization and postal financial institutions, see "Insurance" under the Services Barriers section.*)

Commercial Law

Japan recently undertook a major reform of its commercial law enacting legislation to modernize its Corporate Code, which entered into force on May 1, 2006. Among other provisions, the new code permits the use of modern merger techniques, including domestic and cross-border triangular mergers. Under pressure from business groups, however, the Japanese government delayed implementation of certain provisions, including those relating to the use of foreign stock as consideration in cross-border triangular mergers, until May 2007. Moreover, as of the end of 2006, it was not clear whether rules implementing the introduction of triangular mergers, in particular tax deferral rules, would be sufficiently flexible to effectively facilitate foreign merger and acquisition activities in Japan.

In its December 2006 Regulatory Reform submission, the United States continued to urge Japan to build on past reforms by further improving its commercial law and corporate governance systems and to reject efforts to protect entrenched management and impede foreign investment in Japan. Specifically, the United States is urging Japan to implement the new triangular merger provisions on schedule and in a manner that does not impose significant restrictions on the use of foreign company shares in cross-border transactions and that facilitates tax deferral benefits in such transactions in appropriate cases.

Japan amended its Securities and Exchange Law in June 2006 to allow companies making tender offers to withdraw or adjust such offers in response to stock splits, stock allocations and other poison pill defensive measures. The increasing number of high profile tender offers in Japan demonstrates the importance of improved corporate governance aimed at protecting shareholder, rather than entrenched management, interests. The United States continues to press Japan to further strengthen corporate governance mechanisms, including by facilitating and encouraging active proxy voting by institutional investors such as pension and mutual funds, requiring authorization of anti-takeover measures by a company committee composed of a majority of outside directors, and encouraging the major Japanese stock exchanges to adopt listing rules or guidelines that encourage best corporate governance practices in the protection of shareholder interests.

Article 821 of the new Company Law continues to create great uncertainty among foreign corporations that conduct their primary business in Japan through their Japanese branch offices. As written, Article 821 appears to prohibit such branches from engaging in transactions in Japan on a continuous basis. An internal notification (*tsutatsu*) was issued by Japan's Ministry of Justice in 2006 clarifying the interpretation of that Article to ensure that it does not adversely affect the operation of foreign companies operating in Japan in a lawful manner; the House of Councillors also adopted a supplementary resolution reaffirming that interpretation. The United States, however, continues to request that Japan amend Article 821 to ensure that it does not apply to U.S. companies operating or desiring to operate in Japan through branch offices that are duly registered and that comply with applicable regulatory and tax laws.

Legal System Reform

Continued reform of the Japanese legal system to foster the efficient provision of international legal services and to promote alternative dispute resolution mechanisms is essential to the establishment of an environment in Japan that is conducive to international business and investment and that supports deregulation and structural reform. After more than 15 years of urging by the United States and the foreign legal community, Japan enacted legislation in 2003 that substantially eliminates restrictions on the freedom of association between foreign and Japanese lawyers, effectively permitting partnership and employment relationships between them.

The United States continues to recommend that Japan further liberalize the legal services market by allowing foreign lawyers to form professional corporations and establish multiple branch offices in Japan and by counting all of the time foreign lawyers spend practicing law in Japan toward the three-year experience requirement for licensure as a foreign legal consultant. In addition, the United States has requested Japan to confirm that Japanese lawyers may become members of international partnerships with lawyers outside Japan without restriction,

The United States is also urging Japan to promote arbitration and other alternative dispute resolution (ADR) procedures, including by allowing foreign lawyers and non-lawyers to act as neutrals in any international ADR proceedings taking place in Japan and to make clear that foreign lawyers may represent parties in any such international ADR proceedings.

Distribution and Customs Clearance

The efficiency of Japan's distribution system is hampered by high airport user fees, relatively inefficient and costly customs procedures, low credit card acceptance at traditional merchants and Automated Teller Machines (ATMs), and excessive rules on the activities of private express delivery companies. The government of Japan has streamlined the registration of fleet vehicles that was cited as an issue in the 2006 NTE report, although implementation is expected to take another two to five years. The United

States urges that implementation be enjoined more quickly to ease the burden on both domestic and international vehicle fleet providers.

While some progress has been made, further action is needed to fully realize efficiencies in this segment. In its December 2006 Regulatory Reform Initiative recommendations, the United States is urging Japan to make further reforms in the distribution sector, including: (1) reduce airport fees and assure transparency in the setting of those fees at Japan's international airports; (2) streamline customs procedures; (3) implement new parking solutions that facilitate smooth and timely distribution of packages and other items by express and other distribution vehicles; and (4) ensure new regulations do not impede the ability of large-scale retailers to open stores in Japan.

The United States further urges Japan to promote fair and free competition in the express delivery services sector as the privatization of Japan Post continues by ensuring the establishment of a level playing field among competitors. Currently, Japan Post's Express Mail Service (EMS) enjoys numerous regulatory advantages over competing services offered by private firms – most notably in the area of customs clearance.

IMPORT POLICIES

Rice Import System

Although Japan has generally met import volume commitments made during the Uruguay Round and subsequent negotiations, Japan's highly regulated and non-transparent distribution system for imported rice limits meaningful access of U.S. high-quality rice to Japanese consumers. U.S. rice exports to Japan from January-December 2006 were valued just under \$169 million, representing 330,453 metric tons of rice or about 48.5 percent of Japan's minimum access requirement. Less than one-half of 1 percent of rice imported from the United States reaches Japanese consumers, and what does reach them cannot be easily identified as a U.S. product or a product containing U.S. rice. Industry research shows Japanese consumers would choose to buy U.S. high quality rice if it was made available on the Japanese market.

In 1999, Japan established a tariff-rate quota (TRQ) of 682,000 metric tons (milled basis) for imported rice. The Japan Food Department (JFD) of the Ministry of Agriculture, Forestry, and Fisheries (MAFF), manages imports within the TRQ through periodic minimum market access (MMA) tenders for imported rice and through the simultaneous buy-sell system. Imports of U.S. rice under the periodic MMA tenders are destined almost exclusively for government stocks or re-exported as food aid. A small share of U.S. rice imported under these tenders is released from JFD stocks and permitted to enter the industrial food-processing sector. The U.S. rice industry has been disappointed by the JFD's record of buying U.S. high quality medium-grain (Calrose) rice for industrial use, food aid, and blending, rather than premium-quality rice for table use.

Recent stepped-up testing requirements for rice imports have hampered trade of U.S. rice to the Japanese market. In December 2005, MAFF began to impose strict testing requirements on rice imports, ostensibly to ensure compliance with the Japanese government's new Maximum Residue Limits policy. However, rice is the only commodity requiring multiple testing, including a test by the industry which has resulted in a disproportionate increase in the cost of bringing U.S. rice to market.

Rice Stocks Release Program

On July 29, 2005, in an effort to reduce Japan's stocks of rice imported under its WTO Minimum Market Access (MMA) commitment, the Ministry of Agriculture, Forestry and Fisheries introduced a new

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program under which a certain quantity of MMA rice stocks is released to certain rice-flour producers via Japanese flour millers. Although the stated purpose of this policy is to reduce stock levels of U.S. rice, this program in effect channels the release of imported rice stocks from the domestic whole kernel or 'table' market to industrial use, which in turn has displaced imports of rice-flour cake mixes which are made with rice-flour, sugar and/or starch. Japanese data shows that rice-flour based cake mix imports from the United States during the January-December 2006 period were down 14 percent by quantity and nearly 8 percent by value compared with the same period in 2005. The United States is concerned this policy potentially raises national treatment concerns as it only applies to imports.

Wheat Import System

Japan requires that wheat be imported through the Ministry of Agriculture, Forestry and Fishery's Food Department, which then releases wheat to Japanese flour millers at prices that are substantially above import prices. These high wheat prices discourage wheat consumption by increasing the cost of wheat-based foods in Japan. The United States remains concerned by the operation of a state trading entity for wheat and its potential to distort trade beyond simple tariff measures.

Corn for Industrial Use

Japan's domestic potato starch blending requirement is scheduled to be abolished at the start of Japan FY 2007 (April 2007). While the United States views this as a positive step, the reforms do not go far enough to be truly market based. In part, the current system will be replaced with a levy or tax payment arrangement on the cornstarch industry to help support the domestic potato industry. As a consequence, the United States intends to carefully monitor the administration of this new system for any market distorting activities.

Pork Import Regime

Japan is the world's largest importer of pork, importing a record 880,000 tons in Japan FY 2005. U.S. pork exports to Japan that period were valued at \$1.0 billion.

Japan's pork import system includes a gate price and a safeguard negotiated during the Uruguay Round which automatically raises tariffs if imports are 19 percent or more above the average level of imports during the previous three years. The gate price system distorts pork trade by encouraging Japanese importers to buy mixed shipments of different cuts of pork (rather than the cuts the market would otherwise demand) to minimize tariffs by keeping the average cost, insurance, and freight (CIF) price of their shipments at or below the gate price.

The United States is intent on negotiating a change in the pork import regime in the Doha Development Agenda.

Beef Safeguard

Once Japan fully opens its beef market, the United States is concerned about the possibility that Japan's beef safeguards will be triggered, which could hamper the United States' ability to regain historical export levels in the near future (*see the section titled, "Beef" under the "Standards, Testing, Labeling and Certification" heading for context*).

Japan's beef safeguard was negotiated during the Uruguay Round to afford protection to domestic producers in the event of an import surge. The safeguard is triggered when imports increase by more than

17 percent from the previous Japanese fiscal year on a cumulative quarterly basis. Once triggered, the safeguard remains in place for the rest of the fiscal year. If triggered, beef tariffs will rise to 50 percent (from 38.5 percent).

The United States is seeking a change in the beef safeguard in the Doha Development Agenda negotiations.

Fish Products

Although Japan has been the most important export market for U.S. fish and seafood products for over 30 years (with a peak of 73 percent of seafood exports going to Japan in 1988), in 2005, U.S. seafood exports to Japan fell to 27 percent of U.S. seafood exports and in 2006 will have decreased to approximately 23 percent. Based on November 2006 statistics, Japan may drop to become the second place export destination for U.S. seafood products for the first time in many years, with the European Union just slightly ahead.

Tariffs on Japanese seafood imports are generally low; however, tariffs on a number of products (e.g. cod, Pollock surimi, herring, squid, and sardines) make it difficult for U.S. exporters to sell to the Japanese market and for Japanese processors to import raw materials necessary to sustain their processing industry. Japan also maintains several species-specific import quotas on fish products. U.S. fish and fish products subject to import quotas include pollock, surimi, pollock roe, herring, Pacific cod, mackerel, Pacific whiting, squid and sardines.

During the Uruguay Round, Japan agreed to cut tariffs by about one-third on a number of fishery items, but avoided commitments to modify or eliminate import quotas. As part of ongoing WTO Doha negotiations, WTO Members including the United States and Japan have committed to clarify and improve rules on fisheries subsidies in the WTO Negotiating Group on Rules.

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

Japan maintains high tariffs on a number of food products that are important exports for the United States, including red meat, citrus, wine and a variety of processed foods. Examples of double-digit import tariffs include a 38 percent tariff on beef, a 32 percent tariff on oranges, a 40 percent tariff on processed cheese, 30 percent tariff on natural cheese, a 17 percent tariff on apples, and a 15 to 29 percent tariff on wine depending on the HTS classification. These high tariffs generally apply to food products where Japan is protecting domestic producers.

High tariffs have discouraged the import of these products. Tariff reductions are therefore a high priority for the United States in the Doha Development Agenda agriculture negotiations.

Propriety Ingredient Information Disclosure Requirement for Import

Japan requires commercial shipments of new-to-market products to disclose the names and percentages of all ingredients, names, and percentages of all food additives, and a description of the manufacturing process as part of its product classification process. This process is overly burdensome and runs the risk of making public proprietary information to potential competitors.

Wood Products, Housing, and Building Materials

U.S. exports of wood products, housing and building materials to Japan from January-August 2006 were valued at \$474 million. Japan continues to restrict the importation of U.S. manufactured wood products through tariff escalation (i.e., progressively higher tariffs depending on the level of processing of the wood product in question). The elimination of tariffs on wood products has been a long standing U.S. objective, although Japan remains one of the most prominent countries to resist the U.S. Government's initiative to further liberalize global tariffs on wood products.

In 2001, the United States and Japan agreed that future discussions on wood/building products issues would be pursued under the government auspices of the Wood Products Subcommittee and its two technical committees, the Building Experts Committee (BEC) and JAS Technical Committee (JTC).

Marine Craft

Japan continues to maintain an inspection system for new boats and marine engines that is unique in the world in its severity and complexity. Japan's regulations, written and administered by the Ministry of Land, Infrastructure and Transport (MLIT) and the Japan Craft Inspection Organization, are complicated, vague and subject to arbitrary and inconsistent interpretation and contain many rules and requirements that no other country considers necessary. These unusual rules and the requirement that each and every imported boat be individually inspected place an enormous burden on Japanese importers and American boat manufacturers and effectively constitute a significant barrier.

In the United States-Japan Small Craft Working Group meetings held between 2002 and 2004 and in other fora going back to 1999, the U.S. marine industry and the U.S. Government have repeatedly expressed concerns to Japan's regulatory authorities about the negative effects that Japan's small craft inspection system has on U.S. boat imports. However, to date only limited measures have been taken in response.

The United States and Japan agreed at the Trade Forum in December 2005 that the United States would offer a proposal for Japan to exempt recreational craft having CE certification from the Japanese inspection system. Subsequent discussions confirmed that Japanese officials were willing to discuss the CE mark issue. In September 2006, U.S. industry made such a proposal to MLIT but the proposal was quickly rejected and there has been no offer to discuss any of its details.

The United States urges Japan to adopt internationally accepted regulations, particularly with regard to certification of international standards, which ensure a high level of boater safety without imposing overly burdensome requirements on manufacturers and importers.

Leather/Footwear

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

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

Above-quota imports of footwear still face market access barriers, despite the fact that Japan has met its Uruguay Round agreements to lower the *ad valorem* ceiling rate by 50 percent and the alternative "per pair" or specific-rate ceiling by 10 percent. According to the latest Japanese government customs tariff schedule, the above-quota rates have declined to the higher duty of either 30 percent *ad valorem* or 4,300 yen per pair. Japan is entitled to apply the higher of the two rates.

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

STANDARDS, TESTING, LABELING AND CERTIFICATION

Japan applies several standards that limit trade in farm, forest and industrial products. In particular, there has been a noticeable increase in Japan's use of standards and other administrative requirements to limit imports of agricultural goods.

U.S. industry has commented that Japan's stringent testing methods and low tolerances for preservatives and heavy metals in plant products make it nearly impossible to satisfy import requirements for those products. The United States is urging Japan to establish appropriate quantitative limits for preservatives and heavy metals in plant products, which are both safe and practical.

Beef

On July 27, 2006, Japan partially reopened its market to U.S. beef. Except for an approximate one month period from December 2005 to January 2006, Japan's market had been effectively closed since the December 2003 detection of a single cow with Bovine Spongiform Encephalopathy (BSE) in Washington State.

Japan allows the import of U.S. beef from animals aged 20 months or younger. This policy, however, has prevented the United States from regaining all but a small portion of its historic level of exports to the Japanese market. Before the ban, Japan was the largest export market for U.S. beef and beef products, totaling roughly \$1.4 billion annually.

The United States has urged Japan to bring its BSE measures in line with international guidelines set by the World Animal Health Organization (OIE) by allowing imports of all beef and beef products deemed safe. The United States will work vigorously toward achieving this important objective through use of various bilateral and multilateral fora.

Enforcement of Maximum Residue Limits (MRLs)

New Japanese regulatory requirements specify that foods containing pesticide residues will not be allowed on the Japanese market unless residue levels conform to national Maximum Residue Limit (MRL) standards. These new regulations, known as the "Positive List", became effective on May 29, 2006. The United States worked closely with the Ministry of Health, Labor, and Welfare (MHLW) to ensure that potentially trade restrictive measures relating to the new positive list were addressed to

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minimize disruptions to U.S. agricultural trade with Japan. However, several outstanding issues remain, including MHLW's MRL enforcement policy that predates the implementation of the new positive list.

A major U.S. concern is that import violations may be treated more harshly than domestic violations. When an MRL violation is detected in a shipment of food, MHLW indiscriminately takes action against the entire industry of the country where the food product was sourced. Domestic violations, however, are addressed on a company-by-company basis. As a result, domestic violations are treated much more favorably, raising potential national treatment concerns. Trade for a country can be severely impacted by just two violations, regardless of the level of the violation or the degree of the threat to health. To address these concerns, the United States is urging MHLW, through the United States-Japan Regulatory Reform Initiative, to implement a regime that is the least trade restrictive possible, provides national treatment to imports, and is in accordance with international practices.

Phytosanitary Issues

Since Japan opened its market in 1978, the Pacific Northwest has exported over 9 million cartons of fresh cherries to Japan. Cherries exported to Japan must be fumigated with methyl bromide to address Japan's alleged concerns regarding codling moth.

Based on U.S. Department of Agriculture research that demonstrates that cherries are not a suitable host for codling moth, the U.S. Government has requested that Japan remove the specific treatment requirement for sweet cherries. In its place, the U.S. Government has submitted a systems approach to the Japanese government for consideration, which combines post harvest commodity inspection with good orchard pest management practices. The industry has supplied documentation that the proposed systems approach provides quarantine security, which is equivalent or better than that provided by methyl bromide fumigation. Pilot programs conducted in the Pacific Northwest and California demonstrated that the systems approach is effective.

Based on the current market conditions in Japan, U.S. industry expects a substantial increase in export sales once methyl bromide fumigation is replaced by a systems approach. The U.S. Government will continue to work with Japan to remove its fumigation requirement.

Labeling of Beef

The Ministry of Agriculture, Forestry, and Fisheries proposed guidelines regarding the labeling of "wagyu" beef that, if adopted, would bar use of the term "wagyu" on cattle that was not born and raised in Japan. The United States is concerned by the proposed regulation and is monitoring this situation closely.

Building Size, Designs and Wood Products

The Japanese government has adopted and implemented regulations with respect to indoor air quality and the emission of certain volatile organic compounds, including formaldehyde, which are found in some building materials. Regulations on indoor air quality covering volatile organic compounds appear to be overly restrictive for some products such as wall coverings. The United States also has concerns about guidelines for other chemicals, especially if those guidelines become mandatory as well.

Biotechnology

Japan is one of the largest importers of bioengineered grains, including about 15 million metric tons of U.S. corn and 4.5 million metric tons of U.S. soybeans worth several billion dollars.

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Japan has implemented an advanced biotechnology regulatory system which now requires mandatory food, feed and environmental approvals. A new Food Safety Commission established in 2003 conducts many risk assessment duties to support product evaluations by the Ministry of Health, Labor and Welfare and Ministry of Agriculture, Forestry and Fisheries.

Biotechnology developers are facing growing constraints to meet Japan's requirements for feed and environmental review. Irregular meetings of the Feed Subcommittee, the absence of standard operating procedures, and an overall lack of transparency and predictability have significantly delayed feed approvals. In addition, a combination of local regulations and public pressure on research institutions (which often conduct field testing under contract) have made it increasingly difficult to secure sites for mandatory field trials for environmental reviews. Addressing these key administrative aspects of Japan's feed and environmental approval process is important to ensuring the large number of products in the development pipeline, including several new nutritional and performance traits, are reviewed in an efficient manner.

The United States hopes Japan will continue to participate in discussions on biotechnology advancement and regulation in international fora, such as the WTO, the Codex Alimentarius Commission, the Organization for Economic Cooperation and Development (OECD), and the Asia Pacific Economic Cooperation (APEC) forum. Given the continuous development of new biotechnologically-produced food products, the United States and Japan share a common interest in working together to promote effective biotechnology approval and regulatory policies – aspects the United States urges Japan to consider under the Regulatory Reform Initiative.

Restrictive Food Additive List

Japan's list of food additives restricts imports of several U.S. food products, especially processed foods. The list, which limits the use of specific food additives on a product-by-product basis, is out of step with international practice. For example, the list effectively prohibits the importation of light mayonnaise, creamy mustard, or figs containing potassium sorbate, a food additive evaluated and accepted by numerous national and international standard-setting organizations, including the Joint FAO/WHO Experts Committee on Food Additives. In spite of this prohibition on imports, Japan allows the use of potassium sorbate in 36 other foods, most of which are traditional Japanese food products not normally produced outside Japan.

U.S. manufacturers have also complained that the process for gaining approval for indirect food additives (which do not remain on food), such as solvents, is slow and lacks transparency.

In 2002, Japan created a list of 46 food additives for expedited review. The United States and many of Japan's other trading partners have been disappointed by the lack of progress by the Ministry of Health, Labor, and Welfare and the Food Safety Commission in finalizing reviews and approving many of these additives, despite in several cases having been provided with extensive safety data. In addition, Japan classifies post-harvest fungicides as food additives (involving a separate registration process), even though the international community, including Codex, classifies them as pesticides. To address some of these concerns, the United States has urged Japan through the Regulatory Reform Initiative to complete its review of food additives in an expedited fashion.

Microbial Content Standards

Japan's standards under the Food Sanitation Law for microbial content on frozen foods are, in certain instances, impractical and overly restrictive, particularly for foods that require cooking before consumption.

Nutritional Supplements

Although Japan has taken steps toward liberalization of its \$11.7 billion nutritional supplements market, many barriers to market access remain. Restrictions on health and nutrition claims are a major concern. In Japan, nutritional supplements are classified as food. Only foods that are approved as Foods for Specific Health Uses (FOSHU) or Foods with Nutritional Function Claims (FNFC) are allowed to have health or nutrition claims. However, because of the costly and time-consuming approval process for FOSHU and the limited range of vitamins and minerals that qualify for FNFC, producers are not able to obtain FOSHU or FNFC approval for a majority of nutritional supplements. This limits the information available to consumers at the point of sale and hinders the ability of producers to differentiate their products. Other issues of concern include restrictions on food additives, enforcement of maximum residue levels, a lack of standard forms and procedures among import quarantine offices, and the high level of import duties for nutritional supplements compared to those for pharmaceuticals containing the same ingredient. The U.S. Government continues to address these issues through the Regulatory Reform and Competition Policy Initiative.

Poultry

Since 2002, Japan has imposed a number of national and statewide bans on the import of U.S. poultry meat due to the detection of both high pathogenic notifiable avian influenza (HPNAI) and low pathogenic notifiable avian influenza (LPNAI) in United States poultry. These bans run counter to international guidelines and have unnecessarily disrupted millions of dollars in the U.S. poultry trade.

According to international guidelines, recently revised by the World Animal Health Organization (OIE), countries must report any findings in domestic poultry of HPNAI and subtypes (H5 and H7) of the avian influenza, regardless of its pathogenicity. These guidelines also provide for importers from these countries to impose certain national or regional restrictions where HPNAI is reported, but not where LPNAI is reported. Instead, where HPNAI is reported, the guidelines provide for banning on a limited basis, preferably to zones where the HPNAI has occurred in domestic poultry, while allowing imports from other regions in the exporting country so long as the exporting country has effective controls and surveillance measures in place to quarantine the affected region. As a result of these bans as well as other factors, U.S. poultry meat exports to Japan have decreased substantially from roughly \$81 million in 2001 to \$45 million in 2002, and between \$29 to \$30 million in 2003, 2004, and 2005.

Cosmetics and Quasi-Drugs

Japan is the second-largest market in the world for cosmetics after the United States, but regulatory barriers limit consumer access to safe and innovative products. Unlike the U.S. over-the-counter drug monograph system, Japan requires pre-market approval for products that are classified as quasi-drugs under the Pharmaceutical Affairs Law. The approval process has burdensome and nontransparent requirements that do not enhance product safety, quality, or efficacy. In addition, certain advertising claims for cosmetics and quasi-drugs may not be made even though these claims are based on verifiable data. Allowing these claims would enable companies to provide consumers with information that would help them make sound choices. Other concerns related to cosmetics and quasi-drugs include a lack of

information on regulations and guidance available in a timely and accessible manner on the website of the Ministry of Health, Labor and Welfare; unpredictable time frames for product standard revisions; and long lead times for importation and approval.

GOVERNMENT PROCUREMENT

Japan is a signatory to the WTO Agreement on Government Procurement (GPA). Under the GPA, Japan covers the procurement of a number of central government agencies, all of its prefectures and several large cities, and a number of government enterprises. For procurement of construction services by sub-central and most government enterprises covered under the GPA, Japan applies a threshold of \$22 million, which is three times the threshold applied by the United States and most other GPA Parties. The U.S. Government seeks to expand access to Japan's government procurement market, in particular through the reduction of its construction services thresholds.

Construction, Architecture and Engineering

Although Japan has the second-largest public works market in the world (\$156 billion for 2006), U.S. firms annually obtain far less than 1 percent of projects awarded. Two public works agreements are in effect: the 1988 U.S.-Japan Major Projects Arrangements (MPA) (updated in 1991) and the 1994 U.S.-Japan Public Works Agreement, which includes the "Action Plan on Reform of the Bidding and Contracting Procedures for Public Works" (Action Plan). The MPA included a list of 42 projects in which international participation is encouraged. Under the Action Plan, Japan must use open and competitive procedures for procurements valued at or above the thresholds established in the WTO Agreement on Government Procurement (WTO/GPA), to which Japan is also a party. Public works issues are raised in the Trade Forum under the U.S.-Japan Economic Partnership for Growth.

U.S. companies continue to face obstacles when trying to maneuver Japan's complex regulatory system. Problematic practices that continue to inhibit the full involvement of U.S. design/consulting and construction firms in Japan's public works sector include bid-rigging (*dango*), under which companies consult and prearrange a bid winner. Numerous instances of government-initiated collusive bidding (*kansei dango*) at the prefectural level in 2006 highlighted the lack of a truly fair market environment for U.S. firms. The United States has asked Japan to continue to address this problem.

Another problematic practice is the use of excessively narrow, Japan-specific qualification and evaluation criteria that exclude U.S. firms from competing for projects. The United States has asked Japan to develop procedures to simplify the qualification process for foreign firms that have experience outside of Japan similar to that required by the qualification criteria. The United States also has asked Japan to ensure that procurements list all of the qualifying criteria for a project. The Action Plan requires that definitive criteria be published in a concrete manner so that firms can judge if they can qualify for projects. Other concerns include the use of excessively high Business Evaluation scores, unreasonable restrictions on the formation of joint ventures, unclear or conflicting bid/contract procedures, extremely low design fees, and excessive and costly documentation requirements for design bids.

The United States is pressing Japan to commission more Project Management (PM) and Construction Management (CM) projects during this fiscal year and structure procurements in such a way that foreign firms with appropriate expertise are able to compete. (CM and PM are advanced project delivery and management systems that maximize the efficiency of a project.) The United States is also promoting U.S. firms' participation in new types of public works projects in Japan such as Urban Renewal, Private Finance Initiative (PFI) and Local Area Renewal projects.

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The United States is paying special attention to several major projects covered by the public works agreements of particular interest to U.S. companies. These projects include: Okinawa Institute of Science and Technology; Haneda Airport development and expansion; Kansai International Airport; Central Japan International Airport; Kyushu University Relocation Project; Gaikan Expressway Project; Metropolitan Expressway Shinagawa Route Projects; major public buildings, large-scale hospital building projects, urban development and redevelopment projects; major PFI projects; and remaining MPA projects. The United States believes the MPA continues to apply to the Central Japan International Airport project.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

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

Patents

In July 2006, the U.S. Patent Office (USPTO) and Japan Patent Office (JPO) began a pilot project, the "Patent Prosecution Highway," that allows prompt examination of corresponding patent applications of companies of the other country. Under this framework, an applicant whose claims are determined to be allowable/patentable in the office where it was first filed can request that its corresponding application filed in the second office be promptly examined provided certain conditions are met. The second office would also be able to utilize much of the work by the first office. The two sides have agreed to a goal of issuing a first office action within 9 months of the request.

Despite improving cooperation on patent issues bilaterally and internationally, the United States remains concerned with several aspects of Japan's patent administration, including the relatively slow process of patent litigation in Japanese courts, the lack of an effective means to compel compliance with discovery procedures, the practice of affording only narrow patent claim interpretation, and the lack of adequate protection for confidential information produced relative to discovery.

In recent years, Japan has taken a number of steps to address these issues. A revised patent law took effect on January 1, 2000. This law was designed to make it easier for plaintiffs to prove patent infringement in courts. Key provisions include requiring defendants to justify their actions, obligating defendants to cooperate with calculation experts, giving judges discretion over the amount of damages, increasing the penalty in cases where patents were obtained fraudulently and allowing courts to seek technical advice from JPO. The United States will continue to monitor closely whether these revisions reduce the cost of access to Japanese courts that has been particularly onerous to foreign patent owners in the past. In 2005, an Intellectual Property High Court was established with specially trained judges to review IPR cases. The United States welcomes these steps to improve the level of patent protection in Japan and will continue working with Japan to strengthen its patent laws in several fora, including the Regulatory Reform Initiative, where the United States urged Japan in its recommendations to reconsider usage of the 3-year deferred examination system and adopt procedures to avoid "piecemeal" examinations.

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Copyrights

The increasing use of the Internet and explosive growth of high-speed broadband in Japan has presented new challenges for protecting IPR, especially for copyrighted materials. The protection of this material is critical for electronic commerce to flourish and for the continued development of content-related industries such as games, music, film, and software. The United States continues to be concerned that Japan's Internet Service Provider liability law does not provide adequate protection for the works of rights holders on the Internet or the appropriate and necessary balance of interests among telecommunications carriers, service providers, rights holders and website owners. The United States urges Japan to use all the opportunities available to improve these shortcomings in the law. The scope of protection for temporary copies remains vague in Japan, which could erode the ability to protect copyrighted materials. The United States will continue to monitor developments in this area.

Concerning Internet Protocol (IP) multicasting and/or rebroadcasting of television programs over the Internet, the United States also urges Japan to ensure that changes to Japan's measures foster market-based solutions and comport with international obligations.

The United States is also urging Japan to reduce the piracy rate, especially in light of the growing threat of online piracy. A notable step toward creating an effective deterrent against piracy, providing compensation to rights holders, and improving the efficiency of copyright cases in Japan's courts would be amending Japan's Civil Procedures Act to provide for an award of statutory damages at the election of the rights holders as an alternative to actual damages. In order to address movie piracy in particular, the enactment of effective anti-camcording legislation against the use of recording devices in movie theaters would also prove beneficial. In addition, the granting of *ex officio* authority to police and prosecutors to enable these officials to investigate and prosecute crimes on their own initiative by removing the requirement of right holder consent for prosecutions would further contribute to increasing protections of copyrights. Furthermore, as a means to set an example for the private sector, the United States urges Japan to make public and issue regulations and a decree forbidding any copyright infringement in its government operations.

The United States is also concerned about the personal use exception both as it applies to the Internet and to students and book piracy. Japan should make its law clear that the use of peer-to-peer networks to download and copy copyrighted works without the rights holder's authorization is not permitted under the personal use exception. The personal use exception also appears to allow students to copy entire textbooks for personal use as long as they do not distribute copies. The United States urges Japan to explicitly incorporate the three-part test from international treaties into the Copyright Law to address both these problems.

The United States is concerned about the provision on in Japan's Copyright Act for protection of effective technological measures used by copyright owners to protect their works. The provision applies only to devices the principal function of which is circumvention, and it does not protect access controls against circumvention.

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

copyrights laws in FY 2007, which the United States hopes will address many of the concerns raised with Japan in its December 2006 Regulatory Reform Initiative recommendations.

Trademarks

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

In spite of the existence of provisions in Japan's Unfair Competition Law designed to afford greater protection to well-known marks, protection of such marks remains weak in some respects, such as in its registration or designation.

Geographical Indications (GIs)

Articles 22 to 24 of the TRIPS Agreement set forth the obligations of WTO Members with respect to GIs and their relationships to trademarks. It is unclear whether Japan currently provides interested parties with the legal means to prevent misuse of a GI or whether Japan provides trademark owners with the legal means for resolving conflicts between trademarks and asserted GIs. The United States understands the Japanese government is currently studying the issue of GI protection and fully supports that effort. Outstanding concerns remain, since it is unclear whether Japan maintains an undisclosed list of protected GIs against which applications for trademark registration are reviewed. Reports have indicated that the Japanese government is considering the use of GIs to protect the identity of traditional food products from well-known production areas in Japan, but it is unclear how Japan would implement such protection. Japan has recently announced that it has three new Japanese terms which have been designated as GIs for wines and spirits by the Commissioner of the National Tax Agency through its Labeling Standard Concerning Geographical Indications, "to be protected in the territories of WTO Members." The United States is concerned as to why the Japanese Tax Commissioner is designating GIs to be protected outside of Japan, and whether foreign GIs are directly registrable under the Japanese GI system without intervention by a foreign government. The United States looks forward to receiving further information on these concerns.

Trade Secrets

Although Japan amended its Civil Procedures Act to improve the protection of trade secrets in Japanese courts by excluding court records containing trade secrets from public access, the law is inadequate. Because Japan's Constitution prohibits closed trials, the owner of a trade secret seeking redress for misappropriation of that secret in a Japanese court is forced to disclose elements of the trade secret in seeking protection. Because of this, and the fact that court discussions of trade secrets remain open to the public with no attendant confidentiality obligation on either the parties or their attorneys, protection of trade secrets in Japan's courts will continue to be considerably weaker than in the courts of the United States and other developed countries. The Diet passed a bill to partially amend the Unfair Competition Prevention Law in May 2003. The bill contains a provision that states that a person who illegally acquires, uses, and discloses corporate secrets is subject to criminal sanctions. The scope of the amendment, however, is limited. The United States continues to urge Japan to undertake further reform.

Border Enforcement

The United States continues to monitor implementation by the Japan Customs and Tariff Bureau (JCTB) of a policy to allow parallel imports of patented products based on a 1997 Japan Supreme Court ruling. Further, insofar as Japan provides *ex officio* border enforcement of trademarks and copyrights through the JCTB, efforts should be made to enhance such enforcement through aggressive interdiction of infringing articles. In an effort to bolster Japan's border control measures, the United States has urged Japan to improve its application, inspection, and detention procedures to make it easier for foreign rights holders to obtain effective protection against infringed intellectual property rights at the border. Although Japan increased the amount of resources devoted to enforcement during 2004, the United States urges Japan to continue to improve and tighten its border enforcement to ensure effective implementation of its TRIPS obligations.

SERVICES BARRIERS

Insurance

Japan's private insurance market is the second-largest in the world, after that of the United States, with direct net premiums of an estimated 36.9 trillion yen (over \$300 billion) in Japan FY 2005. In addition to the offerings of Japanese and foreign private insurers, substantial amounts of insurance are also provided to Japanese consumers by the large life insurance unit (Kampo) of government-owned Japan Post, the National Public Health Insurance System, and a web of insurance cooperatives (*kyosai*).

Insurance Agreements were concluded between the United States and Japan in 1994 and 1996. These agreements greatly facilitated growth in the presence of foreign insurance companies in Japan's market since that time. As of Japan FY 2005, foreign insurers held an estimated 25.7 percent of the private life insurance market (total market excluding Kampo and *kyosai*) and a 5.16 percent share of the private non-life insurance market. In the third sector, foreign firms have approximately 57 percent of the private sector life medical/nursing care insurance market and an approximate 75 percent share of the private sector medical/cancer market in Japan FY 2005.

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 the Japanese government's regulatory framework fosters an open, fair, and competitive insurance market.

Postal Insurance: Japan Post's insurance business, or Kampo, continues to be the largest player by far in Japan's insurance market, which is larger than the four largest private sector Japanese life insurers combined. In Japan FY 2005, there were 61 million Kampo-issued life insurance policies in force compared to 125 million for all private life insurance companies combined. The U.S. Government has long-standing concerns about tax, regulatory, and other advantages given to Kampo over its private sector competitors as well as over the impact these advantages have had on competition in Japan's insurance market. It remains vital that Japan eliminate these advantages and create a level playing field.

The U.S. Government is closely monitoring the Japanese government's initiative to privatize and reform Japan Post. The Japan Post reform framework established by Japan's Diet in 2005 includes a number of key measures that, if implemented fully, will represent long-awaited progress in areas of concern to U.S. and other insurers in the market. Importantly, the legislation also included the establishment of equivalent conditions of competition between Japan Post and the private sector as a basic principle of the reforms.

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In addition to eliminating Japan Post's tax and regulatory advantages and ensuring equal supervisory treatment, the U.S. Government continues to look to Japan to take other steps necessary to achieve a level playing field. Among those steps, the U.S. Government urges that adequate measures are implemented to ensure cross-subsidization does not take place among the newly created Japan Post businesses and related entities, including by ensuring Japan Post's strict compliance with the Insurance Business Law's arms-length rule and requiring adequate financial disclosures to demonstrate that cross-subsidization is in fact not occurring. The U.S. Government also continues, for example, to emphasize importance of ensuring the new company established to manage Japan's post office network will transparently and fairly select insurance products of private providers for distribution throughout the network.

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

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

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

Kyosai: Insurance businesses run by cooperatives, or *kyosai*, occupy a substantial presence in Japan's insurance market. According to the Japan Cooperative Insurance Association, *kyosai*-issued policies amounted to more than 20 percent of all in-force life policies in the market and 35 percent of all in-force non-life policies in 2002, the last year for which statistics are available.

Some *kyosai* are regulated by their respective agencies of jurisdiction (the Ministry of Agriculture, Forestry and Fisheries, or the Ministry of Health, Labor and Welfare, for example) instead of by the Financial Services Agency (FSA), while others have been allowed to operate without any regulatory supervision at all. These separate regulatory schemes undermine the ability of the Japanese government to provide companies and policyholders a sound, transparent regulatory environment, and afford *kyosai* critical business, regulatory, and tax advantages over their private sector competitors. The U.S.

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Government has stated its position that all *kyosai* should be subject to the same regulatory standards and oversight as their private sector counterparts to ensure a level playing field and to protect consumers.

The Japanese government took some important steps in 2006 to bring more oversight scrutiny to unregulated *kyosai*. Under changes being phased in through 2008, a new “small-amount, short-term” *kyosai* provider category has been created, and previously unregulated *kyosai* that meet the criteria for selling small-amount and short-term insurance policies to customers were required to register with the FSA. Those previously unregulated *kyosai* will be supervised by the FSA and held to some of the same regulatory standards as private sector insurers. Previously unregulated *kyosai* that do not meet these criteria will be required to meet the same license requirements as private insurers. Other *kyosai*, including public welfare cooperatives and cooperatives run by workers within private corporations, will continue to be allowed to operate with a minimum of regulatory supervision. As the Japanese government implements this new system and reviews its operation as required under the amended law, the U.S. Government urges that additional steps be taken to hold *kyosai* to the same regulations and FSA supervision as are applied to private companies.

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

Policyholder Protection Corporations: The Life and Non-life Policyholder Protection Corporations (PPCs) are mandatory policyholder protection systems created in 1998 to provide capital and management support to insolvent insurers. As a result of subsequent industry failures, private sector insurers have been called upon to contribute considerable sums to the PPC since that time. U.S. industry, particularly life insurers, has expressed serious concern over the burden of these contributions. The U.S. Government has stressed the need for a sustainable funding framework that does not unfairly burden private companies.

Japan’s Diet passed legislation in 2005 to renew the PPC system starting in April 2006. While some improvements were made on the previous system under the legislation, the PPC system nonetheless continues to rely upon pre-funding by its members, instead of adopting a system of funding to follow an insolvency that results in a draw of funds from the PPC (post-funding). The U.S. Government continues to urge Japan to adopt more fundamental changes in the PPC systems, including the post-funding approach, when the next renewal of the system is enacted.

Bank Sales: Initial steps taken in 2001 and in 2002 to allow for limited sales of insurance products through banks were augmented with a new step, effective December 2005, to further liberalize this sales channel. Although this new step is welcome, the range of products now available through banks nonetheless represents a small percentage of the universe of private insurance products that could be made available to Japanese consumers through banks.

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

Professional Services

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

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

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

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

Educational Services: Excessive regulation has discouraged foreign universities from operating branch campuses in Japan, presenting obstacles in the form of both administrative requirements and restrictions on pedagogical choices. The U.S.-Japan Investment Initiative has taken up these issues, and the Japanese government has established a new category of "Foreign University - Japan Campus" for accredited institutions of higher education whose home campus is in the United States or elsewhere. Four U.S. institutions have been granted this status as of September 2006. This designation has provided these campuses with a number of important benefits (such as student rail passes and the authority to issue student visas) similar to those accorded Japanese educational institutions. However, the new status for foreign universities does not yet grant the tax benefits enjoyed by Japanese institutions and their students. The United States continues to urge Japan's Ministry of Education, Culture, Sports, Science and Technology to work with these foreign universities to find a nationwide solution that grants these institutions the appropriate tax status and allows them to continue to provide their unique contributions to Japan's educational environment.

INVESTMENT BARRIERS

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

Much of the recent increase in FDI flows reflects restructuring in the financial services and telecommunications sectors. The Japanese government has recognized the importance of FDI in

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revitalizing its economy. Former Prime Minister Koizumi, for example, vowed in January 2003 to double the stock of FDI in Japan in five years. Although that goal was not fully achieved, Prime Minister Abe, in his first policy speech before the Diet in September, reaffirmed the government's goal of further doubling the stock of FDI in Japan to the equivalent of 5 percent of Gross Domestic Product (GDP) by 2010. Japan has taken several recent steps to improve the FDI environment, including revision of the Corporate Code to permit the use of triangular stock swaps for international M&A deals. However, full implementation was postponed until April 2007. U.S. businesses have applauded steps taken thus far but continue to urge that full liberalization of M&A rules be implemented as scheduled and that tax rules be clarified and amended to facilitate use of modern merger techniques.

Cross-border M&A is more difficult in Japan than in other countries, partly because of conservative attitudes towards outside investors and partly because of differing management techniques and the relative lack of financial transparency and disclosure. The scarcity of qualified lawyers, auditors, and accountants is another impediment. There have, however, been growing numbers of M&A deals, the majority of which are between fully domestic companies, a development that is slowly breaking down the traditional antipathy toward such deals and toward FDI in general. But this has only highlighted the remaining legal and regulatory hurdles in the way of such deals, not the least of which are remaining weaknesses in corporate governance. In its December 2006 Regulatory Reform Initiative submission, the United States again urged Japan to facilitate such deals by promulgating regulations to require companies to disclose to shareholders any anti-takeover measures they adopt and provide an explanation of why such measures are necessary. The United States also urges Japan to take measures to promote active proxy voting by institutional investors and encourage the Investment Trust Association to adopt rules on proxy voting and disclosure of voting policies and voting records by mutual fund and other investment trust managers.

The U.S.-Japan Investment Initiative, co-chaired by the U.S. Department of State and Japan's Ministry of Economy, Trade and Industry (METI), was established in 2001 to encourage policy changes that improve the overall environment for foreign (and domestic) investment and to focus on specific barriers in certain sectors, including educational and medical services. The Investment Initiative Working Group holds semi-annual meetings and sponsors investment promotion seminars with active private sector participation in Japan and the United States.

ANTICOMPETITIVE PRACTICES

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

Law against Unjustified Premiums and Misleading Representations: Foreign companies looking to enter the Japanese market, who depend on innovative sales techniques to promote their company names and products, face a substantial obstacle in the Japan Fair Trade Commission's (JFTC) restrictions on premiums. Although the Japanese government has made nominal changes to the Law against Unjustified Premiums and Misleading Representations over the past two decades, the law itself and JFTC's overly restrictive enforcement of its provisions block many common and legitimate sales techniques such as product giveaways and lotteries. In addition, "fair trade councils" (essentially, private trade associations) set their promotion standards through self-imposed "fair competition codes" that are recognized by the JFTC. These codes frequently impose additional standards that are stricter than required by JFTC regulations under the Premiums Law. As a result, vested manufacturing and retailing interests are protected to the detriment of new entrants to the market. As of March 31, 2006, (the end of the most recent Japanese fiscal year), there were still 40 JFTC-authorized premium codes.

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ELECTRONIC COMMERCE

The United States continues to urge Japan through the Regulatory Reform Initiative to take measures that maximize the adoption and use of information technology (IT) and electronic commerce, including: (1) removing regulatory and non-regulatory barriers; (2) strengthening the protection of intellectual property rights; (3) implementing the review of the Privacy Law in a transparent, manner effectively promoting the free flow of information and privacy protection; and (4) ensuring effective network and online security. The United States is engaged with Japan on these and other electronic commerce issues in the Regulatory Reform Initiative's IT Working Group (*see the "Information Technologies" section under Regulatory Reform*).

OTHER BARRIERS

Aerospace

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

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

Japanese defense projects are carried out according to the Mid-Term Defense Program (Japan FY 2005-2009), which began in April 2005, and has a projected budget of \$224 billion over this five-year period. Major projects include ground and maritime ballistic missile defense systems, new maritime patrol aircraft, and new transport and tanker aircraft.

Although Japan has considered its main space launch vehicle programs as indigenous for many years, U.S. firms continue to participate actively in those space systems, including Japan's primary space launch vehicle, the HII-A. The U.S. Government has welcomed Japan's plans to develop a supplementary GPS navigation satellite constellation known as the "quasi-zenith" system.

The United States is working very closely at the technical level with Japanese counterparts to ensure the Japanese system remains compatible with the U.S. system and anticipates that U.S. companies will have the opportunity to supply major components of this system. The United States will continue to promote expanded access by U.S. companies to commercial opportunities in Japan's domestic space programs as appropriate.

Autos and Automotive Parts

Further opening of Japan's automobile and automotive parts markets remains an important U.S. Government objective. A variety of non-tariff barriers have impeded access to Japan's automotive market. While there has been a trend toward closer integration and important technological advancements in the global automotive industry over the past several years, the actual effect of these changes on access to Japan's market remains unclear.

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The overall U.S. automotive trade imbalance with Japan stood at \$56.8 billion in 2006 (\$43.2 billion deficit in autos and \$13.6 billion deficit in automotive parts). Meanwhile, overall sales of North American-made vehicles and parts in Japan remain low. Even as U.S. automakers have invested in Japanese automobile manufacturers, foreign access to Japan's automotive distribution network remains troubling to U.S. automobile companies. According to the most recent import statistics available from Japan Automobile Importers Association (JAIA), sales of U.S. produced motor vehicles in Japan decreased in 2005 to 19,130 units.

Under the United States-Japan Economic Partnership for Growth, the United States continues to address crosscutting structural and regulatory reform issues affecting the automotive sector, including expanding opportunities for foreign investment, strengthening competition policy, and increasing transparency in rule making.

Civil Aviation

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

Since the 1998 agreement was signed, the two sides have held several rounds of formal and informal talks aimed at further liberalization, but have been unable to make any progress. Key U.S. concerns include restrictions on operating rights for non-incumbent cargo carriers, limitations on same country carrier code-sharing, change of gauge limitations, and restrictive pricing practice.

Due to its geographic location as the closest landing point in Asia from the United States, U.S. carriers have maintained large hub operations at Narita International Airport. Nonetheless, in comparison to similar international airports in other countries, movements at Narita fall well below potential airport capacity, unnecessarily limiting slot availability. In periods of high demand, U.S. non-incumbent combination carriers have been unable to operate routes made available under the 1998 Memorandum of Understanding. A second runway opened in April 2002 provides additional slots, but at less than 2500 meters, the runway cannot accommodate most long-haul operations. An extension project to allow use of this runway for long-haul routes is underway, but this project is bundled with other capital upgrades and the overall budget tops 33 billion yen. At this point it is not clear this project will be able to pay for itself, and it is possible an increase in the already high user-fees will be used to finance it. Recently lowered landing fees at Narita were offset in part by raising other fees and introducing new ones. The issue of excessively high landing fees at Narita, Kansai and Central Japan International Airport (Centrair) airports continues to be raised in the United States-Japan Regulatory Reform Initiative and in bilateral aviation discussions.

The international business and tourism sector in Japan is constrained by the high landing and users fees at Narita, Kansai, and Centrair Airports. Opening the formula used to calculate landing fees at Japan's international airports to public comment and ensuring the landing fee calculation at all airports is transparent both for domestic and international flights and based on international standards would benefit both Japanese consumers and the civil aviation industry. In the United States-Japan Regulatory Reform Initiative, the U.S. Government recommends that an independent economic regulator for "corporatized" airports, such as Narita Airport, should be part of system that would ensure fees are set transparently and fairly.

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

Business Aviation

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

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

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

Electric Utilities

The United States continues to stress that by introducing genuine competition into non-fuel procurement (valued at approximately \$10 billion annually), Japan can effectively reduce the cost of its electric power, which remains among the highest in the industrialized world. U.S. exports should rise significantly if barriers are lifted. U.S. exports currently account for approximately 3.5 percent of Japanese electric utility procurements, or around \$350 million per year. Japan's utilities actively participate in the New Orleans Association, a U.S. Embassy-sponsored forum that enhances communication between Japanese electric power utilities and U.S. suppliers of non-fuel materials, equipment, and services. The United States continues to urge Japanese utilities to further increase procurement of foreign products and services (which are often more economical) and ensure transparency and fairness in the procurement process.

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

In addition, because each utility uses its own specifications (in some cases, different departments of a utility use their own specifications), suppliers must prepare more than ten production lines in order to sell

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to Japan's ten electric power companies. The United States thus urges Japanese firms to simplify and streamline their procurement guidelines while continuing their efforts to expand bidding opportunities for foreign firms.

Transport/Ports

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

Since 1999, the United States has expressed its concern that reforms have not lessened JHTA's ability to deter new entry and restructuring in the ports sector. The United States has noted that the revised Port Transportation Business Law did eliminate the economic needs test and licensing requirement at the nine large ports, although the amended law still maintains a permission system for new entrants to port services operations in those ports. The Port Transportation Business Law introduces new requirements that run counter to the need for efficient port operations and discriminate against new entrants wishing to offer port services. For example, minimum manning levels for new entrants was set at 150 percent; new terminal operators are required to conduct all terminal operations as a joint venture or under a close ties relationship with established Japanese operators; a new licensing rule was introduced, requiring excessive and unnecessary information such as business plans; and the Japanese government now has the authority to disallow rates for port services found to be anticompetitive. In addition, MLIT has not addressed concerns about the prior consultation process conducted by the JHTA nor about the apparent threat of illegal strikes against foreign carriers who obtain permission to operate their own container terminals.

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