JAPAN

In 1997, the U.S. goods trade deficit with Japan was $55.7 billion, an increase of $8.0 billion (17 percent) from the U.S. trade deficit of $47.6 billion in 1996. U.S. merchandise exports to Japan were $65.7 billion, a decrease of $1.9 billion (2.8 percent) from the level of U.S. exports to Japan in 1996. Japan was the United States' third largest export market in 1997. U.S. imports from Japan were $121.4 billion in 1997, an increase of $6.1 billion (5.3 percent) from the level of imports in 1996. The stock of U.S. foreign direct investment (FDI) in Japan in 1996 was $39.6 billion, an increase of 3.1 percent from the level of U.S. FDI in 1995. U.S. FDI in Japan is concentrated largely in the manufacturing, finance, and wholesale sectors.

Overview

The Clinton Administration continued to make progress in 1997 on improving market access for U.S. exports of goods and services into Asia's largest economy. While Japan's economic stagnation depressed imports, resulting in an increase in Japan's current account and global trade surplus, it also presented an opportunity to press the Japanese Government to address long-term, structural impediments to market access for U.S. goods and services. The United States concluded new agreements and resolved disputes with Japan in several important sectors which will offer significantly expanded opportunities for American exports to Japan. The most comprehensive of these agreements was the Enhanced Initiative on Deregulation and Competition Policy, announced by President Clinton and Prime Minister Hashimoto in June. Other bilateral agreements or settlements concluded during the past year addressed barriers affecting: wood products, sound recordings, tomatoes, telecommunications procurement, maritime and port practices, Nippon Telegraph and Telephone (NTT) procurement, distilled spirits, and civil aviation.

The Administration's approach focused on: monitoring and enforcement of existing agreements covering a range of key sectors, from autos and auto parts to telecommunications; negotiating new agreements through bilateral, regional and multilateral approaches; and encouraging significant structural reform and deregulation to open more sectors of Japan's economy to competition and stimulate domestic demand-led growth in Japan.

This strategy fit with the Clinton Administration's comprehensive approach to the U.S. bilateral economic relationship with Japan, which was embodied in the United States-Japan Framework for a New Economic Partnership ("Framework Agreement"), signed by President Clinton and then-Prime Minister Miyazawa on July 10, 1993. Under the Framework Agreement, the United States and Japan have agreed to focus on increasing foreign firms' access to the Japanese market not only by eliminating sector-specific barriers, but also by addressing structural and macroeconomic obstacles. While Japan has reduced its formal tariff rates on imports to very low levels, it has maintained non-tariff barriers, such as non-transparent,
discriminatory standards, exclusionary business practices, and a business environment that protects domestic companies and restricts the free flow of competitive foreign goods into the Japanese market. An important innovation of the Framework Agreement was its emphasis on objective quantitative and qualitative criteria for monitoring and enforcing of each agreement reached, which enables a more complete assessment of implementation of each agreement and provides a dynamic measure of the degree to which Japan's market is opening to foreign goods and services.

Japan

A major policy goal under the Framework Agreement has been to promote regulatory reform and competition in Japan. Building on the Framework Agreement, the Enhanced Initiative on Deregulation and Competition Policy has become the vehicle for bilateral efforts to promote comprehensive deregulation and strengthen competition enforcement. This initiative supplements Japan's own efforts, under its Deregulation Action Plan, to liberalize and deregulate its economy. To this end, in November 1997, the United States presented a detailed submission proposing specific deregulatory steps for the Japanese Government to take to address burdensome regulation throughout the Japanese economy. Such over-regulation lowers the standard of living of Japanese consumers and creates market access barriers which disadvantage imports, contributing to Japan's global trade surplus.

The Administration forged several new sectoral agreements in 1997 which addressed longstanding barriers to U.S. goods and services, created new business opportunities for U.S. firms, and settled trade disputes with Japan. For example, two agreements concerning telecommunications procurement by Nippon Telegraph and Telephone (NTT) and the National Police Agency, the world's largest telecommunications equipment corporation, were designed to ensure fair access to this important market for U.S. suppliers. The United States will continue to place a high priority on further liberalization of Japan's huge telecommunications equipment and services markets. In the wake of strong action by the Federal Maritime Commission, the United States and Japan also reached two agreements in 1997 under which Japan committed to reform its highly restrictive port practices system, streamlining and liberalizing foreign shippers' access to Japanese harbor services. And in January 1998, the United States and Japan concluded a civil aviation agreement which will significantly liberalize the bilateral civil aviation market and result in benefits for both countries.

The Administration continued to focus attention in 1997 on the monitoring and enforcement of existing agreements to ensure their complete and successful implementation. U.S. and Japanese officials met throughout the year to discuss progress under important agreements covering: autos and auto parts, insurance, flat glass, construction, semiconductors, medical devices and pharmaceutical products, and government procurement of computers and supercomputers.

The United States also addressed market access barriers in Japan through the World Trade Organization (WTO) Dispute Settlement Mechanism. In January, the Administration settled a dispute over Japan's failure to adequately protect sound recordings, resolving the WTO dispute settlement proceeding against Japan. To settle this dispute, Japan adopted amendments to its Copyright Law in December 1996 to provide full protection to sound recordings produced from 1946 to 1971, addressing a deficiency which U.S. industry estimated cost it $500 million annually in Japan. In December, the U.S. reached a settlement with Japan over implementation of the WTO panel decision against Japan's discriminatory tax on distilled spirits. As a result of this settlement, Japan will dramatically lower, and in some cases eliminate, its tariffs on a wide range of white and brown spirits and eliminate its discriminatory tax system on distilled spirits.

The United States initiated WTO dispute settlement procedures against Japan in 1996 regarding market access restrictions in Japan's consumer photographic film and paper sector. The United States argued that the Japanese Government had implemented an extensive array of measures over the past 30 years to offset the effects of tariff, import, and foreign investment liberalization and limit the sale of imported consumer photographic film and paper in Japan. In its final report to the parties, issued in January 1998, the WTO panel failed to find Japan in violation of its WTO obligations. The United States was very disappointed with these findings, stating that the report sidestepped the core issues, particularly the combined effects of the numerous

measures Japan imposed to protect its market. Subsequently, the Clinton Administration announced a new market-opening initiative to continue to press for meaningful access to this market. Under this initiative, an interagency monitoring and enforcement committee will monitor Japan's implementation of its representations to the WTO panel regarding the openness of this market.

In addition to sectoral and structural initiatives, Japan also committed under the Framework to address the fundamental macroeconomic asymmetries that have afflicted Japan's international economic relations. In particular, Japan agreed to work toward reducing its global current account surplus as a percentage of its gross domestic product (GDP). While in 1992 Japan's current account surplus was 3.2 percent of GDP, by 1996, it had dropped to around 1.5 percent ($66 billion). In 1997, however, Japan's economic growth virtually stalled and its current account surplus increased dramatically once again to about 2.3 percent of GDP ($93.5 billion). The Administration has repeatedly emphasized to the Japanese Government the importance of proceeding with its commitment to ensure domestic demand-led growth and avoid a sustained and significant increase in its current account surplus.

U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy

Background -- Japan and Deregulation

Japan's recent government deregulation efforts notwithstanding, the Japanese economy is characterized by excessive, outdated regulations. Unnecessary regulations restrain economic growth, raise the cost of doing business in Japan, lower the standard of living for Japanese consumers, and impede imports. Japanese economists estimate that the government regulates about 40 percent of all economic activity in Japan. Examples of excessive regulation include price controls, unique standards, and burdensome testing and certification requirements. The Japanese Government estimates that if its deregulation plans are fully implemented, from JFY 1998-2003 the Japanese GDP would grow by an additional 0.9 percent annually, while the ratio of current account surplus to GDP would decline 0.9 percent.

Regulations lie at the heart of many of the market access problems faced by American companies doing business in Japan. Some regulations are aimed squarely at imports; others are part of a system which protects the status quo against new market entrants, disproportionately affecting foreign firms. The United States Government has aggressively pushed for elimination of regulations which impede market access for American companies, and many recent U.S.-Japan trade agreements have addressed issues related to the regulation of Japanese markets.

Since 1995, the Japanese Government has focused its energies in this area on implementation of a three-year Deregulation Action Plan. The current action plan will expire at the end of March 1998. In order to encourage Japan to adopt meaningful commitments to deregulate, the U.S. and other trading partners have provided Japan with annual submissions detailing specific deregulation requests. Unfortunately, progress under the Deregulation Action Plan has been modest.

To promote deregulation, the Government of Japan established, by law, an Administrative Reform Council, comprised of representatives from Japan's private sector, academia and the media. Many of the Administrative Reform Council's deregulation recommendations to the Japanese Government were in line with the requests of the United States and others. Given the Council's lack of authority to compel adoption of its

recommendations, however, Japanese ministries and agencies often ignored the most important recommendations. The Administrative Reform Council's mandate expired in December 1997.

In February 1998, the Hashimoto Cabinet established a Deregulation Committee, comprised of seven former members of the Administrative Reform Council's Deregulation Subcommittee. This Deregulation Committee is tasked with compiling a new three-year deregulation action plan by the end of March 1998. The Deregulation Committee's mandate beyond March 1998 is unclear. It appears the Japanese Government is considering whether and how to establish a successor entity to the Administrative Reform Council. The United States has urged that a new entity under the Prime Minister's Office be created which will have a mandate to commit Japan to implementation of new deregulation measures and monitor measures already announced.

The Enhanced Initiative on Deregulation and Competition Policy

In an effort to promote the goals of the Framework Agreement, accelerate the pace of deregulation in Japan, and increase market access for foreign goods and services, President Clinton and Prime Minister Hashimoto on June 19, 1997 agreed to establish the Enhanced Initiative on Deregulation and Competition Policy. The Enhanced Initiative addresses both sectoral and structural issues, and seeks reform of relevant government laws, regulations, and guidance which impede market access for competitive foreign goods and services. Under this initiative, five expert-level groups have been meeting: four sectoral groups in the areas of telecommunications, housing, medical devices and pharmaceutical products, and financial services; and one on structural issues, focusing on competition policy, distribution, and transparency and other government practices. Senior-level meetings, chaired by the Deputy USTR and the Deputy Foreign Minister, were held on November 14, 1997 in Washington, and March 4, 1998 in Tokyo to spur progress under this initiative. At their November 1997 meeting in Vancouver, President Clinton and Prime Minster Hashimoto agreed on the need to demonstrate concrete progress under this initiative by the next G-7 Summit in Birmingham, England in May 1998. The United States anticipates that Japan will demonstrate its commitment to carry out meaningful deregulation, to stimulate domestic demand, and to increase market access for foreign goods and services by the time of the Birmingham Summit.

In November 1997, the United States provided to the Government of Japan the "Submission by the Government of the United States to the Government of Japan regarding Deregulation, Competition Policy, and Transparency and other Government Practices." This represented a detailed submission of deregulation measures covering all of the sectoral and structural areas under the Enhanced Initiative, as well as other sectors. A summary of the key deregulatory areas follows.

Sectoral Deregulation

Telecommunications

In the telecommunications sector, the United States is seeking regulatory changes which will bring more competition to a sector long encumbered by excessive, outdated regulations and by dominant carriers (NTT and *Kokusai Denshin Denwa* (KDD)) that exercise market power to deter the entry and development of new competitors. The United States' submission targets deregulation in basic telecommunications, direct-to-home (DTH) satellite service, wireless equipment and cable television. Specific issues include over-priced interconnection rates, foreign investment restrictions, onerous tariff and licensing procedures, restrictions on

satellite services, and burdensome equipment certification procedures.

Japan has made some progress in deregulating this sector which should increase competitive opportunities. For example, as a result of bilateral consultations, direct-to-home satellite service providers will be able to offer a significantly expanded number of channels; international telecommunications service providers will be able to use leased lines to bypass the over-priced international settlement system and bring international rates in line with those of competitive markets, which are a fraction of Japan's rates; Japan will eliminate the restrictions on foreign investment in its major international carrier, KDD; it will streamline licensing and tariff procedures which unduly encumber telecommunications providers; it will eliminate restrictions on using third parties for transit for international telecommunications traffic; and it will also reduce fees and simplify procedures for testing and certifying wireless equipment. We will monitor these commitments closely.

However, ensuring a truly competitive market, especially for local telecommunications competition, will require much more. For example, the United States has urged Japan to adopt a pro-competitive interconnection regime incorporating long-run incremental cost methodology by the end of 1998, without which progress across the entire basic telecommunication sector will be in jeopardy; that Japan take action to ensure transparent, timely, and non-discriminatory access to rights-of-way for new entrants wishing to establish telecommunications or CATV infrastructure in Japan; that Japan introduce measures to ensure that dominant carriers do not engage in anticompetitive pricing; and further liberalize DTH by permitting unlimited channel use and the use of statistical multiplexing to promote more efficient use of the broadcast spectrum.

Medical Devices and Pharmaceutical Products

The United States continues to seek greater market access for U.S. medical devices and pharmaceutical products through the Enhanced Initiative on Deregulation and the Market-Oriented, Sector Selective (MOSS) Medical/Pharmaceutical talks. As Japan undertakes potentially extensive health care reforms, price reimbursement and regulatory issues remain the focus of bilateral consultations. The Administration conducted government consultations on Japanese deregulation of medical devices and pharmaceutical products in September and November 1997 and March 1998.

The bilateral consultations addressed, in particular, specific Japanese government regulatory policies that continue to hinder the ability of U.S. firms to supply innovative and cost-effective medical devices and pharmaceutical products. The United States urged Japan’s Ministry of Health and Welfare to ensure that the pricing system revision under consideration follow a consistent, transparent process and not be imposed disproportionately, or inappropriately, on new and innovative medical devices and pharmaceuticals.

Of particular importance, the United States strongly opposes Japan’s proposed implementation of a reference pricing system for pharmaceuticals. The United States believes that prices should be market-based.

In March 1998, in response to priority U.S. Government deregulation requests, Japan announced its intention to undertake necessary measures to expand the acceptance of foreign clinical data and expedite approvals for new drug applications. These changes, while welcome, represent only incremental improvements. The United States will continue pressing for substantive deregulatory actions on these issues, as well as other U.S. deregulation priorities.

Japan

The Administration believes that structural problems underlying Japan's health care system prevent efficient care delivery, substantially increase costs, and impede the timely introduction of new, innovative, and life-saving medical devices and pharmaceutical products. Cutting costs and improving the health care system in Japan will require the elimination of these inefficiencies and increased availability and use of competitive foreign medical and pharmaceutical products.

Housing

Under the Enhanced Initiative, the United States and Japan established a Housing Experts group which met in July and November 1997 and in February and March 1998. The purpose of the group is to promote improved market access in Japan for foreign suppliers of wood building products as called for in the 1990 U.S.-Japan Wood Products bilateral agreement, and to promote full implementation of Japan's Housing Initiative announced by Prime Minister Hashimoto in March 1996. This initiative calls for the reduction of housing costs in Japan by one-third by the year 2000, and places a special emphasis on improved access for imported building products in the short term. Improved market access for wood and other building products and performance-based standards will lead not only to increased market access opportunities for imports, but also to higher quality, safer, and more affordable housing in Japan.

To advance the work of these groups, the United States included in its November 1997 deregulation submission, a number of recommendations to expedite housing deregulation and reduce housing costs in Japan. Some of the proposed measures included: Japan's full and active participation in the APEC initiative for forest products trade liberalization, including the phase-out of tariffs on value-added wood products; expeditious approval of pending applications by U.S. grading and testing organizations, e.g., the American Lumber Standards Committee and Underwriter's Laboratories; publication of testing methods and procedures to implement the new performance based alternative for 2x4 wooden construction, based on international practice; amendment of the Building Standards Law to provide for performance-based alternatives to prescriptive building standards; and implementation of this amendment in a user-friendly manner, consistent with international practice.

While dialogue on standards-related issues has been constructive, the grademark approval process and the resolution of important technical standards-related issues has been slow. For example, while a new performance-based 2x4 construction alternative was announced in March 1997, the testing procedures required for its implementation have not yet been published. The United States is pressing for expeditious action and resolution of outstanding issues like these.

Financial Services

On February 13, 1995, the United States and Japan concluded a comprehensive financial services agreement under the auspices of the U.S.-Japan Framework Agreement. This agreement provides for the liberalization of legal and operational constraints that impeded access by foreign financial services providers in the areas of asset management, corporate securities, and cross-border financial transactions. In the two years since the agreement was concluded, the Japanese Government has implemented the vast majority of commitments within the agreed upon time frames. In some areas, Japan has either accelerated the implementation of certain commitments or expanded their scope.

The United States is monitoring the agreement to ensure that implementation remains on schedule and is assessing the effect of the actions undertaken, using the quantitative and qualitative criteria included in the agreement. At the most recent follow-up meeting in October 1997, the United States emphasized the need for further improvements in financial disclosure and transparency.

In an announcement on November 11, 1996, Prime Minister Hashimoto committed Japan to conducting broad-based deregulation of its financial sector, aimed at making Tokyo's financial markets comparable to those of New York and London by the year 2001. The Japanese Government introduced financial liberalization legislation into the Diet in March 1998.

Structural Deregulation

Competition Law and Policy

Under the Enhanced Initiative on Deregulation and Competition Policy, the United States has recommended several measures which it believes would lead to tougher Antimonopoly Law enforcement and strengthen competition policy. Despite the recent "upgrade" of the Japan Fair Trade Commission's (JFTC) organizational status, the United States continues to believe that further strengthening of competition law enforcement and policy in Japan is critical to improving market access. Foreign companies continue to face numerous impediments in accessing Japan's distribution channels for a wide range of sectors, including: the automotive, paper and paperboard, flat glass, and photographic film and paper markets. The Administration has focused on the following Antimonopoly Law and competition policy issues under the Enhanced Initiative.

Deregulation Process and the JFTC: The United States is urging more active participation by the JFTC in Japan's deregulatory process. The JFTC is the only Japanese agency mandated to promote competition, and the JFTC's low level of involvement in the deregulation debate has been noticeable. The United States has requested that the Deregulation Committee invite the JFTC to participate regularly in its meetings because the JFTC could provide important competition analysis and assistance. Also, the United States has urged the JFTC to establish a framework for proposing and reviewing deregulatory measures.

Antimonopoly Law Compliance Programs: In its November 1997 deregulation submission, the U.S. Government recommended that the JFTC initiate a review of the Antimonopoly Law compliance programs of influential companies in markets where foreign companies have experienced market access problems, e.g., flat glass, paper and paperboard. In February, 1998, the JFTC announced it would survey the top 2500 Japanese firms regarding their Antimonopoly Law compliance programs. The United States has urged the JFTC not only to publish the results of its survey but also to make specific recommendations regarding how firms can improve their Antimonopoly Law compliance programs.

Economic Surveys Transparency: The JFTC over the last few years has completed a number of economic surveys on such sectors as photographic film and paper, flat glass, and paper and paperboard in markets where U.S. companies have encountered anticompetitive activities that inhibit market access. Although these economic surveys are useful as a means to better understand an industry, it is often not known whether firms in the surveyed industry comply with recommendations or advisements made by the JFTC. To address this problem, the United States is urging the JFTC to implement a transparent follow-up procedure to monitor whether or not firms have reformed potentially anticompetitive business practices in accordance with measures

recommended or advised by the JFTC.

Private Party Injunctions: For several years, the United States has urged Japan to amend its Antimonopoly Law to make it easier for private citizens to bring lawsuits based on violations of the Antimonopoly Law. Current legal requirements discourage private citizens from filing suits. The Ministry of International Trade and Industry (MITI) established a study group in September 1997, to consider whether the Government of Japan should amend the Antimonopoly Law to allow private parties to sue for an injunction based on a violation of the Antimonopoly Law. The U.S. Government has expressed the strong hope that the MITI study group's conclusions on this issue will be supportive of amending the Antimonopoly Law. The U.S. Government also has urged the JFTC to support amending the Antimonopoly Law to provide for private injunction actions. The Japan Federation of Bar Associations recently announced its support for an amendment allowing private parties to sue for injunctions. Given the JFTC's resource and staffing constraints, and the importance of stronger competition policy and law enforcement, the U.S. Government maintains that it is important that private citizens also be able to enforce the Antimonopoly Law. In March, 1998, the JFTC announced that it planned to set up a study group to review this issue.

Antimonopoly Law Exemptions: The U.S. Government has urged that numerous exemptions to the Antimonopoly Law either be abolished or substantially narrowed in scope. In June 1997, the Diet passed legislation to abolish or narrow numerous exemptions. In December 1997, the Government of Japan announced its intent to abolish the exemptions for Depression Cartels and Rationalization Cartels, two of the more objectionable exemptions. By March 31, 1998, the JFTC will complete its review of all outstanding exemptions and is expected to recommend abolishing or narrowing additional exemptions.

Bid-rigging: Bid-rigging continues to be a serious problem in Japan. The U.S. Government has called for more aggressive enforcement actions against these activities. In order to improve enforcement, the United States has urged Japan to strengthen the JFTC's investigatory powers, proposing for example that the JFTC share power with the Public Prosecutor's Office to conduct criminal investigations. This concern regarding the JFTC's investigatory powers has been echoed in the Japanese press which suggested strengthening the JFTC's compulsory powers in line with other investigative bodies such as the Securities and Exchange Surveillance Commission.

JFTC Resources: The United States has consistently argued since the Structural Impediments Initiative that the JFTC's budget and staff must be increased to ensure that it is able to carry out its mandate. The JFTC's duties are rapidly increasing; for example, the abolition of numerous Antimonopoly Law exemptions now requires the JFTC to police more behavior. The U.S. Government has recommended that the JFTC staff increase at an annual rate of 20 persons, and that the JFTC should be exempt from the Japanese Government's present rule requiring government organs to submit zero-growth budgets.

Distribution

Japan's highly regulated, inefficient distribution system is widely recognized as a significant trade and investment barrier. In the Enhanced Initiative's Sub-group on Structural Issues, the United States targeted laws, regulations, and practices that contribute to abnormally high costs of distribution in Japan arising from slow customs processing, overregulation of the trucking and warehouse industries, and excessive regulatory

restrictions in the retail sector. In its November 1997 deregulation submission, the United States requested the implementation of significant deregulation measures to address key distribution problems faced by foreign firms.

Large-Scale Retail Store Law: This law has long been an obstacle to foreign investors and exporters by limiting the establishment, expansion, and business operations of large stores in Japan, the stores most likely to serve as distributors of imported products. Under the Large-Scale Retail Store Law, Japanese consumers also lose. By impeding the business operations of large stores, the law has reduced productivity in merchandise retailing, raised costs, discouraged new domestic capital investment and ultimately decreased the selection and quality of goods and services.

In December 1997, two MITI advisory councils issued a joint recommendation that the Large-Scale Retail Store Law be abolished, and MITI announced its intention to do so by the spring of 1999. The Government of Japan is considering replacing this law with the Large-Scale Retail Store Location Law, which would allow local jurisdictions to regulate large store openings or expansions for the purpose of maintaining the local environment, but allegedly would eliminate the supply/demand considerations of the existing law. Additionally, the Ministry of Construction has proposed the amendment of the City Planning Law to expand the ability of local authorities to regulate zoning. The United States is extremely concerned about the possibility for abuse or inconsistent application of this new legislation, and stressed the need for procedural transparency, clear and specific implementation guidelines, effective central government monitoring, and a central government process for handling grievances. The United States also has urged MITI to voluntarily use a public notice and comment process in implementing the Large-Scale Retail Store Location Law to improve transparency and promote business and consumer confidence.

The United States also is seeking the elimination of other market adjustment laws, such as the *Bunyaho* which affects the business activities of large-scale enterprises to ensure business opportunities for small and medium-sized enterprises and the *Shochoho* Retail Business Adjustment Law. The United States is particularly concerned about the *Bunyaho* being used to restrict the opening of new multiplex cinema complexes.

Customs Processing: Despite progress in recent years, Japanese import clearance procedures remain slow and cumbersome by industrial country standards, raising costs for U.S. exporters and Japanese consumers. Current U.S. and Japanese Government work to improve import clearance under the Enhanced Initiative builds on regular ongoing bilateral consultations between customs agencies and on the work of the Working Group on Import Procedures under the Structural Impediments Initiative.

These discussions have helped promote changes in Japan's import processing procedures, including the elimination of the requirement to process all air cargo through a separate cargo holding area, the institution of a computerized customs processing system, integration of that computer system with inspection authorities from the Ministry of Health and Welfare and the Ministry of Agriculture, Forestry and Fisheries, and establishment of a pre-arrival approval customs clearance procedure. Remaining problems, described in greater detail below under Import Clearance Procedures, will continue to be a priority for the Structural Deregulation Sub-group under the Enhanced Initiative.

Transportation and Warehousing: Japanese laws limit competition and raise costs in the trucking business by, inter alia, requiring new entrants to meet minimum-number-of-vehicle requirements and by imposing

burdensome rate filing requirements on companies. The United States has requested the Government of Japan to: establish a generally available nationwide trucking operating license that would be available to international companies serving Japan that wish to engage in intermodal shipping operations; remove any district licensing requirements for trucking services that specify a minimum number of vehicles; eliminate pricing restrictions on freight forwarding; and reduce significantly the restrictions on entry in the warehouse sector, including licensing and notification requirements, with the goals of reducing shortages of storage space, lowering high fees, and minimizing burdens for foreign firms related to the distribution of their products.

Transparency and Other Government Practices

Improvements in the transparency of the public policy process and increased opportunities for public participation in the administrative system are necessary counterparts of sectoral deregulation in Japan. Such improvements could play an important role in reducing market access problems of foreign firms in Japan.

Lack of Transparency in Administrative Practices: Foreign firms are disadvantaged by the lack of transparency in Japanese administrative practices. As a consequence, the United States has been pressing Japan for years to make its administrative procedures and practices more open and transparent. Recently under the Enhanced Initiative, the United States has raised specific concerns, including the following:

Lack of an Information Disclosure Law: To date, Japan has not enacted an information disclosure law, analogous to the U.S. Freedom of Information Law, which would provide foreign firms, as well as the Japanese public, with access to records and other information in the control of governmental entities. However, based upon a recommendation by the Administrative Reform Council in 1996, the Government of Japan is expected to submit information disclosure legislation to the Diet by the end of JFY 1997 (March 31, 1998). One of the U.S. priorities under the Enhanced Initiative is the expeditious enactment and implementation of an information disclosure law that would provide the public with effective access to government information in Japan.

Lack of a Public Rulemaking Process: Japanese ministries and agencies prepare regulations in a "black box" with participation generally limited to bureaucrats, former bureaucrats and special interests. Others with an interest in the proposed regulation are generally denied the opportunity to take part in the process. Under the Enhanced Initiative, the United States has set as a priority Japan's adoption of a public rulemaking process that would enable all interested parties to participate effectively in the development of regulations. The United States notes that the Prime Minister's Conference on Administrative Reform *(gyosei kaikaku kaigi*), in its report in December 1997, also recommended adoption of a notice and comment process in Japan. Under a notice and comment process, all governmental entities would be required to publish proposed regulations, provide a reasonable opportunity for interested parties and the general public to provide comments on the proposed regulation, and to give serious consideration to the comments in preparing the final regulation. To date, only the Japan Fair Trade Commission and the Ministry of Posts and Telecommunications have used a notice and comment process in some of their rulemaking efforts. Pending the adoption of such a system in Japan, the United States has been urging individual ministries to undertake voluntarily such a process when they develop regulations and policies of particular public interest.

Use of Administrative Guidance: The lack of transparency in the Government of Japan's extensive use of informal directives or "administrative guidance" remains a serious concern to the United States. Despite requirements in the 1994 Administrative Procedure Law that administrative guidance be put into writing upon

the request of the private party receiving oral guidance and when administrative guidance is issued to multiple persons, according to a Management and Coordination Agency survey, there have been few instances in which it has been issued in writing. The United States has called upon the Government of Japan to increase the disciplines imposed on the use of administrative guidance.

Use of Advisory Councils: The Government of Japan often relies upon advisory councils (*shingikai)*, established by ministries and agencies to formulate policies and recommendations. While the councils have the appearance of objectivity and independence from the bureaucracy, in fact their members include former bureaucrats, their secretariats are staffed by the affected ministry, and they are essentially expected to endorse policies developed or advocated by the ministry. Under the Enhanced Initiative, the United States has called upon Japan to enhance the transparency and objectivity of the advisory councils. The Prime Minister's Conference on Administrative Reform, in its report in December 1997, called for similar reforms of the advisory council process.

Need for Improvement of the Application Process: Despite provisions of the 1994 Administrative Procedure Law, which were designed to standardize administrative procedures, and make them more transparent and fair, U.S. firms have repeatedly complained about the burdensome and unpredictable nature of the application process in Japan. Potential applicants for licenses, permits and other approvals often must engage in extensive prior consultations with governmental entities and satisfy numerous requests for additional information before they are allowed by the ministry to submit their application. These prior consultations, which may take six months to a year or more, and the repeated requests for information appear to arise because the standards, criteria and other requirements used to evaluate an application often are not adequately set out in published regulations. Under the Enhanced Initiative, the United States has called upon the Government of Japan to take measures to remedy this situation.

IMPORT POLICIES

In the Uruguay Round, Japan agreed to "zero for zero" tariff eliminations on pharmaceuticals, paper and printed products, beer, whisky, and brandy, agricultural equipment, medical equipment, construction equipment, furniture, steel, and toys. Japan also adopted the chemical harmonization initiative. Japan cut tariffs on copper and aluminum, with the top rate reduced from 12.8 percent to 7.5 percent. Japan is one of the 43 signatories of the Information Technology Agreement of 1997, which eliminates tariffs on the overwhelming majority of covered products by the year 2000. Japan's remaining high tariffs affect primarily agricultural and food products, including white distilled spirits, processed food products, wood and wood products, and leather and leather products. Tariffs on white distilled spirits will be eliminated under the December settlement of the WTO distilled spirits dispute.

In November 1997, at the APEC Leaders' meeting in Vancouver, Canada, the United States, Japan and 16 other APEC economies endorsed a program of accelerated trade liberalization measures in nine sectoral areas: environmental goods and services, the energy sector, fish and fish products, toys, forest products, gems and jewelry, medical equipment and instruments, chemicals, and a telecommunications mutual recognition agreement. As the world's second largest economy, Japan's full participation in these initiatives will be vital to ensuring their successful completion in 1998 as directed by APEC Leaders.

Distilled Spirits

Japan

In July 1996, a WTO panel ruled against Japan in dispute settlement proceedings initiated in 1995 by the United States, Canada, and the European Union regarding the discriminatory effects of Japan's excise tax system on imported distilled spirits. In October 1996, the WTO Appellate Body upheld the panel's ruling and reaffirmed that the Government of Japan's unequal taxation of domestic and imported distilled spirits is discriminatory and violates Japan's GATT obligations. The ruling required that Japan bring its liquor tax laws into conformity with GATT standards. Japan's initial proposed solution, however, maintained a three percent difference between domestic shochu and imported spirits and called for a 23-month and five-year implementation period for high grade and low grade shochu, respectively. The United States immediately requested WTO arbitration, and the arbitrator ruled that Japan had 15 months to come into full WTO compliance.

Following many rounds of negotiations in 1997, the United States and Japan successfully settled their WTO dispute. In return for allowing the Japanese Government to maintain a tax disparity between Japanese low grade shochu and imported distilled spirits beyond the arbitrator's deadline of February 1998, Japan agreed to accelerate implementation of excise tax rate increases on high grade shochu and decreases on whisky to May 1, 1998, and on low grade shochu to October 1, 2000. Moreover, the United States received a substantial compensation package, including the elimination of tariffs on all brown spirits, vodka, rum, liqueurs and gin by April 1, 2002. These measures go well beyond those taken in the Uruguay Round, in which Japan delayed to 2004 tariff elimination on brown spirits and refused to consider tariff elimination on white spirits.

The U.S. distilled spirits industry estimates that this settlement will reduce excise taxes on U.S. spirits exports to Japan by nearly 60 percent, resulting in an annual tax savings of $94 million. Annual U.S.-origin spirits exports to Japan are conservatively estimated to increase by 20 percent.

Fresh Horticultural Products

Japan continues to restrict the importation of numerous U.S. fresh fruits, vegetables and other horticultural products. Some U.S. products, like eggplant, potatoes, and plums, are totally banned due to Japanese concerns about entry of pests or plant diseases.

In instances where the United States has obtained phytosanitary protocols which permit importation of several other horticultural products, such as apples, cherries, and nectarines, these apply to only specific limited product varieties, while excluding other almost identical varieties. This has occurred despite presentation of scientific evidence to the Japanese authorities that effective treatments against pests of one variety can be extended easily to protect new varieties. Under the current system, new varieties must undergo costly and time-consuming additional scientific research and testing before they can be allowed entry under a phytosanitary protocol. U.S. experts contend these Japanese requirements are unfounded scientifically and are a barrier to trade. The U.S. Government continues to seek systemic reform in Japan's policy. After failing to reach a resolution through bilateral discussions, and through WTO consultations, the United States requested a WTO dispute resolution panel to decide the issue. The panel will hold its first substantive meeting with the parties on April 2-3, 1998.

U.S. fresh horticultural product exports to Japan are also hampered by burdensome on-site inspection requirements. Under the current policy, Japan requires inspection at the exporting country production site by Japanese Government inspectors, even when the Ministry of Agriculture, Forestry and Fisheries cannot provide

enough inspectors to accomplish the job expeditiously and at reasonable cost. In annual bilateral discussions and under the auspices of Japan's own deregulation initiative, the U.S. Government has requested that Japan allow U.S. authorities to perform the work under Japanese Government supervision. Significant progress has been made on these requests, particularly for the cherry program. The issue will continue to be discussed, however, as additional liberalization is warranted.

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

After repeated requests by foreign governments for reform, the Ministry of Agriculture, Forestry and Fisheries has begun to implement a non-quarantine pest list by partially amending the Plant Quarantine Law to exempt 30 pests and six plant diseases from fumigation requirements. While this appears to be an important positive step, the list does not include various commonplace pests of interest for U.S. horticultural product exports. The U.S. Government will continue to press the Government of Japan in all available technical and deregulatory fora to develop a comprehensive list of non-quarantine pests and transparent inspection procedures in an effort to reduce excessive fumigation.

Fish Products

Japan maintains nine global and two bilateral import quotas on fish products. U.S. fishery exports to Japan subject to import quotas include: pollock surimi, pollock roe, herring, cod, mackerel, whiting, squid, and several other fish products. These quota-controlled imports into Japan account for hundreds of millions of dollars in sales annually, approximately one-fourth of total fishery exports to Japan. In the past several years, there has been a downward trend in sales of these import-quota controlled items, largely due to the economic recession in Japan. In the Uruguay Round, Japan agreed to cut tariffs by about one-third on a number of fishery items, but avoided commitments to modify or eliminate import quotas. While Japan has taken steps to improve its administration of the import quotas on mackerel, jack mackerel and kelp in 1997, the application procedures and the lack of transparency on other fish products still cause concern for U.S. exporters. At the January 1997 session of the annual fishery trade consultations, the United States and Japan agreed to continue formal discussions to identify solutions to these import quota issues at the 1998 session.

The Fisheries Sector has been identified as one of the nine sectors for Early Voluntary Sectoral Liberalization under APEC. At Japan's request, a section on cooperative fisheries management was included in the proposal. The fisheries initiative will contribute significantly to trade liberalization in the region and with Japan.

General Food Products

In the Uruguay Round, Japan agreed to bind tariffs on all agricultural products and to reduce bound rates by an average of 36 percent during the six-year period 1995-2000, with a minimum 15 percent reduction on each tariff line. Japan also agreed to gradually reduce tariffs on imports of beef, pork, fresh oranges, cheese, confectionery, vegetable oils, and various other items. Even after full implementation of the Uruguay Round

cuts, however, imports of many intermediate and consumer-oriented food and beverage products will still face relatively high tariffs, including: beef, fresh oranges, fresh apples, citrus and other fruit juices, corn grits, confectionery, snack foods, ice cream, and processed tomato products.

Japan also agreed in the Uruguay Round to convert all import bans and quotas (except for rice) to tariffs, which would be reduced between 1995 and 2000. Inflexible import quotas for wheat, barley, starches, peanuts, and dairy products were replaced by tariff rate quotas. Japan retains state trading authority and price stabilization schemes for these products but is currently studying proposals to liberalize imports to a small degree.

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

Import Clearance Procedures

Despite progress in recent years, Japanese import clearance procedures remain slow and cumbersome by industrial country standards, raising costs for U.S. exporters companies and Japanese consumers. Continuing U.S. and Japanese Government efforts to improve import clearance are being discussed under the Enhanced Initiative on Deregulation and Competition Policy as well as in regular bilateral consultations between customs agencies.

These discussions have helped promote changes in Japan's import processing procedures including: the elimination of the requirement to process all air cargo through a separate cargo holding area (Baraki-cargo area) 30 kilometers from Tokyo's Narita airport; the institution of a computerized customs processing system; integration of that computer system with inspection authorities from the Ministry of Health and Welfare and the Ministry of Agriculture, Forestry and Fisheries; and establishment of a pre-arrival customs clearance procedure. As a result of these changes, the cargo cleared on site at the Narita Airport has increased from 51 percent to 76 percent and the average time required for customs clearance has been reduced.

Problems remain however. For example, while the Customs Division established a new computer connection with other inspection agencies in 1997, many of the inspection agencies' automated systems still are not compatible. Average processing times remain slow relative to other OECD countries. User fees at the Narita and Osaka's Kansai Airports are still high. The application of customs regulations and rulings is not uniform throughout Japan. Customs processing hours of operation are short. An extension, from 8:30-5:00 to 7:00-8:00, for the free processing of imports would greatly benefit importers and ease the process of onward transportation. Additionally, the United States is concerned that the new Additional Tax (Law), inaugurated in October of 1997, will cause a slowdown in customs processing and result in higher costs. This law institutes an "administrative punishment" for mistakes, clerical or otherwise, which will cause importers to spend more time preparing paperwork and customs officials to spend more time checking it. Japan's current system also disadvantages imports by allowing only five high-value and 20 low-value items per import declaration, but allowing 15 high-value items and 60 low-value items on export declarations, both assessed at a rate of 7,800 yen for an hourly declaration.

Increasing the personal tax exemption for imported goods from 10,000 yen to 30,000 yen would make catalog

purchases a more attractive choice for Japanese consumers and benefit foreign catalog retailers. Japanese Customs undertook to hire temporary workers to deal with the annual backlog of packages that accumulate during the Christmas season.

Leather and Leather Products

In 1991, Japan liberalized treatment of footwear imports, setting a footwear quota of 2.4 million pairs per year which, by Japanese Fiscal Year 1997, has been raised to roughly 12 million pairs per year. In the Uruguay Round, Japan committed to reduce tariffs over an eight-year period on under-quota imports of leather footwear, crust leather and other leather categories. The U.S. Government and U.S. leather and leather footwear industries continue to push for elimination or further liberalization of the quotas.

Above-quota imports of footwear still face stiff barriers. The above-qouta tariff is currently 48.8 percent or 4,612.50 yen per pair, whichever is higher. These rates will drop to 30 percent or 4,300 yen, whichever is higher, by 2002. In principle, the over-quota tariff rate will be reduced by 50 percent and the yen minimum alternative rate by 10 percent over the eight-year phase-in period. In practice, however, the yen minimum alternative rate is applied in a manner which negates the effect of the larger tariff rate reduction. Moreover, while above-quota imports grew substantially in JFY 1996, they still totaled only about 7.7 percent of under-quota imports, suggesting that the higher rates for above-quota imports are effectively discouraging additional imports.

Low-Malt Beer

Since 1994 two major Japanese brewers have been marketing low-malt beers called "happoshu" or "sparkling brew" in Japan. One reason for producing this beer was to take advantage of a lower domestic liquor tax (excise tax). The excise tax on beer in Japan is divided into three categories according to malt content: the lower the content, the lower the tax rate. Under the 1994 Liquor Tax Law, "beer" was categorized as a beverage with malt content of 67 percent or more, and sparkling brew was categorized as "miscellaneous liquor" subject to a lower excise tax. Some imported malt beverages were categorized in the same, lower-tax sparkling brew category.

In October 1996, the Ministry of Finance redefined the categories of malt beverages to reduce the significant tax advantage enjoyed by the sparkling brews. As a result, some U.S. exporters of lower-malt content beer had to reformulate their products to retain the lower tax treatment and remain competitive with domestic sparkling brews.

Imported beverages with lower malt content are classified for customs purposes as "other fermented beverages" which, until the tariffs on beer and sparkling brews were equalized in April 1997, resulted in low-malt beer being assessed at a tariff rate approximately seven times higher than that on regular beer. This prohibitive tariff rate levied on imports prior to April 1997 greatly discouraged U.S. export sales of low-malt beer to Japan and gave the two major Japanese producers a major advantage in a growing product category for which retail sales total nearly $100 million, or six percent of the malt beverage market.

Racehorses

Japan

The Japan Racing Association restricts participation of foreign horses in Japanese races. In addition, only Japanese residents may register with the Japan Racing Association as racehorse owners in Japan. The United States and other interested countries have pressed Japan to liberalize access for foreign horses, with modest success. By 1997, nine Japan Racing Association races have been opened to foreign racehorses with race experience outside Japan. The Japan Racing Association has announced that it will increase this number to eleven by 1998.

Rice

Under the Uruguay Round Agreement on Agriculture, Japan committed to provide market access concessions for imported rice. Specifically, Japan agreed to increase the amount of imported rice to eight percent of domestic consumption by JFY 2000. For JFY 1997, Japan agreed to import 530,600 tons (milled rice basis). Within this import commitment, Japan also has established a simultaneous-buy-sell (SBS) system for some imported rice, allowing importers and exporters to set quality and other requirements, subject to Food Agency approval.

In JFY 1997, the Government of Japan conducted four "SBS" rice tenders and five "ordinary" rice tenders, totaling 543,250 tons. Of this amount, 272,128 tons (50.1 percent) originated in the United States. Overall, 489,200 tons of rice entered under the Food Agency's "ordinary" import system (U.S. share: 48.6 percent), and 54,050 tons were purchased under the "SBS" system (U.S. share: 63.3 percent).

The U.S. Government has expressed concern to Japanese officials that much of the rice purchased under Japan's WTO commitments has been put into stocks, because this policy prevents imported rice from reaching Japanese consumers, contrary to the spirit of Japan's WTO market access commitments. Further, U.S. officials remain concerned over the nature of Japan's food aid donations. We will continue to monitor closely Japan's rice purchases in the coming year.

Wood Products/Housing

The elimination of tariffs on value-added wood products has been a longstanding U.S. objective in Japan. At the November 1997 APEC Summit, APEC economies, including Japan, endorsed free trade negotiation initiatives in nine sectors, including forest products (which covers wood, paper, printed materials and wood furniture). A key component of the forest products initiative is the elimination of tariffs for wood products in the 2002-2004 time frame. Work on these sectoral trade liberalization proposals is due to be completed by the June 1998 APEC Trade Ministers meeting, with implementation due to begin in 1999.

Japan is the United States' top export market for wood products. Exports of forest products totaled $2.7 billion in calendar year 1997, down 18 percent from the level in 1996. A sluggish housing market and the continued depreciation of the yen against the U.S. dollar reduced Japan's import levels for wood last year. To expand the market for wood products in Japan, the Government of Japan must restore consumer confidence, increase competition through product standardization, and remove barriers which include restrictive codes and standards under the Building Standard Law, unjustifiably cumbersome testing methods for engineered wood products, and tariff escalation on value-added wood products.

The United States seeks greater regulatory transparency and acceptance of U.S. products for residential construction, a growing part of Japan's $140 billion building materials market. Housing has been designated as one of four priority sectors under U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy and is described in further detail in that section.

STANDARDS, TESTING, LABELING, AND CERTIFICATION

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

The principal organization that adjudicates standards and certification disputes between foreign companies and the Government of Japan is the Office of the Trade and Investment Ombudsman (OTO). In 1994, the Office of the Trade and Investment Ombudsman came under the Prime Minister's office and was authorized to recommend actions to appropriate ministries. The Office of the Trade and Investment Ombudsman has had some modest impact but still lacks formal enforcement authority.

Biotechnology

Japan has taken a scientific approach to the regulation of trade in agricultural biotechnology products produced using genetically-modified organisms (GMOs). To date, the Ministry of Agriculture, Forestry and Fisheries and the Ministry of Health and Welfare, which have regulatory responsibility for biotechnology products, have approved the importation of fifteen GMO varieties, including corn, potatoes, cotton, and soybeans.

The U.S. and Japanese regulatory approaches to biotech products are closely aligned and both countries continue to cooperate on food safety initiatives within international fora (OECD, APEC, Codex Alimentarius). However, the Japanese Government is still developing its policy on GMO regulation and labeling. In response to Japanese consumer concern about labeling foods produced using biotechnology, the Ministry of Agriculture, Forestry and Fisheries organized a twenty-member biotechnology food labeling discussion group, comprised of farmers, scholars, consumers, producers and distributors, and the Diet has created a new subcommittee to review the sufficiency of current regulations on disclosure and safety assessment.

Dietary Supplements

In March 1996, the OTO issued a ruling supporting significant deregulation of vitamins, herbs, and minerals. The OTO’s Market Access Ombudsman Council recommended, among other things, that dietary supplements normally distributed and marketed overseas as foods should be treated as foods, and not as pharmaceuticals under the purview of Japan’s Pharmaceutical Affairs Law. This recommendation called on the Ministry of Health and Welfare to take action to accomplish this for vitamins in JFY 1996, herbs in JFY 1997, and minerals in JFY 1998.

Ministry of Health and Welfare's actions to date raise concerns that it will not accomplish the task set for it by the OTO. The Ministry established study groups composed of government, industry, and academic experts to study each category of dietary supplement but the work of these study groups has become bogged down.

The United States views the slow pace of this process, and consequent prospects for timely reform, as a continuing concern.

The Ministry of Health and Welfare identified in March 1997 seven vitamins to be treated as foods and six other vitamins to fall between pharmaceutical and food regulations. The basis for the Ministry's decision was unclear, as is the status of the six vitamins which were not clearly reclassified as foods. A further concern arises from the fact that even those seven vitamins now treated as foods may face insurmountable barriers when marketed in tablet form due to the fact that common excipients used to make such tablets may not appear on the positive list of food additives under the Food Sanitation Law. Therefore, vitamins containing these excipients still cannot be sold in Japan.

The U.S. Government continues to work with the Ministry of Health and Welfare in the MOSS reviews, the OTO, and other fora to achieve market access for U.S. dietary supplements through full and meaningful implementation of the OTO recommendations. A major focus of attention will be the announcement by the Ministry of Health and Welfare of steps to reclassify herbal products as foods by April 1, 1998.

Food Additives

Processed food imports into Japan often are hampered by Japanese standards affecting food additives, even though those additives may be generally recognized as safe elsewhere. Japan is revising its Food Sanitation Law to bring its processes for assessing food additives into conformity with WTO Sanitary and Phytosanitary (SPS) measures. Still, Japan's regulations concerning food additives remain unusually strict. The U.S. Government encourages U.S. firms and industry associations to file applications with Japan's Ministry of Health and Welfare allowing sufficient time for assessment. The United States has raised Japan's regulation of food additives in bilateral talks on deregulation.

Pesticides Residues

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

While the Government of Japan has made progress in establishing pesticide residue standards in line with internationally recognized tolerance levels, further government action remains necessary to help counter misleading information regarding the safety of imported food and agricultural products.

Veterinary Drugs

The United States also is concerned by Japan's safety review process for veterinary drugs. Japan's practice of waiting for CODEX to adopt an international standard before evaluating scientific evidence results in unnecessary delays in establishing tolerance levels for veterinary drugs in Japan. Japan's policy of prohibiting detectable residue levels of these drugs, without conducting a risk assessment in a timely manner, appears to be inconsistent with Japan's obligations under the WTO SPS Agreement. The United States has urged Japan to undertake evaluation of scientific evidence in order to establish tolerance levels for new veterinary drugs in a timely fashion, and not to delay the process waiting for the outcome of CODEX deliberations. Japan's recent

decision to proceed with a safety review of chlortetracycline (CTC) simultaneously with the CODEX deliberations is encouraging to the extent that it reflects a decision by the Japanese Government to conduct these reviews in a more timely manner.

GOVERNMENT PROCUREMENT

Computers

U.S. makers of computer goods and services are global leaders in technology and performance and are among the largest and most successful foreign firms in Japan. However, they have long been under-represented in the Japanese Government market for computers, where their share has been one third or less of their share of the larger, more competitive Japanese private sector market. To rectify this anomalous situation, the United States and Japan concluded a government procurement agreement on computers in January 1992. Under the agreement, the Government of Japan agreed to institute changes to its procurement practices with the goal of expanding government purchases of competitive foreign computer equipment, software and services.

Results from the agreement have been unsatisfactory. Foreign computer manufacturers' share of the Japanese Government market for midrange and mainframe computers and workstations increased from 6.6 percent in 1991 to 13.7 percent in 1994, but much of this gain was reversed by 1996, as the foreign share dropped to 9.3 percent. These figures compare unfavorably with a fairly consistent foreign market share of more than 30 percent of Japan's private sector computer market. Broken down by market segments, the data reveals that from 1994 to 1996 foreign market share of purchases by national government agencies declined from 11.9 to 9.4 percent, and the foreign share of the quasi-government market (important government-related entities like Nippon Telephone and Telegraph and the Japan Rail companies) fell from 21.2 percent to 10.7 percent.

Similar trends describe the procurement of personal computers. The foreign share has declined steadily from a high of 15.0 percent in 1992 to 7.7 percent in 1996. This has occurred despite total Japanese Government spending on personal computers tripling between 1993 and 1996.

The United States expressed concern about the decline in the foreign market share of Japan's public sector procurement of computers at the annual review under the bilateral computer agreement in Tokyo on October 30, 1997. Specifically, the United States noted continuing reports of unjust low-priced sales by Japanese manufacturers, unequal access to bidding information, and sole-sourcing of procurements by government agencies, particularly for important systems integration contracts. The United States also called for expanded and improved application of the Japanese Government's "Overall Greatest Value" methodology, which allows procuring entities to give greater consideration to quality and performance factors in addition to price in evaluating bids for computer procurements. The two governments also discussed the appropriateness of lowering the 100,000 SDR threshold, which is the minimum value of procurements covered under the Agreement. This restriction is limiting the scope of the Agreement, as lower-cost personal computers, workstations, and network servers comprise an increasing proportion of purchases. These smaller computers tend to be acquired in a more decentralized manner and in lower value amounts than more traditional large computers.

In view of American computer makers' proven track record of global competitiveness, and the responsibility of the Japanese Government to ensure that its procurement is conducted in a fair and non-discriminatory manner, the limited access of U.S. computer companies to the Japanese Government market remains a matter of serious

concern. The two government are scheduled to later this year.

Construction, Architecture and Engineering

Although American firms have experienced some symbolic successes in Japan's construction, architectural, and engineering sector for public works projects over the past year, the U.S. Government continues to be concerned about the serious problems that remain. The U.S. Government will continue to work with Japan to resolve these issues and expects to see substantial improvement in this sector prior to the next annual review of the U.S.-Japan public works construction arrangements in the summer of 1998.

The United States and Japan meet annually to review two arrangements covering this sector -- the Major Projects Arrangement (MPA) 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, agreed to in 1988 and amended in 1991, was designed to improve access to Japan's public works construction market and includes a list of 42 projects covered by the MPA. Under the Action Plan, Japan must use open and competitive procedures on procurements valued at or above the threshold levels of the WTO Government Procurement Agreement. Also under the Action Plan, Japan reaffirmed its MPA commitments, which will remain in effect until all projects covered by the MPA are completed.

Over the past year, U.S. firms have experienced limited success in this sector. During the third annual review of the public works construction arrangements in July 1997, the U.S. Government learned that American firms won over $100 million in contracts in Japan since the 1996 review. Although this figure was three times higher than the amount won the previous year -- when U.S. firms encountered many operational impediments in the implementation of the Action Plan -- it falls far short of the value of the contracts won by American firms during the development of Kansai International Airport in the late 1980's. The United States hopes to see substantial improvement before the 1998 review, particularly now that the procurements for the multi-billion dollar Chubu New International Airport (Chubu Airport) near Nagoya are moving forward.

The United States has been watching closely the development of Chubu Airport, an MPA project. Work on the Chubu Airport is underway and is expected to be completed prior to the World Exposition 2005, which will be hosted by Japan's Aichi Prefecture. Although the commissioning entity for this project is not expected to be formed until Spring 1998, Japan agreed in 1997 to apply MPA procedures voluntarily even before the project becomes "official" with the establishment of the commissioning entity. The U.S. Government appreciated Japan's willingness to do this and was pleased to learn in November 1997 that the first Chubu Airport design procurement covered by the MPA was awarded to a consortium that included American firms. The U.S. Government hopes this sets an important precedent for future work for American firms on this project and other airport projects.

An American company was awarded in November 1997 a public works construction project as the prime (or solo) contractor, for the first time in Japan. American firms previously have won construction contracts in Japan but always as members of joint ventures. The U.S. Government hopes this leads to future involvement of American firms as prime contractors in construction projects in Japan.

Despite such progress, many barriers that limit U.S. firms' participation in the public works market remain. For example, the U.S. Government has asked Japan during recent reviews to, inter alia: (1) eliminate overly

restrictive prequalification conditions that serve to preclude U.S. firms from participating in public works projects at the application stage; (2) simplify the complex registration and application procedures for these projects; and (3) allow for the free formation of joint ventures for public works projects. The U.S. Government believes the freedom to form joint ventures leads to the use of each company's expertise in ways that ensure that a project will be carried out as efficiently and effectively as possible -- both in terms of time and cost. Although Japan has taken some steps in these areas, problems persist and the U.S. Government looks forward to further improvement.

The U.S. Government continues to monitor developments in this sector very closely. At the 1998 annual review, the U.S. Government expects to see practical improvements in these problem areas and a significant increase in the level of foreign participation in the Japanese public works market.

Medical Technology

The United States concluded the Medical Technology Procurement Arrangement in November 1994, with the goal of significantly increasing market access and sales of competitive foreign medical products and services in the Japanese public sector procurement market. U.S. firms are the world's largest producers of advanced medical technologies. In the Japanese public sector market, however, U.S. industry's share is relatively low. This agreement represents an important step forward in the ability of foreign firms to more effectively sell medical technology products and services in Japan's public sector.

The agreement establishes fair and transparent procedures that must be used by governmental entities in procuring major medical equipment and services. The agreement also specifies a set of quantitative and qualitative criteria to annually assess its implementation, including: value and share of contracts awarded to foreign firms by each government entity; number and value of contracts awarded through single tendering; and foreign access to procurement information.

A key element of the agreement is the requirement that procurement decisions for central government purchases above a specified threshold (lowered to 385,000 Special Drawing Rights on April 1, 1998) be made on the basis of the overall greatest value method (OGVM) of bid evaluation, instead of lowest-bid. U.S. equipment is generally more innovative and offers special features or extraordinary performance. OGVM permits procurement decisions based not just on initial price, but on a complete assessment of the product's value over its life cycle. This ensures buyers the flexibility to select products based on the most favorable combination of price and performance.

Japanese central government entities use OGVM in selecting medical equipment valued above the established thresholds, and have found the methodology to be very effective in procuring the kinds of equipment they need to provide quality medical care to their patients. Prefectural and municipal hospitals, however, are obligated under Japanese law to use exclusively the lowest-bid procedure of evaluation. This hinders the ability of U.S. companies to sell in this significant portion of the Japanese market. Under the agreement, the Japanese Government is required to encourage prefectural and local governments to utilize measures similar to those adopted by the central government entities. The Ministry of Home Affairs, the agency responsible for the applicable laws on government procurement, has shown little inclination to undertake necessary legal measures to allow prefectural and local governments to use OGVM in bid evaluation. The American Chamber of Commerce in Japan has filed a complaint with the Office of the Trade Ombudsman requesting the Japanese

Government revise the relevant Cabinet order to permit the use of OGVM in bid evaluation by local and prefectural entities. As a result of Japanese Government inaction, the United States has raised this issue under the Enhanced Initiative on Deregulation.

In 1995, the estimated foreign market share of government procurement covered by the agreement totaled 38.6 percent. The foreign market share rose slightly in 1996 to 41.2 percent. Japanese public sector procurement addressed by the arrangement provisions topped 75 billion yen in 1996 -- or about $700 million.

While Japan's implementation of the Arrangement requires further improvements, the United States considers that Japan is demonstrating a general adherence to the intent of the arrangement to provide greater market access and sales in its government procurement sector. The United States will use the next review to press for greater transparency, strict compliance with arrangement provisions, and seek the expanded use of overall greatest value methodology.

Satellites

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

From 1990 to 1997, U.S. satellite makers won all five contracts (with a combined value exceeding $1 billion) openly bid under the competitive procedures outlined in this agreement. The most recent contract was a $100 million weather/navigation satellite procurement by the Ministry of Transportation, which was won by Space Systems Loral.

Despite U.S. firms' success under this agreement, the United States continues to be concerned about Japan's National Space Development Agency (NASDA) exclusion of certain satellite procurements from coverage under the agreement as "research and development satellites." The United States recognizes that R&D satellites can be excluded from open bidding under the agreement, but has raised with the Japanese Government its concern that an overly-broad definition of R&D could unfairly deny U.S. and other foreign satellite makers access to procurement opportunities. In October 1996, the National Space Development Agency awarded a $350 million contract to a Japanese firm for two data relay satellites outside the open bidding procedures. The United States continues to closely monitor this and subsequent Government of Japan procurements to ensure that such R&D procurements are consistent with the bilateral agreement -- that they incorporate technology new to Japan, are not intended for the provision of regular services, and do not finance the development of satellites or satellite componentry that can be used in the commercial or non-R&D government market.

Supercomputers

The United States and Japan concluded the 1990 U.S.-Japan Procedures to Introduce Supercomputers to ensure fair access for U.S. supercomputer manufacturers to Japan's high-performance computer market. Results under the 1990 Supercomputer Agreement have been mixed, with the U.S. share fluctuating considerably over the period. U.S. supercomputer manufacturers were awarded only 27 percent of the procurements during the first three years of the arrangement, but U.S. market share increased to roughly 40-45 percent of procurements in JFY 1993 and 1994. However, U.S. market share has deteriorated since then, reaching only 9 percent in 1995 and

25 percent in 1996. U.S. companies did not bid on any of the four Japanese Government supercomputer procurements in 1997, although they did participate as a subcontractor in one procurement, supplying a supercomputer for a procurement awarded to a Japanese firm.

The Japanese Government has publicly announced nine supercomputer procurements for JFY 1998. The current threshold under the supercomputer arrangement is 5 gigaflops. Most of the procurements for JFY 1998 and beyond are significantly above this threshold.

The United States remains concerned about persistent market access barriers in this sector, and notes the U.S. share of the public procurement market has generally remained well below the U.S. manufacturers' 45-50 percent of the Japanese private sector supercomputer market. The United States is increasingly concerned about reports that Japanese Government entities are drafting tender specifications to favor preferred vendors and requiring proprietary design-based (rather than performance-based) features or other non-essential elements that only a specific vendor is able to provide. Moreover, despite the arrangement's goal of increasing competitive opportunities in the Japanese supercomputer market, more than half of the Japanese Government's "competitive tenders" for supercomputer procurements in JFY 1995 and 1996 have attracted only a single bidder, with other companies concluding that specifications and other factors so clearly favored one bidder that the time and expense of preparing a bid is not be justified. In addition, deep discounting of pricing by Japanese companies remains a problem, and procuring entities continue to give insufficient weight to non-price factors.

At the annual review of the implementation of the supercomputer arrangement on November 7, 1997, the U.S. Government urged the Japanese Government to address these specific issues and to intensify its efforts to ensure fair access for U.S. supercomputer manufacturers. The U.S. Government will continue to press these issues with Japan.

Telecommunications

NTT Arrangement: In September 1997, the NTT procurement arrangements were renewed for the sixth time since 1980. The renewed arrangements contained improved NTT procurement procedures designed to increase procurement transparency, enhance access to technical specifications and other information needed to prepare a bid, and promote increased reliance on international standards. In addition, the arrangement was extended to NTT Communication-ware Corporation (NTT COMWARE), which joined three other NTT subsidiaries (NTT Data Communications, NTT Mobile Communications, and NTT Power and Building Facilities) in agreeing to voluntarily adopt the measures. The current arrangement is due to expire when NTT is restructured in 1999. The two governments agreed to review the arrangement before its expiration to determine future treatment. NTT, Japan's single largest purchaser of telecommunications equipment, accounts for more than one third of Japan's $35 billion telecommunication equipment market.

The United States and Japan held a review of the NTT Arrangement in August 1997. During this review, NTT reported that its procurement of all foreign products increased from 152 billion yen in JFY 1995 to 173 billion yen in JFY 1996 (approximately $1.4 billion, at 120 yen/dollar) . While NTT's purchases of foreign telecommunications equipment also increased, the increase in market share for these products was minimal. Considering U.S. firms' competitiveness, evidenced by worldwide export growth of over 19 percent in the first half of 1997, and significantly better results in the Japanese private sector market, these results are disappointing.

Japan

The poor results U.S. companies have achieved with NTT as compared with their sales to the private Japanese telecommunications sector suggest that NTT is still captive to its monopoly legacy and is not fully responsive to market principles in its procurement. The Japanese government's reluctance to introduce real competition in the service sector appears to be fueled by a view that only NTT, with access to monopoly rents, can, in partnership with Japanese companies, develop Japan's information infrastructure. Evidence indicates that NTT continues to favor its "family companies" for the bulk of its telecommunications equipment purchases; that NTT continues to over-engineer and under-document specifications; that specifications are often Japan-specific or NTT-specific; and that allocation of supplier market share for products is often based on non-transparent criteria. These practices raise costs to NTT and its customers, impede competition, and pose significant market access barriers.

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

These issues all point to the need to closely monitor procurements under the NTT arrangement and to continue to seek ways to improve the arrangement's implementation. Until vigorous competition is introduced in both the equipment and service markets, such oversight is vital. These issues will be the subject of review in mid-1998.

Public Sector Procurement Agreement on Telecommunications Products and Services: The 1994 U.S.-Japan Public Sector Procurement Agreement on telecommunications products and services was intended to improve access and sales for foreign telecommunications firms selling to Japan's public sector. Pursuant to the agreement, Japan has introduced procedures to eliminate barriers such as obstacles to participation in pre-solicitation and specification-drafting for large-scale telecommunications procurements; ambiguous award criteria; excessive sole sourcing; and the absence of an effective bid protest mechanism. The public sector procurement agreement also includes quantitative and qualitative criteria for measuring progress such as: annual value and share of purchases of foreign products; annual numbers of entities buying foreign products and services; annual numbers and values for contracts awarded as a result of single tendering; and new subcontracting opportunities for foreign suppliers.

The United States and Japan held their third annual review of this agreement in February 1998. This review covered Japanese government procurements of telecommunications equipment and services in CY 1996. The U.S. side expressed concern about the sharp reduction in the foreign share of Japanese government procurement of telecommunications products and services from 13 percent in 1995 to 3.5 percent in 1996. The United States questioned the coverage offered under this agreement and expressed concern about possible unwarranted use of operational safety and national security exemptions to avoid the need for open procurements in some cases.

The United States also has continuing concerns about the Japanese government's increased reliance on contracts awarded through sole source tendering in 1996. Despite the fact that the agreement calls for a reduction in sole sourcing, the share of total procurements for telecommunications equipment and services done through sole source tendering grew from 5 percent in 1994 to around 15 percent in 1996. The U.S. Government urged the

Japanese Government to take immediate steps to reverse this negative trend.

In 1995, the U.S. raised concerns regarding practices of the National Police Agency, which had kept a major telecommunications procurement out of the open bidding process. Following numerous consultations, the National Police Agency agreed in 1997 to revise this procurement and bid it openly. Initial steps taken by the National Police Agency were satisfactory and we will continue to monitor this procurement through its final stages to ensure it is consistent with the terms of both our bilateral and WTO government procurement agreements.

LACK OF INTELLECTUAL PROPERTY PROTECTION

In March 1997, revisions to Japanese law came into effect which will protect sound recordings produced in the United States and other WTO countries within the past 50 years. This represented the resolution of the first intellectual property dispute settlement case at the WTO, which the United States initiated against Japan in 1996 over Japan's failure to provide full "retroactive" protection to pre-existing sound recordings in accordance with the TRIPs (Trade Related Aspects of Intellectual Property) Agreement. Although the TRIPs agreement required developed countries as of January 1996 to protect sound recordings produced in other WTO countries within the past 50 years -- i.e., produced in 1946 or later -- Japan only protected foreign sound recordings produced in 1971 or later. Japan ultimately agreed to provide such protection, doing so through legislation adopted in December 1996 that came into effect in March 1997. In January 1997, the United States and Japan jointly notified the WTO that the matter had been resolved.

In April 1997, Japan was placed on the Special 301 "Watch List" of countries from which the United States seeks stronger intellectual property rights protection. This followed three years in which Japan had been placed on the "Priority Watch List;" the lowering reflected the resolution of the sound recordings dispute and improvements to Japanese trademark law over the year preceding April 1997. Japan was cited in 1997 for continuing problematic patent practices, inadequate protection of trade secrets, and high levels of end-use software piracy. Intellectual property rights issues continue to be the focus of U.S.-Japan discussions in a number of multilateral, regional and bilateral fora.

Copyrights

U.S. computer software groups remain concerned about the significant problem of end-user piracy in Japan. U.S. and some Japanese software developers seek stronger legal and procedural provisions to allow the prosecution of end-user pirates, including the establishment of a more effective system of applying for and receiving ex parte provisional relief on a timely basis. Japan also has agreed to the World Intellectual Property Organization Copyright Treaty and the Performances and Phonograms Treaty, which when ratified will provide new protection for performers and producers of sound recordings.

Patents

Even with Japan's implementation of two 1994 bilateral patent agreements, significant problems with the Japanese patent system remain. Two important examples are narrow patent claim interpretation before the Japan Patent Office and narrow patent claim interpretation in the courts.

Japan

On February 24, 1998, the Japanese Supreme Court issued its first decision to permit an infringement finding under the "doctrine of equivalents." This represents a positive step toward broadening Japanese courts' generally narrow interpretation of patent claims. The Japanese courts previously found infringement only when literal infringement of patent claims existed. As a result, competitors could avoid liability merely by changing an element of the invention even if the resulting product was substantially similar to the patented product. In contrast, courts in the United States and in most other countries, in appropriate circumstances, find infringement if the defendant has either literally or substantially infringed on the patent. That is, infringement is found even if the infringer has deviated from the patent in certain marginal and unimportant ways. This latter practice is known as the "doctrine of equivalents." The United States is pleased with the February 24 Japanese Supreme Court decision affirming the doctrine of equivalents and will follow closely future lower court treatment of such cases.

Another issue of concern to the United States for many years has been the relatively long processing time for patent examination in Japan. While noting the progress made by the Japan Patent Office in reducing the average length of patent examination from 36 months to 28 months, the U.S. Government looks to the Government of Japan to continue its efforts to reduce pendency further. It is important that Japan reduce examination pendency to levels comparable to those in other industrialized countries.

Trade Secrets

Japan's protection of trade secrets is inadequate. Because the Japanese Constitution prohibits closed trials, the owner of a trade secret seeking redress for misappropriation of that secret in a Japanese court is placed in the untenable position of not being able to protect the trade secret without disclosing it publicly. A recent amendment to Japan's civil procedures act should improve the protection of trade secrets in Japanese courts by excluding court records containing trade secrets from public access. However, this legislation does not adequately address the problem. Court discussions of trade secrets will remain open to the public and neither the parties nor their attorneys have confidentiality obligations. Thus protection of trade secrets in Japan's courts will continue to be considerably weaker than in the courts of the United States and other developed countries.

Trademarks

A number of revisions to Japan's Trademark Law came into force on April 1, 1997. The revisions are intended to accelerate the granting of trademark rights, strengthen protection of well-known marks, address problems related to unused trademarks, and simplify trademark registration procedures in order to bring Japan into compliance with the Trademark Law Treaty. These measures also increase penalties for trademark infringement. The effect of these revisions to the law is not yet clear. Historically, the trademark registration process in Japan has been slow, requiring approximately 36 months versus 16-18 months in the United States. Since trademarks must be registered in Japan to ensure enforcement, delays in registration have made it difficult for foreign parties to enforce their marks. Protection of well-known marks also has been weak.

SERVICES BARRIERS

Financial Services

Japanese financial markets traditionally have been highly segmented and strictly regulated, and as such, have

discouraged the introduction of innovative products where foreign firms may enjoy a competitive advantage and otherwise restricted business opportunities for foreign firms. Some of the restrictions that have impeded access include the use of administrative guidance, *keiretsu* (interlocking business relationships), lack of transparency, inadequate disclosure, the use of a positive list to define a security, and lengthy processing of applications for new products. These restrictions have hindered the emergence of a fully competitive market for financial services in Japan.

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

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

The U.S. Government is currently monitoring the agreement to ensure that implementation remains on schedule and to assess the impact of the actions undertaken using the quantitative and qualitative criteria included in the agreement. At the March and October 1997 reviews, the U.S. Government emphasized the need for further improvements in financial disclosure and transparency. Japan also signed the WTO Financial Services Agreement in December 1997, thereby binding many liberalization measures agreed to bilaterally.

In an announcement on November 11, 1996, Prime Minister Ryutaro Hashimoto committed the Japanese Government to conducting broad-based deregulation of Japan's financial sector, aimed at making Tokyo's financial markets comparable to those of New York and London by 2001. The Japanese Government's "Big Bang" financial reform plans involve such major changes as allowing mutual entry across financial sectors, tax changes, liberalization of commissions, liberalization of foreign exchange transactions, tightened disclosure rules, and further liberalization of asset management regulations. These changes could create important new business opportunities for U.S. financial services providers. Despite increased attention to financial sector stability issues in late 1997 following several prominent financial bankruptcies, the Japanese government has thus far adhered to its reform schedule, with a few exceptions. The Japanese Government introduced financial liberalization legislation into the Diet in March 1998. The U.S. Government will continue to watch developments closely.

Insurance

Japan is the world's second largest market for insurance with annual premium revenues of $332 billion in JFY 1996. Ministry of Finance regulations, informal guidance, and non-transparent industry association activities all serve to limit competition and market access in Japanese insurance market. While foreign market shares of other G-7 countries' domestic insurance markets ranged from 10 to 33 percent, foreign firms' share of the Japanese market is only 3.9 percent. Foreign firms have only a 1.7 percent share of the primary life insurance market and a 2.8 percent share of the primary non-life market (mostly auto, fire and marine insurance). Together these two primary sectors account for roughly 95 percent of Japan's entire insurance market. Foreign firms have played an important role in developing new products and sales channels in the remaining five percent of the

market, the so-called *third sector*, as reflected in their 42 percent share of this sector.

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

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

The agreement inter alia calls for five government corporations with large annual insurance requirements to use fair, transparent, non-discriminatory, and competitive criteria in their annual allocation of insurance premium shares. This remains a key concern: only one of those five government corporations (the Housing Loan Corporation) has disclosed its premium allocation criteria; and for all five corporations, the foreign share of premiums remains negligible, even relative to foreign insurers' small share of the private sector Japanese insurance market. The agreement also calls for Japanese and foreign insurers in Japan to complete by March 1995 a study of the impact of *keiretsu* business relationships and case agents on insurance purchasing patterns in Japan, and for the Japan Fair Trade Commission (JFTC) to conduct its own study of the same issues. As of February 1998, the private sector study essentially has been abandoned due to the Japanese domestic industry's obstinacy to the design of, and participation in, a meaningful study. The JFTC announced in November 1997 that it had begun its own study with a goal of its completion by the end of 1998.

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

1996 Insurance Agreement: Under the 1994 agreement, the Government of Japan committed to avoid "radical change" in the third sector until foreign, small and mid-sized insurers (which have a greater degree of dependence on the third sector markets) have had a reasonable period to compete in significantly deregulated primary life and non-life sectors. The "supplementary measures" agreed to in December 1996 define the extent and timing of primary sector deregulation by Ministry of Finance. These measures also define the scope of business activities of the Japanese insurance subsidiaries in the third sector consistent with the commitment to avoid radical change. In December 1997, the Japanese Government agreed to bind these commitments under the WTO Financial Services Agreement.

Under the 1996 agreement, the Government of Japan committed to approve by September 1997 applications for automobile insurance with differentiated rates based on a range of risk criteria, e.g., age, gender, driving history, geography, and vehicle usage. This commitment was implemented on schedule. It also committed to obtain Diet passage and implement legislation amending the Rating Organizations Law to eliminate the rating organizations' authority to set industry-wide rates for automobile and fire insurance. Currently, the rating organizations, comprised of all non-life insurers, operate as rate-setting cartels exempt from Japan's Antimonopoly Act. The Ministry of Finance recently submitted legislation to the Diet to implement these reforms of the rating organizations and has expressed its intention to have these reforms in place prior to July 1, 1998.

Japan also implemented its commitment to expand the list of products to be included under the "notification system." This has accelerated the introduction of innovative products, including several important liability lines. The Ministry of Finance also has reduced the threshold above which insurers will be permitted to offer flexible rates for commercial fire insurance from the 30 billion yen (contract value) in place at the time of the 1996 agreement, to 20 billion yen in January 1997. This ceiling will be further reduced to seven billion yen by April 1998.

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

In January 1998, the U.S. and Japan conducted their most recent biannual review of Japan’s implementation of its commitments under the insurance agreements. The U.S. raised serious concerns with the lack of transparency of Japan’s insurance reform process. In particular, foreign firms have not been given a meaningful voice in the discussions to reform the rating organizations. A similar disturbing lack of transparency is seen in the process to establish a Payment Guarantee System, revise rates for personal accident insurance, and reallocate premiums of the Housing Loan Corporation among insurance providers, and in the approval process for new products and rates. Similarly, the United States is extremely concerned with the diminution of the third sector safeguards caused by increased activity on the part of Japanese insurance firms and subsidiaries in this segment of the market. The United States is actively pursuing these issues at senior levels with Japan so as to ensure full and faithful implementation of the insurance agreements.

Professional Services

The ability of foreign firms and individuals to provide professional services in Japan is inhibited by a complex network of legal, regulatory and commercial practices barriers. U.S. professional services providers are highly competitive and the U.S. Government expects the export of such services to continue to grow in the future. These services are important, not only as U.S. exports in themselves, but as vehicles to facilitate access for U.S. exporters of other services and goods to the Japanese market. Additionally, U.S. services professionals often can contribute valuable expertise gained from operating widely in international markets and stimulate innovations for the economies in which they serve.

Japan

The Administration continues to seek improved access for professional services providers in Japan, through bilateral dialogue for construction, architectural, and engineering services (see Construction, Architecture and Engineering), under the Enhanced Deregulation Initiative for legal services, and multilaterally in the WTO for accounting and auditing services. Through the WTO Working Party on Professional Services, WTO members are developing disciplines on the regulation of the accountancy sector to make it easier for accountants to provide their services on a cross-border basis or in other countries. Forthcoming GATS negotiations in the year 2000 also will offer an opportunity for liberalization of accountancy and other professional services.

Accounting and Auditing Services

U.S. providers of accounting and auditing services face a series of regulatory and market access barriers in Japan which impede their ability to serve this important market. Regulated accounting services may be provided only by individuals qualified as a Certified Public Accountant (CPA) under Japanese law, or by an Audit Corporation (composed of five or more partners who are Japanese CPAs). To become qualified as a CPA in Japan, a foreign accountant must pass a special examination for foreigners, to obtain a professional certification. This examination was last offered in 1975. CPAs in Japan must also be registered as members of the Japanese Institute of Certified Public Accountants and pay membership fees.

Only individuals who are Japanese CPAs can establish, own, or serve as directors of Audit Corporations
An Audit Corporation may employ foreign CPAs as staff, but foreign CPAs are not allowed to conduct audit activities. Furthermore, an Audit Corporation may engage in a partnership/association relationship with foreign CPAs only if the partnership/association does not provide audit services. Audit Corporations are prohibited from providing tax-related services, although the same individual may perform both functions as long as totally separate offices are maintained. Establishment is required for Audit Corporations, but not for firms supplying accountancy services other than audits.

Branches and subsidiaries of foreign firms are not authorized to provide regulated accounting services. A foreign firm cannot practice under its internationally-recognized name; its official firm name must be in Japanese and is subject to approval by the Japanese Institute of Certified Public Accountants. A firm may use its internationally-recognized name, e.g., on its letterheads or business cards, in parallel with its official firm name in Japanese. Restrictions on marketing apply to all accountancy services provided by CPAs and audit corporations.

Legal Services

Since the 1970s, U.S. lawyers have sought greater access to the Japanese legal services market and full freedom of association with Japanese lawyers. However, strong opposition from the *Nichibenren* (Japan Federation of Bar Associations) and an unwilling Japanese bureaucracy have consistently failed to address primary U.S. concerns.

Beginning in 1987, Japan has allowed foreign lawyers to establish offices in Japan and advise on matters concerning the law of their home jurisdictions in Japan, as foreign legal consultants (*gaikokuho jimu bengoshi*), subject to restrictions set out in the Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers (Law No. 66 of 1986, as amended). Since the law was enacted, Japan has liberalized several of the restrictions on foreign lawyers, including those related to the use of law firm names and the representation

of parties in international arbitrations in Japan. However, it has adamantly refused to remove the most restrictive regulatory hurdle facing foreign lawyers in Japan -- the ban on hiring or forming partnerships with Japanese lawyers (*bengoshi*) in Japan.

In 1996, the Japanese Ministry of Justice and the *Nichibenren* jointly formed a Study Committee on Foreign Lawyers (Study Committee) with a broad mandate to examine ways to liberalize the restrictions on the provision of legal services by foreign lawyers in Japan. The Study Committee focused on three issues: the partnership and employment ban; the ability of foreign legal consultants to advise on third country law (the law of countries other than Japan, the home jurisdiction or designated jurisdictions); and the length of experience required before a foreign lawyer could register as a foreign legal consultant. However, the Study Committee's final report, issued on October 30, 1997, was extremely disappointing as it recommended only marginally liberalized restrictions.

In particular, the Study Committee recommended no change in the discriminatory practice of allowing *bengoshi* to hire foreign lawyers, while forbidding foreign firms from hiring *bengoshi*. It rejected any relaxation of the ban on partnerships and employment. Instead, it recommended continuation of the current arrangement of "registered associations" *(tokutei kyodo jigyo*) between *bengoshi* and foreign legal consultants, but that they be allowed to handle a slightly broader scope of business. The foreign legal community considers the registered association to be cumbersome and inadequate, and an unsatisfactory structure for providing fully integrated transnational legal services in Japan. Its shortcomings are illustrated by the following statistics. As of July 1997, 80 foreign legal consultants were registered in Japan, representing 45 foreign law firms. However, of these, only six law firms had entered into registered associations with a Japanese lawyer since January 1, 1995, when this form of association became possible.

The Study Committee recommended liberalization of the ability of foreign legal consultants to practice third country law and reduction from five years to three years of the amount of experience required before a foreign attorney can register as a foreign legal consultant. But at the same time, it proposed that a foreign lawyer be able to count only one of the current two years spent in Japan employed by a *bengoshi* or a foreign legal consultant toward the three-year requirement.

In a November 7, 1997 submission to the Japanese Government in the context of the Enhanced Initiative on Deregulation and Competition Policy, the United States stressed that the liberalization of Japanese legal services must keep pace with ongoing deregulation and market liberalization measures to ensure that both Japanese and foreign parties are able to obtain fully integrated transnational legal services in Japan. To that end, the United States made specific proposals, with the removal of the ban on partnerships and employment as its top priority. It also called for full credit to be given to the time a foreign lawyer works in Japan for a *bengoshi* or a foreign lawyer, and urged Japan to allow foreign legal consultants to advise on third country law to the same extent as Japanese lawyers.

The United States also requested that Japan increase significantly the number of Japanese lawyers entering the practice by more than doubling the number of persons allowed to enter the Supreme Court's Legal Research and Training Institute, from the current 700 persons to at least 1,500 trainees each year. In addition, the United States has sought the removal of restrictions on the employment of related Japanese legal professionals, including tax attorneys (*zeirishi*) and patent attorneys (*benrishi*) by foreign law firms, and on the representation by foreign legal consultants of clients before Japanese governmental entities.

Japan

The U.S. will continue to press Japan to remove unnecessary and unreasonable restrictions on foreign lawyers in Japan, in particular the ban on partnership and employment.

Telecommunications Services

The United States has deep concerns about the costs and conditions associated with interconnection to the Nippon Telegraph and Telephone Corporation (NTT) network. While the Ministry of Posts and Telecommunications (MPT) has published useful guidelines on interconnection, NTT's interconnection rates are much higher than those in the United States and most European nations. As interconnection is a critical element in permitting competition, the United States is strongly urging Japan to set interconnection rates as close as possible to competitive market prices to prevent NTT from imposing excessive costs on competitors. The high costs NTT is trying to impose on its competitors derive from its monopoly legacy, when NTT was free to spend on infrastructure development without the effective discipline of market forces. This is clear in the inefficiency of the NTT network: judged by value of plant per minute of traffic, NTT's costs are about four times those of U.S. local exchange carriers -- costs which NTT imposes on its competitors by embedding them in interconnection fees.

The only recognized solution for ensuring fair, cost-based interconnection is to price it according to market-based, forward looking costs, i.e., long run incremental costs (LRIC). Japan has failed to commit to LRIC, dealing a serious blow to prospects for full-fledged competition in this sector.

Other issues of concern include high up-front costs that NTT charges its competitors for network modifications associated with interconnection, the lack of an open and transparent process for developing network interfaces, long delays by NTT in providing interconnection, and NTT's practice of levying discriminatory charges for services, such as directory assistance, on its competitors.

The United States has expressed concerns about possible anticompetitive implications of some aspects of NTT's planned restructuring, scheduled to be completed during 1999. Issues of concern include joint marketing by regional and long distance carriers, possible cross-subsidization, and personnel exchange between corporate units. The United States has urged Japan to establish stronger safeguards to guard against possible anticompetitive activities by NTT, which still controls over 90 percent of the domestic Japanese telecommunications market.

NTT's entry into international services is cause for significant concern. It must be preceded by effective, cost-based interconnection and adequate competition safeguards to prevent NTT from leveraging its de facto monopoly control over local services into anticompetitive advantages in the market for international services. The U.S. Government will be monitoring this issue closely over the next year.

The U.S. Government also has been urging the Government of Japan to abolish investment restrictions in NTT, eliminate foreign investment restrictions for cable TV providers and direct-to-home satellite broadcasters that do not provide telecommunications services, enhance access to rights of way for constructing infrastructure, streamline of burdensome licensing and equipment certification procedures, and enhance transparency in rulemaking and administrative procedures.

The U.S. Government also was active in 1997 in encouraging the Government of Japan to implement its

commitment in the WTO Basic Telecommunications Agreement to allow international simple resale (ISR) services. The United States was encouraged by Japan's final policy on ISR, announced in December 1997, which recognizes that ISR must be permitted outside of the international settlements system. The United States will closely monitor implementation of this service to ensure that U.S. companies are able to provide ISR services in a timely and commercially viable manner.

The United States also was encouraged by MPT plans, announced in late 1997, to relax rules concerning the number of channels a direct-to-home (DTH) satellite broadcaster can control, simplify licensing procedures for consignors, liberalize the setting of transponder fees, relax some ownership restrictions, and eliminate the fully allocated costing methodology for calculating transponder fees. However, the United States remains concerned about a wide range of regulatory barriers that still impede DTH and other broadcasting services. Specifically, the United States is urging Japan to eliminate all restrictions on the number of channels DTH providers can offer. One immediate action Japan should undertake, which would permit providers to offer more channels within the existing regulatory framework, is to eliminate restrictions on the use of advanced transmission technology (statistical multiplexing) which can increase efficient use of the spectrum by up to 30 percent.

INVESTMENT BARRIERS

Japan's stock of inward foreign direct investment (FDI), relative to the overall size of the Japanese economy, is minuscule compared to that of other advanced industrialized countries. In 1996, for example, the value of Japan's stock of inward FDI totaled only 0.8 percent of the nation's 1996 gross domestic product, as compared to 8.3 percent for the United States. Japan's outward investment flows, on the other hand, dwarf investment into Japan: the ratio of outward-to-inward FDI averaged 12-to-1 between 1990 and 1996. In 1996, Japanese overseas FDI was $48 billion; Japan's inward FDI was only $7 billion (actually a record high year). The scarcity of foreign investment into Japan contributes to large external trade imbalances and helps impede market access for competitive foreign companies. The Government of Japan actively discouraged foreign investment during the high growth periods of the 1950s to the early 1980s. The legacy of these policies and Japan's high-cost, over-regulated economy are low levels of investment by foreign firms in Japan.

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

Although many direct legal restrictions on foreign direct investment have been eliminated, bureaucratic obstacles remain. Japan's low level of inward FDI flows in recent years also reflects the impact of exclusionary business practices, high market entry costs, and discriminatory use of bureaucratic discretion. While Japan's foreign exchange laws currently require only ex-post notification of planned investment in most cases, a number of sectors (e.g., agriculture, mining, forestry, fishing) still require prior notification to government ministries. Restrictions on foreign investment in direct broadcasting services, cable television operators, and the NTT and *Kokusai Denshin Denwa* (KDD) telephone carriers remain a concern. The Government of Japan has indicated that it will submit a bill that will eliminate foreign investment restrictions in KDD in 1998 and is studying possible further liberalization of foreign investment limits in cable television.

Japan

Difficulty in acquiring existing Japanese firms -- as well as doubts about whether such firms, once acquired, can continue productive business relations with other Japanese companies -- make investment access through mergers and acquisitions much more difficult in Japan than in other countries. As a result, few foreign companies have been able to perform mergers and acquisitions in Japan, the major avenue for FDI (some 80 percent) in other Organization for Economic Cooperation and Development (OECD) countries. Extensive cross-shareholding among allied companies and difficulties foreign firms encounter in hiring local employees also inhibit direct foreign investment. Insufficient accounting disclosure, even by listed firms, increases the risks associated with mergers and acquisitions.

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

In reality, however, many of Japan's FDI promotion policies are grafted onto domestic regional development promotion programs, and focus exclusively on attracting manufacturing investment. While physical infrastructure is often improved as an incentive to investors, other forms of incentives remain small in scale and relatively inflexible in application, and many investors find them insufficient to offset other major impediments to investment.

The United States and Japan held investment consultations in December 1997, which focused on labor, mergers and acquisitions, local investment incentives, land policy and sectoral restrictions on investment.

ANTICOMPETITIVE PRACTICES

Anticompetitive practices are a cross-cutting issue in U.S.-Japan trade relations. In addition to the discussion in this section, there is further discussion related to anticompetitive practices and Antimonopoly Law enforcement in other sections: the Enhanced Initiative on Deregulation and Competition Policy, Insurance, Flat Glass, Paper and Paperboard, and Consumer Photographic Film and Paper.

Exclusionary Business Practices

American firms trying to enter or participate in the Japanese market face a host of exclusionary Japanese business practices that block market access opportunities. These include the following:

Anticompetitive private practices -- such as bid-rigging, price-fixing, and refusals to deal -- that violate

the Antimonopoly Act and other Japanese laws but often go unpunished;

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

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

Industry associations and other business organizations that develop and enforce industry-specific rules limiting or regulating, among other things, fees, commissions, rebates, advertising, and labeling for the purpose of maintaining "orderly competition" among their members, and often among non-members.

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

Cartels can pose serious barriers for foreign exporters and foreign companies that seek to invest in Japan. The Japan Fair Trade Commission (JFTC) is responsible for deterring and punishing illegal cartel behavior, but is an uneven enforcer with limited resources and strength to use its prosecutorial powers.

Japan Fair Trade Commission's Enforcement Record

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

The JFTC's ability to enforce Japan's fair competition laws is hindered by its historically weak stature among Japanese ministries, shortage of personnel, and perceived lack of autonomy. The JFTC was "upgraded" in 1996 to allow the formation of an administrative general affairs bureau, an economic bureau, investigations bureau, and a new special investigation division to handle major cases. Previously, the JFTC only had departments, which relegated JFTC officials to a lower status relative to ministry officials. However, the JFTC failed to gain approval for the creation of a competition policy bureau and did not achieve the substantial gains it needs in

antitrust enforcement personnel. In JFY 1997, JFTC staff increased by only 13 members from levels of the previous year to a total of 545, of which 248 (12 more than JFY 1996) are engaged in investigation-related work. There are 55 investigators (up nine) in the special investigations department.

In JFY 1998, the Government of Japan plans to increase the JFTC's budget by 1.1 percent and increase its personnel by ten, of which seven will be assigned to the investigation bureau. All the same, these numbers remain too small for the JFTC to enforce competition laws and policies adequately. This is especially true given the potential effects on the competitive environment of the liberalization of holding companies (effective December 17, 1997), the increase in mergers (up 13.4 percent in 1997), and the continued efforts to narrow or abolish Antimonopoly Law exemptions. In its November 1997 submission to the Government of Japan under the Enhanced Initiative, the United States requested that the Government of Japan increase the JFTC staff to 700.

Although the JFTC recently has improved its enforcement performance, the enhancement has not been enough to shed its public image as an ineffective watchdog. For example, after maintaining surcharge orders for cartel practices at very low levels during the 1980s, since 1990, the JFTC has steadily increased its penalties, imposing 7.5 billion yen in surcharges against 368 companies in JFY 1996. However, the JFTC rarely criminally prosecutes antimonopoly violators -- tackling only four cases since 1990 -- and actual imprisonment for antimonopoly violations is unheard of. The JFTC's infrequent use of the Anti-monopoly Law's criminal provisions undermines deterrence of illegal business practices.

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

Laws Distorting Competition

The JFTC itself administers or assists in administering a number of laws and regulations that distort competition and often have anticompetitive effects.

Law Against Unjustified Premiums and Misleading Representations: The JFTC imposes unrealistic limits on the use of premium offers (prizes), and thereby discourages even legitimate cash lotteries and product giveaways used in sales promotions. Foreign newcomers, who depend on innovative sales techniques to market their company names and products, are severely impaired by the JFTC's restrictions on premiums. In addition, the law aims to deter misleading or fraudulent advertising and labeling, in itself a worthy policy. However, the JFTC's practice of allowing "fair trade associations" (essentially, private trade associations) to set their own promotion, advertising and labeling standards through self-imposed "fair competition codes" creates difficulties, especially for newcomers who are unfamiliar with local guidelines. Trade associations can and often do use the

cover of these codes to set additional standards that are stricter than the JFTC's regulations under the Premiums Law.

As of January 1998, there are 48 JFTC-authorized private premium codes. In April 1996, the JFTC incrementally liberalized its rules on premiums and other sales promotions, for example, by raising the maximum value of "open" cash lotteries (not requiring a purchase) to ten million yen; repealing restrictions on premiums offered by department stores; and eliminating the 50,000 yen ceiling on consumer premiums (while retaining price caps as a percentage of the transaction value). Further, over the last two years the JFTC abolished 24 of 29 industry-specific premium limits; the five industries that remain subject to stricter rules are real estate, household electrical appliances, newspapers, magazines, and hospital management. However, these changes fall short of the dramatic liberalization measures requested by the U.S. Government in Framework discussions and in the November 1997 deregulation submission to the Government of Japan.

Resale Price Maintenance: In April 1997, the Government of Japan abolished all product exemptions of the Antimonopoly Act, with the prominent exception of copyrighted products (books, magazines, newspapers, and CDs). There is no reason that retail price maintenance should be treated any differently under the Antimonopoly Act than any other practice. The JFTC currently is considering limiting or eliminating the retail price maintenance exemption for copyrighted products -- on January 13, 1998, a study group to the JFTC recommended a phased elimination of the exemption -- and will announce its decision by March 31, 1998.

Business Reform Law: On April 1, 1995 the Japanese Government implemented the Law to Promote Business Reform for Specified Industries (Business Reform Law) which authorizes MITI to implement industrial policy measures in designated industries. Under the law, in return for a firm in a designated industry adopting a MITI approved business reform plan, MITI will provide preferential measures, e.g., special depreciation allowances, company registration tax reductions, to the firm. This type of preferential treatment distorts the market mechanism and runs counter to Japan’s efforts to liberalize its economy through deregulation. Moreover, a number of the targeted industries are leading Japanese industries hardly in need of preferential treatment, e.g., automobiles, telecommunications.

Additionally, under Article 7 of the Business Reform Law, when firms in the same industry jointly submit business reform proposals, the reviewing Minister may consult with the JFTC regarding the joint applications. The JFTC may provide legal analysis to the Minister, and if an Antimonopoly Law problem exists, the Minister will have an opportunity to further consult with the JFTC. In its November 1997 deregulation submission, the United States urged the Japanese Government to abolish Article 7 of the Business Reform Law because: (1) it inappropriately diminishes the independence of the JFTC by setting up a consultation mechanism; and (2) it may be construed as an Antimonopoly Law exemption.

Cartel Exemptions: In June 1997, the Government of Japan decided to abolish numerous antitrust-exempted cartels. Still, 52 cartels retain their exemption from Antimonopoly Act application: 12 under individual laws, 7 under the Antimonopoly Act, and 33 under the Antimonopoly Exemption Act. The Government of Japan has pledged that it will review all remaining cartel systems with an eye toward elimination, and is expected to announce its decision by March 31, 1998. The Government of Japan announced in December 1997 that it plans to eliminate the exemptions for Depression Cartels and Rationalization Cartels.

Relationship Between Government and Industry

Japan

Japanese regulators view their role not simply as neutral arbiters of a legal rule-based system, but as active players in the guidance of their respective industries. The close government-industry relationship in Japan often works to the disadvantage of foreign firms trying to enter or participate in the Japanese market because the relationship favors domestic firms. Several aspects of the relationship are of particular concern.

Privatization of Regulations: The Government of Japan delegates, both formally or informally, governmental or public policy functions, such as industry standard development, product certifications and entry authorizations, to industry associations and other business-related organizations that are generally not under any obligation to conduct their operations in an open, transparent and non-discriminatory manner or to include foreign firms in their deliberations. Under the Enhanced Initiative, the United States has asked the Government of Japan to refrain from such delegations to industry associations and to ensure that, when there is a demonstrated need for such delegations, that they are carried out by the associations in an open, transparent and non-discriminatory manner and do not restrict the business activities of firms that are not members of the association.

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

OTHER BARRIERS

Aerospace

Japan is the United States' largest foreign market for aircraft and aerospace products, and many Japanese firms have entered into long-term and productive relationships with American aerospace firms. However, certain aspects of U.S.-Japan aerospace trade bear watching. The Japan Defense Agency's general preference for licensing foreign technology for production in Japan has meant that U.S. defense aerospace exports have been lower than would occur in a more market-driven environment. With respect to commercial aerospace, the Ministry of International Trade and Industry plays an active role in supporting the domestic aerospace industry, funding feasibility studies for new projects and technologies, and apportioning work among the major Japanese aerospace companies. Moreover, the Japan Defense Agency plays a role in the development of defense aerospace projects with significant commercial ramifications. Largely as a result of these policies, a significant transfer of U.S. aerospace technology to Japan has occurred, and Japan has become a major supplier of parts and components to foreign aircraft assemblers.

With respect to space systems, the Japanese Government’s focus on the development of indigenous systems disregards the frequent availability of proven U.S. technology and products. However, in 1996, Japan revised its space development policy with the aim of reducing the cost of the H-2 rocket, Japan’s indigenous launch vehicle, and as part of that revision opened procurement practices for this vehicle to non-Japanese suppliers. Partially as a result, two U.S. suppliers have won openly bid contracts for the provision of rocket parts. The United States welcomes this action, and will monitor subsequent procurements for the H-2A rocket to ensure that the procurement process is indeed open and transparent. In addition, the United States will also continue to push for greater access to areas where Japan’s preference for the development of domestic space technologies has been

most pronounced, including: space recorders and scientific instruments; sensors for earth resources and astronomical research satellites; and software and ground-based data processing, storage and distribution systems.

The U.S. Government will continue to monitor developments to ensure that the Japanese aerospace market remains open and that Japanese Government actions do not adversely affect export prospects for U.S. aerospace companies.

Autos and Auto Parts

The objectives of the 1995 U.S.-Japan Automotive Agreement are to eliminate market access barriers and significantly expand sales opportunities in this sector. Under the Agreement, the Japanese Government committed to improve access for foreign vehicle manufacturers, expand opportunities for U.S. original equipment parts manufacturers in Japan and the United States, and eliminate regulations that restrict access for U.S. automotive parts suppliers to the Japanese repair market. The Agreement included 17 objective criteria which evaluate progress toward achieving the Agreement's objectives. In conjunction with the conclusion of the Agreement, the five major Japanese auto manufacturers also announced plans to increase purchases of foreign auto parts in Japan and to expand production of vehicles and major components in the United States.

The Administration attaches high priority to vigorous implementation of the Automotive Agreement because of the importance of this sector to the U.S. economy. An Interagency Enforcement Team, headed by USTR and the Department of Commerce, was established to monitor implementation and assess progress achieved under this Agreement. This team issues a semi-annual report evaluating progress since the Agreement was reached. The fourth and most recent of these reports was issued on December 4, 1997.

The U.S. Government has become increasingly concerned over the past year about the lack of progress toward achieving many of the Agreement's key objectives, although the Agreement has generated satisfactory results in some areas. The United States relayed its specific concerns to Japan at the second annual review of the Automotive Agreement held in San Francisco in October 1997, and its concerns were echoed by representatives from the European Union, Canada, and Australia. The United States called upon Japan to take additional, concrete actions to ensure ongoing improvements in market access and sales opportunities in the Japanese automotive market and urged it to take immediate, substantial deregulatory and market-opening action to foster domestic demand-led growth.

Vehicles: After increasing 34 percent in 1996, sales in Japan of motor vehicles produced by the Big Three in North America declined 20 percent in 1997. This drop well exceeded the 5 percent contraction of the Japanese auto market. Moreover, it occurred despite the Big Three's maintenance of competitive prices in the face of a weak yen and major investments in expanded distribution networks and research facilities in Japan.

Foreign access to Japan's automotive distribution network remains a serious problem. U.S. auto companies continue to seek high-quality, high-volume dealerships, but some Japanese dealers continue to have reservations about carrying competing foreign vehicles for fear that doing so would compromise their relationships with Japanese manufacturers and thereby jeopardize their business. The Big Three U.S. automakers have added a total of 177 new outlets through direct franchise agreements with Japanese dealers since the signing of the Agreement, with the pace diminishing markedly over the past year. In response to a U.S. request, the

Japan

Government of Japan held a series of meetings with Japanese auto manufacturers and dealers to remind them that dealers are free to carry competing products of any manufacturer. Vigorous efforts in this area are critical to the ability of foreign automakers to gain direct and complete access to dealerships, which is key to achieving real access to the Japanese automotive market.

Auto Parts: Exports of U.S.-made auto parts to Japan increased 13 percent in 1997 and sales to Japanese transplants increased 4.2 percent during the first half of JFY 1997. At the same time, U.S. imports of parts from Japan fell 11.8 percent during 1997 -- in large part because Japanese transplants are substituting parts imported from Japan with U.S.-made parts. Nonetheless, sales of original equipment (OE) parts to Japan continue to be low. Furthermore, despite large percentage increases, actual U.S. aftermarket parts sales to both Japanese auto companies in the U.S. and Japanese auto companies in Japan remain small.

The Japanese auto manufacturers have made considerable progress in implementing the global business plans they announced at the time the Automotive Agreement was signed. In the United States, the automakers have boosted production of passenger cars, light trucks, and a range of components, including engines and transmissions. These production increases have and will continue to lead to new sales opportunities for U.S. suppliers and increased employment opportunities for U.S. workers.

Deregulating the certified service garage system is critical to increasing access of foreign parts suppliers to Japan's auto parts market. Restrictions limiting where and by whom repairs may be conducted restrict the creation of a competitive, independent auto parts aftermarket. Auto parts deemed by the Japanese Government to be critical to vehicle safety, or so-called "critical parts," cannot be replaced or repaired without inspection by a Ministry of Transport (MOT) Land Office official, unless repairs are conducted at an MOT-designated or certified garage. Garages that are not designated or certified may not perform such repairs. However, U.S. industry asserts, and the U.S. Government agrees, that critical parts repairs can be made with no adverse effect on safety as long as they are done by qualified mechanics. The Ministry of Transport has submitted legislation to the Diet that would permit vehicle-owners to repair critical parts on their own vehicles without the need for an MOT inspection. While a positive first step, this step alone is unlikely to result in meaningful improvements in market access for foreign auto parts manufacturers because virtually no Japanese consumers repair their own cars.

In February 1997, the Ministry of Transport introduced two new categories of service garages into the Japanese certified garage system. This action is encouraging competition and creating new opportunities for foreign auto parts producers by permitting smaller, independent garages, which are more inclined to use foreign parts, to undertake repairs previously limited to dealerships or other MOT-certified garages. To date, 205 specialized certified garages have been established. To facilitate the establishment of these new garages, the U.S. Government and industry has requested that the Ministry of Transport revise regulations regarding the certification of mechanics employed by these garages. The Ministry of Transport held public hearings on this proposal on February 9-10, 1998, but has not yet determined its response to this proposal.

The U.S. Government is extremely concerned about the lack of ongoing and significant deregulation in the automotive sector, and has strongly urged the Japanese Government to undertake additional deregulatory measures that will result in improved foreign access to the Japanese automotive market. Despite the Japanese Government's commitment to deregulation generally and in this sector specifically, the Ministry of Transport has rejected several deregulatory requests by the U.S. Government and private sector during the past year. In

particular, the Japanese Government has not removed any additional significant items from the dissembly repair regulations since the Agreement was signed, despite its commitment under the Agreement to review the need for maintaining items on this list.

In January 1998, the Ministry of Transport informed the U.S. Government of draft legislation regarding auto parts certification and recall procedures intended to bring Japan's certification system into conformity with the UNECE 1958 Agreement for the mutual recognition of auto standards. The United States raised strong concerns regarding the lack of transparency and adequate notice it was provided on this issue, as well as concerns that the new procedures could potentially discriminate against foreign auto parts suppliers, particularly in the repair market. In early February, the Ministry of Transport dropped the recall proposal and assured the United States that the implementation process for the new certification system will be transparent and that it will give U.S. comments on the enabling ministerial ordinances full consideration. The Ministry of Transport also assured the United States that the new certification system was a first step toward international harmonization of automotive regulations and certification, and that it strongly supports the U.S. efforts to establish a global agreement on automotive standards and certification. The U.S. Government will closely monitor developments in this area.

Civil Aviation

More than 12 million air passengers travel annually between the United States and Japan; U.S. carriers transport almost two-thirds of them. U.S. carriers also are highly competitive in the cargo sector, enjoying a market share of about 55 percent. With nearly 40 percent of U.S. exports to Japan moving by air, Japan is by far the largest air freight market for U.S. carriers. U.S.-Japan air service currently earns approximately $6 billion in revenue for American carriers each year.

On January 30, 1998, the United States and Japan concluded a new civil aviation agreement which will significantly liberalize the bilateral civil aviation market. This agreement eliminates restrictions and resolves disputes for incumbent carriers. It lifts all restrictions on the number of flights operated and points served between the United States and Japan by incumbent combination and all-cargo carriers (United Airlines, Northwest Airlines and Federal Express). It also resolves the long-standing dispute over our incumbent carriers' rights to fly from Japan to other international points beyond Japan.

The agreement also opens doors for non-incumbent carriers. Non-incumbent Acombination@ carriers, currently Delta, American and Continental, gain the right to offer an additional 90 weekly round-trip flights between the United States and Japan, nearly tripling their access to this market. (Combination carriers carry both passengers and cargo.) Two new non-incumbent combination carriers will be able to enter the U.S.-Japan market, one immediately and another in two years. Non-incumbent all-cargo carriers, UPS and Polar Air Cargo, gain valuable new opportunities to transport cargo to destinations beyond Japan. An additional all-cargo carrier will be able to enter the market in four years.

Code sharing is permitted for the first time. U.S. and Japanese carriers can code share freely, U.S. carriers can code share among themselves on many operations to Japan and beyond, and U.S. carriers can code share with third-country carriers on operations to and beyond Japan. Other new service also will be available, including an increase in charter operations, from the current 400 flights per year, to 600 flights per year in two years, and rising eventually to 800 flights per year. Distribution and pricing provisions of the agreement will also promote competition. The Japanese Government has guaranteed U.S. carriers fair and equal opportunity to contract with

wholesalers and travel agents and to set up enterprises to market their services directly to consumers.

The anticipated economic benefits of this agreement will be substantial to both U.S. carriers and passengers and result in a projected increase of roughly $1 billion annually in U.S. aviation services exports.

While the United States is pleased to have reached this significantly market-opening agreement with Japan, the Administration remains committed to seeking further liberalization of this bilateral civil aviation market consistent with the Administration's global civil aviation policy of "open skies." The goal of this policy is to minimize government interference in the civil aviation market and provide full and equal opportunities for U.S. and foreign passenger and cargo carriers to compete in each other's markets. The United States and Japan have agreed to meet by May 1998 to consider further steps to liberalize pricing, with talks to resume within three years regarding a fully liberalized bilateral civil aviation agreement. If we do not reach that goal by 2002, supplemental liberalization will automatically transpire under the terms of the 1998 agreement.

Electrical Utilities

The cost of electric power in Japan is the highest in the industrialized world. Although private sector enterprises, Japan's ten electric utilities have regional monopolies and are among the largest and most profitable companies in Japan. To enhance Japan's competitiveness, the Japanese Government has sought to reform the electric power industry and introduce measures aimed at reducing electric power rates to international rates by 2001.

The United States believes that the most effective way for Japan to reduce costs in this sector would be the introduction of real competition into non-fuel procurement -- specifically, the elimination of discriminatory and nontransparent procurement practices and unnecessarily burdensome regulations and other barriers that limit the access of U.S. suppliers to this market. Non-fuel procurement presently is valued annually at approximately $25 billion, with imports representing only about 5 percent of total non-fuel procurement, which is considerably lower than the foreign share of other developed markets. With some Japanese utilities making progress in this area but others lagging behind, the United States continues to work to encourage the utilities to internationalize their procurement.

Among the barriers faced by foreign firms are standards and specifications used by Japanese utility companies that often discriminate against or otherwise disproportionately affect foreign suppliers. Particular problems in this regard are: the use of narrow, technical standards rather than performance-based standards; the lack of harmonization with standards used by other nations and even with specifications used by other utilities within Japan; and requirements that suppliers provide detailed information on standards and specifications for spare parts originating from outside sources.

The United States also seeks greater transparency and fairness in the procurement process. Expensive and time-consuming procedures are generally required for a company to be added to the list of designated suppliers for a particular utility company, including requests that suppliers submit detailed information on proprietary manufacturing processes. Equal access to procurement information also is a problem, and foreign firms often do not learn about procurements until after they have been awarded. Moreover, U.S. firms have expressed concerns that the periods allocated for bid submission and product delivery are too short and that, while many utilities make procurement information available in English, bid documents and related technical documents must be submitted exclusively in Japanese.

In addition, exclusionary business practices by Japanese company groups, including manufacturers, construction and engineering firms, and parts suppliers, impede foreign access to this market.

Some Japanese utilities have taken concrete steps to streamline and simplify their procurement standards and adopt international standards. Those that have done so have increased the range of items procured from foreign suppliers and the number of registered vendors in each of the past five years.

In addition, some Japanese utilities have taken a more active role in developing relations with potential U.S. suppliers. Through the New Orleans Association (NOA) -- a forum designed to help U.S. suppliers of power generation, transmission and distribution equipment gain access to the Japanese power equipment market -- utilities have made strong efforts to explain their procurement procedures, learn about U.S. products, and establish business relationships with U.S. suppliers. Several utilities have published procurement information in English on their internet home pages and have sent company buyer missions to U.S. trade shows. Moreover, some utilities have assisted U.S. firms in developing relations with distributors and service companies to facilitate the procurement and after-sales service process. Although representing only a small part of non-fuel procurement, telecommunications products also is an area where utilities are making notable progress in expanding foreign procurement.

While the principal focus of U.S. efforts in this sector has been the utility companies themselves, during the past year, government-to-government channels have been opened as well. The U.S. Government has initiated a dialogue with MITI's Agency for Natural Resources and Energy (ANRE) which will allow the United States to provide Japan with specific input on regulatory concerns and valuable information on the U.S. experience with electric utility deregulation. Among U.S. regulatory concerns are: equipment inspections and reporting requirements under the Electricity Utilities Industry Law, which are unnecessarily burdensome and discourage foreign firms from competing in this sector. In addition, the High Pressure Gas Law, which requires foreign manufacturers to apply for inspection of all designated equipment, includes complex and costly requirements that burden foreign suppliers to the Japanese market.

The U.S. Government also is monitoring closely the activities of the Electricity Utility Industry Council, an advisory group to the ANRE. In December 1997, the Council issued an interim report, which recommended increasing the supply of electricity by independent power producers, the introduction of greater competition in the area of thermal power generation, and a review of the bid solicitation and evaluation process. The Council is expected to issue a final report in May 1998.

Flat Glass

Japan’s flat glass market was valued at $4.5 billion in 1997, the second largest in the world. Three Japanese manufacturers dominate the market: Asahi Flat Glass controls half the market, Nippon Sheet about a third, and Central Glass about a fifth. Foreign market share was about 5.7 percent in 1995, 7 percent in 1996, and 6 percent in 1997. Half or more of the import share is accounted for by transactions between affiliated Japanese parties for automotive and other uses.

Foreign access to Japan's glass market is of serious concern to the U.S. Government. In January 1995, the United States and Japan signed an agreement to open Japan's flat glass market to foreign suppliers. Pursuant to that agreement, Japanese glass distributors publicly stated that they would diversify supply sources to include

competitive foreign glass suppliers and that they would not discriminate among suppliers based on capital affiliation. Japanese glassmakers voiced support for diversifying their de facto exclusive distribution networks. The Japanese Government committed to rewrite building standards to promote increased use of insulated glass (where the United States has strong competitive advantages) and to promote increased competition in glass procurement for construction projects based on nondiscriminatory technical and performance specifications and competitive commercial terms.

Progress in implementing the Glass Agreement is measured using both quantitative and qualitative criteria, including access to public sector procurement in Japan. Consultations to assess progress are held annually. The two governments conducted the first review of the agreement in the fall of 1995 and three additional reviews since.

An important test of the Agreement's success is whether there has been a change in the extent to which Japanese distributors and glaziers deal in or use imported flat glass, considering that token dealings or use do not demonstrate diversification of supply sources. According to a March 1997 MITI survey, 80 percent of distributors surveyed planned to maintain the status quo (58.4 percent) or decrease their use of foreign glass (21.5 percent). This is a disturbing setback in meeting the goals of this agreement.

Concerns about lagging progress prompted a special review of the Glass Agreement in October 1997, at the request of the United States. The United States pointed to numerous recent reports of Japanese manufacturers' anticompetitive behavior in attempting to retain domestic market share. These practices include selective withholding of supply, use of restrictive trade associations and discriminatory pricing against customers who purchase significant amounts of foreign flat glass.

The Japanese glass distribution network remains closed to foreign glass producers through a sophisticated system of interlocking relationships. Japanese manufacturers exert control over the distribution system in many ways. Financial control has increased with respect to the larger, more efficient distributors. At the same time, financial interests in smaller, weaker distributors have been sold off. Glass manufacturers often require the payment of security deposits -- collateral equal to about 90 days' sales -- by exclusive distributors. These deposits, which began as a means of establishing credit, maintain a tangible link between distributors and manufacturers and help restrain purchases of flat glass from foreign suppliers. Established distributors are growing resentful of this system because manufacturers no longer pay above-market interest rates on security deposits and no longer uniformly require such deposits from new customers. Cutting centers are commonly owned by Japanese manufacturers and used as a means of controlling distributors. Japanese manufacturers own some 250 flat glass cutting centers throughout Japan. In about half of these, the land and warehouses are owned by a distributor. Manufacturers have changed from a unified pricing policy to one of separate pricing for each distributor.

At the October 1997 special review, the U.S. delegation recommended that the Japan Fair Trade Commission review the current state of the industry, which the agency itself described in 1993 as "highly oligopolistic." The Ministry of Construction acknowledged that it had not fulfilled its commitment to promote greater use of insulating glass by amending energy conservation standards for residential housing. The Ministry of Construction also has failed to upgrade safety standards, as it pledged to do under the agreement.

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

insulating glass, where foreign glass companies have a strong competitive advantage. The next set of consultations under the glass agreement will be held in the spring of 1998.

Pharmaceutical Products and Medical Devices

In addition to bilateral consultations under the Enhanced Initiative on Deregulation, the U.S. Government continues to pursue improved market access for medical devices and pharmaceutical products in the context of the Market-Oriented Sector-Selective (MOSS) Medical Equipment and Pharmaceutical talks.
The U.S. Government remains concerned that a variety of obstacles significantly impede the ability of U.S. pharmaceutical and medical equipment manufacturers to sell in Japan. In addition to regulatory barriers, described in the section on the Enhanced Initiative on Deregulation, the Administration is addressing specific trade issues associated with Japan's current reimbursement system for medical devices and ongoing price revisions for drugs and devices. Japan's reimbursement system often lacks transparency. Under Japan's national health care insurance system, reimbursement prices for drugs and devices frequently do not appropriately reward the true benefits of innovative products, and prices are frequently determined and revised based on a non-transparent and seemingly arbitrary basis. Other priority issues under discussion in the MOSS talks include impediments to the sale of dietary supplements (described in the section on Standards) and greater foreign industry access to Japan's policy-making process.

Paper and Paper Products

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

There has been no meaningful increase in Japanese imports of paper and paperboard products. In 1996, Japan's import penetration in this sector was still only 5.1 percent, with the United States accounting for 1.9 percent. This level of import penetration is the smallest in the industrialized world.

Despite continued U.S. efforts to press the Japanese Government to open its market, including the citation of market access problems in Japan in this sector as a practice that may warrant future identification as a "priority" foreign country practice under provisions of the Super 301, the Japanese government has insisted that it does not maintain barriers to market access in this sector. A key problem U.S. producers have pointed to has been weak enforcement of Japan's Antimonopoly Law and exclusionary business practices. Hence, U.S. negotiators have engaged in discussions about competition issues affecting this sector under the Enhanced Initiative's expert level group on Competition Law and Policy. The United States also has sought Japan's full participation in the APEC forest products sectoral liberalization initiative which envisages, among other, the accelerated phase out of tariffs on paper and paperboard products in Japan.

Consumer Photographic Film and Paper

Japan

Foreign photographic film and paper manufacturers face a variety of barriers that restrict access and sale of their products in the Japanese market, the second largest film market in the world. These barriers have prevented foreign firms from gaining access to the main distribution channels for film. As a result, less than 3 percent of the film sold through wholesale distribution channels is imported and foreign firms are unable to gain any access to nearly two-thirds of film outlets in Japan.

On July 2, 1995, in response to a petition by Eastman Kodak, the USTR initiated an investigation under Section 302(a) of the 1974 Trade Act of barriers to access to the Japanese market for consumer photographic film and paper. After an extensive investigation, on June 13, 1996, USTR made a determination of unreasonable practices by the Government of Japan with respect to the sale and distribution of consumer photographic materials in Japan. The investigation showed that the Government of Japan built, supported, and tolerated a market structure that impedes U.S. exports of consumer photographic materials to Japan, and in which restrictive business practices occur that also impede exports of these products to Japan.

As a result of these findings, the Administration initiated dispute settlement procedures against Japan under the WTO dispute settlement mechanism alleging that Japanese Government measures were inconsistent with the General Agreement on Tariffs and Trade (GATT). The European Union and Mexico joined the United States as third parties to the case. The United States also requested consultations under the General Agreement on Trade in Services (GATS) and a GATT contracting parties' decision on restrictive business practices.

The United States argued that the Government of Japan had implemented an extensive array of measures of the past 30 years to offset the effects of tariff, import, and foreign investment liberalization and limit the sale of imported consumer photographic film and paper in the Japanese market. These measures contributed to a narrowing of distribution channels under the control of the dominant Japanese film manufacturer, restrictions on the expansion and operation of large stores, in which foreign products are more likely to be sold, and limits on the use of economic inducements, premiums and other marketing techniques to gain market recognition.

The WTO Panel on film issued its interim report to the United States and Japan on December 5, 1997, failing to find Japan in violation of its GATT obligations. The United States expressed its serious disappointment with the Panel's findings, stating that the interim report sidestepped the core issues raised by the United States, particularly the combined effects of the numerous measures Japan imposed to protect its market.

Despite the disappointing Panel results, the United States noted that pursuing the WTO dispute has led Japan to take some steps that will benefit U.S. and other foreign film manufacturers. Japan is moving toward eliminating the Large-Scale Retail Store Law, one of the measures the United States challenged. Japan also substantially relaxed impediments to foreign firms' ability to promote their products in Japan and removed film from the list of sectors covered by the Business Reform Law, which help secure financing and other assistance for firms facing declines or risks of declines in production or employment.

The final WTO film panel report, which differed little from the interim report, was issued to the parties on January 30, 1998, and the United States does not intend to appeal the decision. On February 3, the Administration announced a new market-opening initiative aimed at improving access for imported photographic film and paper in the Japanese market. The Administration established an interagency monitoring and enforcement committee to review whether Japan's implementation of the measures at issue in the WTO dispute is consistent with the formal representations it made to the WTO panel. Contrary to the experience of U.S. and

other foreign photographic film and paper manufacturers, the Government of Japan stated to the international tribunal that it neither restricts foreign imports of foreign photographic film and paper nor does it tolerate restrictive business practices by private firms that would have a similar result. For example, the Government of Japan represented to the WTO panel that it: (1) encourages imports of foreign photographic film and paper; (2) does not tolerate restraints on competition in this sector; (3) prohibits practices that discourage the opening of large stores; (4) does not discriminate against foreign firms in this sector; and (5) does not restrain price competition in the photographic film and paper sector.

The interagency monitoring and enforcement committee, co-chaired by USTR and the Department of Commerce, will review Japan's representations on a regular basis, using all relevant information. In particular, it will consider information from industry describing whether Japan's representations are being borne out in the market, information on Japanese Government actions to implement, monitor, and enforce the measures about which it made representations, and data on foreign access to wholesale and retail distribution channels to determine whether this access is improving. The committee will conduct and report on the results of the review semi-annually, with the first review to be completed in July 1998.

On June 13, 1996, the United States requested consultations with Japan under Article XXIII of the GATS, concerning measures affecting distribution services, applied by the Government of Japan pursuant to or in connection with the Large-Scale Retail Stores Law and other adjustment measures. Consultations took place on July 10 and on November 7-8, 1996. In December 1997, the Government of Japan began considering legislation to repeal the Large-Scale Retail Stores Law (see Structural Deregulation). The United States is monitoring legislative developments carefully.

Sea Transport and Freight

American carriers serving Japanese ports have encountered for many years a restrictive, inefficient and discriminatory system of port transportation services. Following extensive research and deliberation, the Federal Maritime Commission (FMC) determined in February 1997 that Japan maintained unfair shipping practices and proposed fines against Japanese ocean freight operators. The FMC delayed implementation of those fines following an understanding between the U.S. and Japanese governments reached in April, in which the Japanese Government pledged to grant foreign carriers port transport licenses and, at the same time, to reform the prior consultation system which allocates work on the waterfront and requires carriers to obtain approval for any change in their vessel operations.

Japan's failure to carry out these reforms by July 31, 1997, resulted in FMC implementation of the fines on September 4, 1997. The two governments reached an understanding in October, 1997, which was recognized in an exchange of letters between Secretary of State Albright and Japanese Ambassador Saito. The understanding noted two agreements among the Japanese Government, foreign ship owners, Japanese ship owners and the Japanese Harbor Transport Association, in which they committed to improve the current prior consultation system, and to establish an alternative method to the current prior consultation system. The Ministry of Transport also agreed to approve foreign carriers' applications for harbor services licenses if those applications satisfied the requirements set out in the April understanding. The U.S. Government believes that these actions provide a solid foundation for reform of Japanese port practices. Sanctions were suspended on November 13, 1997. The U.S. Government continues to vigorously monitor the agreement to ensure its full implementation.

Japan

Significant deregulation of port transport services is still needed, particularly elimination of the supply-demand adjustment requirement and rules that underpin allocation of port transport work. The United States has asked that this deregulation be completed by December 1998.

Semiconductors

In 1996, the United States and Japan announced a new arrangement on semiconductor trade. The new measures, like the 1986 and 1991 semiconductor arrangements which preceded them, were negotiated to address persistent problems of market access for U.S. manufacturers of semiconductors. The 1996 measures represent an innovative multi-dimensional approach to a sector in which market access is promoted not only through government-level discussion but through concrete industry-level partnership.

The cornerstone of the 1996 arrangement is an industry-to-industry agreement under which industries in the U.S. and Japan established a "Semiconductor Council" to promote cooperative activities, discuss market access concerns, and expand international cooperation. Included within the Council's scope are both a continuation of existing user-supplier cooperative activities (in the area of semiconductor technologies for telecommunications, automotive and emerging applications) and a range of new supplier-supplier cooperative activities (in such areas as standards, intellectual property, environmental and safety issues, and others). Industry experts also will collect and analyze data on the state of the semiconductor market and its prospects, and report this information quarterly to governments. The intention is to provide a complete picture of the market situation in the Japanese and other key markets. Based on their commitment to expeditious elimination of semiconductor tariffs under the WTO Information Technology Agreement, industry associations from the European Union and the Republic of Korea were invited to join the Semiconductor Council in 1997, and were present at the initial meeting of the Semiconductor Council in April 1997.

Second, the measures, through a bilateral government statement, also established a multilateral Government Consultative Mechanism, essentially to oversee and interact with the Semiconductor Council. Governments whose industries have joined the Council participate in these consultations, which occur at least once a year. The first meeting of the Government Consultative Mechanism for Semiconductors was held in May, 1997 in Hawaii, where participating governments received the reports prepared by industry and were briefed on the cooperative activities conducted by the Council members, and market trends in Japan and other major markets.

The measures also, through the bilateral government statement, established the "Global Governmental Forum" (GGF). Governments of all major semiconductor-producing nations and economies are invited to participate in this forum, which meets annually to discuss policy issues of interest to the semiconductor industry (e.g., trade and investment liberalizations, environmental issues, worker health and safety, intellectual property protection, and other matters). The second annual GGF was held in Washington in January 1998, with the United States, Japan, the EU, Korea, and Chinese Taipei attending.

Finally, subsequent to the announcement of the new arrangement on semiconductors, the Semiconductor Industry Association (SIA) and the Electronics Industries Association of Japan (EIAJ) announced an industry-level agreement on anti-dumping, which reaffirmed the need to avoid injurious dumping through effective and expeditious antidumping measures consistent with the GATT and WTO Antidumping Agreement. Consistent with this agreement, individual semiconductor producing companies are continuing to collect and maintain specified data on a voluntary basis, which can be produced in an antidumping investigation on an expedited

basis.

Due to the concerted efforts made by all parties, the 1996 measures have continued to lead to greater access to the Japanese market for foreign semiconductor manufacturers. After a slow start, industry organized a full schedule of user-supplier activities for 1997, which was complemented by a range of useful supplier-supplier activities. Foreign market share in the Japanese semiconductor market, of which U.S. producers account for approximately two-thirds, dropped from 35.8 percent in the second quarter of 1997 to 32.1 percent in the third quarter of 1997 (the last quarter for which statistics are available). The Administration will continue to work closely with U.S. industry and the Japanese Government to ensure that the commitments made in the 1996 semiconductor agreement are fully and successfully implemented.