JAPAN

TRADE SUMMARY

The Japanese economy continues to be characterized by low economic growth, structural rigidity, excessive regulation, and market access barriers. Largely as a consequence of continued sluggish demand in Japan, the U.S. goods trade deficit with Japan increased to $81.3 billion in 2000, a ten percent increase from $73.9 billion in 1999. U.S. merchandise exports to Japan rose $7.8 billion (primarily electrical machinery, computers and computer parts) to $65.3 billion in 2000, while U.S. imports from Japan increased $15.2 billion (primarily autos, auto parts and electrical machinery) to $146.6 billion. U.S. exports of private commercial services (i.e., excluding military and government) to Japan were $30.5 billion in 1999, and U.S. services imports from Japan were $15.7 billion. Sales of services in Japan by majority U.S.-owned affiliates were $22.8 billion in 1998, while services in the United States by majority Japanese-owned firms were $16.4 billion. The stock of U.S. foreign direct investment in Japan in 1999 was $47.8 billion, mainly in the manufacturing, services, and finance sectors. This amount is an increase of 34.1 percent from 1998 levels.

OVERVIEW

The U.S. Government attaches top priority to further opening Japan's markets to U.S. goods and services, deregulating Japan's economy, and promoting structural reform. In line with this objective, the United States continues to stress the vital need for sustained, domestic demand-led growth and urges that Japan continue to provide macroeconomic policy support for recovery, take steps to strengthen its financial system, and implement comprehensive deregulation, structural reform and market-opening initiatives.

To open and deregulate Japan's market, the United States continued to pursue a multi-faceted approach which has centered upon: (1) urging major structural reform and deregulation to open more sectors of Japan's economy to competition; (2) negotiating new trade agreements; (3) monitoring and enforcing existing trade agreements covering key sectors, including autos and auto parts, insurance, and government procurement; and (4) addressing concerns through regional and multilateral fora.

Currently, the main vehicle for bilateral efforts to promote comprehensive deregulation and structural reform, as well as to strengthen Japan's competition policy, is the Enhanced Initiative on Deregulation and Competition Policy ("Enhanced Initiative") launched by the United States and Japan in 1997. In July 2000, the United States and Japan announced a Third Joint Status Report under the Enhanced Initiative in which Japan agreed to deregulate its economy both structurally in such areas as competition policy and transparency, and in several key sectors including, telecommunications, housing, financial services, medical devices, pharmaceuticals, and energy. Of particular significance was Japan's agreement to substantially cut the rates which the Nippon Telegraph and Telephone Companies charge to competitors that connect to their local networks. Lowering these interconnection rates to levels agreed upon will, in itself, save U.S. and other competitive carriers over $2 billion over the next two years. These cuts will reduce the cost of business-to-business transactions and Internet usage, and also benefit Japanese consumers by facilitating better service and lower costs as well.

Also in July, the United States and Japan agreed to extend the Enhanced Initiative into a fourth year. In October 2000, the United States provided Japan with a detailed submission calling for the adoption of significant regulatory reforms in key sectors and structural areas to further open and deregulate Japan's economy. These measures would provide increased access in the Japanese market for U.S. and other foreign firms. For the first time, the U.S. submission included numerous proposals specifically related to cutting-edge information-technology issues, including e-commerce. The submission also included for the first time

suggested revisions of Japan's Commercial Code, which provides the regulatory framework for doing business in Japan. The United States looks forward to working with Japan in completing a fourth Joint Status Report later this year that details an additional set of Japanese deregulatory measures to build upon the extensive achievements made to date under the first three years of the Initiative.

The United States also continued to focus attention in 2000 on the monitoring and enforcement of existing trade agreements to ensure their complete and successful implementation. In particular over the last year, the United States urged Japan to make progress on our bilateral agreements covering autos and auto parts; insurance; construction and NTT procurement. Although progress in many sectors has been interrupted over the past several years due to the economic slowdown in Japan, the United States remains committed to closely monitoring Japanese implementation of our trade agreements to ensure that U.S. rights under these agreements are fully enforced. The United States also continued to work closely with Japan in 2000 to prevent the recurrence of harmful steel import surges, and to address the structural issues detailed in the July 2000 Report to the President on Global Steel Trade.

Throughout 2000, the United States worked through both the World Trade Organization (WTO) and the Asia-Pacific Economic Cooperation (APEC) to ensure that our market-opening goals in Japan are well coordinated with our agendas for these fora, including those on agriculture and services. Moreover, the United States and Japan continue to consult on Japan's implementation of the WTO's ruling that found in favor of the United States in a case against Japan's unfairly burdensome and discriminatory requirements on varietal testing of fruits exported to Japan.

Note: On January 6, 2001, the Japanese Government undertook a reorganization, which resulted in the consolidation and renaming of several of its ministries and other entities. For the purposes of this report, the former name of the ministry is used when referring to actions of the ministry up to January 6, 2001. For any references to current or future actions by a ministry, the new name will be used. The reorganized ministries relevant to this report are: the Ministry of Economy, Trade and Industry (METI) (formerly the Ministry of International Trade and Industry - MITI); Ministry of Public Management, Home Affairs, Posts & Telecommunications (MPHPT) (formerly the Ministry of Post and Telecommunications - MPT , the Ministry of Home Affairs, and the Management and Coordination Agency- MCA); Ministry of Health, Labor and Welfare (MHLW) (formerly the Ministry of Health and Welfare - MHW, and the Ministry of Labor - MOL); Ministry of Land, Infrastructure and Transport (MLIT) (formerly the Ministry of Construction - MOC, the Ministry of Transportation - MOT, and the National Land Agency).

Deregulation

Despite Japan's recent focus on deregulation, the Japanese economy remains burdened by unnecessary, costly, and excessive regulations. Over- regulation restrains economic growth, raises the cost of doing business in Japan, prevents competition from nurturing market-based efficiencies in the private sector, and impedes imports. It also raises prices and increases the cost of living for Japanese consumers. In January 2000, Japan's Economic Planning Agency (EPA) released a study which determined that deregulation steps implemented since 1989 in eight key sectors generated roughly $82 billion in savings for Japanese consumers. In addition, the study calculated

that deregulation in the domestic telecommunications and electricity sectors alone saved the average Japanese family of four roughly $450 in 1998. The EPA also released an estimate in September 2000 that deregulation created 1.1 million jobs in the 1990s in the transportation, communications, wholesale, retail and services sectors.

In addition to slowing growth in Japan, government over-regulation lies at the heart of many market access problems faced by U.S. companies doing business in Japan. Some regulations are aimed squarely at the entry of foreign goods and services. Others are part of a system that protects the status quo against market entrants (both foreign and Japanese), stifling entrepreneurship and inhibiting risk-taking and innovation. The United States continues to push for the elimination of regulations in Japan that impede market access for U.S. good and services.

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

To accelerate the pace of deregulation in Japan and increase market access for U.S. goods and services, the United States and Japan established the Enhanced Initiative on Deregulation and Competition Policy ("Enhanced Initiative") on June 19, 1997. The Enhanced Initiative addresses key sectors, including telecommunications, information-technology, medical devices and pharmaceuticals, housing, financial services and energy. It also addresses cross-cutting structural areas, including competition policy, distribution, transparency, revision of Japan's Commercial Code, and legal system reform. Under the Enhanced Initiative, the United States has sought the reform of government laws, regulations, administrative guidance and other measures that impede market access for U.S. goods and services in Japan.

During 2000 -- the third year of the Enhanced Initiative -- progress was made in eliminating Japan's regulatory barriers. In a third Joint Status Report issued in July 2000, Japan agreed to numerous deregulation measures, including:

- Reducing the rates competitors pay to interconnect with Nippon Telegraph and Telephone's network by about 50 percent at the regional level and 20 percent at the local level, effective April 2001;
- Adopting 25 new regulatory measures that will increase U.S. manufacturers' access to Japan's medical devices and pharmaceutical markets, including a reduction in the approval processing time for new drugs by 50 percent;
- Ensuring fair, open and non-discriminatory access to the electricity transmission grid -- the utility-owned network that is the only channel for transmitting electricity from one point to another in Japan;
- Undertaking steps to begin modernizing Japan's legal system, including establishment of the Judicial Reform Council, which will make reform recommendations by July 2001;
- Increasing transparency and bureaucratic accountability by introducing a government-wide policy evaluation system;
- Enacting several financial services-related measures, including introduction of a "no-action" letter system that should improve the transparency and predictability of the regulatory process;
- Revising Japanese law to free landlords from automatic lease renewal practices that wil improve housing options for millions of Japanese families and create enormous opportunities for domestic and foreign builders and suppliers;

- Introducing defined-contribution pension plans (pending Diet approval) to further expand financial sector and investor opportunities;
- Speeding new and innovative insurance products to the market by shortening standard product examination periods and reviewing whether the streamlined "notification" system can be extended to additional commercial and personal insurance lines;
- Ensuring that the Japan Fair Trade Commission (JFTC) enforces the Antimonopoly Act against anti-competitive behavior by dominant firms in such sectors as energy and telecommunications; and
- Lowering charges by Japanese Customs for overtime costs, saving millions of dollars for importers.

In October 2000, the United States presented its fourth annual submission to the Japanese Government under the Enhanced Initiative, which details additional deregulation measures the United States is seeking in each of the sectors and structural areas under the initiative. For the first time, the U.S. submission includes proposed revisions to Japan's Commercial Code and suggested measures to promote deregulation in the information-technology sector. U.S. officials urged Japan to adopt these measures at working-level meetings held in Tokyo in October/November 2000. In December 2000, a Vice-Ministerial meeting was held to review the status of these requests and to narrow differences on outstanding issues. The United States looks forward to working with Japan in completing a fourth Joint Status Report later this year, which will specify substantive new market-opening measures to further deregulate Japan's economy.

SECTORAL DEREGULATION

Telecommunications

This sector has long been encumbered by excessive, outdated regulations and controlled by a dominant carrier, Nippon Telegraph and Telephone Corporation (NTT). NTT was restructured in July 1999 into a long distance/international carrier and two regional telephone carriers operating under a single holding company. The reorganization, however, has not eliminated the ability of the NTT companies, notably the regional companies which control access to greater than 95 percent of the local telephone network, to exercise their market power to inhibit new competitors and services. These problems are compounded by the fact that the Ministry of Post and Telecommunications (MPT, and its successor within the newly created Ministry of Public Management, Home Affairs and Posts and Telecommunications, MPHPT), which regulates the telecommunications sector, has no firm legal mandate to promote competition.

Under the Enhanced Initiative, the United States is seeking regulatory changes to promote competition in Japan's telecommunications sector. Given that the Japanese telecommunications and broadcasting services market is worth an estimated $130 billion per year (and has the potential to expand significantly), a more open and accessible Japanese telecommunications market will translate into significant increased opportunities for U.S., other foreign, and Japanese domestic carriers and service providers to enter and compete successfully against incumbent Japanese carriers.

As a result of bilateral discussions, Japan introduced a pro-competitive methodology for setting interconnection rates in FY 2000, fulfilling a May 1998 commitment under the Enhanced Initiative. In the Third Joint Status

Report, Japan agreed to a formulation of the long-run incremental cost (LRIC) model which will result in rate reductions of 20 percent (for interconnection at the local switch) to 50 percent (at the regional switch), with most of the reduction to take effect in FY 2000. The first stage of this reduction was reflected in the draft FY 2000 interconnection tariffs. Despite these negotiated reductions, interconnection rates in Japan remain higher than international standards. In CY 2000, Japan initiated a study to address deficiencies in the LRIC model. The U.S. Government and Japan agreed to discuss further reductions as well as the application of LRIC to unbundled portions of the local network when revisions to the model are examined in 2002.

Japan's telecommunications regulatory framework focuses on whether carriers own or lease lines, not whether they have dominance in the market. Under a dominant carrier approach, regulators promote competition by focusing regulatory oversight on "dominant carriers" – carriers in a position to hold consumers and competitors "hostage" through control over services or underlying facilities – while allowing carriers without such market power to operate with minimal restraint to speed the introduction of new services and technologies. The United States has strongly urged Japan to adopt a legal framework that establishes the promotion of competition for the benefit of consumers as the clear primary objective of telecommunications regulation and to make "dominant carrier regulation" the key component of this system.

Japan recently took an important step toward addressing some of the United States' concerns. In December 2000, MPT released a study of telecommunications policy reforms necessary to introduce competition into the sector. Proposals included the development of dominant carrier regulation, rules for unbundling the optical fiber network, guidelines for collocation and access to rights of way controlled by the NTT regional companies and public utilities, and a process to revise mobile carrier rates. Specific changes instituted before the end of CY 2000 by the Japanese Government included unbundling optical fiber (although formal conditions for unbundling have not yet been developed). The extent of proposed reforms fell short of the United States' call for a fundamental, pro-competitive evolution in the regulatory structure but represents an important first step. Most of the details of the proposed reforms remain undefined and through our discussions with Japan, we are urging more concrete measures to carry out these proposals. Implementation of these steps is expected to take a year or more, which is an extremely lengthy period in such a dynamic sector.

These actions and commitments, which the United States continues to monitor closely, should help address important market access and regulatory barriers. Nevertheless, ensuring effective competition, especially in the local telecommunications markets, will require Japan to demonstrate that it can allow for the operation of an independent regulator more attuned to providing equitable opportunities to new entrants and less biased towards the interests of an operator still majority-owned by the Japanese Government. The recent enforcement action taken by the JFTC regarding access to NTT facilities for collocation represents a very important step toward ensuring competition in the market and once again illustrates the importance of establishing a truly independent regulatory authority that can exercise oversight and take the necessary measures to safeguard competition in this sector.

In addition, Japan has recently announced its plan to establish a dispute settlement panel for

the telecommunications industry within MPHPT. The United States is encouraged that the Japanese Government recognizes the need to address disputes in the industry more effectively. However, the U.S. Government is skeptical that this panel is a viable solution, because it appears that this panel lacks the independence, full-time expertise, and enforcement powers necessary to be a totally independent regulator that can ensure a competitive telecommunications market in Japan.

Several serious concerns remain for this sector and the United States has asked Japan to address specific market access impediments related to a wide range of areas, both through its October 2000 submission and in bilateral consultations:

Interconnection and Pricing: One of the most significant examples of insufficient safeguards on dominant carriers impeding competition is the high cost and onerous conditions that NTT regional operators are allowed to impose on their competitors. Even with the implementation of agreed rate reductions, the interconnection rates that these operators charge their competitors to use their network are currently four times as high as similar rates in the United States and Germany. As such, NTT has been allowed to pass along its inefficiencies and bloated cost structure to its competitors. Full implementation of a revised LRIC model is expected to address this concern. In addition, MPHPT has permitted NTT to recover costs for developing and introducing new services such as ISDN by charging these costs to competitors while it subsidizes this service for its retail customers. This classic "price squeeze" behavior – forcing its competitors to lose money if they are to price a competing service at or below NTT's retail rates – ensures that NTT maintains dominance over the market. This also highlights the inherent contradiction of Japan's regulatory regime in that MPHPT is simultaneously engaged in industrial policy – promotion of ISDN and fiber-to-the-home – while trying to regulate a dominant carrier.

This type of behavior has had a major impact on local competitors, which are losing money on many local services and have been paying as much as 70 percent of the revenues they receive from all calls back to NTT in interconnection charges. Compounding this problem, MPHPT has also allowed NTT regional companies to adopt discriminatory pricing schemes that leverage their virtual monopolies (greater than 95 percent of all local subscribers) to ensure that traffic stays on NTT's network. Under these pricing schemes, NTT regional company subscribers cannot get discounts on calls to numbers on competitors' local networks, even if they are in the same area. As most of these discount plans are used for Internet access, they effectively force Internet Service Providers (ISPs) to locate on NTT's network if they want to service NTT's huge customer base. This denies competitors the ability to host ISPs on their own network, a lucrative business, and forces competitors to pay substantial interconnection fees when their subscribers access ISPs on NTT's network. Under these circumstances, not only do competitors lose the ability to host ISPs, but they also are unable to match NTT's flat rate user rates for dial-up Internet services because of the interconnection fees they must pay NTT.

New entrants to Japan's telecommunications market have expressed concern about the extremely high and non-transparent interconnection and access rates charged by dominant wireless service provider NTT DoCoMo as well. There is no explanation of how these exorbitant rates are calculated. In addition, DoCoMo has used its market power (servicing over 33 million subscribers) to insist

that it be allowed to set prices for both incoming and outgoing calls for its network. This puts new entrants at a severe disadvantage, as they are unable to compete on price – one of their most important strategies. As a result, they usually end up paying DoCoMo a much greater per-minute charge for passing calls to DoCoMo than DoCoMo pays them when it passes calls to the new entrants. While MPT promised in April 1999 to ensure that DoCoMo's interconnection rates are cost-oriented and non-discriminatory, the situation has not improved significantly. The United States has asked MPHPT to take measures to increase the transparency of DoCoMo's interconnection regime, require DoCoMo to allow other carriers to set retail rates, and consider imposing the more stringent interconnection conditions of a "designated carrier" on DoCoMo.

Rights-of-way: New competitors in Japan find it extremely time-consuming and expensive to build competing networks in Japan because of a lack of access to rights-of-way. Specifically, there are no safeguards against NTT and other utilities (with substantial investments in telecommunications firms) denying or delaying access to, or charging exorbitant rates for the use of, poles, ducts, conduits and other "rights-of-way" facilities. New carriers thus find it extremely difficult, time-consuming, and expensive to obtain rights to use these facilities. Moreover, if new entrants attempt to dig roads to lay their own cables and facilities, they encounter a labyrinth of restrictions that industry sources say makes the construction about ten times more expensive and can result in digging times six times longer than in other major international cities. The United States has proposed that Japan establish pro-competitive rules to ensure non-discriminatory, transparent, timely, and cost-based access for telecommunications carriers and cable TV operators. The recommendation of a Japanese study group set up at the request of the United States to address this problem – voluntary publishing by NTT and electric utilities that control rights-of-way of their application procedures to increase transparency – fell far short of the type of measures that are necessary to promote competition. In January 2001, Japan began the process of drafting guidelines on the use of poles and ducts owned by public utilities in the telecom sector. The United States continues to urge that there be mandatory rights-of-way access for new competitors.

Unbundling: Enhanced government oversight to assist new entrants in building their networks also is needed to require dominant local carriers to provide other carriers access to their network on an "unbundled" (or separate) basis. Currently, Japan's interconnection guidelines contain only a narrow list of functions that must be "unbundled" for new competitors, and do not require that these unbundled elements be priced in a pro-competitive manner. The United States has requested that Japan expand the list of elements that must be unbundled by a dominant carrier and ensure that new and existing elements are provided on rates, terms, and conditions that are timely, reasonable and non-discriminatory. This mandatory unbundling will greatly assist new carriers in building their networks - particularly, if as the United States recommends, unbundled elements are priced at LRIC.

Leased lines: MPT recently relaxed restrictions on leasing so that carriers which own facilities can lease circuits from other such carriers. However, while MPHPT provides several means – now including leasing - for new carriers to use other carriers' facilities, they are required to apply for MPHPT approval of these arrangements. This adds extra time and expense for new carriers and increases uncertainty in business planning because many of the criteria MPHPT uses to determine the approval of these requests are non-transparent. The United States

has requested that MPHPT eliminate current restrictions and allow carriers to freely combine both owned and leased facilities in their network without the need for government approval.

Other barriers: The United States also has asked Japan to address the complaints of new entrants regarding the difficulty and expense of getting access to space in NTT's buildings needed to interconnect with NTT's network (co-location space), as well as restricted access to internal wiring in private buildings throughout Japan. In 2000, MPT ordered the NTT regional companies to reduce the cost and time required for co-location, but this process remains relatively expensive and time-consuming. Finally, in response to NTT's restructuring into four companies as of July 1, 1999, the United States has urged Japan to strengthen its safeguards against anti-competitive cross-subsidization by the NTT successor companies.

Because several of these issues, notably interconnection costing, discriminatory pricing, unbundling, and the use of leased capacity, relate to Japan's WTO commitments, Japan's actions to address these areas will come under heavy scrutiny.

Information Technology

The United States welcomes Japan's recent determination to move to the forefront of IT within five years. A key factor in bolstering Japan's economic growth will be the building of a vibrant information technology sector. In recognizing the importance of this sector, the United States included proposals in its October 2000 deregulation submission which reflect the U.S. experience that government's most important role is ensuring that market mechanisms such as competition and innovation are allowed to flourish, and also which are designed to dovetail with Japan's goal of achieving an IT revolution. In both these proposals as well as at expert-level talks in early 2001, the United States has recommended steps to improve the regulatory environment in Japan for operating and investing in the IT sector through: 1) greater intellectual property rights protection in the digital environment, including the expeditious ratification of the WIPO Performances and Phonograms Treaty; 2) a commitment to free trade in "digital products" such as software, music and video; 3) reform of laws permitting paperless electronic commerce in sectors such as the consumer finance sector; 4) carrier liability laws which will attain the proper balance between the interests of telecom carriers, service providers, right holders and web site owners; and would be adequate and effective in protecting the rights of right holders; 5) greater use of electronic commerce for government procurement; 6) a commitment to market-based approaches to technology standards (versus government-mandated standards); and 7) an emphasis on a self-regulatory approach to consumer protection and privacy.

With regard to these recommendations, the United States is particularly concerned that Japan's progress in building a vibrant information technology sector may be seriously hindered by the lack of progress on three issues: 1) Although Japan signed both the WIPO Copyright Treaty (WCT) and the Performances and Phonograms Treaty (WPPT) which are a single package designed to provide necessary protection for copyrighted works and music on-line, Japan has only ratified the WCT but not the WPPT. Continued delay in ratification of the WPPT will have a damaging effect on our respective music industries. The United States urges Japan to expeditiously ratify the WPPT without further delay. 2) The current lack of clear-cut liability rules for certain carriers such as Internet Service Providers (ISP) in Japan creates significant market uncertainty if such carriers are held responsible for illegal activities

by users, e.g. copyright violations. Business is unacceptably risky for carriers without proper liability protection, because they could be subject to broad-based legal attacks for the actions of users over which they have no knowledge or control. The United States learned in drafting the Digital Millennium Copyright Act that there is a complex and delicate balance between the interests of telecom carriers, service providers, right holders and web site owners. Although the United States welcomes Japan's consideration of carrier liability legislation, the U.S. Government urges Japan to ensure that these interests and issues are fully and properly addressed in any draft legislation, and that the legislation drafting process itself is transparent. 3) The lack of explicit protection under Japan's Copyright Law for "temporary copies," e.g. digital copies made in the RAM of a computer, could erode the ability to protect copyrighted materials in Japan. The United States urges Japan to clarify this issue and ensure that its Copyright Law explicitly provides protection for temporary copies. Further discussion of this issue can be found in the Copyright subsection.

The United States urges Japan to expeditiously resolve these specific areas of concern in order to facilitate Japan's goal of achieving an IT revolution.

Medical Devices and Pharmaceuticals

Under the 1986 Report on Medical Equipment and Pharmaceuticals Market-Oriented, Sector-Selective (MOSS) Discussions, the United States and Japan have continued to address regulatory and market access concerns in the medical device and pharmaceutical sectors. The MOSS Med/Pharm working group now also serves as a venue for discussion of medical device and pharmaceutical issues under the Enhanced Initiative. The United States and Japan held consultations on Japanese deregulation of medical devices and pharmaceuticals in January/February, March, September, and December 2000.

Expediting regulatory review and approval is a key goal. Under the Enhanced Initiative, Japan shortened its regulatory processing time for new drug applications (NDA) from 18 months to 12 months in April 2000. The reduction of this processing time, combined with other measures Japan has implemented under the Enhanced Initiative, including permitting direct communication between reviewers and applicants, should aid in reducing NDA review times. In addition, Japan is encouraging the active use of binding consultations between reviewers and applicants before NDA submission. These consultations are being used and some improvement in approval times is already evident.

In many cases a new drug is found to be effective in treating additional but similar types of indications, i.e. types of ailments. In the past, the rapid introduction of drugs for additional indications in Japan was hampered because a clinical work or regulatory review on an additional indication was restricted until the initial indication was approved. To significantly improve this situation Japan has agreed under the Enhanced Initiative to allow for continued clinical studies, including work on additional indications during the NDA review of the new drug's initial indication and the ability to submit an NDA for an additional indication while the NDA for the new drug's initial indication is still pending.

The United States continues to closely monitor Japan's implementation of these measures and continues to urge Japan to realize total approval times of 12 months.

Given the short product life cycles for many medical devices, delays in regulatory approval

can result in significant revenue losses for manufacturers and slow patient access to new technologies.

On April 1, 2000, Japan took steps designed to reduce redundant medical device reviews. In doing so, it expanded the categories for medical device approval from “me-too” and “new,” by adding a third category of "improved" devices. While this change was intended to improve the approval system for medical devices by exempting improved and new devices from review by one regulatory body, it has also generated considerable concern that devices previously approved as “me-too” (subject to 4-month time clock) may be designated as improved (subject to one-year time clock). Such a shift could cause significant approval delays for a number of U.S. products. The United States has sought to clarify the medical device approval categories. Japan also agreed to allow applicants to consult with reviewers prior to application submission regarding proper device classification. However, steps need to be taken to ensure that such advice is treated as binding.

Japan has agreed to consult with U.S. industry regarding the reform of its biocompatibility testing requirements with the objective of minimizing the data burden on applicants. The United States looks forward to this consultation resulting in a testing regime more closely conforming to standard international practices.

The United States is urging Japan to deregulate the Measurement Law’s (ML) treatment of thermometers and blood pressure gauges which are subject to the Pharmaceutical Affairs Law’s (PAL) approval process that ensures the safety and accuracy of the devices. As the two laws have the same goal, the United States is proposing a notification system by which an applicant would apply for approval under the PAL and then be allowed to meet the requirements of the ML with a notification, without being subject to additional ML review.

Under the Enhanced Initiative, Japan has expanded the acceptance of foreign clinical data in the approval of new medical devices and pharmaceuticals. In August 1998, Japan adopted the International Conference on Harmonization (ICH) E-5 Guidelines regarding the use of foreign clinical data in pharmaceutical approvals which has facilitated the use of such data. Most recently, Japan has affirmed that it is possible to submit a bridging data package, as defined by ICH E5 Guidelines, without a new bridging study, in order to obtain product approval, if ICH and Good Clinical Practices-consistent data for extrapolation are available to confirm comparability.

The United States is monitoring closely the implementation of these steps urging Japan to require additional domestic clinical tests only when there is a clear need under the ICH Guidelines to extrapolate that data to the Asian population.

In addition to regulatory barriers, the United States is seeking to address specific market access issues associated with Japan’s current reimbursement system. The goal of the United States is to promote objectivity and transparency in order to ensure that pricing decisions are not made in an arbitrary manner. In formulating its health care reforms, Japan has agreed to formally recognize the value of innovation so as not to impede or prevent the introduction of innovative products that bring improved and more cost-effective treatments to patients.

To improve the transparency of the reimbursement process, an appeals process for medical device and pharmaceutical pricing decisions was implemented on October 1, 2000. It is important that applicants have sufficient access to appeals bodies and to the Japanese

Government which ultimately is responsible for pricing decisions. It is critical that these bodies do not expand their mandate to attempt to change or manipulate the written pricing rules to arrive at inappropriately low prices. The United States will monitor the implementation of this process carefully.

On October 1, 2000, as previously agreed, Japan implemented restructured pricing categories for PTCA catheters, orthopedic implants, and pacemakers. In a way that did not result in disproportionate burdens on individual products or companies, the United States has urged that Japan proceed in a like fashion (including sufficient consultations with industry) as medical devices that are currently reimbursed by individual Japanese prefectures are standardized under the national scheme.

Also pursuant to Japan's Enhanced Initiative undertakings, on October 1, 2000, Japan implemented major reforms to its medical device pricing system that will allow for faster reimbursement listings of many products. Under the current system, the introduction of such products can be delayed for years. The U.S. industry has outlined a number of practical approaches which it believes warrants careful consideration, including approaches that would speed the introduction of such products while limiting Japan's financial exposure.

As Japan moves forward with the formulation of pharmaceutical pricing reform to be implemented by April 1, 2002, the United States has urged Japan to continue to discuss the pharmaceutical pricing system with related parties, including U.S. industry, in order to promote innovation and increase the availability of innovative pharmaceutical products. U.S. industry has developed a comprehensive pharmaceutical reform proposal which it believes warrants careful consideration.

As part of this reform process Japan is revising the system by which drugs used as price comparators are selected. It is essential that this process proceed in a transparent manner that is based on recognized scientific principles.

Under the Enhanced Initiative, Japan has agreed to ensure transparency in the consideration of health care policies by allowing foreign pharmaceutical and medical device manufacturers meaningful opportunities to provide their opinions. The United States urges Japan to carefully consider input provided by U.S. industry, as well as to incorporate such input into policies ultimately adopted.

Housing

The housing experts group established under the Enhanced Initiative met in February and November 2000. The group promotes improved market access in Japan for foreign suppliers of wood and non-wood building products and systems. Achievement of this objective and increased reliance on performance-based standards by Japan will increase opportunities for American exporters and encourage the construction of higher quality, safer, and more affordable housing in Japan.

U.S. proposals on this front have led to several significant changes. For example, under the Third Joint Status Report, Japan agreed to clarify performance-based requirements for fireproof buildings, allowing for the construction of four-story, multi-family and mixed use wood-frame buildings. This will further encourage the construction of wood-frame houses and could ultimately mean substantial increases in the sales of U.S. wood products. In addition, Japan's revision of the Land and House Lease Law in December 1999 will improve housing conditions for millions of Japanese families and create enormous opportunities for domestic and foreign builders

and suppliers. In the October 2000 deregulation submission to Japan, U.S. housing proposals focused on laws, policies, and procedures that inhibit the development of a secondary housing and renovation market in Japan. Reform of these structural weaknesses would significantly broaden the Japanese housing market and create new commercial opportunities for U.S. suppliers.

As a proportion of its overall housing market, Japan's home resale market is far smaller than that of the United States. Japan lacks an adequate property appraisal system. In addition, Japan's overemphasis on the chronological age of housing discourages both renovation and resale of the existing housing stock leading Japanese consumers to see renovation as a consumption expenditure rather than an investment in long-term housing value. The United States proposed that Japan reform its housing appraisal system so that maintenance and renovation are factored into a nation-wide system of value assessments. The United States also urged the Government of Japan to make greater use of the Internet to disseminate information about the housing market.

Finally, the United States' submission focused on technical building regulations and standards issues that continue to impede the use of U.S. building products and building systems.

Financial Services

Japanese financial markets traditionally have been both 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. Among the restrictions that have impeded access are the use of administrative guidance, existence of a *keiretsu* system (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. Each of these restrictions has hindered the emergence of a fully competitive market for financial services in Japan.

In an effort to eliminate or reduce these barriers, in February 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 five years since the agreement was signed, Japan has implemented the specific commitments made within the specified time frames. In some instances, the timetable for implementation was accelerated. In several areas, Japan has taken or announced additional actions for future implementation to improve the liberalization of Japanese financial markets.

The past few years have seen notable changes in Japan's financial sector. Foreign financial institutions have made important acquisitions in securities brokerage, insurance, and banking. Consolidation among Japanese financial institutions has increased in an effort to cut costs and boost competitiveness, while traditional segmentation among various types of financial institutions is gradually being phased out. These changes have expanded opportunities for foreign financial firms in Japan to compete on a clear and level playing field. While supervision and disclosure have improved, it is important that Japan continue to move forward in establishing clear and consistent regulation and supervision of financial institutions, in line with international standards and best practice.

Financial sector deregulation continued in 2000. Introduction of a "no-action" letter procedure by financial regulators, agreed to as a part of the Enhanced Initiative, will increase transparency and encourage introduction of innovative financial products. Accounting standards were strengthened in April with the introduction of market-value accounting and required disclosure of unfunded pension liabilities. Pension fund management was eased to simplify transfer of securities to a new asset manager. Real Estate Investment Trusts (REITS), introduced in November, should accelerate the trend brought about by the accounting reforms of removing bad assets from balance sheets and should help revitalize the property market.

Internet banks and non-financial corporate ownership of banks were permitted during the year. Electronic delivery of disclosure forms to government agencies and of prospectuses and other documents to investors will increase efficiency and reduce administrative costs for financial firms. The Japanese government is also developing procedures to permit exemption from withholding tax for foreign holders of government bonds, held through foreign custodians, and to allow global risk management and the provision of other shared services by financial conglomerates.

The United States continues to monitor implementation of the agreement and to assess the impact of the actions undertaken using the quantitative and qualitative criteria included in the agreement. At the October 2000 review, the United States emphasized the need for Japan to move forward in establishing clear and consistent regulation and supervision of financial institutions in line with international standards and best practices. The United States also is monitoring Japan's progress under the "Big Bang" initiative to ensure that implementation remains on schedule.

Energy

The United States views the energy discussions under the Enhanced Initiative as an important means of providing input to Japan as it deregulates this key sector, and as a way of supporting the Government of Japan's goals of improving energy efficiency and lowering energy costs (which are among the highest in the world) to international levels by 2001. Achievement of Japan's goals largely depends on its ability to attract new entrants into its electricity market -- the third-largest power market in the world -- and to create vigorous competition in this sector.

Electricity: Throughout 1998, a committee of the Electric Utilities Industry Council (EUIC) -- a private sector advisory group to the Agency for Natural Resources and Energy (ANRE) and the Ministry of International Trade and Industry (MITI), ANRE's parent ministry - developed plans to liberalize the Japanese power market. The committee's final report called for "partial liberalization" of the power market, with retail sale of electricity to be liberalized for large-scale users served by extra-high voltage networks (of 20,000 volts or higher). These users account for approximately 27 percent of total electricity consumption in Japan. While welcoming the partial liberalization of the electricity sector, the U.S. Government expressed its view that the EUIC proposals would make only modest progress towards Japan's goals of achieving significantly lower energy costs and improving energy efficiency.

During 1998, the initial year of the Energy Working Group, the United States presented proposals for addressing specific regulations that impede the sale of U.S. equipment and services in the Japanese energy sector. Japan agreed to take concrete steps to address many of the U.S. concerns regarding standards, inspection and certification requirements, and

other regulations covering the import of specific types of energy-related equipment. Japan also agreed to liberalize regulations governing the expansion of existing power generation facilities.

During the third year of the Enhanced Initiative, Japan took several significant steps towards liberalizing its electricity sector. On March 21, 2000, Japan implemented its plan to partially liberalize this sector and abolished its antimonopoly exemption for natural monopolies, including electricity and gas. Japan also agreed to: (1) fully implement and enforce measures designed to ensure fair, open, and non-discriminatory access to its electricity transmission grid -- the utility-owned network that is the only channel for transmitting electricity from one point to another in Japan; (2) disclose information on the development of transmission rates by utilities so that new firms seeking to compete in the market can determine if these rates are being set fairly; and (3) establish a fair, transparent, and non-discriminatory framework for access to its natural gas sector.

While electricity prices have slightly fluctuated following the March 2000 partial deregulation of the sector, no appreciable drop in rates has resulted. Since that time, there has also been little market entry in this sector. There is concern among potential market entrants that the current system will not adequately encourage competition.

In the fourth year of the Enhanced Initiative, the United States stressed the importance of: (1) independent regulation; (2) competition policy safeguards; (3) unbundling and open access to transmission and distribution grids; (4) increased transparency of pricing for electricity transmission and distribution; and (5) measuring progress towards liberalization in a timely fashion. The United States and Japan discussed these proposals at the working group level in November 2000.

Natural Gas: In November 1999, Japan implemented a law reducing by half the threshold at which firms are qualified to purchase gas in the liberalized portion of this market. The following month, MITI and the JFTC drafted proposed Fair Transactions Guidelines for Gas, on which the US provided public comments. These guidelines were released in March 2000. Based on the methodology proposed in a November 2000 report on interconnection tariffs and rates, four designated gas utilities are currently preparing to release new interconnection charges by the end of March 2001. As of early 2001, the four gas utilities and several electric utilities and oil companies were competing in the market using negotiated interconnection rates. No foreign firms or subsidiaries have entered the market.

The United States continues to raise concerns that gas deregulation will have a significant impact on electricity deregulation since new entrant electric power producers are likely to use natural gas as a fuel. As such, gas transmission charges, as well as the terms and conditions of access to pipelines and to liquefied natural gas (LNG) terminals, through which all of Japan's gas flows, will be critical. In the fourth year of the Enhanced Initiative, the U.S. stressed the importance of unbundling and open access to LNG terminals and pipelines, transparency in gas transport pricing, and the need to measure progress towards liberalization of the gas market in a timely fashion. The United States and Japan discussed these proposals and developments in this sector at the working group level in November 2000.

The U.S. Government will continue to closely follow developments in the energy sector and will strongly urge Japan to take steps to ensure open and fair access to this market.

STRUCTURAL DEREGULATION

Antimonopoly Law and Competition Policy

Under the Enhanced Initiative, the United States has proposed a number of progressive measures to strengthen competition policy and generate more effective enforcement of Japan's Antimonopoly Act (AMA), which are critical to improving market access. Foreign companies continue to face numerous impediments, including anticompetitive practices, to accessing Japan's distribution channels across a wide range of sectors, including the automotive, flat glass, and photographic film and paper markets.

A key reason for the occurrence of anti-competitive business practices in Japan is the historically weak antitrust enforcement record of the Japan Fair Trade Commission (JFTC). The JFTC routinely has faced domestic criticism for its lack of bureaucratic clout and inability to exercise its enforcement powers aggressively. There have been improvements in recent years due to sustained U.S. efforts under the Structural Impediments Initiative, the U.S.-Japan Framework Agreement, the Enhanced Initiative, and annual bilateral antitrust consultations. The United States has focused particular attention on achieving genuine progress in the following AMA and competition policy-related issues under the Enhanced Initiative.

Independence of the JFTC: An independent JFTC has been a longstanding and important principle of Japan's antimonopoly enforcement system that the United States strongly believes should be maintained. In this regard, the United States urged Japan to ensure the continued independence of the JFTC when it was subsumed under the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) in 2001 as part of the central government's reorganization. The Ministry is also responsible for postal services and telecommunications policy, raising the real risk that the JFTC will not be able to act independently in the crucial area of posts and telecommunications, both in enforcement decisions and competition advocacy. The JFTC Chairman and the MPHPT Minister each have made oral commitments, consistent with the July 2000 Third Joint Status Report, that the JFTC's application of the AMA in the posts and telecommunications areas will not be obstructed, and that the integrity of the JFTC's personnel system and budget will be maintained. The United States has recommended that these commitments be formalized. In any event, continued monitoring of the JFTC's independence will be necessary as the new administrative arrangements are put into practice.

Anticartel Enforcement: Bid rigging and collusive cartel activity continue to be serious problems in Japan. While the JFTC's record in terms of actions taken against, and surcharges collected from, violators of the AMA has increased in recent years, the JFTC still faces serious constraints in building an effective enforcement program. For example, in CY 1999 the JFTC took legal measures in 32 cases – five more than in CY 1998, and the total amount of administrative surcharges was 7.37 billion yen, more that double that of 1998. However totals remain modest in absolute terms, and Japan recently enacted legislation to expand the number of small- and medium-sized enterprises that will face reduced surcharges should they violate the AMA in the future. Moreover, while the JFTC is not alone among competition agencies in the world in its heavy reliance on administrative actions instead of criminal penalties, the JFTC's infrequent use of the Antimonopoly Act's criminal provisions undermines its deterrence of cartel behavior. In fact, no corporate executive has ever been imprisoned for violating the AMA. Still, the

JFTC initiated two criminal prosecutions of Antimonopoly Law violations in 1999, the most in any single year.

There are a number of factors that limit criminal enforcement against hard core AMA violations. First, the JFTC does not have the types of investigatory powers enjoyed by other Japanese criminal investigating authorities, including the power to conduct compulsory searches and seizures. Nor does it have the ability to reduce criminal sanctions or administrative surcharges for companies that come forward to expose illegal activities. These weaknesses make it difficult for the JFTC to gather enough evidence to support filing a criminal complaint with the Ministry of Justice. Second, an extraordinary provision in the AMA that requires the Ministry of Justice to explain to the Prime Minister why it has not pursued a criminal referral from the JFTC has resulted in the Ministry of Justice demanding an exceptionally high degree of evidence before accepting such a referral from the JFTC. These types of systemic weaknesses make criminal prosecution of executives and firms for hard core AMA violations the exception rather than the rule in Japan.

To address some of these weaknesses in cartel enforcement, the United States, in its October 2000 deregulation submission, called for more aggressive enforcement actions to combat these activities. The United States has made a number of recommendations, including: JFTC adoption of a corporate leniency program that would provide incentives for firms to come forward with evidence of anticompetitive activities; strengthening the Criminal Code and AMA to augment sanctions against government officials that aid or abet bid-rigging; applying surcharges against firms that engage in collusive boycotts and bolstering administrative controls on bid-rigging by the Ministry of Land, Infrastructure and Transport (MLIT). (This ministry was created in January 2001 with the merger of the Ministries of Construction, Transport, and National Land Agency.)

Private Remedies: The United States strongly believes that the unfettered availability of injunctive relief and monetary damages to private litigants is an integral part of a comprehensive and effective antimonopoly legal regime. Private AMA enforcement can help reinforce for Japanese firms the importance of conforming their business practices to the AMA, which in turn will keep markets free, open and competitive.

Legislation providing for private actions seeking injunctions against an alleged violator of the AMA was enacted by the Diet in May 2000 and is due to go into effect on April 1, 2001. This is a welcome development. Nevertheless there is concern that the new law does not apply to the most egregious AMA violations, such as cartel behavior and monopolization, and that the Japanese court system lacks the capacity and expertise to allow for fully effective implementation of the new law. Regarding private actions for monetary damages, legal remedies do exist. However, due to a variety of factors, only 14 private actions for damages have been brought under the AMA since 1947. Further improvements in the private litigation system are needed before it will become a reliable avenue for the deterrence and redress of antimonopoly violations.

Promotion of Deregulation by the JFTC: Successful regulatory reform in Japan must be built on a solid foundation of effective competition policy. As the only Japanese agency charged with promoting competition throughout the economy, the JFTC should substantially boost its efforts as an advocate of competition policy and regulatory reform. The United States has proposed that the JFTC actively participate in the process of deregulating Japan's public utilities. This is

necessary to ensure both that maximum deregulation occurs in the electricity, natural gas and telecommunications sectors consistent with sound competition policy, and that anti-competitive conduct by incumbent utilities will be strictly dealt with under the AMA. Some steps have been taken: A bill was passed in May 2000 to remove the AMA exemption for the electricity, gas and railroad sectors; the JFTC is working in parallel with the telecommunications regulators of the former MPT to prepare guidelines for the development of dominant carrier regulation in the telecommunications sector for release in early 2001. Significantly, the JFTC's investigation of and warning to NTT East concerning possible anticompetitive behavior, the first time the JFTC had pursued a giant firm in the telecommunications sector for abuse of market power, was widely hailed as the kind of more aggressive posture that is necessary if the JFTC is to be truly effective in fostering and protecting a competitive marketplace in Japan. The United States has urged Japan to be vigilant in enforcing the AMA against violations in these sectors. With regard to the distribution sector, the United States recommended that the JFTC take further steps to promote competition, for example, by surveying manufacturer-distributor equity and personnel relationships in highly oligopolistic sectors.

JFTC Staffing & Resources: The JFTC's ability to enforce Japan's AMA is hindered by its shortage of personnel. The United States has urged for more than a decade that the JFTC's budget and staff be increased significantly to ensure that it is able to carry out its mandate fully. In JFY 2000, JFTC staff increased by only 8 from the previous year to a total of 564, of which 263 (three more than in JFY 1999) are engaged in investigation-related work. The United States recommended that the JFTC staff be increased by an extraordinary amount in JFY 2000, or by at least 40 persons. Unfortunately, Japan's draft JFY 2001 budget increases the JFTC's budget by only 2.3 percent and boosts its personnel by only 11, of which 9 will be assigned to the investigation bureau. These increases remain too small for the JFTC to adequately enforce the AMA and to engage in necessary competition promotion. This is especially true given the potential effects on Japan's competitive environment of the increase in mergers (up more than 20 percent in CY 2000), the liberalization of holding companies, the elimination of many AMA exemptions, and stepped up deregulation that now require the JFTC to police more business behavior.

Distribution

Japan's highly regulated, inefficient distribution system is widely recognized as a significant trade and investment barrier. Through the Enhanced Initiative's working group on structural issues, the United States has focused on laws, regulations, and practices that contribute to the abnormally high costs of distribution in Japan, such as slow customs processing and excessive regulatory restrictions in the retail sector (see "Import Policies" section of this chapter). In its October 2000 deregulation submission, the United States urged Japan to implement significant deregulatory measures to address key distribution problems faced by foreign firms.

Regulation of Large-Scale Retail Stores: The Large-Scale Retail Store Law (Daiten Ho) was long an obstacle to foreign investors and exporters, with its limitations on the establishment, expansion and business operations of large stores in Japan, which are more likely than other retail outlets to handle imported products. By impeding the business operations of large stores, the Law reduced productivity in merchandise retailing by raising costs, discouraged new domestic capital investment, and diminished the selection and

quality of goods and services to the detriment of Japanese consumers.

On June 1, 2000, Japan abolished the Large-Scale Retail Store Law and replaced it with the Large-Scale Retail Store Location Law (Daiten Ricchi Ho - SLL). The new Law provides that regulation of large stores will no longer be based on supply-demand considerations, but on the degree to which a large store opening or expansion affects the local environment, particularly traffic, noise, parking, and garbage removal. Local governments are responsible for implementation of the new Law, but they are not permitted to impose restrictions on new large stores to protect local retailers from competition. While the United States welcomed the elimination of the Large-Scale Retail Store Law, the manner in which the new SLL is implemented will determine whether it affords greater market access for large stores.

To facilitate consistent, transparent, and predictable implementation of the new SLL, the Ministry of International Trade and Industry (MITI)(now METI), in the Third Joint Status Report under the Enhanced Initiative, has set out its past and future actions as follows: (1) MITI established official contact points (Daiten-Ricchi Ho Contact Points) on May 23, 2000 within the MITI headquarters in Tokyo and at eight regional bureaus to receive and facilitate resolution of complaints from interested parties regarding application of the Law. MITI published details of the new arrangements, including the names and addresses of the contact points; (2) MITI has explained to relevant local governments the purpose and content of the Law by holding several meetings with prefectures and Designated (the 12 largest) cities, and has provided officials of such local government authorities with technical training. MITI will continue to provide information regarding the implementation of the Law and the role of its contact points; (3) MITI is encouraging local governments to coordinate closely among their relevant sections and offices on all large-scale store environmental issues arising under the new Law. The regional MITI contact officer assists with this coordination; and (4) MITI is working to facilitate a smooth transition from the repeal of the Daiten-Ho to the implementation of the Daiten-Ricchi Ho.

In spite of these positive commitments, the United States shares the concern of many large retailers in Japan over the possibility for abuse or inconsistent application of the new authority by local governments. To eliminate such concerns and to ensure the proper implementation of the new Law, the United States reiterated in its 2000 deregulation submission that METI should: (1) closely review application of the SLL by local governments and take appropriate measures to ensure that they apply the Law fairly, reasonably, and uniformly; and (2) continue to provide information to local governments and developers of large retail stores on the parameters of the authority of local governments under the SLL with regard to opening of large-scale stores. Implementation of the SLL provides Japan with an opportunity to ensure that the number of large retailers grows consistent with the interests of Japanese consumers, and raises the low productivity of Japan's distribution sector.

Transparency and Other Government Practices

Over the past several years, the Government of Japan has taken significant measures to improve its regulatory system. However, additional measures are necessary if Japan is to achieve the level of transparency and accountability recognized as essential by the OECD in its 1999 Review of Regulatory Reform in Japan. The Japanese Government has stated that one of the four main objectives of the central government

reform of January 2001 is to increase government transparency. Consistent with this objective, the United States has urged Japan to introduce a broad regulatory reform program designed to bring greater transparency and accountability to its regulatory system. The underlying premise of the reform program should be that ministries and agencies must justify to the public the rationale for adopting, changing, or continuing new or existing regulations, and be held accountable for their actions. Regulations should be the exception and not the rule, meaning that regulations that are not directly linked to public policy interests should be abolished or not adopted. The public should be given an effective means of participating in the development and assessment of regulations. The program should encompass both public and private regulations. Under the Enhanced Initiative the United States has raised specific concerns including the following:

Introduction of a Rulemaking Process: Effective April 1, 1999, Japan adopted its first government-wide public comment process which requires central government entities to give notice and invite public comments on draft regulations. While the Japanese rulemaking process has become more transparent since the Public Comment Procedure has been in effect, it appears to have had only marginal impact on the substance of new regulations. In most cases, the submission of comments does not appear to have made any appreciable difference in the formulation of final regulations, as they have generally differed little, if at all, from the draft regulations. For these reasons, and to improve the use and effectiveness of the Public Comment Procedure, the United States has urged the Japanese Government to: (1) require at a minimum a 30-day comment period and provide a 60-day comment period to the maximum extent possible; (2) expand solicitation of public comments to trade publications, the Internet and the mass media; (3) make the full comments, rather than just the summaries of the comments, public; (4) incorporate the Public Comment Procedure into legislation; and (5) require all advisory councils (*shingikai*, *kenkyukai*, *benkyokai* and *kondankai*) to solicit public comments before they finalize reports and recommendations.

Policy Evaluation System: The United States has commended the Japanese Government for its decision to implement a government-wide policy evaluation (*seisaku hyoka*) system with the reorganization of the central government in January 2001. The new system, if properly and comprehensively implemented, has the potential of improving the transparency of the central government and strengthening the accountability of ministries and agencies. In instituting that system, the United States urged the Japanese Government to: (1) expeditiously incorporate the policy evaluation system into a statute; and (2) ensure that the new MPHPT has the necessary authority to ensure compliance with the new system.

Regulatory Impact Analysis: In its review of Japan, the OECD observed that "Regulatory analysis would help officials understand the consequences of their regulatory decisions, improve the transparency of regulation, and identify more flexible and cost-effective policy instruments, such as economic instruments. Such alternatives are not widely used in Japan." To enhance transparency in its policy-making and administrative management, the United States has urged Japan to introduce a government-wide Regulatory Impact Analysis (RIA) system. As a first step, the United States has urged Japan to build on the report of the Management and Coordination Agency's (MCA's) study group (*Kenkyukai*) on the introduction of policy evaluation to establish an advisory council to develop recommendations by the end of JFY 2001 for the introduction of a government-wide RIA system that would

subject regulatory changes with a significant economic impact to analysis and public notice and comments. The advisory council should be directed to propose measures that would: (1) apply cost/benefit analysis (both quantifiable and non-quantifiable) to such proposed regulatory changes; (2) use the best available scientific, technical, and economic data when reviewing proposed regulations; and (3) provide an opportunity for interested parties and the public in general to comment on the cost/benefit analyses, as well as on the reasonableness of the assumptions and methodologies used.

Administrative Procedures and Practices Related to Licenses, Permits and Approvals: U.S. businesses continue to raise concerns with the administrative practices of Japanese ministries and agencies that unnecessarily complicate and burden the process of obtaining licenses, permits and other approvals. These concerns persist despite the Japanese Government's repeated assurances that ministries and agencies are complying with the 1994 Administrative Procedure Law, which was intended to address many of these concerns. Building on MCA's plans to publish a report of the measures taken by each government agency in response to its June 1999 "Recommendations Based on the Survey on Securing Fairness and Transparency in Administrative Procedures," the U.S. Government urged MCA (MCA is now part of MPHPT) to make its report available to the public and solicit public comments within JFY 2000 as to whether the measures taken by the various government agencies are sufficient.

Administrative Guidance: The lack of transparency inherent in Japan's excessive and extensive use of informal directives or "administrative guidance" remains a serious concern to the United States. Despite the 1994 Administrative Procedure Law's (APL) requirements that Japan provide, upon request, in writing, a copy of administrative guidance to a private party receiving oral guidance from the Government or when it is issued to multiple persons, an MCA survey indicates that there have been few instances where this has occurred. The U.S. Government has urged the Japanese Government to amend the APL to require ministries and agencies to issue all administrative guidance in writing.

Public Participation in Development of Legislation: Ministries and agencies draft the vast majority of Japanese legislation which is generally enacted with few, if any, amendments. In most cases, there is no opportunity for interested parties that are not represented on advisory councils or that do not have special access to ministries and agencies, to have any input into the development of the legislation. Accordingly, the U.S. Government has urged the Japanese Government to take appropriate measures to require ministries and agencies, before they submit draft legislation to the Diet, to provide an opportunity for the public to review and comment on the draft legislation, allowing at least 30 days for public comments, and, to the maximum extent possible, 60 days.

Self-Regulating Organizations: As Japan reforms its regulatory regime, it is essential that special public corporations *(tokushu hojin*), industry associations and other private sector organizations are not allowed to substitute private regulations ("*min-min kisei"*) in place of government regulations. In addition, there is a need for greater transparency and monitoring of the role of private regulations in the Japanese economy. Under the Enhanced Initiative, the United States has urged Japan to undertake a variety of measures to require self-regulating organizations that are established under the authority of a law to increase their transparency and accountability. For example, they should be required to use fair and transparent public comment procedures that allow participation by interested persons before adopting or issuing

rules. Furthermore the U.S. has urged the Japanese Government: (1) to prohibit government entities from delegating governmental or public policy functions, such as product certifications or approvals, to industry associations, *tokushu hojin* and other quasi-public organizations, other than by statutory authorization; and (2) to take appropriate measures to ensure that there are no conflicts of interest within self-regulating organizations between their regulatory functions and their obligations to their members.

Commercial Code

The United States has commended the Japanese Government for undertaking a major initiative to reform its Commercial Code, which is scheduled for completion in 2002. Revision of the Code, the first comprehensive review in half a century, will have a profound effect on the ability of firms to structure themselves effectively to participate in modern global capital markets and to operate efficiently. The current Code stifles investment (both domestic and foreign) and is hurting Japan's efforts to integrate more fully into the international economy. If done correctly, revision of the Code should introduce greater flexibility in the organization, management and capital structure of companies, and improve their efficiency and accountability. The reforms should also enhance the ability of foreign firms to enter and operate in the Japanese market, as well as help revitalize Japan's economy.

The United States has urged Japan to ensure that Code reform is sufficiently comprehensive and bold so as to remove the substantial impediments to investment and financial transactions in the current Code and to make corporate management more accountable and efficient. The United States has recommended that Japan consider revisions of the Commercial Code that would: (1) make corporate boards more independent of management and accountable to shareholders; (2) eliminate many of the current restrictions on a company's capital structure; (3) move Japan closer to international standards of accounting and disclosure; and (4) facilitate corporate transactions and operations, including by allowing corporations to use an audit committee of independent directors, in place of outside statutory auditors (*shagai kansayaku*).

Modernization of the Code will be a highly technical and complex process. To be done effectively, it will require close cooperation with those most affected by the changes and other experts. The United States therefore has recommended that Japan formally open its revision process to international business and academic experts with broad experience in the issues involved. The United States is urging Japan to implement the Code improvement as early as possible in the Japanese Fiscal Year 2002.

Legal System Reform

In the Third Joint Status Report, the Japanese Government recognized the need to reform its judicial system "to meet the needs of Japanese society." The United States included in its October 2000 submission to the Japanese Government recommendations on legal reform issues of particular concern to the international business community. These included: (1) increasing the number of legal professionals, which as a general principle should not be set arbitrarily by regulatory authorities or by professional organizations, but rather should be determined by the demands of the market ; (2) improving the efficiency and speed of civil litigation, by, for example, expanding the number of judges and reducing the time between court filings and decisions; (3) reforming its arcane Arbitration Law to meet modern international business needs; (4)

expanding judicial review of administrative actions; (5) improving the ability of courts to issue and enforce prompt and effective orders to remedy legal violations; (6) improving the transparency of judicial proceedings; and (7) ensuring that Japan's civil litigation system is compatible to the greatest extent possible with foreign court procedures and needs.

IMPORT POLICIES

Import Clearance Procedures

Despite progress in recent years, Japan's import clearance procedures remain slow and cumbersome by industrial country standards, resulting in increased costs for both U.S. exporters and Japanese consumers.

Continuing efforts by the United States and Japan to improve import clearance are being discussed under the Enhanced Initiative, as well as in regular bilateral consultations between customs agencies. These discussions have helped promote changes in Japan's import processing procedures, including: adopting simplified declaration procedures for designated types of goods; establishing a prior classification information system using e-mail; eliminating the requirement to process all air cargo through a separate cargo holding area 30 kilometers from Tokyo's Narita airport (Baraki cargo area); instituting a computerized customs processing system; and integrating that computer system with inspection authorities from the Ministry of Health, Labor and Welfare (MHLW) and the Ministry of Agriculture, Forestry, and Fisheries (MAFF). Japan has also taken significant steps towards introducing paperless processing procedures.

Although these changes have resulted in a reduction in the average time required for customs clearance, problems remain. Average processing times in Japan, for example, remain slow relative to other advanced industrial countries. A June 1999 Japan External Trade Organization (JETRO) survey showed that Japan's release time for ocean-going freight is more than three times as long as other countries surveyed (United States, U.K., Germany, France, and the Netherlands). As for airfreight, Japan's release time was shorter than that of the U.K., but longer than that of the United States and Germany.

In order to address these deficiencies, the U.S. Government and U.S. firms have urged Japan to: (1) extend the application of the new Simplified Declaration Procedures to express carriers; (2) institute changes in the warehousing system (hozei), which currently involves a painstaking "match-up" of documents against goods before imports are released; and (3) appoint a single, lead agency to coordinate responses and to address customs issues as they relate to clearance.

In addition, user fees remain high. The United States has asked Japan to increase the import *de minimis* value for exemption from user fees from 10,000 yen (less than $100) to 30,000 yen in order to improve efficiency and reduce manpower requirements. The United States also has requested that Japan calculate dutiable import values on a "free on board" (FOB) rather than a "cost, insurance, freight" (CIF) basis. Finally, the U.S. Government and U.S. companies have asked for more transparency through expanded public comment procedures in the operation of the Nippon Automated Cargo Clearance System (NACCS).

Given the wide-ranging effect of customs clearance costs and delays on current and potential U.S. exporters, catalog retailers, courier services, and Japan-based enterprises which require the importation of goods and equipment, it is difficult to estimate the dollar effect of streamlining Japanese customs

procedures. However, one U.S. courier has estimated that full implementation of the above measures would lower the cost to consumers of importing products using express carriers by around 25 percent. The same carrier estimates that changing the *de minimis* exemption alone would reduce annual duties by tens of billions of yen, while encouraging dramatic increases in orders from Japanese consumers.

Distilled Spirits

In July 1996, a WTO Dispute Settlement Panel ruled against Japan in proceedings initiated by the United States, Canada, and the European Union. The panel found that Japan's liquor tax regime discriminated against imported distilled spirits and was therefore inconsistent with Japan's WTO obligations. The United States sought binding arbitration when it became apparent that Japan did not intend to bring its tax system into WTO compliance within a "reasonable period" as provided for under WTO rules. The arbitration ruling in February 1997 supported the position of the United States. After considerable negotiation, the United States and Japan reached a settlement in December 1997 ensuring that Japan would bring its liquor taxation system into WTO conformity. Japan also agreed to eliminate tariffs on all brown spirits (including whisky and brandy), and on vodka, rum, liqueurs, and gin by April 1, 2002.

Japan revised its liquor excise tax system in three stages: October 1, 1997; May 1, 1998; and October 1, 2000. Taxation rates for all distilled spirits were brought into WTO conformity by May 1998, with the exception of low-grade *shochu*, which was harmonized on October 1, 2000. At the same time, the liquor tax for imported whiskey and brandy was reduced by 58 percent, while the tax on high-grade *shochu* was raised by 59 percent.

The United States will continue to closely monitor Japan's implementation of the settlement to ensure that tariffs are eliminated under the agreed schedule, and that no measures are adopted that would undermine the settlement's benefits.

Fish Products

Japan is the most important export market for U.S. fish and seafood, taking 42.7 percent of U.S. exports in 2000. Japan maintains several species-specific import quotas (IQs) on fish products. U.S. fishery exports to Japan subject to import quotas include: pollock, surimi, pollock roe, herring, Pacific cod, mackerel, whiting, squid, sardines, and several other fish products. These quota-controlled imports into Japan account for hundreds of millions of dollars in sales annually, or approximately one-fourth of total U.S. 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. During the Uruguay Round, Japan agreed to cut tariffs by about one-third on a number of fishery items, but avoided commitments to modify or eliminate import quotas.

The U.S. and Japan hold annual fish consultations to discuss marine science, ecology and other topics of interest, such as eco-labeling and FAO, WTO, and other bilateral and international fishery-related issues. The two countries continue to discuss fishery trade issues at the technical level annually, and held a meeting on seafood trade issues in December in Seattle which included a second industry-to-industry meeting in as many years. Over the past few years, Japan has made substantial changes in the fish IQ system as part of its deregulation efforts, due in large part to recommendations from the U.S. and European Union. These changes include: greater transparency in disclosing the recipients of IQs,

including names and addresses of recipients and amounts allocated and actually imported by individual recipients; changes in the timing of IQ allocation schedules; and separation of several types of fish (including mackerel, sardine, Pacific cod and others) from the "Fish and Shellfish IQ" into individual categories with quotas listed by weight rather than total value. Nevertheless, application procedures and other elements of the IQ system still cause concern for U.S. exporters.

Agricultural and Food Products

During the Uruguay Round, Japan agreed to bind tariffs on all agricultural products and to reduce bound rates by an average of 36 percent during 1995-2000, with a minimum 15 percent reduction on each tariff line. This included tariff reductions on imports of beef, pork, fresh oranges, cheese, confectionery, vegetable oils, and other items. Japan agreed to convert immediately all import bans and quotas to tariffs, which would be reduced between 1995 and 2000. The one exception was for rice, where the quota was converted to a tariff system in 1999. Tariff-rate quotas replaced import quotas for wheat, barley, starches, peanuts, and dairy products. Japan retains state trading authority and price stabilization schemes for these products.

However, even after full implementation of the Uruguay Round cuts, imported agricultural products still face a complex tariff and tariff-rate quota structure including the use of non-ad valorem tariffs that conceal high applied rates. A wide range of intermediate and consumer-oriented food and beverage products are subject to tariffs between 10 percent and 40 percent, including beef, fresh oranges, fresh apples, waffles and other bakery products, confectionery, snack foods, ice cream, citrus and other fruit juices and processed tomato products. The import taxes raise food prices for consumers and cost U.S. food and agricultural exporters lost sales every year.

In December 2000, Japan announced its proposal for WTO agricultural negotiations. The proposal summarizes Japan's position on market access, domestic support, state trading, export disciplines, and developing countries. While not listing specific targets for tariffs, domestic support, tariff-rate quotas, etc., the proposal states Japan cannot accept any reductions in support or protection that would hinder efforts to increase Japan's self-sufficiency for key commodities.

Leather

In 1991, Japan liberalized treatment of footwear imports, setting a footwear quota of 2.4 million pairs per year. By JFY 1998, it had raised that quota to roughly 12 million pairs per year. In the Uruguay Round, Japan committed itself to reduce tariffs over an eight-year period on under-quota imports of leather footwear, crust leather and other categories.

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

Above-quota imports of footwear still face stiff market access barriers. Since January 1, 2000, the above-quota tariff is 37.5 percent or 4,425 yen per pair, whichever is higher. These rates will decline 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 that negates the effect of the larger tariff rate reduction.

Rice

Japan's highly protected rice market has long been a target for liberalization efforts. During the Uruguay Round, Japan agreed to begin to open its domestic rice market and establish a minimum access (MA) commitment for rice imports. Japan committed to import 379,000 metric tons in 1995/1996. This quota increased to 758,000 tons during the final year of the Uruguay Round implementation period (2000/2001), but on April 1, 1999, Japan implemented a new rice regime that transformed the import quota system into a tariff quota system. Under "tariffication," a specific duty is applied to imports outside of Japanese minimum access rice imports. By adopting a tariff quota system, Japan is allowed to reduce the annual growth rate of its minimum access rice imports to 0.4 percent.

In 2000 (the final year of Uruguay Round implementation period), Japan was expected to import 682,000 metric tons of rice (milled basis), 76,000 tons less than would have been imported in the absence of tariffication in 2000. The Japan Food Agency (JFA), under minimum access, controls the imports volume of all rice into Japan through the Ordinary Minimum Access system and the Simultaneous-Buy-Sell (SBS) system.

Since the Uruguay Round, the United States has been the single largest foreign supplier of rice to the Japanese market, supplying approximately one-half of Japan's total imports. Japan has also become the U.S.'s number one export market for rice with exports valued at about $130 million in 2000. In cooperation with its Japanese customers, the U.S. rice industry has improved its production, handling, and milling techniques for the unique varieties that are produced specifically for Japan's market. To advance this effort, the U.S. rice industry has actively engaged in technical discussions with Japan and made efforts to improve its price competitiveness under the SBS tendering system.

Despite Japan's Uruguay Round commitments and efforts by the U.S. industry to meet Japan's needs, full market access for American rice has not been achieved. The majority of U.S. rice imports are either blended with Japanese domestic rice or exported as food aid. Therefore, under the current administration of the SBS, there is little opportunity for Japanese consumers to choose high quality, cost-competitive, U.S. rice.

Further, access for imported rice appears to be taking another step backward. The Government of Japan recently tabled a new proposal, as part of its WTO agricultural negotiations that would decrease Japan's Minimum Access (MA) commitment for rice allegedly because of surplus rice stocks and falling domestic rice prices. This proposal is counter to Japan's commitment under the Agreement on Agriculture for enhanced agricultural trade reform, and contrary to the basic WTO objective of reducing market access barriers. In addition, any revisions to the existing import regime to be implemented in 2001 must ensure that U.S. rice access is not compromised.

Expanding market access for U.S. rice hinges on increasing MA, reducing tariffs, getting more U.S. table rice to the consumer, maintaining a significant U.S. market share, changing the import system to make pricing and bidding more transparent, and revising the SBS system so the market can function and SBS licenses are awarded on the basis of quality and price.

Wood Products and Housing

Japan is the second leading U.S. export market for wood products. Exports of U.S. forest products totaled $1.5 billion in calendar year 2000, down six percent from the level in 1999. The sluggish Japanese housing market, a sector using over 80 percent of imported wood products, is principally responsible for the decline.

Housing has been designated as one of five priority sectors under the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy. Facilitation of wood-frame construction and development of a secondary housing market are central U.S. objectives in housing discussions under the initiative, and progress in this area is described in detail in the deregulation section of this report. In addition to meetings held in connection with the Enhanced Initiative, the United States and Japan discuss wood product and housing material issues in the Building Experts Committee, the JAS Technical Committee, and the Wood Products Subcommittee. These committees were set up under the terms of the 1990 U.S.-Japan Wood Products Agreement.

To expand the market for U.S. wood products in Japan, the United States has urged Japan to remove remaining barriers, such as prescriptive codes and standards in the Building Standard Law, Japan Industrial Standards (JIS), and Japan Agricultural Standards (JAS). These barriers limit the approval and acceptance of imported building materials.

A longstanding U.S. objective in Japan has been the elimination of tariffs on value-added wood products. Japan's failure to support the Accelerated Tariff Liberalization initiative (see "Import Policies" section of this chapter) precluded agreement on a phase-out of tariffs for wood products and the acceleration of the phase-out of tariffs for paper, printed materials, and wooden furniture. The United States will continue to urge Japan to play a constructive role in concluding an agreement in the context of any new WTO negotiations with a view to eliminating wood product tariffs in the 2002-2004 time frame.

In addition to reduction of tariffs and reform of the regulatory environment, there is much that Japan can do to develop its wood products market, including taking steps to rebuild consumer confidence in order to increase home purchases and renovation, continue changes to the tax system to stimulate the new and used home market, reform its land and lease laws, expand the home mortgage system, and eliminate subsidies for its domestic wood products sector.

Marine Craft

Japan's non-transparent system of small craft safety regulation for boats, marine engines, and marine equipment is a serious impediment to market access in this sector. The regulations, which are administered by the Ministry of Land, Infrastructure and Transport (MLIT) and the Japan Craft Inspection Organization, are often vague and subject to arbitrary and inconsistent interpretation. Testing requirements can be expensive, while documentation requirements are non-transparent and burdensome, forcing companies to disclose sensitive proprietary information about product design, material specifications, and manufacturing techniques. Inspection fees are high and unrelated to the costs of conducting the inspections.

This regulatory system unnecessarily increases the costs of U.S. manufacturers, burdens Japanese consumers with higher prices and reduced access to imported boats, motors, and equipment, and provides no increased safety benefits compared with U.S. and European

regulations. Japan has in the past expressed its intent to adopt international safety standards for small craft and marine engines, and participates actively on international standards drafting committees. Japan has made little progress, however, in harmonizing its small craft regulations with international practices. In late 2000, the United States held a series of discussions with Japanese Government agencies, resulting in Japan's agreement to accept private sector certification to U.S. standards in lieu of conformity to several Japanese regulations; however, many issues remain unresolved and further discussions are planned.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Certification-related problems continue to obstruct access to Japan's markets. Although advances in technology continue to make Japan's standards outdated and restrictive, Japanese industry continues to support safety and other standards unique to Japan for no apparent reasons. In some areas, however, Japan has undertaken to simplify, harmonize, and eliminate restrictive standards in accordance with international practices.

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

Biotechnology

Japan has adopted a largely scientific approach in its approval process for genetically modified (GM) foods. To date, the Ministry of Agriculture, Forestry and Fisheries (MAFF) and the Ministry of Health, Labor, and Welfare (MHLW), which regulate biotechnology products, have approved the importation of 29 GM plant varieties, including corn, potatoes, cotton, and soybeans.

While U.S. and Japanese regulatory approaches to assessing the safety of biotech products have been closely aligned, the United States is seriously concerned by Japan's decision to implement mandatory labeling of 24 whole and semi-processed foods made from corn and soybeans beginning April 2001. The United States is concerned that mandatory labeling will discourage consumers from purchasing foods derived through biotechnology by suggesting a health risk when there is none. In fact, in response to the release of Japan's plans to require labeling, many manufacturers of products to be subject to mandatory labeling have already switched to non-genetically engineered ingredients.

MAFF has stated that the objective of this new mandatory labeling requirement is to provide information to the consumer. Separately, MHLW's mandatory labeling requirement for the same 24 foods is designed "to reassure consumers that these foods have been approved as safe to consume by the Government of Japan." The United States has informed both ministries that it is important for consumers to have information on foods that have been genetically engineered, but that alternatives to labeling, such as educational materials and public fora, can provide more meaningful information to consumers on genetic engineering. The United States will continue to consult closely with Japan in both bilateral and multilateral fora to address outstanding issues in this important area. For example, U.S. agencies continue to work with Japanese officials to reduce Japanese Governement concern about the inadvertent commingling of StarLink biotech

corn with conventional corn.

Dietary Supplements

Dietary supplements (vitamins, minerals, herbs, and non-active ingredients) have traditionally been classified as drugs in Japan. As a result, severe restrictions have been imposed on the shape, dosage, and retail format for such supplements. These regulations create excessive costs and difficulties for most foreign supplement firms participating in the Japanese market. Dietary supplement issues are addressed by the United States through the MOSS/Enhanced Initiative process.

In March 1996, Japan's Office of Trade and Investment Ombudsman (OTO) recommended that products normally distributed and sold abroad as food products should not be regulated as drugs, but be allowed into the Japanese market as food products. Under the Enhanced Initiative, Japan has begun the process of implementing these recommendations. Although some progress has been made, further steps are needed. Two deregulation measures were adopted in early 2000 that did result in incremental but important progress. The first enabled a number of vitamins and mineral supplements to be sold in tablet and capsule forms without dosage restrictions. The second measure allowed 34 herb products previously considered drugs, or whose regulatory status was under review, to be sold as food.

Consistent with its Enhanced Initiative undertakings, Japan is proceeding to allow dietary supplements to make nutritional and health benefit claims, if there are scientific data and information to support such claims. However, concerns have been raised regarding the scope of data that may be required to make such claims. The data requirements of the regulatory system should be reasonable and appropriate, and limited to that necessary to ensure safety and efficacy. Furthermore, regulatory decisions should be based on clear scientific grounds, taking into full consideration all available data and information. Japan has agreed to continue to discuss the scope of using non-Japanese data and information required to evaluate and approve products.

Food Additives

Processed food imports into Japan, such as light mayonnaise, canned fruit and whipping cream, have at times come into conflict with Japan's standards affecting food additives, even though such additives may be approved as safe in other countries by the Joint FAO/WHO Experts Committee on Food Additives. For example, Japan refuses to allow the importation of light mayonnaise (as well as creamy mustard), containing the food additive potassium sorbate, a food additive evaluated and accepted by numerous national and international standard-setting organizations. Other food products containing this additive, however, are permitted to enter Japan.

Through revisions to its Food Sanitation Law (FSL), Japan is working to harmonize its national regulations to conform to the provisions of the WTO Sanitary and Phytosanitary (SPS) Agreement. Currently, Japan's food additive regulations remain unique, especially the listing of "non-natural" additives designated by MHLW pursuant to Article 6 of the FSL. The U.S. Government encourages U.S. firms and industry associations to file applications with MHLW for approval of new additives, allowing sufficient time for assessment. The United States has raised Japan's regulation of food additives under the Enhanced Initiative and intends to continue to urge Japan to adopt regulations that both protect consumers and facilitate international food trade.

Fumigation Policies

Japanese plant quarantine regulations require fumigation on a number of imported fresh horticultural products. The fumigation requirement is particularly detrimental to trade in fresh fruits, vegetables, avocados, lettuce, and cut flowers, which generally do not survive the treatment and must be destroyed. In fact, Japanese produce importers report that if the risk of fumigation were eliminated, imports of U.S. lettuce would grow dramatically. Due to the high risk of product loss from fumigation, sales now typically average less than $5 million per year.

After repeated requests by foreign governments for reform, the Ministry of Agriculture, Forestry, and Fisheries (MAFF) has begun to implement a non-quarantine pest list by partially amending the Plant Quarantine Law to exempt 53 pests and 10 plant diseases from fumigation requirements. While this appears to be an important positive step, the exemption list does not include common insects found on U.S. fresh fruits and vegetables, some of which are known to occur in Japan.

For pests already found in Japan, including many cosmopolitan species of thrips and aphids, Japan insists fumigation is necessary if found on imports, maintaining that the pests are not widely distributed in Japan and are under "official control" by MAFF. However, MAFF does not require fumigation of infested locally grown produce. The United States will continue to urge Japan in appropriate technical and deregulatory fora to develop a comprehensive list of non-quarantine pests and adopt transparent inspection procedures in an effort to reduce excessive, unnecessary, and trade distorting fumigation requirements.

Fresh Apples – Quarantine Requirements for Fireblight

Japan imposes burdensome quarantine restrictions on apples, limiting the ability of U.S. and foreign growers to access the Japanese market. Of particular concern are Japan's requirements that aim to prevent transmission of fireblight, as the scientific evidence does not support the conclusion that apple fruit transmits the bacteria. Japan's quarantine requirements for fireblight include three mandatory tree-by-tree inspections throughout the growing season and a requirement that all apples shipped to Japan be grown within a 500-meter "buffer" zone from other apples in the orchard. The requirements significantly raise costs and reduce competitiveness of U.S. apples in Japan.

The United States has provided evidence that the theoretical risk of transmitting fireblight through apple fruit is infinitesimally small and continues to urge Japan to eliminate or reduce the buffer zone to no more than 10 meters, and to end the tree-by-tree inspection requirement. Discussions between U.S. and Japanese scientists will continue this year in an effort to resolve this issue.

Fresh Potatoes – Golden Nematode and Potato Wart

Japan bans importation of fresh potatoes from the United States. MAFF officials maintain that the ban is necessary to prevent introduction of golden nematode and potato wart into Japan. The United States has urged Japan to immediately lift the ban on fresh potatoes from areas not infested by the golden nematode and potato wart, such as the Pacific Northwest, California, and other U.S. potato exporting areas. Separately, MAFF has raised new concerns regarding a number of viruses that would necessitate post-entry quarantine of imported potatoes even if approval were granted. The United States will continue to urge Japan to eliminate golden nematode and potato wart from the list of quarantine concerns for fresh potatoes.

Fresh Bell Peppers and Fresh Eggplant – Tobacco Blue Mold

Japan continues to ban imports of fresh bell peppers and fresh eggplant based on concerns over tobacco blue mold (TBM). In initial bilateral discussions held in August 1999, the United States emphasized that the fruit of peppers and eggplants are outside any pathway of transmission of TBM. Similar to its initial position to ban all fresh tomatoes due to TBM (a ban which was lifted in 1999), Japan did not address the absence of evidence showing the fruit are a host to the disease and responded that records exist of natural infection.

In bilateral technical meetings held in September 2000, Japan agreed to consider lifting its ban if it can be demonstrated that the fruit is not a host to the disease. Through discussions in both bilateral and international fora, the United States will continue to press its case that the fruit do not transmit the disease.

Pesticides Residue

While Japan has made progress in establishing pesticide residue standards in harmony with internationally recognized tolerance levels, further work with Japan is necessary to help ensure that non-tariff barriers regarding imported food and agricultural products do not unreasonably restrict trade.

Third-party Certification Requirements for Organic Food

MAFF's requirement that U.S. certified organic products must also be certified by MAFF-accredited organizations based in Japan is considered extremely burdensome and may lead to serious curtailment of U.S. exports to Japan. U.S. organic food exports to Japan have been estimated at up to $100 million per year. To avoid any disruption to trade, the United States has proposed that Japan allow USDA ISO Guide 65-accredited certifying organizations to certify U.S. organic products for export to Japan.

Varietal Testing

U.S. agricultural products such as apples, cherries, walnuts and nectarines have been subject to unnecessary phytosanitary restrictions. Japan requires repeated testing of established quarantine treatments each time a new variety of an already-approved commodity has been presented for export from the United States.

After efforts to resolve the varietal testing issue through bilateral negotiations proved unsuccessful, in October 1997, the United States invoked WTO dispute settlement procedures against Japan. On March 19, 1999, the WTO Dispute Settlement Body (DSB) adopted Panel and Appellate Body findings that Japan's varietal testing requirement was: (1) maintained without sufficient scientific evidence, in violation of Article 2.2 of the WTO Sanitary and Phytosanitary Agreement ("SPS Agreement"); (2) not based on a risk assessment, in violation of Article 5.1; and (3) inconsistent with Japan's transparency obligations under paragraph one of Annex B of the SPS Agreement, since Japan did not publish its requirements. The United States and Japan have been consulting since that time on Japan's implementation of the DSB's rulings and recommendations.

Veterinary Drugs

Japan typically waits for the joint FAO/WHO Codex Alimentarius Commission (Codex) to adopt an international standard before evaluating scientific evidence. However, such a policy results in significant delays in establishing tolerance levels for veterinary drugs in Japan. The United States has urged Japan to

undertake this procedure in a timely fashion, and not to delay the process while waiting for the outcome of Codex deliberations, thereby improving the safety review process for veterinary drugs sold in Japan.

GOVERNMENT PROCUREMENT

The United States has concluded bilateral agreements with Japan in six key sectors of the Japanese public sector market: computers, construction, medical technology, satellites, supercomputers, and telecommunications. The aim of these agreements is to improve foreign firms' access to, and expand sales in, Japan's public procurement market. In support of this, the agreements attempt to redress traditional Japanese procurement practices that have historically prevented U.S. and other foreign firms from fully and equally participating in Japan's public sector market.

Computers

U.S. producers of computer goods and services are global leaders in technology and performance and continue to be among the largest and most successful foreign firms in Japan. To address the fact that these firms were notably under-represented in the Japanese public sector market for computers, the United States and Japan concluded a bilateral Computer Agreement in 1992. The agreement, whose aim is to expand government purchases of foreign computer products and services, included provisions requiring: (1) equal access to information and opportunity to participate to all potential bidders; (2) any company that has participated in developing specifications for a procurement be barred from bidding on that same procurement; (3) sole sourcing to be restricted to exceptional cases justified under the GATT/WTO Agreement on Government Procurement; (4) bids be evaluated on a range of criteria set forth in the tender documentation; and (5) unfair low bids be prohibited.

At the last bilateral review of the agreement held in Tokyo in May 1999, Japan presented JFY 1997 data showing that foreign computer firms held 16.5 percent of the public sector market – a 0.6 percent increase over the previous year. However, this followed a 37 percent plunge in Japanese public procurement of foreign computer goods and services between JFY 1995 and JFY 1996. The United States recognized that there had been some movement in a positive direction, but expressed serious concern that, according to Japanese Government data, the foreign share of the public sector computer market was still roughly equivalent to the share that foreign companies held when the Computer Agreement was concluded. Further, the data presented by Japan continues to compare unfavorably with a fairly consistent foreign market share of more than 30 percent of Japan's private sector computer market. The United States concluded that more work needed to be done by Japan to ensure that the objective of the agreement is achieved.

In 1999, given the continued gap between the U.S. share of the Japanese private and public sector computer markets, as well as the rapid technological advancements in this sector, the United States urged Japan to update and improve the implementation of the Computer Agreement. To this end, the United States proposed that Japan more fully utilize the Internet for public procurements, broaden its use of "overall greatest value method" (OGVM) in bid evaluations, and provide advance information to potential bidders on a larger number of upcoming procurements.

Japan has announced its intention to shift government procurement to the Internet in JFY 2005. This entails creating a single Internet site where all Japanese central government procurement information necessary for bidding

for all product categories will be available and allowing bidding on the Internet. Some ministries have already begun posting procurement information on the Internet. The United States has urged Japan to ensure that the views of foreign computer producers are fully taken into account as Japan proceeds with this initiative. The next round of consultations on computers will be held in Spring 2001.

Construction, Architecture and Engineering

There are two public works agreements in effect: the Major Projects Arrangements (MPA), negotiated in 1988 and amended in 1991, and the 1994 U.S.-Japan Public Works Agreement, which includes the "Action Plan on Reform of the Bidding and Contracting Procedures for Public Works" (Action Plan). The MPA was designed to improve access to Japan's public works market and includes a list of 42 projects in which international participation is encouraged. Under the 1994 Agreement, Japan must use open and competitive procedures for procurements valued at or above the thresholds established in the WTO Agreement on Government Procurement (GPA).

The U.S. share of Japan's $300 billion public works market was only $50 million in 1999 (the most recent year for which data are available), a troubling fact given the competitiveness of American design/consulting and construction companies throughout the rest of the world. While the 1994 Agreement remains in effect, the mechanism in the 1994 Agreement requiring annual meetings between the United States and Japan expired on March 31, 2000. Although Japan rejected the U.S. formal request that the consultative mechanism be extended, the U.S. Government continues to believe it is essential for the two governments to meet regularly to discuss implementation of the 1994 Agreement and continuing problems in Japan's public works sector.

The U.S. Government believes there is a significant and persistent pattern of practices of discrimination that impedes U.S. companies from participating effectively in Japan's public works sector. These practices include rampant bid-rigging; unreasonable restrictions on the formation of joint ventures, including the three-company joint venture rule, which limits to three the number of members in joint ventures for most construction projects; use of unreasonably vague and discriminatory qualification and evaluation criteria in the design/consulting and construction areas; and the structuring of procurements and calculation of procurement values so they fall below the thresholds in the agreements.

Japan’s public works market is well-known for its closed nature and for the prevalent use of collusive practices including: 1) bid rigging (or “*dango*”), under which companies consult with one another and prearrange a bid winner; and 2) the "cozy relationships" (*yuchaku*) between politicians and bureaucrats where politicians use their influence to obtain advantageous bid/contract conditions for particular Japanese firms in public works projects. This problem has been compounded by the actions of procuring agency officials who have knowingly assisted bid-rigging conspiracies, as revealed in a number of recent cases. The U.S. Government also is concerned about some disturbing bidding patterns whereby Japanese construction firms have submitted bids that are so low that they raise the question as to whether the work can be performed at that price. The U.S. Government has continued to urge the JFTC, as well as procuring agencies, to take stronger action to combat these practices and impose heavy sanctions on government officials who aid them.

The U.S. Government continues to urge Japan to eliminate the three-company joint venture rule and to allow companies, instead of the procuring entity, to decide how many members to include

in a joint venture. Such decisions should depend on the scope of the work and the various firms' abilities. Regarding Japan's continued use of vague and unreasonable definitive criteria, the U.S. Government urges Japan to define the criteria used in particular procurements so as to maximize, rather than restrict, the number of firms that would be able to participate in the procurement.

For many years, the U.S. Government has urged Japan to introduce Program Management (PM) and Construction Management (CM) into its public works market and to begin this process with a "model" project. (PM and CM are advanced construction methodologies used by U.S. firms to maximize the efficiency of a project in terms of saving time and money). Japan's Ministry of Land, Infrastructure and Transport (MLIT) recently began examining more closely the practical applicability of CM. The U.S. Government urges MLIT to contract out the first CM project as soon as possible.

Japan and the United States agreed in July 1999 to the establishment of the U.S.-Japan Construction Cooperation Forum to facilitate the formation of joint ventures between U.S. and Japanese firms, and to make it possible for U.S. companies to participate more fully in Japan's public works market. Japan hosted the first Forum in October 1999 and the second Forum in June 2000. While the Forum successfully brought together key representatives from Japan's construction, civil engineering, and design companies and U.S. firms interested in Japan's public works market, the increase in U.S. business that the U.S. Government had hoped for has not yet been seen in this sector.

The U.S. Government is paying special attention to several major projects covered by the public works agreements of particular interest to American companies such as the Central Japan International Airport, Haneda Airport East Passenger Terminal Building, Japan Railways procurements, Kansai International Airport, Kobe Airport, Kyushu National Museum, Kyushu University Relocation Project, and New Kitakyushu Airport, in addition to other projects covered by the agreements, including MPA projects that have not yet begun. The U.S. Government urges Japan to involve U.S. firms in these projects to the greatest extent possible.

Medical Technology

The goal of the 1994 Medical Technology Agreement is to significantly increase market access and sales of competitive foreign medical products and services in the Japanese public sector procurement market. U.S. firms continue to be the world's leading producers of advanced medical technologies, and this agreement provides an important step forward in enabling them, as well as other foreign firms, more effectively to sell medical technology products and services in Japan's public sector.

On February 17, 1999, Japan adopted a Cabinet order permitting the use of an "overall greatest value method" (OGVM) basis for bid evaluation, (instead of the lowest-bid) in procurements made at the local and prefectural level. The most recent annual review of the agreement was held in September 1999. Japan presented data for JFY 1997 that showed that foreign market share rose 4.4 percentage points to 45.6 percent. This occurred despite the fact that overall procurement covered by the agreement fell 29.6 percent between JFY 1996 and JFY 1997 (from over 75 billion yen to 53 billion yen). Foreign/domestic head-to-head competition also increased significantly in JFY 1997, with 14.7 percent of contracts contested by multiple bidders, versus seven percent in JFY 1996. This movement away from single bidders indicates that more dynamic competition has developed in this sector.

Satellites

Under the 1990 U.S.-Japan Satellite Agreement, Japan committed to open non-R&D satellite procurements to foreign satellite makers. As defined in the agreement, "R&D" satellites are those designed and used entirely, or almost entirely, for the purpose of in-space development and/or validation of technologies new to either country, and/or non-commercial scientific research. Satellites designed or used for commercial purposes or for the provision of services on a regular basis expressly do not meet the agreement's criteria defining R&D satellites. Coverage of the agreement includes procurement for broadcast satellites by the Nippon Telegraph and Telephone (NTT) companies and the Japan Broadcasting Corporation (NHK), the government-owned television/radio services.

To date, the agreement has been successful in opening the Japanese Government's procurement market to foreign competition. From 1990 through 2000, U.S. satellite makers – world leaders in this field – won seven out of eight contracts (with a combined value of nearly $2 billion) openly bid under the competitive procedures outlined in the agreement. The only contract not won outright by a non-U.S. firm utilized a U.S. system. Given U.S. firms' strength in this area, the United States expects that this access will continue.

The United States continues to carefully monitor Japan's adherence to the terms of the agreement and to ensure that no overly broad definition of an R&D satellite is used that could unfairly deny U.S. satellite manufacturers access to procurement opportunities.

Supercomputers

The United States and Japan concluded the 1990 U.S.-Japan Supercomputer Agreement in order to ensure fair access for U.S. supercomputer manufacturers to Japan's high-performance computing market. Under the agreement, Japan committed to implement transparent, open, and non-discriminatory competitive procurement procedures for supercomputers in the public sector and to ensure that procuring entities are fully able to procure the supercomputer that best enables them to perform their missions.

Results under the 1990 Supercomputer Agreement have been mixed. A significant gap remains between the U.S. share of the competitive Japanese private sector and public sector supercomputer markets. In addition to the discrepancy between the U.S. share of Japan's public and private sector markets, in recent years, the United States has raised concerns over the use by certain Japanese public sector entities of inappropriate technical requirements in public supercomputer procurements. The United States will continue to press Japan to ensure that the terms of the bilateral supercomputer agreement are faithfully implemented, including the use of neutral and nondiscriminatory technical requirements.

On April 25, 2000, the United States and Japan agreed to increase the threshold governing coverage of the Supercomputer Agreement from 50 GIGAFLOPS (50 billion floating point operations per second) to 100 GIGAFLOPS in order to keep pace with the notable advance in technology in this sector. This change went into effect on May 1, 2000.

Telecommunications

NTT Arrangement: On July 1, 1999, concurrent with the restructuring of NTT into a holding company (Nippon Telegraph and Telephone Corporation), two regional companies (NTT East and NTT West), and a long distance/international company (NTT Communications), the United States and Japan

reached agreement on a new NTT Procurement Agreement. This agreement replaced the previous NTT Agreement, which was first concluded in 1980 and subsequently renewed six times. Together, the four NTT successor companies continue to be Japan's single largest purchaser of telecommunications equipment and, according to recent statistics, account for almost one-third of Japan's $32 billion telecommunication equipment market. As such, the "NTT market" has been and continues to be of keen interest to U.S. and other foreign telecommunications firms.

The new 1999 Agreement covers the procurement of all four of the NTT successor companies and will remain in force for two years. In terms of substance, the new agreement: (1) ensures continued government oversight of NTT successor companies' procurement; (2) commits both governments to annual reviews to assess progress; (3) requires NTT successor companies to provide data for review by the governments; and (4) sets forth new, streamlined procurement procedures in which the NTT successor companies commit to procure in an open, non-discriminatory, competitive and transparent manner.

In November 2000, during the first of two reviews under the 1999 Agreement, the NTT companies reported that overall procurement of foreign products increased from 153 billion yen in JFY 1998 to 169 billion yen in JFY 1999. These figures were lower than the 185 billion yen in foreign purchases made by NTT in JFY1997 but were in the context of steadily declining capital expenditures for fixed-line operations. The United States believes that the NTT Agreement has been effective in moving closer to its objective of increasing competition and improving the openness, fairness, and transparency of the telecommunications equipment market in Japan. Nonetheless, the United States expects that there will be continued growth in the NTT successor companies' procurement of foreign equipment, and that the foreign share of procurement by NTT successor companies will increase to levels more consistent with those of Japanese private sector telecommunications carriers (which have traditionally been far more open to foreign products) and with telecommunications markets globally. Because the NTT successor companies procure over $10 billion in equipment and services annually and plan to increase procurement of data- and Internet-related technologies, an area in which U.S. companies are particularly strong, improved access to the NTT market should result in significant new opportunities for U.S. firms. The second review under the new NTT Agreement will be held in the first half of 2001.

Public Sector Procurement Agreement on Telecommunications Products and Services: The objective of the 1994 U.S.-Japan Telecommunications Procurement Agreement is to significantly increase access for foreign telecommunications products and services to Japan's public sector. Pursuant to the agreement, Japan has introduced procedures to eliminate barriers such as: unequal participation in pre-solicitation and specification drafting for large-scale telecommunications procurements; ambiguous award criteria; and excessive sole sourcing. The agreement also includes quantitative and qualitative criteria for measuring progress.

During the most recent annual review held in April 1999, during which JFY 1997 data were reviewed, the United States expressed serious concern about the continued low foreign share of Japanese Government procurement of telecommunications products and services, which Japanese Government data showed to be 3.9 percent. This stands in contrast to the 13 percent market share foreign firms achieved as well as the significant successes that foreign

suppliers have had in selling to Japan's private sector, particularly the new competitors to NTT.

During the April review, the United States noted that despite the fact that the agreement calls for a reduction in sole-source tendering, the percentage of sole-source tendering in total government telecommunications procurements reached 27 percent in JFY 1997. The Ministry of Posts and Telecommunications (now part of MPHPT), the largest government purchaser of telecommunications equipment and services, sole sourced fully one-third of these procurements. The Ministry of International Trade and Industry (now METI) also relied heavily on sole sourcing.

Also at the review, the United States expressed serious concern regarding Japan's failure to provide information on procurements made by the Japan Defense Agency, despite the fact that the Agency is explicitly covered under the bilateral agreement. It also questioned the absence of data from Japan Railways. Finally, the United States expressed concern about agencies' use of specifications that appear biased toward a particular local firm.

The next review is scheduled for the spring of 2001.

INTELLECTUAL PROPERTY RIGHTS PROTECTION

The United States has pursued its intellectual property goals with Japan through a firm policy that has combined close bilateral consultations and negotiated agreements (including two bilateral patent agreements since 1994); effective policy coordination in multilateral and regional fora; and strong action in the WTO when necessary to defend U.S. intellectual property interests in Japan.

The sound recordings dispute of 1996-97, which represented the first intellectual property dispute settlement case at the WTO, was resolved when Japan amended its law to fulfill its WTO obligations. The result of this action has been an increase in the level of protection afforded U.S. intellectual property in Japan, and a greater Japanese role in pushing for stronger worldwide intellectual property protection. Although intellectual property piracy in Japan has dropped and significant improvements have been made to Japan's legal and administrative intellectual property framework, the United States has identified a number of areas where further action by Japan is needed, including: (1) addressing persistent patent-related problems; (2) improving and expanding protection of copyrighted works; (3) expanding protection for well-known trademarks; (4) affording greater protection of trade secret information; and (5) illuminating and gaining access to non-transparent border enforcement mechanisms. As a result of Japan's improved IPR protection, the United States removed Japan from the Special 301 Watch List in May 2000.

The increased use of the Internet raises a number of concerns about intellectual property protection. The United States has included some of these issues in the Enhanced Initiative on Deregulation and Competition Policy discussions. It will be important to continue working to address these Internet related issues in a variety of fora in the future.

Patents

The United States has focused particular attention on improving registration access and approvals, and reforming Japan's practice of affording only narrow patent claim interpretation. Japan has taken steps to implement its commitments under two 1994 bilateral patent agreements which: (1) allow patent applications to the Japan Patent Office (JPO) to be filed in English; (2) permit the

correction of translation errors after patent issuance; (3) end dependent patent compulsory licensing (except in cases where anti-competitive practices have been found); (4) end the practice of allowing third parties to oppose a competitor's patent before it is granted and to hear all opposition claims at the same time; and (5) provide a revised, accelerated examination system. Notwithstanding these steps, the United States remains concerned with several aspects of Japan's patent administration, including the relatively slow process of patent litigation in Japanese courts, the lack of an effective means to compel compliance with discovery procedures, and the lack of adequate protection for confidential information produced relative to discovery.

A revised patent law took effect January 1, 2000. This law is designed to make it easier for plaintiffs to prove patent infringement in courts. Key provisions include increasing requirements on alleged violators to justify their actions, obligating alleged violators to cooperate with calculation experts, giving judges discretion over the amount of damages, increasing the penalty in cases where patents were obtained fraudulently, and allowing courts to seek technical advice from the JPO. The United States will monitor closely whether this revision reduces the burden of proof required by Japanese courts, which has been particularly onerous to foreign patent owners.

As part of the new law, the period between when a patent is applied for and when it must be pursued by an applicant has decreased from seven to three years, effective October 1, 2000. According to the JPO, the average "First Action Period" (the period from the date of patent application until the first response by JPO) was 19 months as of December 1999. The JPO has set a target of reducing the examination period further to 12 months by the end of 2000. Moreover, a government advisory panel released a report in December 1999 urging the Government of Japan to take measures to boost the number of patent lawyers and expand their scope of permitted services in order to improve the use of intellectual property in Japan. Based on the panel's recommendations, the JPO submitted a bill to the Diet that was passed in April 2000 and took effect on January 6, 2001. The United States is encouraged by these steps which are helping to further strengthen the level of patent protection in Japan. We will continue to urge Japan to implement these provisions and enforce its patent laws.

A new issue arising in 2000 was the lack of protection of business method patents in Japan, particularly those related to the Internet. The WTO TRIPS Agreement requires member countries to provide patents for inventions in all fields, including business methods. The United States and Japan are discussing this issue in several fora.

Copyrights

Japan has made progress in combating computer software piracy in recent years, with the "piracy rate," as calculated by U.S. industry, falling from roughly 50 percent (of software in use) in 1994 to roughly 31 percent in 1999. The United States continues to urge Japan to reduce the piracy rate further. Japan amended the copyright law to raise the cap on punitive damages from 3 million to 100 million yen effective January 2001. A notable step toward creating an effective deterrent against piracy would be amending Japan's Civil Procedures Act to award statutory damages rather than actual damages, and to provide for more effective procedures for collecting evidence. In addition, in order to lead the private sector by example, the United States urges Japan to issue a policy statement clarifying Japan's commitment to use only legitimately produced and licensed software in its government's

operations.

In March 1997, Japan amended its copyright law to 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 after Japan failed to provide full "retroactive" protection to pre-existing sound recordings in accordance with the TRIPS (Trade-Related Aspects of Intellectual Property Rights) Agreement. The United States expects similar resolution of piracy over digital networks, including digital music broadcasting services. Japan also has signed the World Intellectual Property Organization (WIPO) Copyright Treaty, providing new protection for authors of works transmitted over the Internet.

With the increased use of the Internet, the protection of copyrighted material becomes more difficult to enforce. The protection of this material is critical for e-commerce to flourish and for the continued development of content such as games, music, and film as well as software. Specific issues in this area include Japan's protection of copyrighted material from temporary copies and the personal use exemption. The United States is concerned by a 2000 Japanese court ruling that a company airing music programs digitally in a program format designed to facilitate copying of those works does not constitute a copyright violation. According to the court, broadcasters have the right to duplicate copyrighted materials and subscribers decide themselves whether or not to copy the music. The court said that by offering such an opportunity to listeners, the broadcasting company was not encouraging them to make copies. Continued interpretations along similar lines could erode the ability to protect copyrighted materials. The United States is particularly concerned by the threat such a position poses to copyrighted works.

A revision of some aspects of Japan's copyright law took effect January 1, 2000, in preparation for Japan's accession to the WIPO Copyright Treaty on March 14. Key provisions of the revised law include criminal penalties for producing and distributing devices designed to circumvent copyrights, and for illegally revising copyright management information to make a profit. The United States is concerned that in the publicly available translation of the Copyright Law, the section on anti-circumvention states that the penalties for copyright circumvention devices will be applied only to devices whose "principal function" is circumvention. The law also expands the coverage of screening rights from motion pictures to still pictures and sets transfer rights so that the first sale doctrine covers films, books, and CDs.

Japan's practices with respect to the treatment of songwriters who collaborate in the creation of musical compositions have raised concern about the treatment of certain composer partnerships. It appears that Japanese authorities are applying inflexible, formalistic rules to the authorship statement on sheet music at the time of publication that, in certain instances, result in a denial of the full term of copyright protection for their works. This practice raises questions under the Berne Convention (and incorporated by reference in the TRIPS Agreement) which states, that "the enjoyment and exercise of [copyright] rights shall not be subject to any formality."

Trademarks

A number of revisions to Japan's Trademark Law came into force in 1997. The revisions aimed 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. Regrettably, in spite of the existence of provisions in Japan's Unfair Competition Law designed to afford greater protection to well-known marks, protection of such marks remains weak.

Legislation passed in preparation for Japan's ratification of the Madrid Protocol in March 2000 contains several useful steps. Effective January 1, 2000, Japan began establishing a system to notify the public of trademark applications received. Effective March 14, 2000, trademark holders are entitled to compensation for damages for the period from application until registration of the trademark. Further, the United States welcomes Japan's improvement in the speed of its average First Action Period for trademark registration process, which dropped from 17 months as of the end of December 1998 to 10 months as of the end of December 1999.

Trade Secrets

Although Japan amended its Civil Procedures Act to improve the protection of trade secrets in Japanese courts by excluding court records containing trade secrets from public access, the legislation is inadequate. Given that Japan's Constitution prohibits closed trials, the owner of a trade secret seeking redress for misappropriation of that secret in a Japanese court is forced to disclose elements of the trade secret in seeking protection. Because of this, and the fact that court discussions of trade secrets remain open to the public with no attendant confidentiality obligation on either the parties or their attorneys, protection of trade secrets in Japan's courts will continue to be considerably weaker than in the courts of the United States and other developed countries. The United States considers this to be unacceptable and continues to urge Japan to undertake further reform in this area.

Border Enforcement

In an effort to bolster Japan's border control measures, the United States has urged Japan to improve its application, inspection and detention procedures to make it easier for foreign rights holders to obtain effective protection against infringed intellectual property rights at the border. Further, insofar as Japan provides ex-officio border enforcement of trademarks and copyrights through the Japan Customs and Tariff Bureau (JCTB), efforts should be made to enhance such enforcement through aggressive interdiction of infringing articles. In addition, the United States is concerned by the 1997 Japan Supreme Court decision to allow parallel imports of patented products and continues to monitor JCTB's implementation of this policy.

SERVICES BARRIERS

This section includes the following subsections: Insurance and Professional Services. Energy services are discussed in the energy subsection of the Sectoral Deregulation Section above.

Insurance

Japan's private insurance market is the second largest in the world, after the United States' insurance sector, with direct net premiums at an estimated $450 billion last year. In addition to the offerings of Japanese and foreign private insurers, there is a large public sector provider of postal life insurance products known as Kampo, the National Public Health Insurance System, and a web of mutual aid societies (Kyosai) that also provide significant amounts of insurance to Japanese consumers. The

Japanese insurance sector, aside from Kampo and the Kyosai, is regulated by the Financial Services Agency (FSA), which was established in June 1998. The FSA is responsible for all aspects of financial regulation in Japan, including inspection, supervision, and surveillance of financial activities related to banking and securities business in addition to insurance.

There are two bilateral agreements between the United States and Japan covering insurance, one concluded in October 1994, and the second in December 1996, both with the goal of achieving a substantial increase in market access and sales for foreign insurance providers and intermediaries in Japan. The 1994 and 1996 bilateral Insurance Agreements have made significant contributions to the deregulation of the Japanese insurance market to date, as their provisions committed the Japanese Government to introduce sweeping measures that resulted in significant improvements in the product approval process, greater use of direct sales of insurance products, and the introduction of risk differentiated automobile insurance. Most fundamental of all, the agreements lifted the obligation to adhere to rates set by the non-life rating organizations once imposed on insurance companies, thereby eliminating the cartels that until recently characterized Japan's non-life insurance market.

One key feature of the 1994 and 1996 Agreements was the inclusion of provisions designed to ensure that deregulation of Japan's highly segmented insurance industry did not proceed at the expense of foreign and small-and medium-sized Japanese insurers. More specifically, the agreements outlined steps and a timeline for substantial deregulation of the Japanese "primary" life and non-life sectors, which account for roughly 95 percent of Japan's insurance market, prior to allowing any radical changes in the so-called "third sector." The third sector, which comprises approximately five percent of Japan's overall insurance market, includes personal accident, cancer, and hospitalization insurance, and is an area in which foreign insurance providers have been particularly competitive. In light of progress made by Japan to deregulate the primary insurance sector as well as its commitment to improve the product approval process further, the U.S. Government confirmed in July 2000 that the bilateral agreement provisions that prohibited life subsidiaries of non-life companies and non-life subsidiaries of life companies from selling third sector insurance products or utilizing certain distribution channels for these products, would be lifted. As a result, deregulation of the third sector began on January 1, 2001. The 1994 and 1996 Insurance Agreements as well as Japan's WTO commitments related to insurance remain in force, and consultations will continue as called for under the agreements.

Largely as a result of the positive changes brought about by the 1994 and 1996 Agreements, foreign insurance companies have visibly and substantially increased their presence in both the life and non-life insurance sectors in Japan. While maintaining their strong third sector sales, U.S. and other foreign insurance companies have rapidly expanded their share in the primary sectors in recent years through product development and marketing innovations. It is estimated that foreign insurers in Japan currently hold about a 3.6 percent share of the total non-life insurance market and 5 percent of the total life insurance market. In the third sector, foreign firms have captured approximately 69 percent of the life market and about 17 percent of the non-life market, according to the most recent figures available. In addition, various new business tie-ups and a number of recent acquisitions in this sector involving foreign firms have significantly increased the foreign presence in Japan.

Despite recent noteworthy success in this sector under the bilateral insurance agreements, a variety of issues of key importance to U.S. insurance companies remain to be addressed. These include further regulatory reform plans related to the third sector and other areas of the Japanese insurance market. The U.S. Government continues to urge the Government of Japan to adopt the goal of increasing competition as one of the basic principles of regulatory reform and to provide the foreign and domestic insurance industry meaningful opportunities to be informed of, comment on and exchange views with Japanese officials regarding the development or revision of guidelines or regulations through such means as public comment procedures and participation on government advisory groups.

The most recent bilateral consultations under the insurance agreements were held in Japan in March 2000. The United States and Japan discussed administrative and regulatory changes in Japan's insurance sector, including issues related to Japan's product approval process and the availability of needed resources and technology within FSA. In light of the recent failures of prominent Japanese insurance companies, the United States and Japan also discussed recent changes related to the life and non-life Policyholder Protection Corporations, which are mandatory policyholder protection systems created by the Japanese Government in 1998 to provide capital and management support to insolvent insurers. U.S. insurers remain seriously concerned that they will be asked to make even higher contributions to these funds in the future. In addition, the United States raised concerns regarding the operations and future plans of Kampo. As in previous meetings, a U.S. regulator representing the National Association of Insurance Commissioners (NAIC), participated in discussions with FSA. The next annual consultations will be held in the spring of 2001 at which time the United States anticipates a full discussion of a wide range of issues.

In addition to the bilateral agreements on insurance, the United States and Japan have discussed various insurance-related issues within the context of the Enhanced Initiative. The United States welcomes the new commitments made by Japan in the area of insurance in the Third Joint Status Report, concluded in July 2000. These included the pursuit of further deregulation and transparency in the insurance sector, the adoption by the Japanese Government of a "no action letter" system to respond to various business queries, and an affirmation that the Government has no current plants to authorize sales of additional non-life insurance products by Kampo. In its October 2000 deregulation submission to Japan, the United States included specific new requests to Japan related to insurance. These focused on transparency in the regulatory reform process, curtailment of Kampo expansion, and the development of plans for the transition of the Postal Services Agency to a Public Corporation in 2003. These items have been and will continue to be discussed during various bilateral deregulation working and high-level meetings in the United States and Japan.

Professional Services

The United States continues to seek improved access for professional service providers in Japan through our bilateral public works agreements for construction, architectural, and engineering services; under the Enhanced Initiative for legal services; and in the WTO for a wide range of other services.

The ability of foreign firms and individuals to provide professional services in Japan is hampered by a complex network of legal, regulatory and commercial practice barriers. U.S. professional services providers are highly

competitive, and the United States expects the export of such services to continue to grow. These services are important, not only as U.S. exports, but as vehicles to facilitate access for U.S. exporters of other services and goods to the Japanese market. Moreover, U.S. services professionals often can contribute valuable expertise gained from broad experience in international markets and stimulate innovations for the economies they serve.

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. In Japan, regulated accounting services may be provided only by individuals qualified as Certified Public Accountants (CPAs) 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 in order 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, however, are not authorized to provide regulated accounting services. Nor can a foreign firm 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. The United States will continue to urge Japan to open this restricted market.

Legal Services: U.S. lawyers have sought greater access to Japan's legal services market and full freedom of association with Japanese lawyers (*bengoshi*) since the 1970s. However, strong opposition from the Japan Federation of Bar Associations (*Nichibenren*) and a reluctant Japanese bureaucracy have largely thwarted this objective.

Since 1987, Japan has allowed foreign lawyers to establish offices and advise on matters concerning the law of their home jurisdictions in Japan as foreign legal consultants (*gaikokuho-jimu-bengoshi* or *gaiben*), subject to restrictions in the Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers (Law No. 66 of 1986, as amended) (Foreign Lawyers Law). Since this Law was enacted, Japan has liberalized several restrictions on foreign lawyers, including: (1) allowing foreign lawyers to represent parties in international arbitrations in Japan; (2) reducing the experience required to register as a foreign legal consultant from five years to three years; (3) allowing foreign lawyers to count the time spent practicing the law of the lawyer's home jurisdiction in a third country toward meeting the three-year experience requirement; and (4) allowing both Japanese lawyers and foreign legal consultants, with certain restrictions, to advertise their services. However, Japan has adamantly refused to remove the most restrictive regulatory hurdle facing foreign lawyers in that country – the ban on hiring or forming partnerships with Japanese lawyers in Japan.

In its October 2000 submission to Japan under the Enhanced Initiative, the United States again stressed the need for Japan's legal service infrastructure to be capable of meeting the needs of Japanese and foreign persons and enterprises that are responding to the opportunities created by market liberalization, deregulation, and increased foreign direct investment into Japan. The United States pointed out that Japan's deregulation and restructuring process, e.g., in the financial services sector, will be seriously impeded if Japan continues to thwart the development of a globally competitive legal services sector in Japan. Both Japanese and foreign persons and enterprises must be able to obtain fully integrated transnational legal services for domestic and cross-border transactions.

Rather than allow Japanese attorneys and foreign lawyers to form full partnerships, as is the common practice in most other countries, Japan in 1995 authorized, through an amendment to the Foreign Lawyers Law, the establishment of an arrangement between Japanese attorneys and foreign lawyers that is unique to Japan – "specified joint enterprises" (*tokutei kyodo jigyo*). Despite an expansion in 1998 of the scope of work that may be undertaken by such enterprises, only a handful of foreign firms have created joint enterprises. Even those that have formed joint enterprises have faced difficulties and do not consider such enterprises a satisfactory alternative to partnerships.

The United States has made the removal of the ban on partnerships and employment a top priority, arguing that Japan should allow foreign lawyers and *bengoshi* to determine on their own the most appropriate form of association that will enable them to best serve their clients' needs. The United States also has stressed that the joint enterprise system does not serve as an adequate substitute for partnerships, nor can the system be adjusted to overcome its inherent defects. In spite of recommendations by the Government of Japan's Regulatory Reform Committee that Japan take steps to "enable foreign legal consultants and Japanese lawyers to provide legal services for any type of issues based upon a complete and comprehensive cooperative relationship," the Ministry of Justice has yet to take any steps toward removing the ban.

The United States also requested that Japan allow foreign lawyers full credit for experience in Japan toward the three-year experience requirement to register as a foreign legal consultant, and not just the one year allowed under current practice. The Ministry of Justice refuses to acknowledge the lack of rational basis for this practice, which renders experience in Japan less valuable than that gained in any other country. In its October 2000 Submission under the Enhanced Initiative, the United States urged Japan to increase the transparency and accountability of self-regulating organizations, including the Nichibenren.

The United States continues to seek the removal of discriminatory restrictions on foreign lawyers on providing advice on so-called "third country" law (that is, the law of a country other than the one that is a foreign lawyer's home jurisdiction). The United States also recommended that Japan increase the number of trainees admitted to the Japanese Supreme Court's Legal Research and Training Institute to no less than 1,500 trainees annually as soon as possible, and explore alternative ways of obtaining legal qualification other than the Institute. As of the beginning of 2000, the number of trainees had been increased to 1,000 per year, and the Ministry of Justice is considering further increases.

The United States continues to urge Japan to remove the ban on partnerships and employment, make the regulation of foreign

lawyers more transparent, and eliminate other unnecessary and unreasonable restrictions on legal services in Japan.

INVESTMENT BARRIERS

Despite its status as the world's second largest economy, Japan continues to have the lowest inward foreign investment as a proportion of total output of any major OECD nation. In JFY 1999, for example, Japan's annual inward foreign direct investment (FDI) totaled $21.5 billion, or only 0.5 percent of its GDP. Nonetheless, FDI in Japan is rising rapidly, albeit from a small base, up slightly more than 100 percent in JFY 1999 from the previous year's level. In the first half of JFY 2000 (April – September), FDI rose 42 percent as compared to the same period in JFY 1999 to a record $17.45 billion, driven by sizeable investments in Japan's financial services sector (which accounted for about 40 percent) and telecommunications sectors (about 38 percent). In the first half of JFY 2000, there were 853 cases of foreign direct investment, up 130 from a year before. Foreign participation in the field of mergers and acquisitions (M&As) also lags in Japan, as compared to other OECD countries, although there is an upward trend. In 1999, there were 1,169 cases of overall M&A recorded (129 of these cases were "out-in" M&A transactions), up from 834 the previous year. 2000 saw a record 1,635 announced mergers and acquisitions involving Japanese companies (175 cases involved "out-in" transactions).

Japan's outward investment flows continue to dwarf investment into Japan, but the gap between outward and inward FDI is narrowing. The ratio of outward FDI to inward FDI averaged 11-to-1 between 1990 and 1996, then shrunk to 3.9-to-1 in JFY 1999. JFY 1999 outward investment was $66.6 billion, up from the previous year's level of $40.7 billion. However, the first six months of JFY 2000 saw a contraction in Japan's outward investment, which declined 48 percent to approximately $25 billion, as compared to the year before.

Although most direct legal restrictions on FDI have been eliminated, bureaucratic obstacles remain, including the occasional 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. More than government-related obstacles, however, Japan's low level of inward FDI flows reflects the impact of exclusionary business practices and high market entry costs.

Difficulty in acquiring existing Japanese firms – as well as doubts about whether such firms, once acquired, can continue normal business patterns with other Japanese companies – make investment access through mergers and acquisitions more difficult in Japan than in other countries. However, the pressure of economic restructuring and the surge in M&As have weakened to a degree *keiretsu* relationships. U.S. investors cite the lack of financial transparency and disclosure and differing management techniques among the obstacles to realizing M&As in Japan. The scarcity of personnel resources experienced in M&A activities, namely lawyers, auditors, and accountants, also inhibit foreign direct investment.

In July 1995, the United States and Japan concluded an arrangement entitled "Policies and Measures Regarding Inward Direct Investment and Buyer-Supplier Relationships" that describes the inward FDI promotion policies instituted by Japan during the course of the Framework Agreement investment negotiations. The arrangement committed Japan to: (1)

expand efforts to inform foreign firms about FDI-related financial and tax incentives and broaden lending and eligibility criteria under these programs; (2) make low interest loans and tax incentives under the 1992 Inward Investment Law available to foreign investors; (3) propose measures to improve the climate for foreign participation in M&As; and (4) strengthen the FDI promotion roles of the JIC, Office of Trade and Investment Ombudsman, JETRO, and the Foreign Investment in Japan Development Corporation.

After the signing of the Investment Arrangement, the bilateral discussions of the Investment Working Group have focused more broadly on needed changes in the basic operating rules of Japanese markets, in order to encourage policy changes that will help improve Japan's overall environment for foreign (and domestic) investment. More specifically, the United States has urged Japan to consider measures that will assist with three key aspects of improving Japan's direct investment environment, including: (1) developing a more active and efficient market for M&As in order to enhance the productivity of capital in Japan; (2) improving land market liquidity and foreign investors' access to land; and (3) increasing the flexibility of Japan's labor markets.

In the area of mergers and acquisitions, U.S. proposals have included: (1) allowing consolidated taxation in order to spur investment by lowering the post-tax cost to a parent firm of investing in new risk ventures; (2) taking steps to unwind extensive cross-shareholding in Japan; (3) improving corporate governance practices in order to mitigate senior management emphasis on firm loyalty over shareholder return, which can lead to premature rejection of M&A offers; (4) continuing with financial market deregulation, such as allowing stock-for-stock transactions and easing stock market listing requirements; (5) improving financial data disclosure to assist firms interested in pursuing M&A relationships with other firms; (6) increasing the availability of M&A-related services, including further easing of restrictions governing the accounting and legal professions; and (7) introducing smoother and more flexible bankruptcy procedures to make it easier for a corporation and its assets to be acquired or merged in a "rescue" format.

U.S. proposals addressing land and real estate transactions focused on improving land market liquidity, and included: (1) undertaking additional land tax relief measures and steps to further shift the burden of land taxation from acquisition taxes to holding taxes; (2) easing regulations on developing property in central urban districts as well as relaxing restrictions on the conversion of agricultural land; (3) changing leasing rules to allow new investors to make flexible use of acquired property; (4) making systematic disclosure of information on real estate transactions; and (5) making changes to the Special Purpose Corporation (SPC) Law and other related regulations to facilitate the creation of real estate investment trusts (REITs).

Finally, the United States stressed the need to improve labor mobility in Japan, recommending that Japan: (1) introduce defined contribution pension plans as a useful way to improve pension portability; (2) deregulate fee-charging employment agencies in order to assist foreign investors in locating needed local talent; (3) liberalize Japan's labor dispatching business in order to help new investors find workers and cut costs, as well as help unemployed workers find work; and (4) ease excessively tight regulations concerning work rules, as well as other bureaucratic procedures which unnecessarily raise costs and lower the efficiency of corporate operations.

At the May 1999 U.S.-Japan Summit, the Investment Working Group presented the

"Report to the President and Prime Minister on the Environment for Foreign Investment in Japan and the United States." The report reviewed key issues and the progress the Government of Japan has made in improving Japan's investment climate. The report also committed the two Governments to continue to exchange information and consult on investment matters.

In the months since the report was submitted, Japan has enacted new and revised legislation which will provide opportunities for foreign investors in the M&A field, including the Industrial Revitalization Law, which provides existing firms undergoing reorganization (both domestic and joint-venture) with tax and credit relief once the firm's business restructuring plan is approved by the Government. A new bankruptcy law (the Civil Reconstruction Law) also may provide investment opportunities as it encourages business reorganization, including spin-offs, rather than forced liquidation of assets. Other legislative changes now provide for stock-for-stock swaps, a major vehicle for M&As, as well as stock options for employees, a key issue for foreign firms wishing to attract high quality employees. In addition, the Government of Japan prepared legislation on corporate divestiture that will facilitate companies' streamlining efforts. New accounting rules are bringing Japan closer to international standards and to a degree have helped reduce extensive cross-shareholding among firms, as the new accounting rules identify non-performing assets and liabilities. While U.S. businesses have applauded these changes, they continue to urge that Japan's tax regulations be clarified and amended to facilitate use of these measures.

The United States and Japan held a joint conference on FDI and M&As in Japan on March 1, 2000, with active participation from the private sector and relevant Japanese ministries. An audience of about 560 United States and Japanese business representatives provided convergent views and detailed suggestions on the need for Japan to increase corporate governance and regulatory transparency, improve accounting and disclosure standards and improve real estate liquidity and labor mobility as means of facilitating both domestic and foreign investment. Both business communities also called for the early introduction of consolidated corporate taxation to assist in spin-offs and new acquisitions. The Department of State and MITI presented the results of the conference to the U.S. President and Japanese Prime Minister before the G-8 Leaders in Okinawa, Japan in July.

In addition, Japan announced in April 2000 that it would undertake sweeping reforms of its commercial code, the first such comprehensive undertaking of the Meiji-era legislation. This initiative was widely welcomed by both domestic and foreign businesses as substantive reforms could lead to more rationalization and efficiency in capital markets and to badly-needed change in the area of corporate governance (see separate NTE section on the Commercial Code).

ANTI-COMPETITIVE PRACTICES

Anti-competitive practices are a cross-cutting issue in U.S.-Japan trade relations. In addition to this section, there is detailed discussion related to anti-competitive practices and Antimonopoly Act (AMA) enforcement in several other sections, particularly under Structural Deregulation.

Exclusionary Business Practices: U.S. 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:

- Anticompetitive private practices that violate the AMA but go unpunished;
- Corporate alliances and exclusive buyer-supplier networks, often involving companies belonging to the same business grouping (*keiretsu*);
- Corporate practices that inhibit foreign direct investment and foreign acquisitions of Japanese firms (e.g., non-transparent accounting and financial disclosure, high levels of cross-shareholding among *keiretsu* member firms, low percentage of publicly traded common stock relative to total capital in many companies, and the general absence of external directors);
- 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 business practices exact a heavy toll on the Japanese economy. For example, many products and services cost substantially more – often by multiples of two or greater – in Tokyo than in other international cities. By constraining market mechanisms, exclusionary business practices reduce the choices available to businesses and consumers, and raise the cost of goods and services. In addition, by discouraging competitors who seek to break into Japan's market with innovative products and services, these practices impede the development of new domestic industries and technologies. Such practices discourage potential foreign investors, whose market presence and technological innovation would stimulate the economy and provide critical channels for exports and sales by foreign firms.

Law Against Unjustified Premiums and Misleading Representations: The JFTC imposes overly restrictive limits on the use of premium offers (prizes) and other sales promotion techniques, and thereby discourages even legitimate cash lotteries and product giveaways used in such promotions. Foreign newcomers, who depend on innovative sales techniques to market their company names and products, are significantly impaired by the JFTC's restrictions on premiums. In addition, the JFTC allows "fair trade associations" (essentially, private trade associations) to set their own promotion standards through self-imposed "fair competition codes." Trade associations can, and often do, use the cover of these codes to adopt additional standards that are stricter than required by JFTC regulations under the Premiums Law and have the effect of restraining vigorous competition. The United States continues to urge Japan to review the necessity of §10-5 of the Premiums and Misrepresentations Law, which provides an exemption for fair trade associations from the AMA, with a view towards abolishing that provision.

As of January 2001, there were 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 10 million yen; repealing restrictions on premiums offered by department stores; and eliminating the 50,000 yen ceiling on consumer premiums (while retaining caps on the value of premiums as a percentage of the transaction value). Moreover, over the last two years, the JFTC abolished 24 of 29 industry-specific regulations that imposed stricter than normal

premium limits. The five industries that remain subject to stricter rules are real estate, household electrical appliances, newspapers, magazines, and hospital management. However, the JFTC changes fall short of the dramatic, pro-competitive liberalization measures requested by the United States under the Enhanced Initiative.

ELECTRONIC COMMERCE

As the second largest economy in the world and the nation with the second largest electronics industry in the world after the United States, Japan is an important market for electronic commerce and a key player in international discussions regarding the regulatory framework for global electronic commerce and the Internet. Japan has, in its policy statements and its regulatory actions to date, endorsed an open, private sector-led and minimally regulated environment for the Internet and electronic commerce.

Nonetheless, the development of both the Internet and electronic commerce lags in Japan compared with other developed countries, with only about a 31 percent of households in Japan with Internet connections in 2000, compared to just over 50 percent in the United States. While the number of Internet users in Japan is on the rise, the United States continues to work with Japan to ensure robust growth in this critical sector, specifically by targeting the high cost of accessing the Internet in Japan. The cost of Internet access in Japan has been estimated by the OECD in 2000 to be double that of the United States, New Zealand, and Canada and four times more expensive than in Korea (for 20 hours, off peak). These charges are a result of the market access barriers to Japan's telecommunications sector (see "Sectoral Deregulation" section of this chapter), and are currently being addressed by the United States and Japan under the Enhanced Initiative.

As Japan moves ahead with its recent determination to achieve an IT revolution within five years, the United States has urged the Japanese Government to rely on the key principles reflected in our Joint Statement on Electronic Commerce at the Birmingham Summit in May 1998, and reaffirmed in the July 2000 Okinawa Charter on Global Information Society. Included among the key principles are that: (1) the private sector should lead in the development of electronic commerce; (2) governments should encourage industry self-regulation; and (3) government regulation, where necessary, should be minimal, transparent, and predictable.

While supporting these general principles, Japan has also been working on specific policy areas. The most notable area is legislation on digital signature passed by the Diet in May 2000. The law sets up a system for certifying agencies to grant digital signatures, which in some cases can substitute for written signatures or seals. In December, public comments were solicited on the issues to be included in the implementing ordinances of the Law on Digital Signatures. U.S. concerns expressed in those comments include the need to clarify whether the law covered both digital signatures of individuals as well as those arising in business-to-business ("B2B") electronic commerce transactions, to clarify what legal status electronic documents using digital signatures have compared to a handwritten signature and/or seal, and to avoid specifying particular technology – in this case for authentication – in the regulations. The United States will be closely monitoring the progress of this legislation.

The Japanese Government is currently drafting legislation on personal data protection to be submitted to the Diet this year. Through discussions under the Enhanced Initiative, the United States has urged that in its legislation, the Japanese Government strike a careful

balance between protecting consumers and the free flow of data that is needed for e-commerce to flourish. The United States has also urged the Japanese Government to issue this and any other draft regulations for public comment.

The United States will continue to work with Japan on these and other electronic commerce issues (e.g., intellectual property protection on the Internet, consumer protection, and electronic payment systems) and to monitor the development of electronic commerce and the Internet in Japan to ensure that Japanese Government-funded test-bed projects for electronic commerce continue to be fully open to participation by U.S. firms and that standards and technologies for electronic commerce and the Internet remain open and internationally interoperable. The United States will also monitor actions by regulators such as MPHPT (e.g. regarding licensing requirements and restrictions on new standards and technologies) to ensure that such actions promote a liberal environment for the growth and development of electronic commerce in Japan.

OTHER BARRIERS

Aerospace

Japan is the largest foreign market for U.S. aircraft and aerospace products, and many Japanese firms have entered into long-term and productive relationships with American aerospace firms. Nonetheless, the United States is continuing to closely monitor several aspects of U.S.-Japan aerospace trade.

Among these is the Japan Defense Agency's general preference for licensing foreign technology for production in Japan, which has resulted in lower U.S. defense aerospace exports than would occur in a more market-driven environment. With respect to commercial aerospace, the United States is monitoring METI's active role in supporting the domestic aerospace industry, funding feasibility studies for new projects and technologies, and the important role it plays in the apportioning of work among the major Japanese aerospace companies. We also are closely watching the role that the Japan Defense Agency plays in the development of defense aerospace projects, which have resulted in a significant transfer of U.S. aerospace technology to Japan and positioned Japan to become a major supplier of parts and components to foreign aircraft assemblers.

With respect to space systems, the United States is monitoring Japan's efforts to develop indigenous systems, which may limit the procurement of proven U.S. technology and products. The United States will 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 United States will continue to monitor developments to ensure that the Japanese aerospace market remains open and that Japanese Government actions do not discriminate against U.S. aerospace firms.

Autos and Auto Parts

The 1995 U.S.-Japan Automotive Agreement sought to eliminate market access barriers and to significantly expand sales opportunities in this sector. Under the agreement, which expired on December 31, 2000, Japan 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. and other competitive foreign automotive parts suppliers to Japan's repair market. The agreement included 17 objective criteria by which the United States and Japan were to evaluate progress. Coincident with the conclusion of the agreement, the five major Japanese auto manufacturers announced plans to increase purchases of foreign auto parts in Japan and expand production of vehicles and major components in the United States.

The U.S. Government attached high priority to vigorous implementation of the Automotive Agreement, given this sector's importance to the U.S. economy. To monitor implementation and assess progress achieved under the agreement, an Interagency Enforcement Team, led by the Office of the U.S. Trade Representative and the Department of Commerce, was established. This team has prepared various reports evaluating progress since the agreement was concluded. The sixth and most recent of these reports was issued in June 1999.

Although the agreement yielded some positive results, such as the deregulation of repair garages and in the areas of standards and certification, in the later years of the agreement the United States seriously questioned the lack of sustained progress toward achieving the agreement's key objectives. The United States conveyed specific concerns to Japan most recently during the fifth annual review of the Automotive Agreement held in Seattle in November 2000. These concerns were echoed by representatives from the European Union, Canada, and Australia, observers to these consultations. The United States and the observer countries called upon Japan to take additional, concrete actions to ensure continuing improvements in market access and sales opportunities in the Japanese automotive market, including immediate, substantial deregulatory and market-opening action to foster domestic demand-led growth in the Japanese economy.

Vehicles: Sales in Japan of motor vehicles produced by Daimler Chrysler, Ford, and General Motors in North America continued to decline in 2000, with their combined sales falling 12 percent compared to 1999 levels. This decline came on the heels of back-to-back, year-on-year declines of 20 percent in 1999 and almost 35 percent in 1998. Today, American car makers sell fewer vehicles in Japan than they did before the Agreement was signed. Structural changes in the automotive industry have led U.S. companies to alter their sale and distribution strategies in Japan. Nonetheless, foreign access to Japan's automotive distribution network has continued to be of concern as U.S. auto companies have worked to strengthen their dealership networks and increase alliances with Japanese companies.

Auto Parts: U.S. auto parts exports to Japan rose to $2.2 billion in 2000 from $1.7 billion in 1995, but figures for 2000 remain below the record 1997 levels of $2.3 billion. While auto parts exports rose steadily and significantly in the first few years of the agreement (20 percent per year from 1993 to 1997), they declined significantly in 1998 and 1999 before rising again in 2000. In addition, actual U.S. aftermarket parts sales to Japanese auto companies in the U.S. and Japanese auto companies in Japan remain low.

The auto trade imbalance rose from $33 billion in 1995 to slightly over $44 billion in 2000, amounting to approximately 54 percent of the overall U.S.-Japan deficit. These trends in the bilateral automotive trade have raised serious concerns about the need for further market-opening efforts by Japan. To address these concerns, in the fall of 2000, the United States initiated a series of negotiations with Japan on the future of the bilateral Automotive

Agreement. Taking into account the significant changes that have taken place in the global automotive market in the last several years, the U.S. Government proposed a five-year, follow-on agreement that was based on the 1995 Agreement and incorporated additional measures to be undertaken by Japan to eliminate remaining market access barriers in the sector, in such areas as deregulation, transparency, and competition policy. The Government of Japan did not accept the U.S. proposal, and as a result, the 1995 Agreement expired on December 31, 2000.

Civil Aviation

On March 14, 1998, the United States and Japan signed a Memorandum of Understanding (MOU) which promised to significantly expand civil air services between the United States and Japan and set the stage for further liberalization. The agreement removed all restrictions on U.S.-Japan services of so-called "incumbent" carriers – United Airlines, Northwest Airlines, and Federal Express for the U.S. side – that operate from any U.S. gateway point to any point in Japan and beyond Japan to third countries, without limitation on the number of flights. It also allowed the United States to designate two additional passenger carriers to serve Japan.

Moreover, U.S. "non-incumbent" combination carriers (carriers that carry both passengers and cargo) now serving Japan – American Airlines, Delta Airlines and Continental Airlines, along with the two newcomers – could add up to 90 more weekly round-trip flights to their current total of 46, nearly tripling access to Japan's huge aviation market. Non-incumbent all-cargo carriers United Parcel Service and Polar Air Cargo gained new operational flexibility, creating valuable new opportunities to transport cargo to destinations beyond Japan. In 2002, another U.S. all-cargo carrier could enter the market.

The MOU allowed, for the first time, extensive code-sharing between U.S. carriers, United States and Japanese carriers, and United States and third country carriers on services between the United States and Japan and beyond Japan. On charters, the MOU provided for each party to provide up to 600 charter flights per year beginning January 1, 2000. This will rise to 800 flights per year in 2002. Distribution and pricing provisions of the new MOU promote competition, and Japan has guaranteed U.S. carriers fair and equal opportunity to contract with wholesalers and travel agents and set up enterprises to market their services directly to consumers. Implementation of the MOU proceeded smoothly in 1999 and 2000. The economic slowdown in Japan and much of Asia affected U.S. carriers in Japan, though demand for frequencies and slots remained high. The scarcity of slots and inadequate facilities at Narita Airport was one blemish on the otherwise positive bilateral relationship. U.S. non-incumbent combination carriers currently cannot operate approximately 40 frequencies per week allotted to them because slots are not available.

As stipulated by the MOU, a new round of talks aimed at "full liberalization" began in November 2000. It was agreed that if these talks do not achieve a fully liberalized agreement, additional benefits will take effect automatically in phases beginning on January 1, 2002. The U.S. is committed to seek further liberalization in line with a global policy of promoting "Open Skies" to minimize government interference in civil aviation, and to provide full and equal opportunities for U.S. and foreign passenger and cargo carriers to compete in each other's market. Bilateral talks will continue in 2001 concerning "Open Skies," slot availability and allocation, and plans to internationalize Haneda Airport.

Narita Airport

The problem of scarce slots and inadequate facilities at Narita Airport became more acute in 2000. Some U.S. carriers have expressed concern that without additional landing slots, larger facilities, and lower landing fees, they will not be able to take full advantage of the current liberalized agreement. A new runway, scheduled to open in 2002, will provide 176 additional daily landing slots, but its limited length will restrict the types of aircraft that can utilize it. The U.S. government is working to ensure that U.S. carriers have fair and equal access to landing slots on the new runway without losing their rights to slots on the old runway. In addition, landing fees at Japan's major airports are as much as five times as high as other major international airports. U.S. and foreign airlines have requested a reduction in fees after the construction of the new runway is complete.

Direct Marketing

In recent years, direct marketing has become an increasingly popular way to sell housewares, personal care products, and health supplements in Japan at a discount compared to prices in local retail stores and has proved to be an effective means of distributing U.S. exports throughout Japan. Local distributors, who are largely part-time independent workers, such as housewives and older people, also can use direct marketing to supplement their family incomes. METI regulates these activities through enforcement of consumer protection laws that prohibit fraudulent or misleading sales practices.

A $22 billion Japanese catalog sales market registered an increase of 4.1 percent in JFY 1999. As part of total direct marketing sales, Internet sales direct to consumers (B2C), while still small in terms of total sales, have expanded rapidly to $3 billion in 1999. The most successful B2C mall, Rakuten, featured 5,400 tenant shops as of January 2001. An optimistic industry forecast is a $32 billion market for B2C in 2003.

The Internet is changing the nature of the direct marketing business. Japanese B2C and business-to-business (B2B) catalog sales are far behind those of the United States, partly because more personal attention by company sales agents were traditionally demanded by client companies in Japan. However, as Japanese business customers become more price-sensitive and are willing to switch to new suppliers, aided in part by improved online services and a reduction in telecommunications costs, they are more prone to switch to Internet shopping.

Electric Utilities

The cost of electric power in Japan is the highest in the industrialized world. The United States believes that one of the most effective ways for Japan to reduce costs in this sector would be to introduce genuine competition into non-fuel procurement, which presently is valued at approximately $17 billion annually.

In general, many utilities have made efforts to increase imports and reduce costs. Some have increased the number of registered companies as potential suppliers and improved the level of procurement information accessible in Japanese and English through the Internet. All the utilities are actively participating in the New Orleans Association (NOA), a U.S. Embassy-sponsored forum that both enhances communication between the Japanese electric power firms and U.S. suppliers of non-fuel materials and equipment and explores business opportunities. While some firms have significantly improved procedures for international procurement, others have lagged behind. The U.S. Government urges Japanese utilities to continue to increase foreign procurement, especially when foreign products prove more economical.

Utilities in Japan have made notable efforts to expand foreign procurement of telecommunications-related products. Since 1994, Japan's electric utilities and their affiliated telecommunications subsidiaries have actively participated in U.S. Embassy sponsored "Onsen Communication" seminars. This program of technical seminars and private meetings has provided U.S. firms with significant access to the technical and procurement staffs of the utilities.

Foreign firms still face barriers due to standards and specifications used by Japanese utilities that often discriminate against and/or disproportionately burden foreign suppliers. Problems remain in the use of narrow, dimension-based technical standards rather than performance-based technical standards, and requirements that suppliers provide detailed information for spare parts originating from outside sources. As each utility uses its own specifications, suppliers have to prepare ten production lines in order to sell their products to the ten electric power companies. Although several utilities are moving to unify their specifications and comply with world standards, this is still a long-term project.

The United States is also seeking greater transparency and fairness in the procurement process. Costly and time-consuming procedures are generally required for a firm to be added to the list of designated suppliers for a particular utility, 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. To expand international procurement to reduce costs, it is important for the utilities to publish specifications in English and accept offer sheets, drawings, explanatory documents, and contract sheets in English.

Some products new to Japan -- although they are widely used in other parts of the world -- have been undergoing safety tests by the utilities for more than three years. In general, utilities' international procurement groups are pro-active in introducing overseas products, but engineering departments are more conservative and closed to foreign suppliers. This gap in attitude between the two departments often frustrates foreign suppliers.

Flat Glass

Despite U.S. flat glass manufacturers' extensive experience and success in other countries and many years of active efforts in Japan, they have failed to break the stranglehold of Japan's flat glass oligopoly.

The flat glass industry has been hit hard by Japan's economic recession. Despite fluctuations in Japan's flat glass market over the past 30 years, the market share of the three domestic producers has remained virtually unchanged. They exert tight control over distribution channels in many ways, including majority ownership, equity and financing ties, employee exchanges, and purchasing quotas. At the same time, they change prices, capacity, and product mix in virtual lockstep, thereby maintaining their market shares with little variation. Asahi Flat Glass controls over 40 percent of the market, Nippon Sheet approximately 30 percent, and Central Glass about 20 percent. Imports, including those by U.S. manufacturers, represent the remainder.

In January 1995, the United States and Japan concluded an agreement to open Japan's flat glass market to foreign suppliers. Japanese glass distributors stated that they would diversify supply sources and would not discriminate among suppliers based on capital affiliation. Japanese glass makers expressed support for diversifying their distribution

networks. The agreement also committed the Government of Japan to encourage the selection of flat glass for public works projects and promote the use of insulated and safety glass. An annual survey was undertaken to assess the openness of the distribution system.

The agreement had some success. For example, it resulted in Japan's adoption on March 30, 1999, of energy conservation standards for both residential and commercial buildings. These standards will raise the energy efficiency of glass installed in new residential structures by 20 percent and in commercial structures by 10 percent. The changes will result over time in increased demand for insulated glass. The agreement also prompted Japan to feature American glass in a number of high-profile public works projects.

However, U.S. and other foreign glass manufacturers still have a minuscule share of Japan's flat glass market, despite the fact that Japanese firms and distributors readily acknowledge the competitive quality and lower cost of American glass. U.S. firms report that their market share of construction-related flat glass has not increased over the last five years. In total, foreign companies supply about seven percent of Japan's flat glass market. In most other major industrial markets, including the United States and the EU, the market share of foreign-owned companies (via imports and in-country production) is more than five times the level in Japan. In addition, import figures in Japan are skewed by imports from foreign subsidiaries of Japanese manufacturers.

The domination by domestic flat glass manufacturers of local distributors shows no sign of abating and may be on the rise. Manufacturers are using Japan's recession and the resulting tight credit market to strengthen their financial hold on the most important glass distributors. In some cases, they assign their own employees to run the distributorships.

A survey undertaken by the JFTC and published on May 20, 1999, found no practices in violation of Japan's antitrust laws. Nevertheless, the JFTC noted the dominant position enjoyed by the three domestic firms in the flat glass market, pointed to a number areas of possible serious concern, and stated its intention to continue its surveillance of the industry. On December 21, 1999, the JFTC issued a formal decision against a Japanese auto glass association and a subsidiary of Japan's largest flat glass manufacturer, and issued warnings about the same behavior to three other industry associations. These organizations decided that members should not carry imported auto glass, and enforced that decision through threats of supply disruption for members who did not comply.

The U.S.-Japan Flat Glass Agreement expired on December 31, 1999. The U.S. and Japan held discussions in March 2000 but could not come to agreement on a bilateral course of action. The U.S. Government then included the competition policy and distribution problems that U.S. flat glass exports have in Japan in its October 2000 submission to the Japanese Government under the Enhanced Initiative. The proposals, included in the distribution and competition policy sections of the submission on structural reform, urged that METI, in conjunction with the JFTC, monitor fully the Japanese flat glass manufacturers and the glass distribution system to ensure compliance with the Anti-Monopoly Act (AMA) and to promote competition in this sector. The United States is working with American glass manufacturers to promote specialty glass that could be used in the construction of new buildings in Japan. The U.S. Government will continue to monitor closely the flat glass industry and urges the Japanese Government to promote competition and eliminate unhealthy oligopolistic behavior

in this sector.

Paper and Paper Products

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

Through 2000, there has been no meaningful increase in Japanese imports of paper and paperboard products, and the level of import penetration for paper and paperboard products in Japan remains the smallest in the industrialized world. According to U.S. producers, exclusionary business practices remain a key problem. U.S. negotiators have discussed competition issues affecting this sector under the Enhanced Initiative's structural issues working group, which takes up AMA enforcement and competition policy.

Consumer Photographic Film and Paper

There has been a long history between the United States and Japan on this issue, particularly regarding lingering concerns related to foreign access to the Japanese photographic film and paper sector. However, there have been some positive developments in this sector recently, including new opportunities for business tie-ups between foreign and Japanese firms. As part of its strategy to increase its presence in the Japanese market, for example, Eastman Kodak Company announced plans to form a joint venture with Mitsubishi Paper Mills Ltd. with respect to photographic goods and photo processing in Japan. The joint venture is expected to provide both companies with strategic and financial benefits as well as improved operating efficiencies in this difficult-to-penetrate segment of the Japanese market. Kodak will have a majority equity share in the tie-up which is expected to be operational in early 2001. The joint venture will have the number two market share position for color photographic paper in Japan, with about one-fifth of the market. The U.S. Government hopes that this signals a lasting improvement in the environment for foreign firms doing business in this sector as well as for foreign investment throughout the Japanese economy. The U.S. Government will continue to monitor whether the Japanese Government undertakes further efforts to encourage business tie-ups between Japanese and foreign firms and whether firms acquired by foreign companies can continue normal business relationships with other Japanese companies in this and other sectors.

Despite such new opportunities, foreign photographic film and paper manufacturers continue to face significant barriers in their efforts to gain access to the Japanese market. Many of the lingering problems in the Japanese photographic film and paper market are a result of a continuation of business practices that limit access to traditional distribution channels and continued government regulatory restrictions. These practices were the subject of WTO dispute settlement procedures initiated by the United States against Japan in 1996, which the EU and Mexico joined as third parties. During the WTO case, the U.S. Government offered

documentation indicating that the Government of Japan built, supported, and tolerated a market structure that impeded U.S. exports of consumer photographic materials to Japan, and in which restrictive business practices occurred that also obstructed exports of these products to Japan. Although the WTO Panel failed to find Japan in violation of its GATT obligations, the United States believes that the core issues raised by the United States, particularly the combined effects of the numerous measures Japan imposed to protect its market, are valid and still need to be addressed fully by the Japanese Government.

Since the disappointing WTO decision, the U.S. Government, through an interagency monitoring and enforcement committee, has carefully reviewed Japan's implementation of its formal representations to the WTO regarding Japan's efforts to ensure openness to imports of photographic film and paper. The committee has routinely surveyed the Japanese photographic film and paper market and gathered information and data obtained from U.S. and other foreign film manufacturers as well as the Government of Japan and has published its findings in periodic monitoring reports.

The continued view of the committee is that further action by the Japanese Government to foster competition and enhance market access in the film and paper sector remains critical, as the U.S. Government continues to receive a variety of reports regarding specific cases of potentially problematic business practices in this sector. In particular, the Japan Fair Trade Commission (JFTC) and Ministry of Economy, Trade and Industry (METI), should take steps to open Japan's distribution system by investigating complaints of anticompetitive behavior, discouraging practices that restrict the establishment of large-scale retail outlets, and ensuring that competitive opportunities in Japan's film and paper sector are consistent with Japan's representations to the WTO. U.S. Government officials have raised these and related concerns with their Japanese counterparts on numerous occasions, including under the Enhanced Initiative.

The U.S. Government remains committed to improving market access for U.S. film manufacturers in Japan, and will continue to press Japan to take further concrete actions to deregulate, actively promote competition, and increase market access for foreign firms.

Sea Transport and Freight

American carriers serving Japanese ports have encountered for many years a restrictive, inefficient and discriminatory system of port transportation services. After the Federal Maritime Commission assessed a $100,000 fee in 1997 on each port call by Japanese shipping lines, an exchange of letters between the governments of the United States and Japan promised substantial Japanese port deregulation. The understanding noted two agreements among the Government of Japan, foreign shipowners, Japanese ship owners and the Japan Harbor Transport Association, in which they committed to improve the prior consultation system and to establish an alternative method to the system.

In May 2000, the Diet approved amendments to the Port Transportation Law incorporating recommendations of the Harbor Transport Subcommittee of the Ministry of Transport. There is no longer an economic needs test for new applicants and fees no longer need to be approved by the government. The revisions, however, still have cumbersome administrative requirements and give the government wide

authority to intervene in pricing decisions of terminal operators. In addition, the law increases the required minimum number of employees by 50 percent, which may have the effect of forcing stevedores to hire excessive labor. The Ministry of Transport has not addressed concerns raised about the prior consultation process or about the threat of illegal strikes. The United States will track how these changes affect port operations and urge faster deregulation in the port sector.

Motorcycles

On October 1, 2000, Japan raised the maximum motorway speed limit for mini-cars and motorcycles to match the full-size automobile speed limit of 100km/hour. This resolved a U.S. complaint first raised with the Government of Japan in 1994.

Japan's ban on tandem riding of motorcycles (carrying a passenger) on motorways is the only remaining restriction on motorcycling in Japan that the U.S. Government now seeks to eliminate. The ban artificially limits Japan's market for large-class motorcycles, adversely affecting U.S. exports. Even more importantly, by forcing riders to use less-safe ordinary roads, the ban significantly reduces the safety of motorcycling in Japan. In March 1994, the United States first appealed to Japan to remove this burdensome restriction and, in June 1999, the U.S. Department of Commerce and U.S. Embassy Tokyo filed a formal petition with Japan's Office of Trade and Investment Ombudsman (OTO). To support its petition, the United States presented testimony and evidence at a November 1999 OTO hearing on the issue. This evidence included data compiled by the independent research firm Dynamic Research Institute that proved: 1) motorways are safer than ordinary roads; and 2) passenger-carrying motorcycles have a much better safety record than single-rider motorcycles. Despite this compelling evidence, so far Japan's National Police Agency has been hesitant to call for any revision of the law. However, the OTO and Government of Japan continue to consider the U.S. petition and evidence and are currently conducting their own survey of motorcycling and tandem riding in other countries. Their findings should be announced in early 2001.

Semiconductors

One area in which the Governments of the United States and Japan have made progress in addressing trade problems is semiconductors. After many years of effort by both Governments as well as their respective semiconductor industries, substantial progress has been achieved in both the level of industry cooperation and market access. Japanese purchases of foreign chips have been around 30 percent for several years. The 1996 bilateral Semiconductor Agreement expired on July 31, 1999, and was replaced by a multilateral Joint Statement on Semiconductors announced by the United States, Japan, Korea, and the European Commission. Taiwan subsequently became a party. The new statement is designed to ensure fair and open global trade in semiconductors and includes the essential elements of the 1996 accord, such as regular meetings among governments and between government and industry representatives. The United States will, however, continue to monitor foreign market share in the Japanese market on a quarterly basis, and once a year will report the average foreign share in the Department of Commerce "U.S. Industry and Trade Outlook." Governments and industries meet annually to review progress under the joint statement. The United States will host the next meeting in June 2001.

Steel

The U.S. steel industry endured tremendous

hardship in 1998 as a sudden and substantial drop in demand for steel in Japan and the rest of Asia created a huge oversupply, much of which Japanese companies diverted to the U.S. market. Japan was the main source of imports to the U.S. market in 1998. While U.S. imports of steel from Japan in 1999 and 2000 were down significantly from 1998 levels, the underlying causes of the surge should be addressed to ensure that this is not repeated in the future.

U.S. steel producers often have expressed concerns that Japanese steel companies may be engaging in anti-competitive practices. With respect to Japan's domestic market, it is alleged that Japan's five integrated producers coordinate output, pricing, and market allocation goals – all with the knowledge of MITI (now METI). In addition, it is alleged that Japanese mills have entered into a series of arrangements with foreign counterparts to regulate bilateral steel trade.

In August 1999, the U.S. Government announced that it would undertake bilateral initiatives with steel exporting nations, including Japan, to address a broad range of practices that support economically unjustifiable capacity. The United States launched a steel dialogue with Japan in September 1999 that continued through 2000. The objectives of the dialogue are to review conditions of steel industries in the two countries, promote market-based trade in a competitive environment, and exchange views on policies affecting the steel industries in the two countries, and on possible approaches to global overcapacity through multilateral fora.

The United States has used the bilateral dialogue to raise its concerns, especially regarding possible obstacles to competition and restructuring in Japan's steel market. These concerns were detailed in Global Steel Trade: Report to the President; released in July 2000. The report documented the role of the Japanese imports in the 1998 steel crisis and the underlying structural distortions in the Japanese steel industry that exacerbated the crisis. Specifically, the report cited substantial information indicating the apparent market coordination among major integrated steel producers; a protected home market with relatively high prices and very low levels of imports due to tight control over steel distribution channels; and an onerous product certification process for steel imports. The United States has expressed concerns about these alleged activities to Japanese officials and has urged them to deal vigorously and effectively with any such activities. The United States will continue to actively address any anti-competitive activity, market access barriers, or market distorting trade practices in the steel sector.