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TRADE SUMMARY

The U.S. trade deficit with Japan totaled \$66.0 billion in 2003, a six percent decrease from 2002. During 2003, two-way goods trade between the United States and Japan was \$170 billion, a two percent decrease from 2002. U.S. goods exports to Japan totaled \$52.1 billion, a 1.2 percent increase from 2002. U.S. goods imports from Japan decreased in 2003 to \$118 billion, a 2.8 percent decrease from the previous year. Japan is currently the 3rd largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Japan were \$29.7 billion in 2002 (latest data available), and U.S. imports from Japan were \$17.3 billion. Sales of services in Japan by majority U.S.-owned affiliates were \$35.4 billion in 2001 (latest data available), while sales of services in the United States by majority Japanese-owned firms were \$24.1 billion.

The stock of U.S. foreign direct investment in Japan in 2002 was \$65.7 billion, up from \$58.2 billion in 2001. U.S. foreign direct investment is concentrated largely in finance, manufacturing, and wholesale sectors.

REGULATORY REFORM OVERVIEW

Japan's regulatory and structural reforms of the past several years are beginning to lay the foundation for economic growth and should, if implemented comprehensively, assist in that economy's return to sustainable growth. The results of a Cabinet report released in December 2003 seem to bear this out. That report concluded that deregulation in Japan from 1992-2002 has resulted in 14.3 trillion yen of economic benefits for the Japanese people, equivalent to 122,000 yen (\$1,200) per capita. In addition, a Japan Center for Economic Research report released the same month concluded that meaningful deregulation would increase Japan's long-term economic growth rate by two percentage points by 2010. The United States therefore welcomes Prime Minister Koizumi's renewed commitment to accelerate regulatory reform and to "restructure the economy and let business do what it does best." This will not only reduce the negative impact of regulations on growth, but also increase market access opportunities for U.S. companies. In particular, the United States welcomes Prime Minister Koizumi's decision to establish a body to carry on the important work of the Council for Regulatory Reform when its mandate expires at the end of March 2004.

The U.S. Japan Regulatory Reform and Competition Policy Initiative

Launched by President Bush and Prime Minister Koizumi on June 30, 2001, the Regulatory Reform and Competition Policy Initiative (the Regulatory Reform Initiative) is one of the six "pillars" of the U.S.-Japan Economic Partnership for Growth (the Partnership). This Initiative addresses key sectors, including telecommunications, information technologies, energy, medical devices and pharmaceuticals, and financial services. It also addresses crosscutting issues, including competition policy, transparency, legal system reform, revision of Japan's commercial law, and distribution. Through the Regulatory Reform Initiative, the United States continues to advocate reform of laws, regulations, administrative guidance and other measures, formal and informal, that impede access to the Japanese market for U.S. goods and services.

The United States and Japan met numerous times in 2003 at the working-level and the deputy/vice minister level to advance the bilateral regulatory reform agenda under the Regulatory Reform Initiative. Progress achieved in 2003 was detailed in the Second Report to the Leaders on May 23, 2003 and presented to President Bush and Prime Minister Koizumi at the G-8 Summit in Evian Les-Bains, France.

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Kicking off the third year of the Regulatory Reform Initiative, the United States submitted its recommendations to Japan on October 24, 2003 in Tokyo. The United States urged Japan to adopt the recommendations included in this document (which can be found at www.ustr.gov) at working-level meetings convened in Tokyo and Washington in late 2003 and early 2004. The deputies also met in early March 2004 to assess the progress of the working groups, set priorities for future meetings, and urge the groups to redouble their efforts to conclude a forward-leaning Third Report to the Leaders before the next G-8 Summit in Sea Island, Georgia in June.

SECTORAL REGULATORY REFORM

Telecommunications

Under the Regulatory Reform Initiative, the United States seeks regulatory changes to promote competition, and thereby innovation and choice, in Japan's telecommunications sector. In 2003, Japan revised the Telecommunications Business Law (TBL), which eliminated filing requirements for competitive telecommunications carriers while preserving the existing dominant carrier regulations. The goal of this revision is to promote market entry by opening up bottleneck facilities and eliminating outdated regulations that limit the flexibility of operators to combine owned and leased facilities. On the other hand, interconnection rates were raised for the first time under the Long-Run Incremental Cost (LRIC) model methodology, and five interconnecting carriers who directly suffer from the new rates filed a suit against the Ministry of Public Management, Home Affairs and Posts and Telecommunications (MPHPT) in July 2003, seeking repeal of the rate increase. That suit remains in the courts.

The outcome of the process to review the TBL is an important indicator of Japan's willingness to overhaul its regulatory framework to address the overwhelming market power of the dominant carrier group, Nippon Telegraph and Telephone Corporation (NTT), of which the Japanese government owns 46 percent. NTT companies control access to greater than 98 percent of the local telephone network, giving them the ability to inhibit new competitors and services while promoting their own products and technologies. These problems are compounded by the fact that MPHPT is unduly influenced by political and industry interests (particularly NTT) that can inhibit competition-enhancing measures. While the United States welcomes the long-overdue deregulation of competitive carriers, it continues to press Japan to implement strong and effective competitive safeguards on the dominant carriers. (The two regional providers under the NTT holding company are NTT East and West, and the mobile provider NTT DoCoMo is 64 percent owned by NTT.)

Through its October 2003 Regulatory Reform submission and in bilateral consultations, the United States has asked Japan to take measures to address specific market access impediments related to a wide range of policies in this sector. If undertaken, these measures should help address important market access and regulatory barriers. Nevertheless, ensuring effective competition in Japan, especially in the local telecommunications markets, will require an independent regulator committed to ensuring equitable opportunities for new entrants and unbiased treatment of all operators. In November 2001, Japan established a Telecommunications Business Dispute Resolution Commission within MPHPT. In its first two years, this Commission mediated a number of interconnection disputes and issued its own administrative judgments on policies in two cases. However, the number of actions being taken by the Commission is decreasing. The United States continues to request that Japan develop a plan to move regulatory functions outside the purview of a ministerial agency, subject to direct political control, to a fully independent organization. It is also important for Japan to establish and exercise meaningful sanction authority by the regulator (imposition of fines, payments of damages, license restrictions) to punish anticompetitive behavior.

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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. As a result of bilateral discussions (1997 - 2001), Japan introduced a pro-competitive methodology (LRIC) for setting interconnection rates. This methodology resulted in rate reductions of 22 percent (for interconnection at the local switch) to 60 percent (at the regional switch) between JFY 2000 and JFY 2002. Partly as a result of lower interconnection rates, competition in local services increased and local calling rates fell by 15 percent or more in 2001. Still, the interconnection rates these operators charged their competitors to use their network were twice comparable rates in the United States, Germany, France or the United Kingdom.

In JFY 2003, however, the interconnection rate at the zone center, where foreign-affiliated carriers tend to interconnect with NTT, was increased by 12 percent. It is believed that the revised rate will be increased by an additional 10 percent in 2004, when rates will be re-calculated based on actual traffic volume. On July 17, 2003, five telecommunications companies filed suit against the MPHPT minister's decision to increase interconnection rates, raising serious questions about the Ministry's impartiality and commitment to competition. If the case moves to Japan's Supreme Court, it could drag on for several years. Meanwhile, MPHPT will conduct another review to determine the rate system to be put in place from JFY 2005. The United States will continue to press Japan to correct the fundamental flaws of the methodology that caused the increased rates, as well as to address its lack of regulatory independence and accountability, which make it vulnerable to political influence throughout the rate-setting process.

Dominant Carrier Regulation: NTT has maintained its dominance through other measures, such as denial of access to emergency services to interconnecting carriers, and proposals for higher interconnection charges on carriers competing with alternative technologies (e.g., for DSL services). Since the December 2001 publication of guidelines for approval of NTT's regional carriers' expansion into new services, NTT East and West have twice applied and received conditional approval: in February 2002, to provide interprefectural virtual private network services, and in October 2003, to offer Internet Protocol-based telephone service to corporate customers. In each of these cases, approval was granted after a public comment procedure in which competing carriers voiced strenuous objections and concerns. The United States continues to monitor whether MPHPT is taking sufficient steps to ensure that NTT East and West will not take advantage of their dominant position to inhibit competition in these new areas.

Mobile Termination: New entrants to Japan's telecommunications market have also expressed concern about the high and non-transparent interconnection and access rates charged by NTT DoCoMo, the dominant wireless service provider. Under reforms to the Telecommunications Business Law in 2001, DoCoMo was recognized as a dominant carrier in 2002, but MPHPT has not required DoCoMo to explain how these rates are calculated. The law places the onus on competing carriers to identify anticompetitive behavior and press for corrective action. In October 2002, in response to such a complaint, the

Telecommunications Business Dispute Settlement Commission found that certain domestic wireline carriers have the right to set the retail rate they offer their customers for their calls from the wireline network to mobile numbers. The Commission also recommended establishment of a rational and transparent system for interconnection rate setting based on this Commission's recommendation. In 2003, MPHPT finally announced a plan to allow wireline carriers to set prices for outgoing calls to mobile networks, enabling them to compete on price with mobile operators.

Rights-of-Way: New competitors in Japan find it extremely time-consuming and expensive to build competing networks in Japan because of costs and difficulties related to access to "rights-of-way." While Japan promulgated guidelines in April 2001 related to access to poles, ducts and conduits held by NTT and utility companies, there are few safeguards against exorbitant rates for the use of poles, ducts, conduits and other rights-of-way facilities. Moreover, if new entrants seek to dig roads to lay their own

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cables and facilities, they encounter a labyrinth of restrictions that industry sources say makes construction roughly ten times more expensive, and can result in digging that takes six times longer than in other major markets. Japan's e-Japan strategy, which is designed to make Japan a global information technologies leader by 2005, includes measures to relieve these problems on an experimental basis. The United States continues to urge mandatory rights-of-way access for new competitors and 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.

Information Technologies

Japan has taken significant steps towards realizing its ambitious plan to become a global leader in information technology (IT). Even so, the Japanese government itself has recognized through the 2003 e-Japan Priority Policy Program that legal and other barriers hinder growth in the IT sector. As Japan responds to the challenges that lie ahead in this pivotal sector, the U.S. Government is working with Japan through the IT Working Group under the Regulatory Reform Initiative to establish a regulatory framework that ensures competition, promotes innovation, allows private sector-led regulation where appropriate, and protects intellectual property rights (IPR) in the digital age. The aim of the IT Working Group is to foster an environment in Japan that promotes development of IT-related businesses and innovative information technologies to spur growth in other key sectors of Japan's economy.

In its October 2003 Regulatory Reform submission, the United States made numerous recommendations on removing regulatory and non-regulatory barriers, strengthening protection of intellectual property rights, promoting and facilitating public and private sector use of electronic commerce, and expanding procurement opportunities for IT-related goods and services.

Specific recommendations include removing barriers that impede business-to-business and business-to-consumer electronic commerce such as allowing non-attorneys to provide online mediation and arbitration services for profit. With regard to strengthening protection of IPR, the United States is urging Japan to extend the term of copyright protection for sound recordings and all other subject matter protected under Japan's Copyright Law, and to strengthen the enforcement system against IPR infringement by adopting a statutory damages system. To promote the use of electronic commerce, the United States is urging Japan to support private sector led mechanisms for privacy and Alternative Dispute Resolution (ADR), ensure that laws governing electronic transactions are technology-neutral, and provide security for commerce in the digital age. The United States urges Japan to ensure consistency, predictability, transparency, and technology neutrality in network security standards and guidelines developed by the Japanese government. The United States is also calling on Japan to support fair and open procurement of information systems for e-government by thoroughly implementing reforms of all ministries' IT procurement procedures to ensure transparency, technological neutrality, and private sector-led innovation.

Electronic Notification: Under current law, the consumer credit sector cannot benefit from the security, speed and efficiency of electronic notifications because consumer lenders are still required to provide written, paper notifications, even when consumers clearly express a preference to receive notices by electronic means. As a result, consumer credit customers are not able to apply for credit cards or receive bills and notifications electronically as a substitute for paper-based transactions. The United States urges Japan to revise the e-notification law or, if necessary, the money lending business law itself so that lenders can allow customers who have consented to electronic notification to receive notification by electronic means.

Personal Data Regulation: The Diet passed the Law on the Protection of Personal Information on May 23, 2003. Going into effect in April 2005, the Law is designed to establish a basic framework for the

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protection of personal information. The United States urges the Japanese government to ensure that the implementing ordinances and guidelines for the Law are developed in a transparent and coordinated manner, so as to prevent overly burdensome or contradictory requirements. In order to facilitate transparency, the United States recommends that Japan identify as quickly as possible the ministries that will issue implementing guidelines and urges that all draft guidelines be available for meaningful public comment.

Digital IPR: Japan's liability rules for Internet Service Providers (ISPs) went into effect in May 2002 along with implementing guidelines drafted by a private sector-led working group. The United States remains concerned that the liability rules remain unclear; do not provide the appropriate balance among the interests of telecommunication carriers, ISPs, right holders, and website owners; and, fail to provide adequate protection for right holders. The lack of adequate protection for right holders prevents them from obtaining appropriate remedies when infringement has occurred; adversely affects the financial stability of several creative industries such as the audio-visual and game software industries; and, may hinder the development of creative works and new products that could be subject to online piracy. The United States urges Japan monitor compliance with the implementing guidelines for ISP liability rules and their effectiveness for ensuring that infringing materials are removed from websites quickly and adequate remedies are provided for any injuries suffered. The United States also continues to urge Japan to support the continued existence of the private sector working group, and any revisions of the guidelines and/or the law for ISP liability rules that may be necessary to ensure an effective "notice and take down system" and the appropriate balance of the rights and interests of all parties.

The Japanese government took a significant step forward in protecting temporary copies, (e.g., digital copies made in the RAM of a computer) by recognizing that "temporary storage" implicates the reproduction right. However, the scope of protection for temporary copies remains vague, which could erode the ability to protect copyrighted materials in Japan. Given the importance of this new interpretation, the United States continues to urge Japan to further clarify and ensure the scope of protection for temporary copies. (*Further discussion of this issue can be found in the Copyright subsection below.*)

Network Security: Japan's Ministry of Economy, Trade and Industry (METI) issued network security guidelines in April 2003 for its own use. MPHPT released similar guidelines for use by local governments. The United States is urging Japan to ensure that any network security standards and guidelines developed for use by the Japanese government be coordinated so as to provide predictability in the private sector, consistent to the extent practicable with standards developed by voluntary industry consensus standards bodies, developed in a transparent manner, and technology neutral and non-trade restrictive.

Information Systems Procurement: Japan's 2003 e-Japan Priority Policy Program strives to digitize administrative procedures at all levels of government, building the foundation of e-government online services. As a result, public institutions will increase dramatically their purchases of hardware, software, and network infrastructure. However, a study group commissioned by METI acknowledged in December 2002 that four major Japanese companies dominate nearly 60 percent of e-government procurement. Japan's newly established Chief Information Officer Council is taking a closer look at information systems procurement. The United States anticipates that new rules announced in an inter-ministerial task force's March 2002 memorandum (revised in March 2003) could create more opportunities for U.S. firms. For example, the ministries agreed that Overall Greatest Value Method (OGVM) will be used for e-government projects valued at 800,000 SDRs or higher. The United States continues to urge Japan to implement in a transparent manner new e-government procurement policies and procedures that are consistent across all the ministries, facilitate open competition, and allow for private sector-led innovation.

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E-Education: The United States continues to make recommendations on e-education as it relates to Japan's Special Zones for Structural Reform (*see Special Zones section under Transparency and Other Government Practices*). The United States is encouraged by the number of Special Zones that have been created to promote IT and e-education. The Special Zones initiative is particularly well-designed and appropriate for spurring growth in the IT sector. In addition, increasing the use of IT in schools throughout Japan will further the IT literacy of Japanese children and educators, increase collaboration and learning opportunities among schools, and make education-related resources more efficient.

Energy

As Japan moves to further liberalize its energy sector, the United States views ongoing bilateral discussions as a key means of providing input into this process and to support Japan's goals of improved energy efficiency and lower energy costs, which are among the highest in the world.

Electricity: Japan embarked on a new phase of electricity sector reform with passage of the Law for the Partial Revision of the Electricity Utility Industry Law and Gas Utility Industry Law (the Law) in June 2003. That reform legislation includes many important elements, such as: (1) establishing a neutral transmission system organization (NSO) to set transmission and distribution rules; (2) securing fairness and transparency of transmission and distribution systems through information firewalls, monitoring, and prevention of cross-subsidization; (3) abolishing the transmission pancaking system; (4) preparing for a nationwide wholesale power exchange; (5) organizing and strengthening the governmental structure responsible for market monitoring and dispute resolution; and (6) setting forth a plan and schedule for expanded retail choice.

To support Japan's electricity reform efforts, the United States continues to share its own experiences on reform of this sector and has made numerous recommendations under the Regulatory Reform Initiative, including that Japan: ensure the energy sector regulatory divisions at the Ministry of the Economy, Trade and Industry (METI) are free from undue political and industry influence; take steps to promote fair and transparent competition in electricity transmission and distribution by all market participants; and, codify the liberalization timetables set forth by relevant METI subcommittees.

During working-level talks in November 2003, the United States urged Japan to expeditiously and transparently implement concrete and detailed ordinances and regulations in ways that ensure the objectives of the Law are fully met. Subsequently, METI took the positive step of soliciting public comments on its draft interim report on the "Detailed Design of the Desirable Future Electricity Industry System." The United States submitted comments in December 2003, calling on METI to: ensure a fair composition of members participating in the NSO; establish effective regulatory oversight of the NSO; and encourage the participation of a maximum number and variety of players in the planned Wholesale Electric Power Exchange.

Natural Gas: In parallel with the electricity sector, Japan is also moving to undertake significant reform of its gas sector. The energy reform legislation passed in June 2003 includes numerous important elements related to this sector, such as: (1) taking special measures to increase pipeline investment incentives and promote interconnection of pipeline networks; (2) securing fair and transparent competition between the gas companies that maintain and operate the network and other companies that use the pipelines; (3) taking necessary measures to separate accounts and prohibit discriminatory treatment towards certain businesses to which gas companies supply gas; (4) promoting third-party usage of liquified natural gas (LNG) terminals by, for example, establishing rules for resolving disputes over negotiations; (5) setting forth a plan and schedule for expanded retail liberalization; and (6) developing

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guidelines and establishing a neutral and fair system for conducting market monitoring and dispute resolution.

As in the electricity sector, the United States continues to share its own experiences on reform of its gas sector and has made numerous recommendations to Japan under the Regulatory Reform Initiative, including that Japan: establish incentives for investment in new gas pipeline construction in regions where the network is not sufficiently developed; create and strengthen a mechanism to conduct more rigorous rate approval examinations and audits; conduct neutral and fair ex-post facto monitoring of the industry; promote construction and improvement of pipelines for gas supply use by parties other than general gas utilities; and establish detailed rules to ensure non-discriminatory negotiations between LNG terminal owners and third-party users of LNG terminals.

In December 2003, the United States submitted public comments on the draft report of the "Detailed Design of the Desirable Future Gas Industry System." In those comments, the United States lauded Japan's movement toward ensuring third-party access to gas pipelines, its recognition of the need to prevent competitive abuses by incumbent gas suppliers, and its efforts to expand customer choice in real terms. The United States, however, raised questions about the difficulty of preventing abuse if gas transportation and supply remain bundled, and expressed concern over potential restrictions being placed on the construction of necessary pipeline capacity. The United States will continue to urge Japan to undertake its reforms in a manner that promotes efficiency, reduces energy costs through competition, and encourages market entry.

Medical Devices and Pharmaceuticals

The United States and Japan address regulatory, reimbursement and other market access concerns in the medical device and pharmaceutical sectors, under the 1986 Market-Oriented, Sector-Selective (MOSS) Medical Equipment and Pharmaceutical Agreement. The two countries discuss their concerns in the Working Group on Medical Devices and Pharmaceuticals, which meets under the MOSS and the Regulatory Reform Initiative. Insuring that Japan's reimbursement system appropriately values innovation and that its regulatory system provides for faster approvals remains the focus of these bilateral consultations.

Japan has recognized that innovation can foster economic growth and improved healthcare, as noted in its healthcare reform plan and "Visions" policy papers. The reform plan focuses on transformation of the insurance system, creation of a new health insurance program for the elderly, and review of the medical fee system. The "Visions" discuss the need to improve the competitiveness of Japan's medical device and pharmaceutical sectors and contain five-year action plans for realizing the "Visions." The U.S. Government welcomes the healthcare reform plan and "Visions" as evidence that Japan is committed to promoting timely access to the most innovative medical devices and pharmaceuticals. In its October 2003 Regulatory Reform submission, the U.S. Government urges Japan to transform its Visions into policy by reforming its regulatory and reimbursement pricing systems. The United States also urges Japan to develop pricing rules that recognize the value of innovative products; abolish rules that penalize or fail to recognize the value of innovation; and make full use of pricing rules, including premium-pricing rules, to reward and stimulate advances in drug research and medical technology.

Japan applies a "foreign price adjustment" rule, a pricing mechanism that caps Japanese prices by linking them to lower prices in other countries. This rule did not address structural problems that raise the cost of doing business in Japan, such as high medical fees and long hospital stays. Japan has used this rule to cut U.S. device prices significantly. These cuts discourage industry innovation, limit patients' access to the best technologies, and raise long-run costs as patients use less effective treatments requiring long hospital stays. As Japan's national health insurance system continues to face high deficits, the United States is

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urging Japan to confront systemic problems that raise costs and adopt a more comprehensive approach to its healthcare system. The U.S. Government is urging Japan to eliminate discriminatory policies that result in discouraging innovation. For example, the United States is urging Japan to end repricing of innovative drugs whose sales exceed forecasts. Use of the market-expansion criteria to cut reimbursement prices undermines innovation as it punishes medicines whose sales rise because they are more effective than other drugs. This practice runs counter to the goal in the Visions to spur the development of cutting-edge health-science industries.

In the May 2003 Second Report to the Leaders under the Regulatory Reform Initiative, Japan committed to take steps that reward innovation. Japan, for example, agreed to use premium pricing to reward and encourage medical device and pharmaceutical innovation as well as to review application of such pricing rules to ensure innovation is encouraged. The U.S. Government continues to urge Japan to make full use of such pricing rules, and to periodically review the new and expanded premium system to ensure premiums are being used to fully recognize and encourage innovation. The United States also has been stressing the need for more transparency in establishing reimbursement pricing, including opportunities for greater interaction among officials from industry, government and pricing organizations.

In another step toward reform, Japan has revised its Pharmaceutical Affairs Law to create the Pharmaceuticals and Medical Devices Agency (PMDA), which was scheduled to oversee pre-marketing and approval of drugs and devices starting April 1, 2004. The U.S. Government welcomes PMDA's creation, as it is expected to speed approvals, improve healthcare administration, and enable Japan to adapt to the bio-genomic age. The United States has been urging Japan to engage in an open dialogue with industry during the creation of the PMDA and to establish a user fee system, based on performance and transparency, that would increase the resources dedicated to faster approvals of new products. Specifically, the U.S. Government has urged Japan to implement from April 1, 2004, transparent performance measures with established baselines. For pharmaceuticals, the United States is urging Japan to work toward reducing its times for new drug approvals to 12 months total time through staged improvements from April 1, 2004. Regarding medical devices, the U.S. Government is urging Japan to speed approvals by setting performance goals that increase the predictability of approval decisions. Increased predictability facilitates new product launches.

For both drugs and devices, the United States continues to request that Japan develop a timely, transparent, and efficient appeals mechanism to arbitrate disagreements between applicants and the PMDA during the development, approval, and post-marketing phases. Regarding post-marketing, the U.S. Government is also urging that manufacturers be allowed to play a significant role in the responses to adverse events. Regarding clinical trials, the U.S. Government believes it is important that U.S. manufacturers be consulted on implementation of the Megatrial Network and that they retain control of their products, studies, and related intellectual property resulting from physician-initiated clinical trials.

Japan's 2002 Blood Law reform established a principle of "self-sufficiency" and included a Supply and Demand Plan that enables the Japanese government to manage supply and demand in the blood market. The United States urges Japan to ensure that the Plan does not discriminate against foreign blood plasma products and is consistent with Japan's international trade obligations. An additional concern is Japan's decision, implemented in July 2003, to draw a distinction between products derived from paid and unpaid blood donors. The United States continues to urge Japan to conduct science-based discussions with all stakeholders in the blood sector and to apply pricing rules fairly and transparently.

Financial Services

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

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Japanese financial institutions has increased in an effort to cut costs and boost competitiveness, while traditional segmentation among various types of financial institutions is steadily 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 practices.

There was additional progress in financial sector deregulation in 2003. The requirement for physical certificates for Japanese Government Bonds and corporate debentures was eliminated on January 6, 2003. This followed the elimination of the requirement for physical certificates for commercial paper on April 1, 2002. In addition, on May 23, 2003 the Diet passed new securities market legislation to diversify corporate stock and bond distribution channels and increase the number of intermediaries. This legislation reduces minimum capital requirements for securities companies, investment trust management companies and investment advisory companies. On the same day, the Diet also passed major shareholder rule revisions designed to prevent abuse by brokers. The new rules authorize the Financial Services Agency (FSA) to inspect major shareholders of brokerage houses, including non-financial corporations and individuals. Finally, on May 30, 2003 the Diet passed legislation introducing a new sales agent system to permit CPAs, licensed tax accountants and financial planners to sell corporate stocks to investors as agents of security brokerage houses. The entire securities market reform package will take effect on April 1, 2004.

Japan also amended the Postal Services Corporation Law in July 2003 to allow private investment advisory companies to provide fund management services for Postal Savings (Yucho) and Postal Life Insurance (Kampo). This is a significant breakthrough for foreign investment firms doing business in Japan, who now have the opportunity to manage funds that constitute a significant percentage of individual savings in Japan.

STRUCTURAL REGULATORY REFORM

Antimonopoly Law and Competition Policy

Under the Regulatory Reform Initiative, the United States has been proposing a number of progressive measures to strengthen competition policy and enforcement of Japan's Antimonopoly Act (AMA) that would bolster competition and improve market access. One of the key problems in addressing anticompetitive practices in the Japanese market has been the historically weak status of the Japan Fair Trade Commission (JFTC) and its lack of sufficient enforcement powers and resources to implement the AMA effectively. There have been improvements, most recently the April 2003 transfer of JFTC to the Cabinet Office from the jurisdiction of the Ministry of Public Management, Home Affairs and Posts and Telecommunications (MPHPT), a move that enhances the JFTC's ability to act independently to promote competition in these crucial sectors. Significant further improvements may result from proposals to amend the AMA, the first significant revision of the AMA in over 25 years, which the JFTC hopes will be submitted to the Diet in Spring 2004. Under the Regulatory Reform Initiative, the United States stresses the need for substantial progress on the following AMA and competition policy-related issues.

Deterrence of AMA Violations. Cartel activity, including widespread bid rigging, continues to be a serious problem in Japan. One important reason is that existing administrative and criminal sanctions do not constitute an adequate deterrent against companies and individuals engaging in unlawful anticompetitive practices. Although the AMA provides for criminal sanctions against violators, criminal prosecutions have been sporadic, and prison sentences against corporate officials have been routinely suspended. The JFTC has initiated only one new criminal prosecution of AMA violators since 1999, in July 2003 when it filed charges against four firms and five individuals for a bid-rigging case involving

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procurement of water meters by the Tokyo Metropolitan Government. In addition, Administrative surcharges are too low to serve as a meaningful deterrent. The current maximum surcharge is six percent of the sales in question over a maximum of three years, but comparisons of prices before and after the JFTC has broken up cartels suggest that illicit profits from such arrangements in Japan average around 20 percent.

In December 2003, the JFTC called for increasing administrative surcharges, introducing a system of additional surcharges for repeat offenders, and expanding the range of violations subject to surcharges and criminal prosecution. In its 2003 Regulatory Reform submission to Japan, the United States calls for increasing surcharges to around 20 percent of the sales in question, applying surcharges to sales during the full term of an illegal conspiracy, more active criminal enforcement, and encouraging judges to impose prison sentences on culpable individuals that are actually served.

JFTC Enforcement Powers. A number of other factors limit the effectiveness of the JFTC's enforcement against egregious AMA violations. The JFTC does not have the powers enjoyed by other Japanese criminal investigation authorities, including the power to conduct compulsory searches and seizures. Nor does it have the authority to reduce or eliminate criminal sanctions and administrative surcharges for companies that come forward to expose illegal activities through a corporate leniency program. In its 2003 Regulatory Reform submission, the United States calls for Japan to introduce a corporate leniency program, criminal accusation procedures in line with other economic crimes, longer terms for cease-and-desist orders, and increased JFTC capacity for economic analysis. In December 2003, the JFTC called for introducing a corporate leniency program, criminal investigation procedures with penalties for interfering with investigations, and streamlined hearing procedures.

The United States is also recommending that Japan take further measures to address prolific bid rigging, including aggressively implementing the newly enacted law against bureaucrat-led bid rigging (so-called *kansei dango*), instituting procedures for collecting overcharges from companies that have participated in bid rigging conspiracies, and assisting citizen suits aimed at recovering overcharges suffered by local governments as a result of bid rigging.

Promotion of Deregulation by the JFTC: As the only Japanese agency charged with promoting competition throughout the economy, the JFTC should substantially boost its actions as an advocate of competition policy and regulatory reform. The United States continues to propose 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, telecommunications, and transportation sectors consistent with sound competition policy, and that anticompetitive conduct by dominant incumbent firms will be strictly dealt with under the AMA. Some steps have been taken. In April 2001, the JFTC established the Information Technologies and Public Utilities Task Force to investigate and take enforcement action against AMA violations in industries undergoing deregulation. This task force continues its efforts, but has been hampered by shortages in JFTC staffing levels and industry expertise, as well as by the need to coordinate bureaucratically with ministries having jurisdiction over the sectors in question.

JFTC Staffing & Resources: The JFTC's ability to enforce the AMA is hindered by its shortage of personnel. Some progress has been made, as seen by the increase in the JFTC's staff levels from 474 in 1990 to 643 for 2003. Even more importantly, the number of the JFTC's investigative staff has increased from 154 in 1990 to 318 in 2003, and JFTC inaugurated an economic research center in 2003, staffed in part by visiting academic economists. Nonetheless, the JFTC remains understaffed, particularly in the areas of economic analysis and investigations, to adequately enforce the AMA and to engage in necessary competition promotion. In its October 2003 Regulatory Reform submission, the United States calls on Japan to increase the staff and budget of the JFTC substantially, with particular focus on personnel with

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advanced legal and economic training, and with detailed knowledge of the structure and workings of complex public utility sectors.

Transparency and Other Government Practices

It is vital that domestic and foreign firms alike have full and equal access to information and ample opportunities to participate in the regulatory and rulemaking process. While Japan has made some progress in expanding public comment opportunities, additional measures are necessary in order to improve government accountability and increase transparency in the regulatory system. In its October 2003 Regulatory Reform submission, the United States therefore urged Japan to increase transparency in the following areas:

Special Zones for Structural Reform: The U.S. Government is closely following the Japanese government's Special Zones for Structural Reform initiative. Prime Minister Koizumi has made the local deregulation zones the centerpiece of his drive to achieve bold regulatory reform and considers the zones as part of his effort to "let the private sector do what it can do." This innovative approach to deregulation and structural reform could provide important opportunities for Japan to return to sustainable growth and for greater market access to U.S. and other foreign firms. Already, U.S. express carriers are benefitting from reduced overtime fees associated with customs processing now in place at zones located in Japan's major ports. U.S. companies are also involved in developing agricultural, information technology, and e-education zones. As Japan moves forward with the zone proposals, the United States is recommending that a focus be placed on expanding market-entry opportunities, that domestic and foreign companies alike have non-discriminatory access to operate in the zones, and that successful measures used in the zones be applied on a national basis as expeditiously as possible so that all of Japan can benefit from this important initiative. In particular, the United States is recommending that the Special Zones Evaluation Committee make its determination about expanding zones nationally in a forward-leaning and transparent manner. Currently there are 236 Special Zones operating throughout Japan.

Public Comment Procedures: Serious concerns with the effectiveness of Japan's Public Comment Procedures (PCP) persist. An annual survey issued on August 22, 2003 by the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) on the use of the PCP again revealed deficiencies. As in past years, a majority of comment periods were less than 30 days while a significant number of periods provided less than a meager 14 days for comment making. Moreover, the percentage of cases in which government agencies incorporated comments into final regulations remained extremely low (at only 14 percent), leading the public to believe that rules and regulations are "final" before they are opened to the public for comment. To address these concerns, and to make the PCP a useful and effective regulatory mechanism, the United States urged Japan in its October 2003 submission to: (1) require the use of a minimum 30-day comment period; and (2) undertake the legal steps necessary to incorporate the PCP into the Administrative Procedure Act, a move that would strengthen the PCP from being a mere guideline to a law. During regulatory reform talks in March 2004, the Japanese government gave encouraging indications that it is seriously considering steps to improve the PCP.

Public Participation in the Development of Legislation: In its October 2003 Regulatory Reform submission, the U.S. Government urged Japanese government ministries and agencies to expand participation in the legislative process by implementing the practice of facilitating public input into draft legislation while it is being developed by groups with Government ties prior to Diet submission. While some ministries and agencies have begun to do this, progress has been slow.

Public Corporations: The United States recognizes that Prime Minister Koizumi's efforts to restructure and privatize Japan's public corporations could have a major economic impact, stimulating competition and efficiency and leading to a more productive use of resources. In its latest reform recommendations,

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the United States is urging Japan to ensure that the restructuring and privatization process is transparent and that the private sector has ample and meaningful opportunity to provide input into any privatization plans that could impact private sector interests, such as Japan Post's (and MPHPT's) decisions relating to Kampo insurance products.

Commercial Law

Japan is making steady progress on its efforts to reform its commercial law, starting with substantial revisions to its Commercial Code in 2002. Reform of Japan's commercial law has been key to the introduction of necessary flexibility into the organization, management and capital structure of Japanese companies and to the facilitation of merger and acquisition activities by both foreign and domestic firms in Japan. Until the 2002 amendments, Japan's Commercial Code stifled investment (both domestic and foreign) and hurt Japan's efforts to integrate more fully into the international economy. The 2002 revisions have introduced greater flexibility to the capital structure of Japanese corporations and strengthen corporate governance mechanisms, both of which should contribute to Japan's efforts to revitalize its economy. The reforms should also enhance the ability of foreign firms to enter and operate in the Japanese market.

Specifically, Japan's Commercial Code was amended in 2002 to: liberalize substantially restrictions on the issuance of stock options; permit companies to issue tracking stock and shares with limited voting rights; eliminate the requirement that foreign companies must set up a branch office in Japan; and provide companies the option of adopting an American-style executive committee (audit, nominating and compensation committee) system, composed of at least a majority of outside directors, as an alternative to appointing statutory auditors.

In its October 2003 Regulatory Reform submission, the United States urges Japan to build on past reforms by further improving its commercial law and corporate governance. Specifically, the United States recommends that it introduce modern merger techniques into its commercial law. Japan undertook to examine the introduction of modern merger techniques, such as triangular mergers and cash mergers, into its commercial law, aiming toward submission of appropriate legislation in 2005. As an interim measure, Japan revised the Industry Revitalization Law to permit firms seeking to restructure to use triangular merger techniques, although tax treatment provisions limit the practical value of this measure to foreign firms. The United States also urges Japan to improve corporate governance in Japan by requiring pension fund and mutual fund managers to adopt proxy voting policies and to vote proxies for the benefit of fund beneficiaries. In addition, the United States urges Japan to provide protection to "whistleblowers" in order to improve corporate governance, and to foster the role of Alternative Dispute Resolution (ADR) mechanisms in Japan by allowing ADR mechanisms to develop freely and flexibly, including by allowing non-lawyers to act as neutrals in ADR proceedings.

Legal System Reform

Reform of the Japanese legal system is essential to the establishment of a legal environment in Japan that is conducive to international business and investment and that supports deregulation and structural reform. After more than 15 years of urging by the United States and the foreign legal community, Japan enacted legislation in 2003 that substantially eliminates restrictions on the freedom of association between foreign and Japanese lawyers, effectively permitting partnership and employment relationships between foreign and Japanese lawyers.

In its October 2003 Regulatory Reform submission, the United States welcomes passage of the new legislation regarding free association between Japanese and foreign lawyers and urged expeditious implementation. The United States also calls on Japan to allow foreign lawyers to form professional

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corporations and establish branches throughout Japan, and to count all of the time foreign lawyers spend practicing law in Japan toward the three-year experience requirement for licensure as a foreign legal consultant. Finally, the United States calls on Japan to meet its stated goal of taking necessary measures to ensure effective judicial oversight of administrative agencies by November 2004.

Distribution and Customs Clearance

While the Japanese government has implemented several measures to streamline its customs processes and improve its distribution system in the context of the Regulatory Reform Initiative, several areas in need of improvement remain. If Japan acts to reform the practices and procedures in these areas, it could enhance the ability of U.S. and other express carriers to provide for the efficient, speedy exchange of goods and information to benefit the Japanese economy and consumer.

In its October 2003 Regulatory Reform submission, the United States outlines several measures that could further improve the distribution environment, including: eliminating overtime fees for import and export processing; allowing foreign carriers to contract directly with Japanese carriers for freight forwarding interline contracts; and, adopting the Free on Board (FOB) method for duty calculation, which more fairly represents the value of the goods being shipped.

Another issue of importance to the United States is the high landing fees at Japan's Narita and Kansai International Airports. These fees, the highest in the world, increase the costs for cargo, mail delivery, and air travel, and are at odds with the region-wide trend of lowering landing fees. To promote financially healthy airline and air-freight industries, the United States is calling on Japan in its October 2003 Regulatory Reform submission to formulate the level of landing fees in an open and transparent manner, using internationally accepted accounting standards, and to base those fees on the actual cost of providing services, just as IATA (the International Air Transport Association) has urged Japan. The Ministry of Land, Infrastructure and Transport (MLIT) has thus far opposed any lowering of these fees.

Additionally, in an effort to improve consumer convenience and expand consumer choice, the United States has made a number of recommendations in the October 2003 submission aimed at increasing the acceptance of credit and debit cards in Japan, and enhancing the security of transactions made with those cards.

IMPORT POLICIES

Rice Import System

Although Japan has generally met import volume commitments made during the Uruguay Round and subsequent negotiations, Japan's highly regulated and non-transparent distribution system for imported rice assures that high quality U.S. rice does not enjoy meaningful access to Japanese consumers. U.S. rice exports to Japan in calendar year 2003 were valued at just over \$113 million, representing 339,472 metric tons of rice or approximately 50 percent of Japan's minimum access requirement. In 1999, Japan established a tariff rate quota (TRQ) that was to assure access to the Japanese market for 682,000 metric tons (milled basis) of imported rice annually. The Japan Food Department (JFD) of the Ministry of Agriculture, Forestry, and Fisheries (MAFF), manages imports within the TRQ through periodic minimum access (MA) tenders for imported rice and by imports through the simultaneous-buy-sell (SBS) system. In both programs, the activities of the JFD lack transparency, and less than one-half of one percent of rice imported from the United States reaches Japanese consumers as an identifiable product of the United States. Imports of U.S. rice under the periodic MA tenders, for example, are destined almost exclusively for government stocks or re-exported as food aid. A small share of U.S. rice imported under these tenders is released from JFD stocks and permitted to enter the industrial food-processing sector.

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Since Japan adopted a tariff system in 1999, no rice has been imported outside of the import quota because it would be subject to a duty of 341 yen per kilogram, which is equivalent to a 400-1,000 percent ad valorem tariff, depending on the variety of rice. Through the MA tenders, the JFD imports roughly 582,000 tons of rice. The U.S. rice industry has been disappointed by the JFD's record of buying medium quality rice for industrial use, food aid, and blending, rather than top quality rice for table use. The U.S. industry also faces barriers in moving rice imported under the JFD's MA tenders into the market place. The industry believes that medium grain U.S. rice - the type of rice imported directly by the JFD - can be competitive in the non-table use market. However, lack of information on obtaining U.S. rice held in JFD stocks has made the development of this commercial market difficult. Under the SBS system, also administered by the JFD, Japan imports the remaining 100,000 tons of its total MA commitment. The U.S. rice industry is particularly concerned over the operation of the SBS system, which was designed to allow exporters access to final consumers in Japan in order to engage in consumer market development. The SBS system, which provides a substantial mark-up to the JFD (equal to the difference between the import price of rice and the wholesale price in Japan), has not allowed U.S. exporters to develop markets in Japan for high-quality short grain U.S. rice used for the table market. In June 2003, the Japanese Diet passed a law that included a comprehensive rice reform plan designed to cut government spending, curb surplus production, and make Japanese rice farmers more efficient. The reforms are scheduled to be fully implemented by 2008. Many areas of the plan, however, remain vague, and there is concern that parts of it may be undone before it is fully implemented. In the long term, the reforms would reduce the need for extremely high levels of protection for Japanese rice farmers. Despite these reforms, Japan's position on rice market access in ongoing WTO agricultural negotiations is to decrease Japan's Minimum Access commitment for rice, allegedly because of Japan's changing demographics and declining rice consumption. This proposal is counter to one of the principal aims of the Doha Development Agenda, which is to open agricultural markets and expand trade. Expanding market access for U.S. rice hinges on increasing Japan's market access commitment, reducing tariffs, changing the import system to make pricing and bidding more transparent, and revising the SBS system so the market can function freely. Currently, Japan's complex import system for rice makes it impossible to ensure price stability and a stable year-long supply of U.S. rice. Since the majority of U.S. rice imports sits in warehouses, U.S. rice importers are denied the opportunity to establish direct relationships with Japanese consumers. The United States will work towards these goals bilaterally in the current WTO round.

Wheat Import System

Japan requires that wheat be imported through the Ministry of Agriculture, Forestry and Fisheries' (MAFF's) Food Department, which then releases wheat to Japanese flour millers at prices that are substantially above import prices. High wheat prices discourage wheat consumption by increasing the cost of wheat-based foods in Japan. The United States is seeking greater discipline on trade distorting practices of state trading companies in the WTO agriculture negotiations.

Corn for Industrial Use

To support demand for domestically produced potatoes and sugar, the Japanese government requires Japanese corn starch manufacturers to blend potato starch with corn starch in manufacturing corn sweeteners. The tonnage of cornstarch production must be matched by purchases of domestic potato and sweet potato starch in the ratio of one part of potato starch for 12 parts of cornstarch. If corn sweetener producers use potato starch at a lower ratio than 1:12, they cannot import corn at the zero tariff rate accorded to the pooled quota. Instead they must pay a tariff on corn equal to 12,000 yen per ton or 50 percent of the value of a shipment, whichever is higher.

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The blending requirement discourages consumption of imported corn by raising the cost of corn sweeteners, and directly displaces over 200,000 metric tons of U.S. corn sales annually. The United States is seeking resolution of this issue in the WTO agriculture negotiations.

Pork Import Regime

U.S. pork exports to Japan, valued at approximately \$800 million annually, comprise more than 65 percent of the value of all U.S. pork exports. However, Japan's pork import system is inflexible and fails to meet the needs of either Japan or the United States. The system includes a gate price and a safeguard negotiated during the Uruguay Round, which automatically raises tariffs if imports are 19 percent or more above the average level of imports during the previous three years.

The gate price system distorts pork trade by encouraging Japanese importers to buy mixed shipments with different cuts of pork. Importers buy mixed shipments in order to minimize tariffs by keeping the average CIF price of their shipments at or below the gate price.

Japan's pork safeguard, which was triggered for the third time in a row in 2003, is also of concern because it results in erratic purchasing patterns. The safeguard system encourages high imports when the safeguard is not in place, and the high imports then tend to trigger the safeguard. Once the safeguard is triggered, importers tend to buy more expensive cuts of pork in order to raise the cost of their import shipments to the new, higher gate price.

The United States seeks substantial reductions in pork tariffs, reform of the gate price system and safeguard, and greater transparency in Japan's import regime. The United States is seeking to resolve this issue in the WTO agriculture negotiations.

Beef Safeguard

The United States has worked with like-minded parties to express opposition to this safeguard at the highest levels of the Japanese government in an effort to remove, or suspend this safeguard. Japan's beef safeguard was negotiated during the Uruguay Round to afford protection to domestic producers in the event of an import surge. The safeguard is triggered when imports increase by more than 17 percent from the previous Japanese Fiscal Year on a cumulative quarterly basis. Once triggered, the safeguard remains in place for the rest of the fiscal year. If triggered, beef tariffs increase from 38.5 percent to 50 percent. The safeguard is expected to be lifted in the first half of 2004 due to decreased Japanese beef imports resulting from Japan's prohibition on U.S. beef exports due to the discovery of a single case of Bovine Spongiform Encephalopathy.

Fish Products

Japan is the most important export market for U.S. fish and seafood, accounting for approximately 40.7 percent of U.S. exports of such products in 2003. Japan maintains several species-specific import quotas on fish products. U.S. fish products subject to import quotas include pollock, surimi, pollock roe, herring, Pacific cod, mackerel, whiting, squid, and sardines. During the Uruguay Round, Japan agreed to cut tariffs by about one-third on a number of fishery items, but avoided commitments to modify or eliminate import quotas.

The United States and Japan held annual fish consultations in November 2003 to discuss marine science, ecology and other bilateral and international fishery-related issues. U.S. exporters have been concerned about the quota application process and other administrative procedures. However, over the past few years, Japan has made substantial improvements in its import quota system for fish products, due in large

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part to recommendations from the United States and European Union. These changes include greater transparency in disclosing the recipients of quota allocations, changes in the timing of quota allocations, and the breakout of several types of fish (including mackerel, sardines, Pacific cod and others) from the "Fish and Shellfish" category into individual categories with quotas listed by weight rather than value.

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

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

High tariffs discourage the use of imported products, and in some cases keep Japanese prices so high that they reduce total consumption of certain products. Tariff reductions are therefore a high priority in the WTO agriculture negotiations.

Wood Products, Housing, and Building Materials

Japan is the second largest overseas export market for U.S. wood products, with U.S. exports totaling nearly \$750 million in 2003. With just under 1.2 million housing starts in 2003, Japan's home building materials market is second in size to only that of the United States. Estimates of the size of the home building materials markets range upward of \$62 billion, not including materials going into the repair and remodeling market. Imports of building materials from the United States fell 6.1 percent, to \$967 million in 2003, in large part due to the strength of the dollar and the high cost of U.S. building materials. The housing market in Japan is not expected to strengthen in the foreseeable future. Starts of North American style wood-frame housing increased by 3.2 percent in 2003, to 81,502 units, and should increase again in 2004.

Japan continues to restrict the import and use of U.S. wood products through tariff escalation (i.e., progressively higher tariffs on more processed wood products). The elimination of tariffs on wood products has been a longstanding U.S. objective, and the United States will continue to urge Japan to eliminate wood product tariffs. In 2001, the United States and Japan agreed that future discussions on wood/building products issues would be under the auspices of the Wood Products Subcommittee and its two technical committees, the Building Experts Committee and JAS Technical Committee. The Wood Products Subcommittee met in Tokyo in April 2002, and the Building Experts Committee and the JAS Technical Committees met in Nagoya in October 2003, to discuss a range of issues related to indoor air quality and fire performance, and acceptance of overseas testing data and calculation methods. The discussions were productive. Japan confirmed that U.S. manufacturers were eligible to apply for and receive a ministerial approval to allow continued use of U.S. building materials in Japan containing formaldehyde. Japan also agreed to consider several U.S. proposals to facilitate the recognition of foreign test data.

Marine Craft

Japan's non-transparent system of small craft safety regulation for boats, marine engines, and marine equipment impede 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 (JCI), are vague and subject to arbitrary and inconsistent interpretation. Product testing requirements are expensive and documentation requirements are non-transparent and burdensome, forcing companies to disclose sensitive proprietary information about product design, material specifications, and manufacturing

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techniques. Inspection fees are excessive and not in line with the actual cost of conducting the inspections. Moreover, considerable restrictions on the use of boat trailers, a principal means of transporting recreational boats throughout the rest of the world, have significantly limited boating in Japan. In addition, a complicated small craft operator's licensing system accompanied by mandatory expensive and lengthy classes have restricted the ability of interested Japanese citizens to acquire the necessary operator's license. The result of this regulatory burden is that boating in Japan remains no safer than in other major boating nations, and the recreational boating industry (marinas, boats, engines, accessories, etc.), has remained unnecessarily and unusually small when compared to other developed nations.

The U.S. Government made some inroads in encouraging Japan to deregulate this market under the Working Group Agreement reached on July 2, 2003. The agreement reduces regulatory burdens on marine engine testing requirements, plastic fuel tank certification and the license system for boat operators. It also will reduce current Japanese regulations and will promote U.S.-Japan marine trade and benefit Japanese consumers while maintaining strict safety standards. The results of the Working Group were reported at the Trade Forum in July 2003, and at that time, it was decided that the Working Group, which includes participants from MLIT, JCI, the Japan Marine Importers Committee, and U.S. industry, would continue to meet for one more year in order to implement the July 2 agreement and to discuss outstanding issues.

In actions separate from the Working Group, Japan announced a number of welcome deregulation measures over the past year. It expanded the definition of a small craft to include those under 24 meters; eliminated licensing and inspection requirements for boats less than three meters in length; and revised its boat operator's license categories. The U.S. Government continues to await the details concerning implementation of these new procedures.

Leather/Footwear

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

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 this quota to roughly 12 million pairs per year. In the Uruguay Round, Japan agreed to reduce tariffs over an eight-year period on under-quota imports of leather footwear, crust leather and other categories.

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

STANDARDS, TESTING, LABELING AND CERTIFICATION

Japan has many standards that limit trade in farm, forest and industrial products. Japan has always been particularly conservative on questions involving food safety, human health and the application of sanitary and phytosanitary standards. However, recently there appears to have been an increase in Japan's use of

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standards and other administrative requirements to limit agricultural and wood product imports in particular, and a greater tendency to deviate from scientific principles in setting new import policies.

Restrictions on building size and designs and products continue to constrain the use of some foreign building products and systems that are commonly used in the United States and elsewhere, thereby limiting choice for consumers and artificially inflating housing costs. The United States continues to have serious reservations about the transparency and basis of certain testing methodologies for evaluating fire resistance and formaldehyde testing.

The Japanese government has adopted and implemented regulations with respect to indoor air quality and the emission of certain volatile organic compounds, including formaldehyde which is found in certain building products. The Japanese government failed to adequately take into consideration the potential impact of these regulations on foreign manufacturers. Prior to the drafting of the regulations, the Japanese government failed to notify the World Trade Organization of the development of guidelines upon which these regulations were based. Prior to the passing the regulations, the Japanese government also failed to provide an opportunity for public comment. (The regulations were based upon guidelines set by the Ministry of Health, Labor and Welfare (MHLW) but became law when mandated by MLIT and other ministries.)

The standard for testing fire resistance is inconsistent with international standards, and the testing criteria are such that test results (for the same product) can vary from one testing laboratory to another. Regulations on indoor air quality covering volatile organic compounds appear to be overly restrictive for products such as wall coverings but are not applied on carpeting and interior furnishings, which emit high levels of formaldehyde. As of late 2003, there were no testing bodies recognized outside of Japan to undertake the necessary testing for fire resistance or indoor air quality.

Fresh Apples Quarantine Requirements for Fireblight

Japan imposes burdensome quarantine restrictions on apples, limiting the ability of U.S. growers to access the Japanese market. Of particular concern are Japan's requirements that aim to prevent transmission of fireblight. Scientific evidence does not support Japan's assertion that mature, symptomless apples can transmit the fireblight bacteria. Japan's quarantine restrictions for fireblight include the prohibition of imports of U.S. apples from any orchard containing fireblight, three inspections of fireblight-free orchards at different times in the growing season, maintenance of a 500-meter fire-blight free buffer zone surrounding export orchards, and post-harvest treatment of apples with chlorine. These requirements are not scientifically based, significantly raise costs, and reduce the competitiveness of U.S. apples in Japan.

Joint research conducted by U.S. and Japanese government scientists confirmed the results of earlier studies that mature, symptomless apples are not carriers of fireblight and provided additional scientific support for the United States' position that Japan's restrictions are unwarranted. In light of Japan's continued refusal to modify its restrictions on the basis of the scientific evidence, on March 1, 2002, the United States initiated WTO dispute settlement procedures. In its report of July 15, 2003, the dispute settlement panel agreed with the United States that Japan's inspection and buffer-zone requirements are inconsistent with Japan's obligations under the *WTO Agreement on the Application of Sanitary and Phytosanitary Measures*. The WTO Appellate Body upheld these findings on November 26, 2003, and the WTO adopted the findings on December 10, 2003. Japan must implement the WTO rulings by June 30, 2004.

Ban on Fresh Potatoes

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Japan bans imports of fresh potatoes from the United States, alleging that such a ban is necessary to prevent the introduction of golden nematode and potato wart into Japan. The United States has urged Japan to immediately lift the ban on fresh potatoes for processing from major production areas not infested by the golden nematode, such as the Pacific Northwest, California, and other U.S. potato exporting areas. Potato wart is not found in the United States. Separately, MAFF has raised new concerns regarding a number of viruses that would necessitate post-entry quarantine of imported potatoes even if the ban were lifted. The United States will continue to urge Japan to recognize disease-free areas in the United States for golden nematode. The United States is also urging Japan to permit imports of peeled potatoes for use in the food service industry, including under the Japanese deregulation initiative.

Excessive Use of Fumigation

Japan requires unnecessary fumigation for a number of imported fresh horticultural products. The fumigation requirement is particularly detrimental to trade in fresh fruits and vegetables, including lettuce, citrus, and cut flowers. Fumigation adds unnecessary costs and results in produce deterioration, making the product unmarketable. The U.S. lettuce industry estimates that exports would increase by at least \$100 million if this issue could be resolved.

Japan routinely requires that imported produce be fumigated for insect species that are already present in Japan. This practice is inconsistent with international practice and with the International Plant Protection Convention (IPPC). Japan claims that these pests are under official control by MAFF in order to limit their spread within Japan. However, in practice, MAFF does not appear to have internationally recognized official control programs for domestically grown produce.

After repeated requests by foreign governments for reform, 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 ten common insect species found on U.S. fresh fruits and vegetables, which are also known to occur in Japan. The United States will continue to urge Japan to adopt international standards, to develop a comprehensive list of non-quarantine pests, and to reduce excessive, unnecessary, trade-distorting and costly fumigation requirements.

Biotechnology

While Japan has adopted a largely scientific approach in its approval process for agricultural biotechnology products, the United States is concerned with the recent changes in Japan's regulatory system, and seeks assurances that new requirements will be science-based, clearly stated, and will provide sufficient time for compliance as well as a smooth transition in order to reduce risk of trade disruption.

To date, MAFF and the MHLW, which regulate biotechnology products, have approved the importation of 55 biotechnology plant varieties for food, including corn, potatoes, cotton, and soybeans. In July 2003, Japan inaugurated a Food Safety Commission (FSC) with responsibility for performing food related risk evaluations. It is still unclear what exact role the FSC will play and what new assessment procedures will be required. Also unclear is what will be required in the mandatory environmental reviews for biotechnology products.

The United States is also concerned by Japan's efforts to expand mandatory labeling of foods made from the products of biotechnology because, by suggesting a health risk, such labeling may discourage consumers from purchasing these foods. In 2002, MAFF included potato products, frozen potatoes, dried potato, potato starch and potato snacks in the mandatory biotechnology-labeling scheme. The United States believes consumers should have information on foods that have been produced through

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biotechnology, but alternatives to mandatory labeling, such as educational materials, public discussions, and voluntary labeling regimes, can provide more meaningful information to consumers. The United States is also concerned by MAFF's plans to expand mandatory labeling on feed and seed, which are now being discussed internally in the Ministry.

The United States is urging Japan to continue to participate in discussions on biotechnology advancement and regulation in international fora, such as the WTO, the Codex Alimentarius Commission, the OECD and APEC. Given the continuous development of new biotechnology-produced food products, the United States and Japan share a common interest in working together to promote effective food safety policies.

Restrictive Food Additive List

Japan's overly restrictive list of food additives still limits imports of U.S. food products, especially processed foods. Japanese regulations, which limit the use of specific food additives on a product-by-product basis, are out of step with international practice. For example, Japan refuses to allow the importation of light mayonnaise, creamy mustard, or figs containing potassium sorbate, a food additive evaluated and accepted by numerous national and international standard-setting organizations, including the Joint FAO/WHO Experts Committee on Food Additives. However, Japan allows its use in 36 other foods, most of which are traditional Japanese food products not normally produced outside of Japan.

Feed Additive Ban

In August 2002, MAFF publicly announced its intent to ban 29 animal feed additives. After gathering additional information, MAFF decided in October to ban only those additives that could create a resistance problem for humans. Antibiotic animal feed additives have been in use for over 30 years. Many countries, including the United States, are in the process of reviewing regulations regarding the use of these antibiotics. In December 2002, the United States received conflicting reports that Japan had decided to move forward with a ban in advance of a report on the matter from a MAFF scientific committee, and seemingly in the absence of a science-based risk assessment. The United States expressed its concerns to the Japanese government and sought assurances that Japan's review of these additives would be performed in a transparent, thorough, and science-based manner. The Japanese government provided such assurances, and the United States will continue to follow the issue closely to ensure that Japan decides this matter in a manner consistent with its WTO obligations.

Nutritional Supplements

Japan is continuing to liberalize its market for nutritional supplements. However, there are still restrictions or prohibitions on the use of many food additives and ingredients commonly used in markets outside Japan. Consequently, many U.S. nutritional supplement products require reformulation for the Japanese market, a costly process for manufacturers. First in 1996 and again in March 2003, the Japanese Market Access Ombudsman Council issued a recommendation that the nutritional supplement market be liberalized. The Ministry of Health, Labor and Welfare (MHLW) responded by undertaking a scientific study of 46 food additives, out of hundreds that still cannot be brought into Japan. The U.S. Government continues to press Japan to open its market to these producers, to establish a means for industry to consult directly with MHLW, and to make regulatory decisions regarding this area as well as other areas based on clear scientific data.

Other Issues

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- The U.S. textiles industry has raised concerns regarding new, stricter formaldehyde labeling and emissions standards proposed by the Japan Industry Standard (JIS). The new standards, adopted in July 2003, may make it difficult for wall covering manufacturers in the United States to export to Japan. The U.S. Government remains concerned about this non-tariff barrier, and continues to monitor this issue.
- Japan banned imports of U.S. beef in December 2003 with the detection of one positive case of Bovine Spongiform Encephalopathy (BSE) in the State of Washington. As of the publication of this report, the U.S. government is taking aggressive action and is working intensively to re-open the market as quickly as possible. In addition, the United States is working in the International Organization for Epizootics to revise international standards on BSE to reflect current scientific knowledge.
- Japan prohibited imports of U.S. poultry in early 2004 due to outbreaks of avian influenza in some U.S. states. The U.S. government is working with the Japanese government to regionalize the import restrictions to only affected states.

GOVERNMENT PROCUREMENT

Computers

While 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's private sector, access to the Japanese public sector computer market remains problematic. The last bilateral review under the 1992 bilateral Computer Agreement was held in March 2001, at which time Japan presented data showing a very slight increase in the foreign share of the public sector market.

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 has proposed that Japan more fully utilize the Internet for government 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.

Construction, Architecture and Engineering

Two public works agreements are in effect: the 1991 U.S.-Japan Major Projects Arrangements (MPA) and the 1994 U.S.-Japan Public Works Agreement, which includes the "Action Plan on Reform of the Bidding and Contracting Procedures for Public Works" (Action Plan). The MPA included 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). Public works issues are raised in the Trade Forum established under the U.S.-Japan Economic Partnership for Growth. During the 2003 Trade Forum, the United States urged Japan to eliminate the obstacles that prevent U.S. companies' full and fair participation in its public works sector. The United States and Japan agreed to hold expert-level meetings on public works issues parallel to the Trade Forum to address bilateral sectoral concerns in greater detail.

Although existing agreements have introduced positive procedural changes in Japan's large public works market (\$210 billion for 2003), U.S. firms annually obtain far less than one percent of projects awarded. Problematic practices inhibit the full involvement of U.S. design and construction firms in this sector, which has become increasingly competitive due to recent decreases in public works spending by the Japanese government. These practices include failure to address rampant bid-rigging, use of arbitrary

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qualification and evaluation criteria to exclude U.S. firms, unreasonable restrictions on the formation of joint ventures, and the structuring of individual procurements so they fall below thresholds established in international agreements.

The public works market continues to be plagued by bid-rigging practices (*dango*), under which companies consult with one another and prearrange a bid winner. The United States welcomes the recent legal and administrative steps taken to address *dango* and urges the Japanese government to increase its efforts to eliminate these practices and sanction government officials who aid them. Some Japanese firms have submitted bids that are so low that they raise the question as to whether the work can be performed without incurring a financial loss. This is hampering U.S. firms' abilities to offer quality services while remaining competitive.

The United States continues to urge Japan to specify 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. Although the United States is pleased that Japan began using Construction Management (CM) for public projects in 2001, it is concerned that discriminatory qualifying criteria may have been used to impede the involvement of U.S. firms in these procurements. During the 2003 Trade Forum, the United States urged Japan to adopt three CM and one Project Management (PM) project during this fiscal year and to structure them such that the increased efficiencies offered by CM technologies are fully utilized and that foreign firms with appropriate expertise are encouraged to compete. (CM and PM are advanced technologies used to maximize the efficiency of a project by saving time and money.) The United States is concerned about how and when ISO 9000 series registration is being used as qualification criteria and urges Japanese commissioning entities not to use ISO 9000 series registration with the effect of creating a barrier to international trade.

During the 2003 Trade Forum, the United States welcomed the Japanese government's announcement of the implementation of the "mixed-type procurement," which allows companies to decide whether to bid solo or as a joint venture, and encouraged the use of this practice for all projects. The United States urged Japan to abolish the three company joint venture rule, which limits to three the number of members in joint ventures for most construction projects, and to allow companies, not procuring entities, to determine the number of companies that should execute a project. The United States also encouraged the proactive use of joint ventures for Design Architect work.

The United States is promoting U.S. firms' effective participation in Urban Renewal (*Toshi Saisei*) projects and Private Finance Initiative (PFI) projects being undertaken by Japan. During the 2003 Trade Forum, the United States urged the Japanese government to fully disclose information regarding these projects and urged all commissioning entities to use the fair, transparent, and non-discriminatory procedures set forth in the Action Plan for these projects. In October 2003, Japanese private sector organizations hosted the fifth U.S.-Japan Construction Cooperation Forum (CCF), which focused on facilitating the formation of joint ventures between U.S. and Japanese design/consulting and construction companies for PFI projects.

The United States is paying special attention to several major projects covered by the public works agreements of particular interest to U.S. companies. These projects include the New Kitakyushu Airport, Haneda Airport including its expansion stages, Central Japan International Airport, Kansai International Airport, Kobe Airport, Kyushu University Relocation Project, Okinawa Graduate University Project, Japan Railways procurements, laboratory projects commissioned by the Ministry of Education, Culture, Sports, Science and Technology, International Medical Center Project, PFI projects such as the Kudan Government Consolidated Office Building Project and the New Statesman Building, and the remainder of projects stipulated in the MPA. During the 2003 Trade Forum, the United States urged the Japanese

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government to ensure that the procurement procedures set forth in the MPA are used for all outstanding MPA projects.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

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

Patents

The United States has focused particular attention on improving the processing and approval of patent applications, and reforming Japan's practice of affording only narrow patent claim interpretation. 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.

In recent years, Japan has taken a number of steps to address these issues. A revised patent law took effect on January 1, 2000. This law is designed to make it easier for plaintiffs to prove patent infringement in courts. Key provisions include requiring defendants to justify their actions, obligating defendants to cooperate with calculation experts, giving judges discretion over the amount of damages, increasing the penalty in cases where patents were obtained fraudulently, and allowing courts to seek technical advice from the Japan Patent Office (JPO). The United States will continue to monitor closely whether these revisions reduce the cost of access to Japanese courts that has been particularly onerous to foreign patent owners in the past. The United States welcomes these steps to improve the level of patent protection in Japan and will continue working with Japan to strengthen its patent laws in several fora.

Copyrights

The increasing use of the Internet and explosive growth of high-speed access in Japan has presented new challenges for protecting intellectual property rights, especially for copyrighted materials. The protection of this material is critical for electronic commerce to flourish and for the continued development of content-related industries such as games, music, film and software. The United States is therefore concerned that Japan's Internet Service Provider (ISP) liability law does not provide adequate protection for the works of right holders on the Internet or the appropriate and necessary balance of interests among telecommunications carriers, service providers, right holders and website owners. The United States urges Japan to use all the opportunities available to improve these shortcomings in the law. (*For more details, see the Information Technologies section under Sectoral Regulatory Reform.*)

The United States is also concerned about Japan's reluctance to clearly stipulate that temporary copies (e.g., copies in the RAM of a computer) implicate the right holder's reproduction right. Article 9 of the Berne Convention, which is incorporated into the TRIPS agreement, provides that authors must have the right of authorizing the reproduction of their works in any manner or form. The WIPO Copyright Treaty

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and WIPO Performances and Phonograms Treaty, to which Japan is a party, contain an agreed statement affirming that the reproduction right fully applies to works in digital form. Japan has acknowledged that some temporary copies are subject to copyright protection by recognizing that "temporary storage" implicates the reproduction right. The United States urges the Japanese government to widely disseminate this information and clearly define the scope of protection for temporary copies.

The United States urges Japan to reduce the piracy rate, especially in light of the growing threat of online piracy. A notable step toward creating an effective deterrent against piracy 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 set an example for the private sector, the United States urges Japan to issue a statement clarifying Japan's agreement to use only legitimately produced and licensed software in its government operations.

The United States is concerned about the provision on anti-circumvention in the Copyright Law, which states that the penalties for TPM circumvention devices will be applied only to devices whose principal function is circumvention.

In a positive vein, the Diet passed legislation to extend the term of copyright protection for cinematographic works, animation, and video games to 70 years to bring the term of protection closer to the international norms among developed countries. The United States continues to urge the Japanese government to extend all copyright terms to life plus 70 years, or where the term of protection of a work (including a photographic work), performance or phonogram is to be calculated on a basis other than the life of a natural person, to 95 years.

Trademarks

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

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. Of particular concern is Japan's register of well-known marks, where employees of the Japan Patent Office make *ex officio* determinations whether a mark is well-known or not. One defect of the "list" approach to well-known mark protection is that one can essentially pay one's way onto the list by requesting defensive registrations in many classes.

Geographical Indications (GI)

Articles 22 to 24 of the TRIPS Agreement set forth the obligations of WTO Members with respect to geographical indications and their relationships to trademarks. It is unclear whether Japan currently provides interested parties with the legal means to prevent misuse of a geographical indication or whether Japan provides trademark owners with the legal means for resolving conflicts between trademarks and asserted geographical indications, as required by the TRIPS Agreement. The United States understands that the Japanese government is currently studying the issue of geographical indication protection and fully supports that effort. Already, the United States has participated in a digital video conference with Japanese Officials and has provided extensive information on the U.S. GI system to AIPPI-Japan, a research arm for the Japanese Patent Office. Outstanding questions in this area remain of particular

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concern since it is unclear whether Japan maintains an undisclosed list of protected geographical indications against which applications for trademark registration are reviewed. MAFF recently proposed the use of geographical indications to protect the identity of traditional food products from well-known production areas in Japan but it is unclear how Japan would implement such protection. The United States looks forward to receiving further information on this issue.

Trade Secrets

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

Border Enforcement

The United States continues to monitor the Japan Customs and Tariff Bureau's (JCTB) implementation of the policy to allow parallel imports of patented products based on a 1997 Japan Supreme Court. Further, insofar as Japan provides *ex officio* border enforcement of trademarks and copyrights through the JCTB, efforts should be made to enhance such enforcement through aggressive interdiction of infringing articles. In an effort to bolster Japan's border control measures, the United States has urged Japan to improve its application, inspection and detention procedures to make it easier for foreign right holders to obtain effective protection against infringed intellectual property rights at the border. Although Japan increased the amount of resources devoted to enforcement during 2003, the United States urges Japan to continue to improve and tighten its border enforcement to ensure effective implementation of TRIPS obligations.

SERVICES BARRIERS

Insurance

Japan's private insurance market is the second largest in the world, after that of the United States, with direct net premiums of an estimated \$319 billion in FY 2002. In addition to the offerings of Japanese and foreign private insurers, there is a large public sector provider of postal life insurance products (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.

Given the size and importance of Japan's private insurance market, the United States continues to place a high priority on establishing a regulatory framework that ensures an open and competitive insurance market in Japan. The United States utilizes several opportunities and fora to raise and address several issues of concern, including through the annual U.S.-Japan bilateral insurance consultations, regularly scheduled Working Groups under the U.S.-Japan Regulatory Reform and Competition Policy Initiative, and regular contact between embassy officers and Japanese government representatives from the relevant Ministries.

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Two bilateral Insurance Agreements, implemented in 1994 and 1996, are in effect and have contributed significantly to the deregulation of the Japanese insurance market. Largely as a result of positive changes brought about by these agreements, foreign insurance companies have substantially increased their presence in Japan, now holding an estimated 5.4 percent share of the total non-life insurance market and 20 percent of the total life insurance market. In the third sector, foreign firms have captured approximately 61 percent of the health-related insurance market and about 24 percent of the non-life market. In addition, new business partnerships and recent acquisitions in this sector involving foreign firms have significantly increased foreign presence in Japan.

Several issues of concern, however, emerged during 2003, including the lack of a level playing field between private industry and Kampo/Kyosai, the introduction of new product offerings by Kampo, and uncertainty regarding future funding of the life and non-life insurance safety net systems or Policyholder Protection Corporations. The United States raised its serious concerns about these and other key issues during U.S.-Japan bilateral insurance consultations, held in Tokyo on November 17, 2003.

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. In April 2003, the three postal services, including Kampo, were transferred to a public postal corporation (Japan Post), which is supervised by the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT).

Kampo and Kyosai enjoy significant tax, legislative and regulatory advantages over private sector insurers. For example, while Kampo and the Kyosai compete with the private sector, both are exempt from Japan's Insurance Business Law and from contributing to Japan's insurance safety net systems. In addition, Kampo and Kyosai both possess advantageous tax status, which in Kampo's case, exempts it from paying any corporate and income taxes. Despite expectations that the Koizumi Administration would move aggressively to reduce the public sector's substantial participation in the insurance market, this has not occurred, and Kampo remains by far the largest player in the insurance market. In FY 2002, there were 84 million Kampo issued life insurance policies in force compared to just 123 million for all private life insurance companies combined. In addition, according to the Japan Cooperative Insurance Association, Kyosai-issued policies amounted to 20 percent of all in-force life policies, and 39 percent of all in-force non-life policies in Japan in FY 2001.

The United States has continuously voiced its Kampo-related concerns to the Japanese government, stressing the need for, inter alia, the continued prohibition on Kampo's ability to underwrite any new insurance products until there is a regulatory level playing field; and for postal financial institutions to be subjected to the same legal, tax and business requirements as their private sector counterparts. As any modification to the postal financial system could have significant impact on competition in the Japanese insurance market, the U.S. Government also strongly urged that any decisions related to the future of the postal financial institutions, including possible privatization, be made and implemented in an open and transparent manner, in full consultation with domestic and foreign private insurers.

Japan Post announced in the fall of 2003 that Kampo would seek approval for a new product which includes a rider providing for supplemental health coverage under a hybrid whole life and term life contract. This product would provide health and life coverage that would expand and contract according to the age of the insured, and is designed to maximize coverage during life cycle periods when the insured is most likely to need it.

The U.S. Government objected strongly to the proposed new product offering, which competes directly for the first time with private sector insurance offerings. It urged MPHPT to listen to concerns raised

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about the new product by the Japanese private sector, other Japanese government agencies, Japanese industry analysts, media, and Japan's major trading partners B and to not approve the new product offering. Unfortunately, MPHPT's Postal Services Policy Council approved the new product offering on November 14, 2003, and Japan Post introduced it in January 2004. The United States will closely monitor the impact this product will have on private insurers and the Japanese insurance market, and urges the Japanese government to prohibit the introduction of any new product offerings by Kampo until there is a level playing field.

The life and non-life Policyholder Protection Corporations (PPCs) are mandatory policyholder protection systems created in 1998 to provide capital and management support to insolvent insurers. The Life PPC fund, in particular, had been nearly depleted as a result of industry failures. Private sector insurers have contributed considerable sums to the PPC systems, and U.S. industry, particularly life insurers, has expressed serious concern at the prospect of additional contributions. The United States has raised the need for transparency in determining future PPC funding, and stressed the need for a sustainable funding framework that did not unfairly burden the private sector and lead to greater imbalance in the competitive playing field with Kampo.

On June 8, 2003, the Japanese government implemented legislation to extend its funding guarantee to the Life PPC that would assess private sector life insurers an additional 100 billion yen. The Japanese government also said that it would thoroughly review the PPC system and consider reforms long recommended by private insurers. U.S. insurers, although displeased with the additional levy, welcomed the review. While commending the Japanese government for its decision to extend its financial commitment to the policyholder protection fund, as well as its commitment to review promptly and thoroughly the safety net system, the U.S. Government has urged throughout 2003 that any such review be undertaken in a timely manner, and stated that the deliberation process should be transparent and should involve interested parties, including foreign insurance companies. The U.S. Government has pressed the Japanese government to begin its review soon, in order to ensure that it is completed, and necessary legislation enacted, before the current Life PPC structure expires on March 31, 2006.

Kyosai operations have also received increased attention in 2003. Some Kyosai are regulated by their respective agencies of jurisdiction (Ministry of Agriculture, Forestry and Fisheries, or Ministry of Health, Labor and Welfare, for example); while others operate without any regulatory supervision. These separate regulatory schemes undermine the ability of the Japanese government to provide companies and policyholders a sound, transparent regulatory environment, and afford Kyosai critical business, regulatory and tax advantages over their private sector competitors. The U.S. Government has stated its position that all Kyosai should be subject to the same regulatory standards and oversight as their private sector counterparts to ensure a level playing field, as well as to protect Japanese consumers.

Since April 2001, banks have been permitted to sell long-term fire insurance, debt repayment support insurance, credit life insurance, and overseas travel accident insurance. In October 2002, the list of permissible products was expanded to include individual annuities, maturity refund personal accident insurance with an annuity payout feature, *zaikei* (asset formation) insurance, and *zaikei* personal accident insurance. Although the U.S. Government welcomes the liberalization of bank sales of annuities, the above list represents only a tiny fraction of the universe of private insurance products that could be made available to Japanese consumers through the bank sales channel. The U.S. Government has urged the Japanese government to promptly and completely liberalize the bank sales channel to allow banks to sell all types of insurance offered by any regulated private insurer and not specifically target third sector products by liberalizing only that sector first. In order to promote bank sales of insurance in a manner that effectively serves the financial planning needs of consumers, the U.S. Government believes the Japanese government should promptly allow banks to use non-financial customer information for the

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purpose of offering insurance products to bank customers upon gaining customer consent on an opt-out notification basis.

The United States will continue to work closely with industry in following these issues and urge the Japanese government to adequately resolve these concerns in an open and transparent manner.

Professional Services

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

Accounting and Auditing Services: U.S. providers of accounting and auditing services face regulatory and market access barriers in Japan that impede their ability to serve this important market. Only Certified Public Accountants (CPAs) or Audit Corporations (made up of five or more Japanese CPAs) can offer accounting services, and foreigners have to pass a special examination to qualify, an examination last offered in 1975. The United States will continue to urge Japan to remove restrictions on accounting services.

Legal Services: As noted above in the "legal system reform" section, 2003 brought sweeping reform in the area of association between Japanese and foreign lawyers, and the new system of Joint Law Firms (*kyodo jigyo*) will be implemented no later than mid-2005.

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

Educational Services: Over-regulation also has discouraged foreign universities from operating branch campuses in Japan, presenting obstacles in the form of both administrative requirements and restrictions on pedagogical choices. The U.S.-Japan Investment Initiative is taking up these issues, and the U.S. Government has urged greater flexibility through the establishment of a new category for foreign institutions of higher education and/or recognition of U.S. accreditation.

INVESTMENT BARRIERS

Despite being the world's second largest economy, Japan continues to have the lowest value of inward foreign direct investment (FDI) as a proportion of total output in any major OECD nation. Foreign participation in mergers and acquisitions (M&A) activity, which accounts for some 80 percent of FDI in other OECD countries, also lags in Japan, although it is on an upward trend. The relative lack of foreign investment can act as a restraint on the expansion of imports. Much of the recent increase in FDI flows represents important opportunities and restructuring in the financial services and telecommunications sectors. Meanwhile, inward FDI is dwarfed by Japan's outward investment flows (\$32.3 billion in CY2002 and \$38.3 billion in CY2001). The Japanese government has recognized the importance of FDI in revitalizing its economy, and Prime Minister Koizumi vowed in January 2003 to double the stock of FDI in Japan in five years. He has set up an "Invest Japan" office under JETRO and encouraged local governments to be more active in welcoming foreign investment and even produced an advertisement to

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be placed in Europe and the United States. Japan has taken several steps in recent years to improve the FDI environment, including passage of legislation in 2003 to permit the use of triangular stock swaps for international M&A deals. U.S. businesses have applauded these changes, but they continue to urge that tax rules be clarified and amended to facilitate use of these measures.

Cross-border M&As are more difficult in Japan than in other countries, partly because of conservative attitudes towards outside investors and partly because of the relative lack of financial transparency and disclosure and differing management techniques. The scarcity of qualified lawyers, auditors, and accountants is another impediment. Nevertheless, some progress has been made through the introduction of consolidated taxation and revised bankruptcy procedures that make it easier for corporations and their assets to be acquired or merged in a "rescue" format.

U.S. proposals for M&A include: (1) making more assets available and reducing due diligence costs; (2) removing the surcharge on consolidated taxation to lower the post-tax cost to parent firms of investing in new risk ventures; (3) improving corporate governance practices to reduce the management bias favoring loyalty to the firm over a return to shareholders; (4) continuing financial market reform, allowing new techniques like triangular mergers and cash mergers (including short-form mergers); (5) improving financial data disclosure; and (6) increasing the availability of M&A-related services, including further easing of restrictions on the accounting and legal professions. The United States and Japan are also exploring ways to facilitate investment in the education and medical service sectors, where regulatory regimes severely restrict foreign participation.

The U.S.-Japan Investment Initiative co-chaired by the U.S. Department of State and Japan's Ministry of Economy, Trade and Industry (METI) was established in 2001 to focus on needed changes in the basic operating rules of Japanese markets and to encourage policy changes to improve the overall environment for foreign (and domestic) investment. The Investment Initiative has held a series of meetings and seminars, scheduled again for 2003-4. The private sector participates actively in this process and has offered detailed suggestions on how to increase transparency, as well as recommending the introduction of new financial instruments for international transactions.

ANTICOMPETITIVE PRACTICES

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

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 often 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. As of December 15, 2003, there were still 39 JFTC-authorized premium codes.

ELECTRONIC COMMERCE

The United States made numerous recommendations in its October 2003 Regulatory Reform submission for increasing consumer confidence and promoting electronic commerce in the private sector, including: removing regulatory and non-regulatory barriers, strengthening the protection of intellectual property

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rights, implementing new privacy legislation in a transparent and consistent manner, ensuring effective network security, and facilitating online transactions and electronic government. The United States is urging Japan to support private sector self-regulatory mechanisms for privacy and alternative dispute resolution, as well as to ensure that laws governing electronic transactions are technology-neutral. The United States will continue to work with Japan on these and other electronic commerce issues through the IT Working Group under the Regulatory Reform Initiative. (*For more details, see the Information Technologies section under Regulatory Reform.*)

Online Procurement: The United States welcomes and supports the Japanese government's measures to digitize administrative procedures at all levels of government. Recognizing the key role that electronic government has in providing the impetus for spurring electronic commerce in the private sector, the United States recommends that Japan further expand and accelerate its electronic government programs to facilitate online transactions between the government and consumers and businesses for procurement, information and online services such as applications and licensing. MPHPT launched its online bidding system for non-public works in November 2002, while all other ministries are expected to do so by April 2004. The United States has urged the Japanese government to design online procurement systems that promote fair and open tendering procedures; and support the concepts of transparency, efficiency, security, and private sector leadership.

OTHER BARRIERS

Aerospace

Japan is the largest foreign market for U.S. aircraft and aerospace products. In 2003, the United States accounted for approximately 87 percent of Japan's aerospace imports, valued at \$3.8 billion. Many Japanese firms have entered into long-term relationships with American aerospace firms.

The commercial aerospace market in Japan is generally open to foreign firms, but the United States is monitoring Japan's funding of feasibility studies for new projects and technologies, and its important role in apportioning work among major Japanese aerospace companies. A recent proposal by METI to develop a 30-to-50-seat commercial aircraft, replacing the earlier YSX project, bears monitoring.

Military procurement by the Japan Defense Agency (JDA) accounts for over half of the domestic production for aircraft and aircraft parts, and continues to offer the largest source of demand in the aircraft industry. Japanese defense projects are carried out according to the current Mid-Term Defense Program (JFY 2001 – JFY 2005) with a projected budget of 25.16 trillion yen, or approximately \$206 billion, over this five-year period. Major projects include: modernization of the F-15 fighter aircraft, procurement of the F-2 fighter support aircraft, air refueling tankers, Apache Attack helicopters, AEGIS destroyers, and development of fixed wing patrol (P-X) and air transport (C-X) aircraft.

Although U.S. firms have frequently won contracts to supply defense equipment to Japan (over 90 percent of the annual foreign defense procurement is from the United States), the JDA has a general preference for domestic production or the licensing of U.S. technology for production in Japan to support the domestic defense industry.

Although Japan has considered its main space launch vehicle programs as indigenous for many years, in fact U.S. firms continue to participate actively in those space systems, including Japan's primary space launch vehicle, the H2-A. The U.S. Government has welcomed Japan's plans to develop a supplementary GPS navigation satellite constellation known as the "quasi-zenith" system, with the first launch scheduled for 2008. The United States is working very closely at the technical level with Japanese counterparts to ensure the Japanese system remains compatible with ours, and anticipates that U.S. companies will have

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the opportunity to supply major components of this system. The United States will continue to promote expanded access by American firms to commercial opportunities within Japan's domestic space programs as appropriate.

Autos and Auto Parts

Further opening of the Japanese auto and auto parts markets remains an important objective of the United States. Access to Japan's automotive market continues to be impeded by a variety of overly restrictive regulations, a lack of transparency in rule making, and lackluster enforcement of antitrust laws. While there has been a trend toward closer integration and important technological advancements in the global automotive industry over the past several years, the effect these changes will have on market access and competition in this sector remain unclear.

The U.S. Government remains disappointed with falling sales of North American-made vehicles and parts in Japan. Sales of motor vehicles produced in the United States declined in 2003, with sales decreasing by 15 percent (year-on-year) following a decline of 17 percent in 2002. U.S. automakers sell less than a quarter as many U.S.-made vehicles in Japan as they did in 1995.

Even as American automakers have invested in Japanese auto manufacturers, foreign access to Japan's automotive distribution network remains troubling to U.S. auto companies. The U.S. automotive trade imbalance with Japan, \$44 billion in 2003 (\$32 billion deficit in autos and \$12 billion deficit in auto parts), is the equivalent of more than 66 percent of the overall U.S. trade deficit with Japan and made up eight percent of the 2003 worldwide U.S. trade deficit.

The Automotive Consultative Group, which is co-chaired by USTR and the Department of Commerce on the U.S. side and METI and Ministry of Land, Infrastructure, and Transport (MLIT) on the Japanese side, met in January 2003. The group discussed industry trends based on a series of trade and economic data on autos and automotive parts provided by both countries and identified areas in which specific action can be taken by Japan to address U.S. concerns. This would include further deregulation (particularly in the automotive parts aftermarket), increased transparency in rules and regulations governing this sector, and more rigorous application of Japanese competition laws. The United States also continues to address cross-cutting issues affecting the automotive sector, such as expanding opportunities for foreign investment, increasing transparency in rule making, and promoting corporate restructuring in the Japanese economy under the Economic Partnership for Growth.

Civil Aviation

Market access for U.S. air carriers in Japan improved significantly with the 1998 bilateral civil aviation agreement, but carriers remain constrained by extremely high airport costs in Japan and by enduring restrictions on traffic rights, operational flexibility, and pricing.

In the 1998 MOU, the two sides agreed to hold further negotiations by 2001 "with the objective of fully liberalizing the civil aviation relationship between Japan and the United States." Although negotiations had been stalled in recent years, in November 2003, officials at Japan's MLIT and the U.S. Government re-engaged in informal talks. Formal talks followed in January 2004 but produced little common ground. The U.S. Government, however, continues to engage MLIT to advance liberalization. The chief U.S. concerns are increased rights for non-incumbent cargo carriers, pricing liberalization, code-sharing, and improvements in the regime for Japan-Pacific Islands service.

Unnecessary restrictions on movements at Narita airport are partially responsible for limited slot availability. In periods of high demand, U.S. non-incumbent combination carriers have been unable to

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operate several routes made available under the 1998 Memorandum of Understanding (MOU). A second runway opened in April 2002 provides additional slots, but at less than 2500 meters, the runway cannot accommodate most long-haul operations. The issue of excessively high landing fees at Narita and Kansai airports continues to be raised in the U.S.-Japan Regulatory Reform talks and in bilateral aviation discussions. (*See Regulatory Reform Initiative, Distribution Section*)

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

Electric Utilities

The United States continues to stress that by introducing genuine competition into non-fuel procurement (valued at approximately \$11 billion annually), Japan can effectively reduce the costs of its electric power, which remain the highest in the industrialized world. U.S. exports currently account for approximately 3.5 percent of Japanese electric utility procurements, or around \$385 million per year. Should barriers be lifted, that share could plausibly rise to five percent, or around \$550 million per year.

Japan's utilities actively participate in the New Orleans Association (NOA), a U.S. Embassy-sponsored forum that enhances communication between Japanese electric power utilities and U.S. suppliers of non-fuel materials, equipment, and services. The United States continues to urge Japanese utilities to further increase procurement of foreign products and services (which often prove more economical) to seek greater transparency and fairness in the procurement process.

Nevertheless, foreign firms face barriers due to standards and specifications used by Japanese utilities that often discriminate against or disproportionately burden foreign suppliers. Problems remain in the use of narrow, dimension-based technical standards rather than performance-based technical standards, and requirements that suppliers provide detailed information for spare parts originating from outside sources. In addition, because each utility uses its own specifications (in some cases, different departments of a utility use their own specifications), suppliers must prepare more than ten production lines in order to sell to Japan's ten electric power companies. Finally, good access to procurement information is difficult to obtain.

Flat Glass

Japan's three domestic flat glass producers to date have maintained largely constant market shares through informal coordination and tight control over distribution channels, thereby restricting market access for U.S. manufacturers. In 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.

The United States engaged Japan in discussions under the Enhanced Initiative on Deregulation and Competition Policy. As a result of these discussions, the Japanese government recognized the economic benefits of competition in the distribution sector. Japan also confirmed that it would be detrimental to competition and a violation of Japan's Antimonopoly Act for distributors to collude to exclude imported or other competitors' products from entering the market, and METI agreed to continue to pursue economic reforms to ensure competition in the distribution sector.

The United States has expressed its concerns regarding access to the flat glass market, most recently in the U.S.-Japan Trade Forum held in July 2003. The U.S. Government highlighted the continuing problems that prevent market entry. The United States continues to urge Japan to take concrete steps to

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promote competition in, and access to, its glass market, and for Japan's Fair Trade Commission to continue monitoring of the market.

Motorcycles

Japan's ban on tandem riding of motorcycles (carrying a passenger) on motorways is the only remaining restriction on motorcycling in Japan that the United States seeks to eliminate. The ban artificially limits Japan's market for large motorcycles, adversely affecting U.S. exports. More important, by forcing riders to use less-safe ordinary roads, the ban significantly reduces the safety of motorcycling in Japan.

The Japan Automobile Manufacturers Association (JAMA) has recommended that Japan lift its ban on tandem riding of motorcycles on highways in Japan, and in February 2001, released a report summarizing a survey it conducted on motorcycle tandem riding on expressways in Europe (specifically, in Germany and Italy). It found that accidents involving tandem motorcycle riders on expressways are extremely rare, and for motorcycles, traveling on expressways is much safer than on public roadways. The report noted that the accident rate involving motorcycle tandem riders is below that of single riders, and no cases could be found in which tandem riding actually caused motorcycle accidents on expressways.

The Japanese government continues to consider the U.S. petition against the ban. Removing the ban on tandem riding of motorcycles on motorways would involve changing Japanese law. In December 2003, the Japan National Police Agency (NPA) announced on its website its intention to seek revision of the Road Traffic Law. The proposed revision includes a repeal of the ban on motorcycle tandem riding on highways for persons 20 years or older that have held large- or medium-size motorcycle driving licenses for more than three years. The U.S. Government strongly supports this reform.

Paper and Paper Products

The United States remains concerned that there has been no meaningful increase in Japanese imports of paper and paperboard products. The level of import penetration for paper and paperboard products in Japan remains the lowest in the industrialized world. According to U.S. producers, exclusionary business practices remain a key problem. U.S. industry representatives estimate that the removal of systemic barriers to the Japanese paper market would result in at least a 10 percent share for U.S. suppliers, or approximately \$5 billion, compared to the current level of \$770 million.

Sea Transport/Ports

U.S. carriers serving Japanese ports have long encountered a restrictive, inefficient, and discriminatory system of port transportation services. In 1997, the U.S. Federal Maritime Commission assessed a \$100,000 fee on each ocean voyage to the United States by Japanese shipping lines, prompting Japan to agree in October 1997 to substantial regulatory reform of its ports sector. The U.S.-Japan understanding also noted side agreements designed to reduce the power of the Japan Harbor Transport Association (JHTA) from deterring competition in the sector. Japan amended its Port Transport Law (effective November 2000) to eliminate the need for new entrants to prove there is surplus demand. Also, fees no longer need to be approved by the Ministry of Land, Infrastructure and Transport (MLIT).

Since 1999, the United States has expressed its concern that reforms have not lessened JHTA's ability to deter new entry and restructuring in the ports sector. The United States has also noted that the revised Port Transport Law contains cumbersome administrative requirements, gives MLIT wide authority to intervene in pricing decisions of terminal operators, and increases minimum permanent staffing by 50 percent. MLIT has not addressed concerns about the prior consultation process nor about the apparent

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threat of illegal strikes against foreign carriers who obtain permission to operate their own container terminals.

The United States' concerns led the Federal Maritime Commission, in August 2001, to order major Japanese shipping lines and ocean carriers that provide substantial U.S.-Japan service to furnish detailed information on the effects of recent changes in Japanese port laws and ordinances. The United States will continue to closely monitor how these changes affect port operations and to urge faster regulatory reform in the port sector. However, both the Japanese and U.S. positions have solidified over the years. At the February 2003 High Level Regulatory Reform meeting, the U.S. Government reiterated its position that the Japanese government has failed to implement important aspects of the wide-ranging port deregulation promised in 1997.

Steel

U.S. steel producers have previously expressed concerns that Japanese steel companies may be engaging in anticompetitive practices. With respect to Japan's domestic market, it has been alleged that Japan's integrated producers have coordinated output, pricing, and market allocation goals. In addition, it has been alleged that Japanese mills have entered into arrangements with foreign counterparts to regulate bilateral steel trade.

Japan participated constructively in bilateral consultations and in OECD High-Level Meetings on Steel during 2003 aimed at reducing excess, inefficient steel-making capacity around the world. The United States will continue to actively address anticompetitive activity, market access barriers, and/or market-distorting trade practices in the steel sector in appropriate multilateral fora, as well as on a bilateral basis.