2001 Country Reports on Economic Policy and Trade Practices
Released by the Bureau of Economic and Business Affairs
U.S. Department of State, February 2002

JAPAN

Key Economic Indicators

(Billions of U.S. dollars unless otherwise noted)

	1999	2000	2001	
Income, Production and Employment:				
Nominal GDP	4,505	4,753	4,129	1/
Real GDP Growth (pct)	0.8	1.5	-0.5	1/
GDP by Sector:				
Agriculture	58	N/A	N/A	
Manufacturing	970	N/A	N/A	
Services	882	N/A	N/A	
Government	403	N/A	N/A	
Per Capita Income (US$)	34,283	36,455	N/A	
Labor Force (millions)	67.8	67.7	68.0	1/
Unemployment Rate (pct)	4.7	4.8	5.0	2/
Money and Prices (annual percentage growth):				
Money Supply (M2+CD)	3.6	2.1	2.9	1/
Consumer Price Inflation	0.3	-0.6	-0.7	1/
Exchange Rate (Yen/US$ - annual average)	13.91	114.9	121	3/
Balance of Payments and Trade:				
Total Exports FOB	403.9	434.0	180	4/
Exports to United States FOB	121.8	129.0	63	4/
Total Imports CIF	280.5	344.2	184	4/
Imports from United States CIF	57.8	65.3	34	4/
Trade Balance	123.4	89.8	30	4/
Trade Balance with United States	64.0	63.7	29	4/
Current Account Surplus/GDP (pct)	2.4	2.5	2.2	1/
External Public Debt	N/A	N/A	N/A	
Fiscal Deficit/GDP (pct)	7.9	-7.5	-6.2	1/
Debt Service Payments/GDP (pct)	N/A	N/A	N/A	
Gold and Foreign Exchange Reserves	288.1	368.3	360	2/
Aid from United States	0	0	0	
Aid from All Other Sources	0	0	0	

1/ 2001 figures are IMF projections (World Economic Outlook, September 2001).
2/ As of end-July, 2001.

3/ January-August 2001, average.
4/ January-June 2001, seasonally adjusted, BOP basis.
Sources: IMF, OECD, Ministry of Finance, Bank of Japan, Economic & Social Research Institute (Cabinet Office).

1. General Policy Framework

The Japanese economy is once again entering recession, in response to weakening external demand and reduction of worldwide investment in high technology sectors. Industrial production and manufacturing employment have both fallen sharply through mid-year, and most private forecasts expect a GDP decline of roughly one percent in 2001, with little if any growth in the following year.

Japan's economic performance has been disappointing for most of the past ten years, with uneven but generally low growth, and persistent deflation (general price declines). The sources of Japan's economic difficulties go back to the collapse of the asset-price bubble in 1991, which left the banking and corporate sector with excessive and often unproductive investment and a huge volume of bad debts. Regulatory barriers that have prevented resources from moving to new growth sectors, and a decline in rates of return on investment have also compounded Japan's economic difficulties.

Until this year, the government response to Japan's sluggish economy has been an expansionary fiscal policy, through a series of supplemental budgets, emergency spending packages (largely concentrated on public works), and special loan guarantees to stem the tide of corporate bankruptcies. The current Koizumi government has sought to break from the policy of fiscal support by capping the government budget deficit and promising thoroughgoing structural reform "without sacred cows." The Bank of Japan has also reduced interest rates on short term funds to essentially zero, but its ability to lower real interest rates has been hampered by persistent deflation.

2. Exchange Rate Policy

The Japanese yen floats against other currencies, although the Japanese authorities have, at times, intervened to counter rapid exchange rate movements. The average exchange rate through the first eight months of 2001 was 121 yen per dollar, compared to 107 yen per dollar in 2000. A new Foreign Exchange Law in April 1998 decontrolled most remaining barriers to cross-border capital transactions.

3. Structural Policies

Pricing Policy: Japan has a market economy, with prices generally set in accordance with supply and demand. However, with high gross retail margins (needed to cover high fixed and personnel costs) and a complex distribution system, Japan's retail prices exhibit greater downward stickiness than in other large market economies. Some sectors, such as construction, are susceptible to cartel-like pricing arrangements, and the government can exert limited authority over pricing in heavily regulated sectors (e.g., transport and warehousing).

Tax Policy: Total tax revenues as a share of the Japanese economy are comparable to the United States. Recent legislation reduced the effective corporate tax rate (combined central and local government) to 40.9 percent, in line with other OECD countries. The maximum marginal rate for personal income taxes was also reduced from 65 percent to 50 percent. There is a "consumption tax" (actually Value-Added Tax) of five percent.

Regulatory and Deregulation Policy: Japan's economy is highly regulated. Although the government and business community recognize that deregulation is needed to spur growth, opposition to change remains strong among vested-interest groups, and the economy remains burdened by numerous national and local government regulations, which have the effect of impeding market access by foreign firms. Official regulations also reinforce traditional Japanese business practices that restrict competition, block new entrants (domestic or foreign), and raise costs. These include high telecommunications interconnection rates, prolonged approval processes for medical devices and pharmaceuticals, and restrictions on foreign lawyers. The Japanese government has concluded an antitrust cooperation agreement with the United States. However, enforcement of competition policy needs additional rigor.

In June 2001, President Bush and Prime Minister Koizumi agreed on a Regulatory Reform and Competition Policy Initiative as part of the new U.S.-Japan Economic Partnership for Growth. During its first year, the Initiative will establish four sectoral working groups to promote deregulation in the telecommunications, information technology, energy, and medical devices/pharmaceutical sectors. An additional "cross-sectoral" working group will address topics that have widespread impact on the economy, including competition policy, transparency in government rule-making, legal reform, commercial code issues, distribution, customs' clearance procedures, business facilitation, and other cross-sectoral issues not directly addressed in the sectoral working groups.

4. Debt Management Policies

Japan is the world's largest net creditor. The Bank of Japan's foreign exchange reserves exceed $270 billion. It is an active participant together with the United States in international discussions of developing-country indebtedness issues in a variety of fora.

5. Significant Barriers to U.S. Exports

Japan is the United States' third largest export market, after Canada and Mexico. The United States is the largest market for Japanese exports. However, in many sectors U.S. exporters continue to have incomplete access to the Japanese market. While Japan has reduced its formal tariff rates on most imports to relatively low levels, it has maintained non-tariff barriers, such as nontransparent regulations and government procedures, discriminatory standards, and exclusionary business practices. Japan also tolerates a business environment that protects established companies and restricts the free flow of competitive foreign goods into the Japanese market.

Transportation: In January 1998, the United States and Japan concluded a new agreement to significantly liberalize the trans-Pacific civil aviation market. This eliminated many restrictions and resolved a dispute over the rights of longtime carriers to fly through Japan to other international destinations. It opened doors for carriers that had recently entered the U.S.-Japan market, more than doubling their access to Japan. The agreement also allowed code sharing (strategic alliances) between American and Japanese carriers for the first time, thereby greatly increasing their operational flexibility. While U.S. carriers have been generally happy with the results of the 1998 agreement, scarcity of slots at Narita airport, along with expensive and inadequate facilities, have limited carriers' ability to use new traffic rights.

U.S.-flag vessels serving Japanese ports have long encountered a restrictive, inefficient and discriminatory system of port transportation services, which prevents foreign shippers from handling their own cargos. After the Federal Maritime Commission (FMC) ruled in 1997 that Japan maintained unfair shipping practices and imposed fines against Japanese ocean freight operators, the Japanese Government pledged to grant foreign carriers port transport licenses and to reform the Japan Harbor Transport Association's prior consultation system, which effectively allocates stevedoring work and restricts new entrants. The revised Port Transportation Business Law, which went into effect in November 2000, mandated that new entrants maintain staffing at 150 percent of current minimums. The FMC continues to monitor the situation.

Energy: The government of Japan has taken a number of steps to begin deregulating its energy sector, including allowing companies with captive power assets to market excess generating capacity to major factories and other major users in March 2000. Within the Regulatory Reform and Competition Policy Initiative under the US-Japan Economic Partnership for Growth framework, the U.S. government is encouraging Japan to speed up the process and create a more transparent and competitive environment for new entrants into the energy market. Open and non-discriminatory access to electrical transmission and distribution grids, and to LNG terminals and pipelines, are key steps for Japan. Competitive, transparent pricing also remains as an important unresolved issue in the Japanese market.

Agricultural and Wood Products: Japan is the largest export market for U.S. farm and wood products. Sales are limited, however, by a variety of protectionist measures maintained by the government of Japan. Key priorities for trade liberalization include tariff reduction on raw and value-added products, elimination of unnecessary plant quarantine measures, more market oriented domestic farm policies, recognition of certification on organic foods and wood products, a commitment to science-based policies and education programs on foods produced through biotechnology, and continued deregulation of the housing sector affecting access for wood products.

Tariff Reduction: Significant tariff reduction in Japan was achieved through the Uruguay Round Agreement, but agricultural tariffs in Japan remain high, ranging from 10 to 40 percent on a wide variety of items, including beef, oranges, and many processed foods. Tariffs on processed wood products place additional costs on end-users. These tariffs limit sales of U.S. farm products by encouraging substitution and/or reducing consumption altogether.

Plant Protection and Quarantine Measures: Japan's failure to adopt system-wide sound scientific plant protection principles restricts entry of a wide variety of U.S. fresh fruits and vegetables. FAS/Japan estimates that unnecessary plant quarantine restrictions and requirements cost U.S. agriculture more than $500 million in lost sales opportunities every year. Japan unnecessarily restricts imports through outright bans on many products without sufficient scientific evidence that entry of the product presents a legitimate threat to local agriculture. Unnecessary testing and inspection requirements raise costs and reduce competitiveness of U.S. produce in Japan. In addition, failure to accept alternatives to methyl bromide fumigation for control of pests and unnecessary fumigation requirements for common pests that are already found in Japan present additional barriers to U.S. agricultural products.

Standards, Testing, Labeling and Certification: Standards, testing, labeling and certification problems hamper market access in Japan. In some cases, advances in technology, products, or processing make Japanese standards outdated and restrictive. Domestic industry often supports standards that are unique and restrict competition, although in some areas external pressure has brought about the simplification or harmonization of standards to comply with international practices.

Biotechnology: Japan has adopted a scientific approach in its approval process for genetically modified (GM) foods. To date, the Ministry of Agriculture and Ministry of Health, Labor and Welfare, which regulate biotechnology products, have approved the importation of more than 30 GM plant varieties, including corn, potatoes, cotton, tomatoes, and soybeans. While U.S. and Japanese regulatory approaches to assessing safety of biotech products have been closely aligned, the United States is very concerned by Japan's decision to implement mandatory labeling of 24 whole and semi-processed foods made from corn and soybeans beginning April 2001.

Accreditation for Wood and Organic Certifiers: In July 1999, the Japanese Agricultural Standard Law was amended to include a procedure to establish the "equivalency" of foreign countries' regulations, a prerequisite for U.S. certification organizations for wood and organic products to apply for accreditation by the Ministry of Agriculture, Forestry and Fisheries (MAFF). This time-consuming, two-step process is required to put them on equal footing with their Japanese counterparts.

Rationalization of Building Standards Laws: The Japanese government has taken steps to make the Building Standard Law (BSL) performance-based, in line with its commitment to implement performance-based codes. Timely approval, acceptance, and ultimately sales of U.S. wood products are still limited by excessive regulation and continued reliance on prescriptive codes/standards. The United States has asked the Japanese government to review certain provisions of the BSL which are overly prescriptive or inconsistent, including fire test requirements and restrictions on the construction of special buildings.

In housing policy, Japan has taken limited steps to make the sector more competitive and to make a greater variety of housing available to consumers at lower cost.

Telecommunications and Broadcasting: Japan is a signatory of the WTO Basic Telecommunications Agreement of 1997, which promotes market access, investment and pro-competitive regulation in the telecommunications industry. In recent years, the United States has pushed Japan to foster a more pro-competitive regime in the telecommunications sector. As a result of the July 2000 U.S.-Japan agreement to implement significant reductions in interconnection fees for connecting to the dominant carriers' local networks, competition has slowly begun to enter the telephone service market. In June 2001, the Ministry of Public Management, Home Affairs, Post and Telecommunications (MPHPT) revised the Telecom Business Law and introduced dominant carrier regulation. However, progress has been incremental and access to the telecommunications' and broadcasting market in Japan remains constrained by both regulatory and anti-competitive practices. New entrants continue to face higher costs and longer waiting periods for connecting to the dominant carriers' local network than in other advanced countries, deterring competition. In addition, new carriers' difficulty in gaining access to facilities and land to build their networks, government restrictions on combining owned and leased facilities in creating a network, and the lack of access to discrete portions of the local dominant carriers' network at reasonable costs have slowed and raised the costs of new carriers' entrance. It is still difficult for competing carriers to resolve problems with dominant carriers under the existing administrative framework.

The United States remains very concerned by the fact that the MPHPT and the Japan Fair Trade Commission are within the same agency and recommends that Japan change the organizational status of the JFTC to an independent agency under the Cabinet Office. Furthermore, the United States continues to urge Japan to establish a strong independent regulator for the telecom business.

Foreign computer and telecommunications equipment suppliers continue to have difficulty selling to the Japanese public sector and have a very small share of the market. Procurement from foreign sources by the Nippon Telegraph and Telephone (NTT) group companies, which collectively are the largest purchaser of telecommunications' equipment in Japan, remain below the level of foreign procurement by Japanese private sector telecommunications' carriers. Foreign investment in NTT and radio/television broadcasting companies is restricted.

The U.S. government believes that mandatory labeling stigmatizes foods derived through biotechnology by suggesting a health risk when there is none. In response to labeling requirements, many Japanese manufacturers of products subject to mandatory labeling have switched to non-genetically engineered ingredients; this shift adds to confusion and misperceptions about the safety of biotech foods. The U.S. government agrees that labeling is necessary when there are health or safety reasons, such as a presence of an allergen, or changes in food characteristics, such as altered nutritional content. In these cases, the specific change, rather than the process by which it is produced, should be the subject of labeling.

The government of Japan has stated that the objective of extending a mandatory labeling requirement to food that has been produced through biotechnology is to provide information to the consumer. The U.S. government agrees that it is important for consumers to have information on foods that have been genetically engineered, and believes there are a number of means other than labeling, such as educational materials and public fora, that can collectively provide more meaningful information to consumers on genetic engineering.

Effective April 1, 2001, all U.S. certified organic foods must be certified by organizations accredited by the Ministry of Agriculture in order to be marketed as "organic." The USDA's ISO Guide 65 accreditation program provides sufficient assurance that certified products meet Japanese standards. Since ISO Guide 65 is the internationally recognized norm for conformity assessments of third-party certifiers, additional accreditation is unnecessary, costly, and threatens continued imports of U.S. organic foods, estimated at up to $100 million per year.

Foreign Direct Investment (FDI): FDI in Japan has remained extremely small in scale relative to the size of the economy. In Japan fiscal year 2000, Japan’s annual inward FDI totaled $28 billion (up from $21.5 billion the previous year), but still only 0.6 percent of its GDP. (Comparatively, FDI for the U.S. in 1999 was $276 billion, according to UN Conference on Trade and Development.) Although foreign investment in Japan is on the rise, Japan continues to attract the smallest amount of FDI as a proportion of total output of any major OECD nation (0.9 percent), reflecting the high costs of doing business (for example, registration, licenses, land prices and rents) and a continuing environment of structural impediments to foreign investment. The challenges facing foreign investors include: laws and regulations that hamper establishing new businesses and acquiring existing businesses, close ties between government and industry, informal exclusive buyer-supplier networks and alliances, and extensive cross-shareholding by Japanese firms.

Recently, the Japanese Government has implemented potentially useful measures for increasing FDI, including a comprehensive revision of its Commercial Code. However, further revisions are needed to ensure a corporate regulatory environment, which allows existing Japanese companies to efficiently restructure, promote the development of new companies, and facilitate foreign firms' entry into the Japanese market. In 2002, the Japanese Diet will consider allowing firms to choose American-style board committees with a majority of outside members instead of statutory auditors (kansayaku). This could greatly improve corporate governance, management accountability to shareholders, and the attractiveness of investing in Japan. Japan has made significant improvements in accounting standards by introducing: consolidated accounting, FY 1999; pension accounting, requiring disclosure of assets and liabilities, and mark-to-market accounting for traded securities, FY 2000; and mark-to-market accounting for cross-held shares and other long-term holdings, FY 2001. However, the Ministry of Finance has yet to approve consolidated taxation, which would allow companies to use restructuring losses in one unit to balance profits in another unit.

There are insufficient numbers of qualified lawyers, accountants, and other professional service providers in Japan, a significant barrier to investment and to corporate and debt restructuring. The number of qualified legal professionals in Japan is inadequate to support the many complex transactions necessary for restructuring Japan's economy. Additionally, Japan places severe limitations on the relationships permitted among Japanese lawyers and registered foreign lawyers.

In October 2001, the United States and Japan launched an Investment Initiative to accelerate the pace of U.S. FDI in Japan and thus contribute to economic growth, job creation, and the introduction of new management practices. A new Investment Group will meet several times yearly and sponsor further measures to improve the investment environment in Japan.

Government Procurement Practices: Japan is a party to the 1996 WTO Government Procurement Agreement. While government procurement in Japan at the national, regional and local levels generally conforms to the letter of the WTO agreement, there have been reports that established domestic competitors continue to enjoy preferential access to tender information from some procuring entities. In some sectors unfair pricing remains a problem, preventing companies from winning contracts based on open and transparent bidding procedures. Some entities continue to draw up tender specifications to favor a preferred vendor, using design-based specifications rather than more neutral performance-based specifications.

Customs Procedures: The Japanese Customs Authority has made progress in automating its clearing procedures, and efforts are underway to integrate the procedures of other government agencies over the next several years. However, U.S. exporters still face relatively slow and burdensome processing. The Japanese government should adapt customs clearance procedures to accommodate the rapid growth of express cargo carriers.

6. Export Subsidies Policies

In 2000, Japan remained the world's top aid donor for the tenth consecutive year, disbursing a total of $13.1 billion in official development assistance (ODA), representing about one-quarter of the total ODA of the advanced industrial countries. Although Japan had been moving towards untying its aid, during recent years this trend has reversed. Both Environmental Aid loans and Special Yen loans are tied to the purchase of Japanese products. This limits U.S. firms' ability to participate in these projects and denies recipient countries the opportunity to use aid as efficiently as possible. The U.S. government has opposed the trend towards retying and continues to address U.S. industry concerns that feasibility studies funded by Japanese grant aid, and tied to the use of Japanese firms, result in technical specifications that unduly favor Japanese firms.

7. Protection of U.S. Intellectual Property Rights

Japan is a party to the Berne and Universal Copyright Conventions, the Paris Convention on Industrial Property, the Patent Cooperation Treaty, and the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). Japan was removed from the Special 301 Watch List on May 1, 2000. However, in the May 2001 Special 301 announcement, the United States expressed concern about some aspects of intellectual property rights protection in Japan and noted that it would continue to carefully monitor these aspects.

While Japan's IPR regime affords national treatment to U.S. entities, the U.S. government has been concerned by the long processing time for patent examination. Recent statistics show that it takes the Japan Patent Office an average of 21 months to respond to an applicant (First Action Period), longer than in other industrialized countries. Since all patent applications are opened to public inspection 18 months after filing, this exposes applications to lengthy public scrutiny with the potential of limiting legal protection.

Many Japanese companies use the patent filing system as a tool of corporate strategy, making many applications to cover slight variations in technology. However, a February 1998 decision by Japan's Supreme Court to permit an infringement finding under "the doctrine of equivalence" may reduce this practice and is a positive step toward broadening Japanese courts' generally narrow interpretation of patent rights. The rights of U.S. subscribers in Japan can be circumscribed by filings of applications for similar inventions or processes.

Japan's protection of trade secrets is inadequate. Because Japan's Constitution prohibits closed trials, the owner of a trade secret seeking redress may find the secret disclosed as part of the judicial process. While a recent amendment to Japan's Civil Procedures Act excludes Japanese court records containing trade secrets from public access, court proceedings remain open to the public and neither the parties nor their attorneys have confidentiality obligations.

Trademarks must be registered in Japan to ensure enforcement, meaning delays make it difficult for foreign parties to enforce their marks. However, Japan is a party to the Madrid Protocol for centralized foreign trademark registration. Japan's Trademark Law was revised in 1997 to speed the granting of trademark rights, strengthen protection to well-known trademarks, address problems related to unused trademarks, simplify registration procedures, and increase infringement penalties. The First Action Period for trademark applications takes about eleven months. The United States will continue monitoring Japan’s approval time.

End-user software piracy remains a major concern of United States and some Japanese software developers. Effective January 2001, Japan raised the level of punitive damages for software piracy from 3 million yen to 100 million yen. However, Japan still does not protect temporary copies, a requirement of the Berne Convention and the 1996 WIPO Copyright Treaty.

The absence of a system of statutory damages is also a problem. Under the Japanese system, right holders need to prove actual loss in order to qualify for compensation from violators. Protection would be improved under a system where right holders only need to prove the loss and could be awarded damages within a fixed range for each work violated.

8. Worker Rights

a. *The Right of Association:* Japan's Constitution and domestic labor law provide for the right of workers to freely associate in unions. 21.5 percent of Japan's labor force is unionized. The Japanese Trade Union Confederation (RENGO), which represents 7.2 million workers, is the largest labor organization. Both public and private sector workers may join a union, although members of the armed forces, police, and firefighters may neither form unions nor strike. The right to strike, although implicit in the constitution, is seldom exercised. The law prohibits retribution against strikers and is effectively enforced.

b. *The Right to Organize and Bargain Collectively:* The constitution provides unions with the right to organize, bargain, and act collectively. These rights are freely exercised, and collective bargaining is practiced widely, particularly during the annual "Spring Wage Offensive" of nationwide negotiations.

c. *Prohibition of Forced or Compulsory Labor:* Article 18 of the Japanese Constitution states that "No person shall be held in bondage of any kind. Involuntary servitude, except as punishment for crime, is prohibited." This provision applies both to adults and children, and forced or bonded labor is not perceived as a problem. Japan is, however, a destination country for the trafficking of women for prostitution through debt bondage.

d. *Minimum Age for Employment of Children:* By law, children under the age of 15 may not be employed, and those under age 18 may not work in dangerous or harmful jobs. Child labor is virtually non-existent in Japan, as societal values and the rigorous enforcement of the Labor Standards Law protect children from exploitation in the workplace.
e. *Acceptable Conditions of Work:* Minimum wages are set on both a sectoral and regional (prefectural) level. Minimum wages range from about $18 per hour in Tokyo to $11 in rural northern Japan. The Labor Standards Law provides for a 40-hour work week in most industries and mandates premium pay for hours worked beyond 40 hours in a week or eight hours in a day. However, labor unions criticize the Japanese Government for failing to enforce working hour regulations in smaller firms. The government effectively administers laws and regulations affecting workplace safety and health.

f. *Worker Rights in Sectors with U.S. Investment:* Labor regulations, working conditions and worker rights in sectors where U.S. capital is invested do not vary from those in other sectors of the economy.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 2000

(Millions of U.S. Dollars)

Category	Amount

Petroleum		(D)
Total Manufacturing		15,173
Food & Kindred Products	1,232	
Chemicals & Allied Products	2,843	
Primary & Fabricated Metals	330	
Industrial Machinery and Equipment	1,581	
Electric & Electronic Equipment	2,033	
Transportation Equipment	2,391	
Other Manufacturing	4,764	
Wholesale Trade		4,689
Banking		733
Finance/Insurance/Real Estate		20,685
Services		8,646
Other Industries		(D)
TOTAL ALL INDUSTRIES		55,606

(D) Suppressed to avoid disclosing data of individual companies.
Source: U.S. Department of Commerce, Bureau of Economic Analysis.