

## **COMMUNICATION FROM JAPAN**

### **ASSESSMENT OF TRADE IN SERVICES**

The following communication has been received from the delegation of Japan with the request that it be circulated to Members of the Council for Trade in Services to assist in the discussion on the Assessment of Trade in Services. This communication has previously been circulated informally at the Council meeting on 22 March.

#### **I. INTRODUCTION**

1. This non-paper has been prepared by the delegation of Japan as our contribution to discussions on "an assessment of trade in services in overall terms and on a sectoral basis with reference to the objectives of this Agreement" pursuant to Article XIX of the GATS.

2. The purpose of the GATS is "to establish a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting the economic growth of all trading partners and the development of developing countries," as is provided in its preamble. However, the background Note of the Secretariat (S/C/W/94) points out that, due to the lack of sufficient statistics of trade in services, it is extremely difficult to make empirical and quantitative assessments on how trade liberalization has affected the expansion of trade and/or the economic development of nations. We should also take into account the short history of the GATS (only four years have passed since its entry into force).

3. Bearing such realities in mind, this paper will outline the current situation of Japan's trade in services and will make inductive indications on how the results of the UR and the following negotiations has affected the expansion of trade in services for Japan, which has the largest service trade deficit in the world.<sup>1</sup>

4. Japan evaluates the GATS and multilateral negotiation for trade in services in the following manner:

- (a) The greater transparency and progressive liberalization:
  - (i) have reduced the cost of entry; and

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<sup>1</sup> This paper understands that the assessment of trade in services with respect to individual sectors has been sufficiently conducted as part of the information exchange program by the Council of Trade in Services since June 1998.

- (ii) enhanced the legal stability and predictability concerning government regulations.

Those changes, together with the general trends of globalization of the world economy, have contributed to a large extent to the expansion of trade in services.

- (b) The progressive liberalization of trade in services within an appropriate regulatory framework contributes not only to enhanced productivity due to economics of scale but also contributes to economic growth even in service importing countries through the transfer of technology to domestic industries, the creation of employments (through transactions in mode 3), and the strengthening of the competitiveness of domestic service industries.

## **II. ANALYSIS OF JAPAN'S TRADE IN SERVICES – CONTRIBUTION AS THE LARGEST NET IMPORTER**

5. Although the existing statistics, in which detailed information on sectors or modes as defined in the GATS are lacking, cannot describe the trade of all services sectors in a sufficiently accurate manner, those statistics are still useful in understanding the overall trend of trade in services.

6. It is clear, even through the current statistics, that *the portion of services industries within the whole national economy is extremely large*. The share of services industries in the Japanese GDP increased from 57.4 per cent in 1970 to 66.1 per cent in 1996. Greater rates of increase were recorded in the distribution and financial sectors, whereas the share of construction and transport services in the whole services sector went down. The pictures of individual sectors are somewhat different from the overall picture of general increase. From the perspective of employment, the share of the labour force employed by the services industries among all the labour force employed increased from 46.0 per cent in 1970 to 61.7 per cent in 1996.<sup>2</sup>

7. *As the largest net importer of services, Japan's role has been significant in the expansion of trade in services through providing services markets to the rest of the world*. According to the WTO Secretariat Note (S/C/W/94, p. 23), Japan is the sixth largest exporter of commercial services (US\$ 68.1 billion) and the second largest importer of such services (US\$ 122.2 billion).

8. According to the Balance of Payment Statistics Yearbook 1998 brought out by IMF, Japan always has a substantial amount of imbalance in trade in services. (As is rightly pointed out in the Secretariat Note, it should be noted that the statistics do not include the trade in services through the establishment of commercial presence). Japan's trade deficits in services were around US\$ 40 billion from 1990 to 1994. However, since the GATS entered into force in 1995, the deficit has been expanding and is now around US\$ 50 to 60 billion.

9. On a sectoral basis, Japan's trade deficit is extremely high in travel services as well as transport (passenger in particular) and patent payment. The expanding trade deficit in the travel and passenger transport services reflects the current trend of increasing numbers of Japanese people going abroad for sightseeing and business purposes. The increase in the transport of goods and patent payment presumably reflects the more active use of patent rights and distribution routes by manufacturing industries. The new trends in recent years include dramatic increase in the amount of

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<sup>2</sup> These statistics come from the National Economy Accounting Yearbook (1998), which was drawn up by Japan's Economic Planning Agency. Services industries, defined in these statistics, consist of construction, electricity/water/gas supply, wholesale and retail distribution, financial and insurance services, real estate, transport, and communication. They do not include government services and non-profit private services within families.

transactions in the fields of information communications and financial services, and the improving trade balance in financial services.

10. Looking at the data from geographical perspectives, Japan's trade in services are most predominantly occupied by transactions with North America, Europe and Asian regions. Japan has made trade deficits in services with respect to all these regions in overall terms. In some sectors, e.g. construction, insurance/finance, and patent payments, Japan records a trade surplus *vis-à-vis* Asia, but Japan marks a large deficit *vis-à-vis* North America and Europe even in those areas.

11. *The foreign direct investment (FDI) to Japan in services areas has also been increasing dramatically in recent years.* According to the statistics based on the government reporting system, the FDI in services increased from US\$ 2.37 billion (FY 1995) to US\$ 4.08 billion (FY 1996). Although the figure marked a slight decrease in FY 1997 to US\$ 3.35 billion, it reached US\$ 3.46 billion in the first half of FY 1998. The overall trends show that the foreign service industries have been very active in making direct investments in Japan (see Chart 1).

12. The share of FDIs in non-manufacturing industries (which are approximately the same as the services industries) far exceeds the share of those in manufacturing industries by the ratio of 6:4 (in FY 1997, 189 FDIs were reported in manufacturing industries which reached US\$ 2.18 billion in total, whereas the figure in non-manufacturing industries was 1112 FDIs which reached US\$ 3.35 billion). These statistics show that the services sector is playing an important role within the FDI flows to Japan and that this trend has continued to grow further in the last few years.

### **III. PROGRESSIVE LIBERALIZATION OF TRADE IN SERVICES THROUGH MULTILATERAL NEGOTIATIONS**

#### **A. JAPAN'S EXPERIENCE**

13. During the UR and the following negotiations on financial services, maritime services, and basic telecoms, Japan proposed high-level trade liberalization offers compared with those proposed by other trading partners and thus, greatly contributed to the further strengthening of the multilateral trade system in the field of services. As is shown in Table 1 on page 11 of the Secretariat's Note (S/C/W/94), Japanese commitments cover a much larger number of sub-sectors compared with other trading partners, in many of which Japan made full commitments both in market access and national treatment for all modes. As for the most-favoured-nation treatment, the fundamental principle which underpins the multilateral trading system, Japan has listed no exemptions.

14. At the time when Japan made commitments, it accomplished the necessary amendments to its domestic legislation, thereby contributing to the expansion of trade in services in the sectors concerned. The following are some of the examples of such efforts:

#### **(a) Legal Services**

15. In the UR negotiations, Japan made commitments in legal services area which include the following:

- Legal services provided by a lawyer qualified as "Bengoshi" under the Japanese Law;
- consultancy services on the law of jurisdiction where the service supplier is a qualified lawyer.

16. When it made commitments on the latter service, Japan amended the law (Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers: Foreign Lawyers Law). In the amendment process, Japan also amended the mandatory reciprocity clause so that it would not need to

list any MFN exemptions.<sup>3</sup> Furthermore, in its additional commitments, Japan permits a foreign qualified lawyer (Gaikokuho-Jimu-Bengoshi) to practice international law, associate with a Japanese lawyer (Bengoshi), and representation in arbitration.<sup>4</sup>

17. Beyond those commitments, Japan made the following liberalization efforts by amending the Foreign Lawyers Law to respond to the needs expressed from outside and within:

- The practical experience requirement for qualification which is necessary for approval was relaxed;
- practice of so-called third-country law was permitted under certain conditions;
- restrictions regarding objectives of a joint enterprise between a Gaikokuho-Jimu-Bengoshi and a Bengoshi were abolished in conducting foreign legal cases;
- representation in the procedure of international arbitration was permitted, regardless of an applicable law.

18. Thanks to the liberalization commitments and the further relaxation of regulations, foreign lawyers are successfully entering into Japanese markets. As of 15 March 1999, 97 lawyers having qualified in 11 foreign countries have been registered as Gaikokuho-Jimu-Bengoshi as Japan, among which 71 belong to foreign law firms.

(b) Basic Telecommunication Services

19. In the basic telecom services, one of the sectors which continued negotiation after the UR, Japan made commitments which abolished all restrictions concerning foreign capital participation and board members with the exception of NTT and KDD. Due to the elimination of foreign capital restrictions, there are now 10 companies (which belong to "Type 1 telecommunication business") where foreign capital participation is more than one-third of the total capital. Among them, seven entered the Japanese telecom market after the entry into force of the Fourth Protocol. Five of the seven companies are 100 per cent owned by foreign capital. Such new entrants have created a desirable competitive environment by the reduction of costs and the creation of various types of services, thus leading to an expansion of employment and increased competitiveness among the service suppliers. For example, due to the new entrants, domestic and international communication prices went down to about one-fifth compared to the price in 1985 (see Chart 2).

#### **IV. JAPAN'S ASSESSMENT OF TRADE IN SERVICES**

##### **B. TRADE EXPANSION EFFECTS CAUSED BY PROGRESSIVE LIBERALIZATION**

20. By their agreement to the GATS, all WTO Members have accepted legal obligations of Most-Favoured-Nation treatment and ensuring transparency, and, according to the conditions and restrictions provided for in their own commitments, they have also accepted further obligations with regard to market access (Article XVI) and national treatment (Article XVII). By expanding the coverage of such obligations through negotiations, the GATS tries to ensure the transparency of domestic regulations and progressive liberalization. Japan considers that such trade liberalization within the framework of the GATS is having the following effects:

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<sup>3</sup> Commercial presence is required and services must be supplied by a natural person.

<sup>4</sup> A service supplier is required to stay in Japan not less than 180 days in a year in modes 1, 2 and 4.

(i) *Reduction of costs for entry and for service supply*

21. The acceptance of obligations under the GATS and further expansion of such obligations through negotiations lead to the expansion of the areas where Members are prohibited from imposing quantitative restrictions in supplying services and where foreign service suppliers are granted no less favourable treatment than the domestic service suppliers. Through such international commitments, *foreign service suppliers will be free from the costs at their entry or after their entry regarding quantitative restrictions and discriminatory treatment.* Although it is impossible to make a quantitative analysis on how much trade is produced through such a mechanism, the examples of the entrance of foreign lawyers and foreign telecom service suppliers clearly show that the current mechanism has a positive impact on the expansion of trade in services.

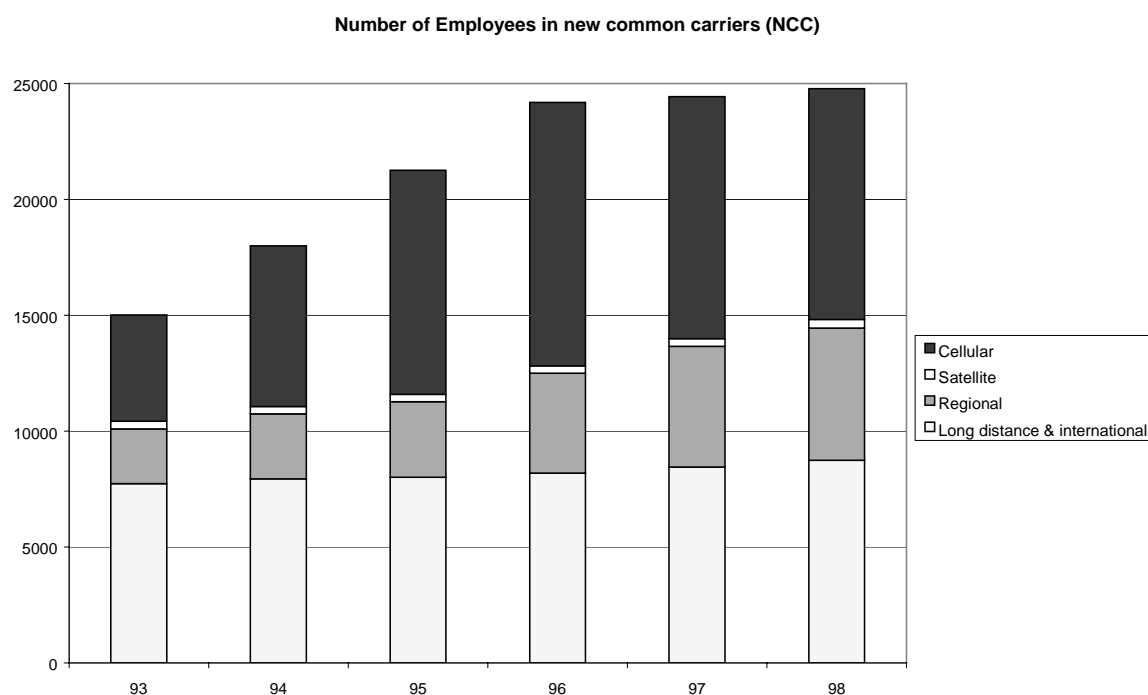
(ii) *Legal stability on Domestic Regulations – Enhancing the Predictability*

22. Commitments annexed to the GATS mean that *Members are not allowed in a legal sense to impose more restrictive measures than they committed in their schedules.* Therefore, liberalization commitments contribute to enhancing transparency and predictability on the measures by Members. The legal stability and predictability have a significance in creating a better environment for investment by foreign service suppliers, and thus facilitate the expansion of foreign direct investments in services by other Members.

C. EFFECTS ON ECONOMIC GROWTH FROM THE PROGRESSIVE LIBERALIZATION OF TRADE IN SERVICES

23. *The liberalization of trade in services and the expansion of such trade contributes not only to the enhanced productivity due to economies of scale but also to economic growth even in service importing countries through the transfer of technology and know-how to domestic industries, the creation of employment (through commercial presence of foreign providers), and the strengthening of the competitiveness of domestic service industries.*

24. For example, in Japan, due to the liberalization of the type 1 telecommunication business, telecom employment doubled during the five years starting 1993, the sales increased by more than 70 per cent, investment for plant and equipment by 50 per cent, and employment of new common carriers by 70 per cent during the same period.



	1993	1994	1995	1996	1997	1998 (estimate)
All NCC	15,007 (16.5%)	17,989 (19.9%)	21,254 (18.1%)	24,176 (13.7%)	24,430 (1.1%)	24,776 (1.4%)
% of Type 1	6.2%	8.0%	9.7%	11.0%	13.4%	13.9%
Long-distance & international	7,732	7,941	8,013	8,196	8,452	8,750
Regional	2,362	2,806	3,254	4,294	5,206	5,693
Satellite	331	323	318	332	326	370
Cellular	4,982	6,919	9,669	11,354	10,446	9,963

25. *Liberalization of services trade also enhances the efficiency of manufacturing business.* For instance, service input ratio in our manufacturing industry, which was 22.2 per cent in 1980, had grown to 29.5 per cent in 1995, close to 30 per cent of the total. In addition to the growing impact of service industry on the manufacturing business, higher productivity ripple effect of service industry lead to the increasing productivity of the whole economy including manufacturing, in tandem with growing knowledge intensity of industrial activities, development of information age, and more active use of outsourcing. Thus development of high-quality service industry through liberalization of trade in services is of great importance in growing the competitiveness of manufacturing business and attracting investment.

26. In response to the above arguments, some studies point out negative elements, e.g. the possible abuse of the monopoly position by foreign companies and tax avoidance. But those problems should be addressed by appropriate competition and taxation policies. Imposing trade regulations would not meet such purposes. The strengthening of trade restrictions may jeopardize even the positive impacts which the trade liberalization is expected to bring about.

27. We sometimes hear the argument that trade liberalization only benefits developed countries and it does not benefit developing countries. We would like to stress that trade liberalization benefits all WTO Members and not developed country Members alone. What should be noted in particular is that the commitments in mode 3 (commercial presence) create a favourable environment for foreign service suppliers and that the entry of foreign service suppliers creates various kinds of positive side effects, including the creation of new employment, the transfer of new technology and know-how, and their contribution to government budgets. When we look at the dramatic increase of entries of foreign financial companies to Japan, it is very clear that foreign services suppliers cannot afford bringing people from home for filling all the posts required for the institution. Foreign investment creates a large amount of local employment, which will bring economic and social benefits to the nation.

#### D. FUTURE AGENDA

28. Japan views that next round of services negotiation should cover all sectors and not exclude *a priori* any specific sector. Particularly in maritime services, where negotiation has been suspended, relevant regulations of the Members have continued to be liberalized, and there is a good prospect of new developments in the forthcoming negotiations. Thus, early completion of the negotiation in this sector will benefit not only to services trade but also to trade in goods. Improving market access and national treatment limitations and MFN exemptions as well as expanding the coverage of commitments will also contribute to the further expansion of services trade.

29. Various technological developments in recent years in the services sectors are creating new services. Electronic commerce, in particular, has been expanding at an astonishing speed after the UR, and is creating a new frontier for the expansion of world trade in services. Discussions

concerning electronic commerce in WTO have been mostly focused on how the existing rules, including the GATS, apply to electronic commerce. The possibility is still open for creating new disciplines for the promoting of the healthy development of electronic commerce in the future by an agreement by all the Members. WTO needs to consider discussing appropriate disciplines so that technological development will bring benefits to all the Members.

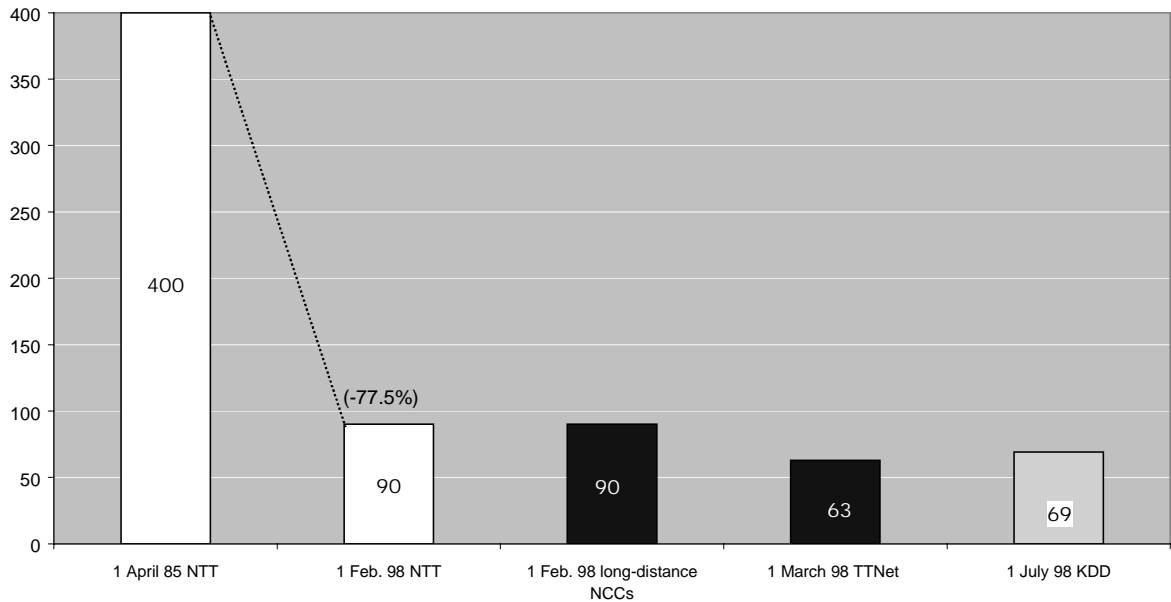
30. The active participation of developing countries in the next round of services negotiation is indispensable to ensure that trade liberalization be conducted pursuant to the purpose of the GATS. Japan expects that developing country Members will specify their own interest from the service trade liberalization and take part in the next round of negotiation with their own concrete ideas and initiatives.

31. Although this paper has stressed the contribution of progressive liberalization in services to the expansion of services trade and economic growth, this does not mean Japan supports the elimination of all kinds of domestic regulations. As is provided in the preamble of the GATS, regulations for legitimate purposes must be allowed. Bearing in mind that the lack of appropriate regulations and controls in the financial markets was one of the reasons for the economic crisis in Asia, the legitimacy of appropriate regulations needs to be duly taken into account in the future negotiations. Therefore, in parallel with the negotiations for commitments, desirable disciplines on domestic regulations need to be considered in the next services negotiations.

## RATE REDUCTIONS CURRENT STATUS OF RATE REDUCTION (UNIT ¥1)

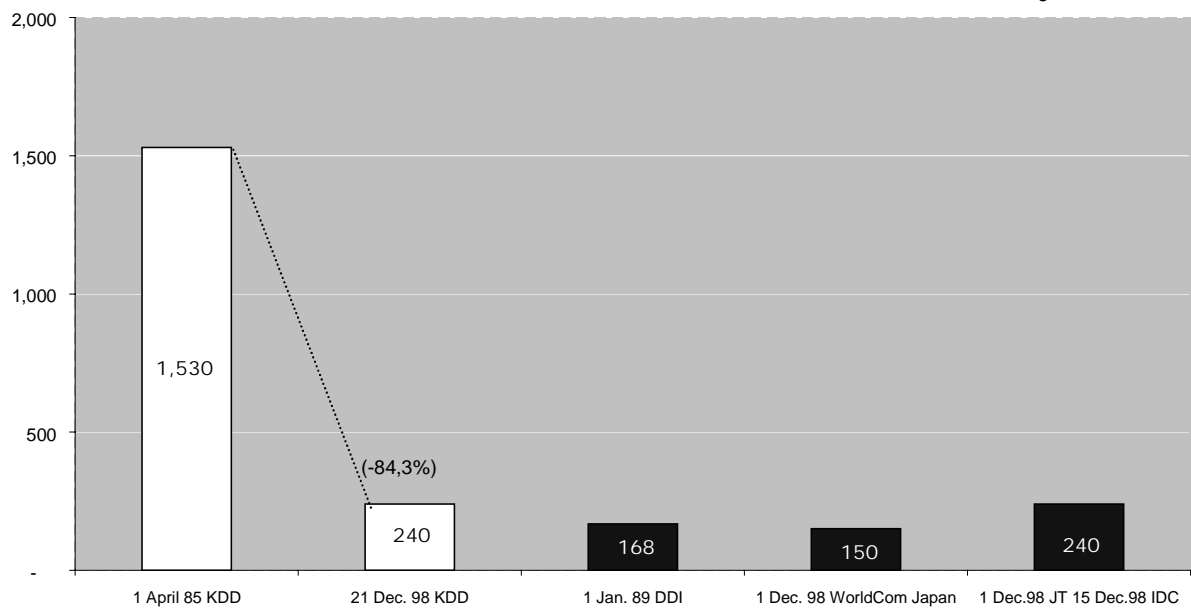
**a) Telephone service**  
**(Tokyo-Osaka [500km]: 3 minutes daytime weekdays)**

Figures are in Yen



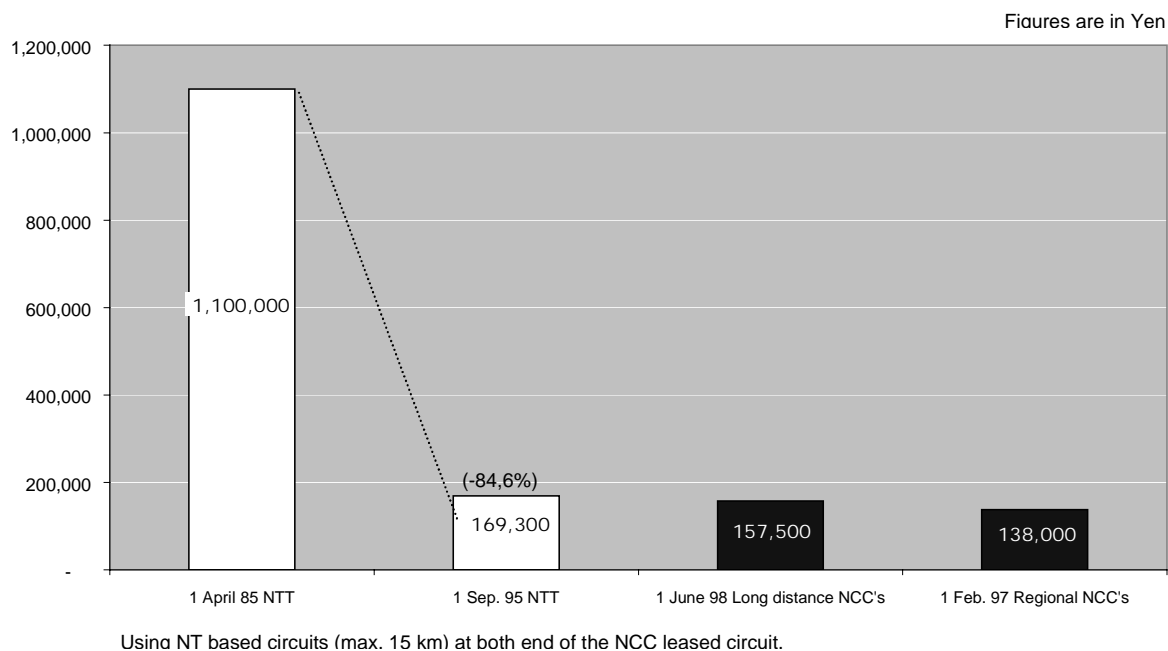
**b) International telephone service**  
**(Japan-US: 3 minutes daytime, international direct dial call)**

Figures are in Yen

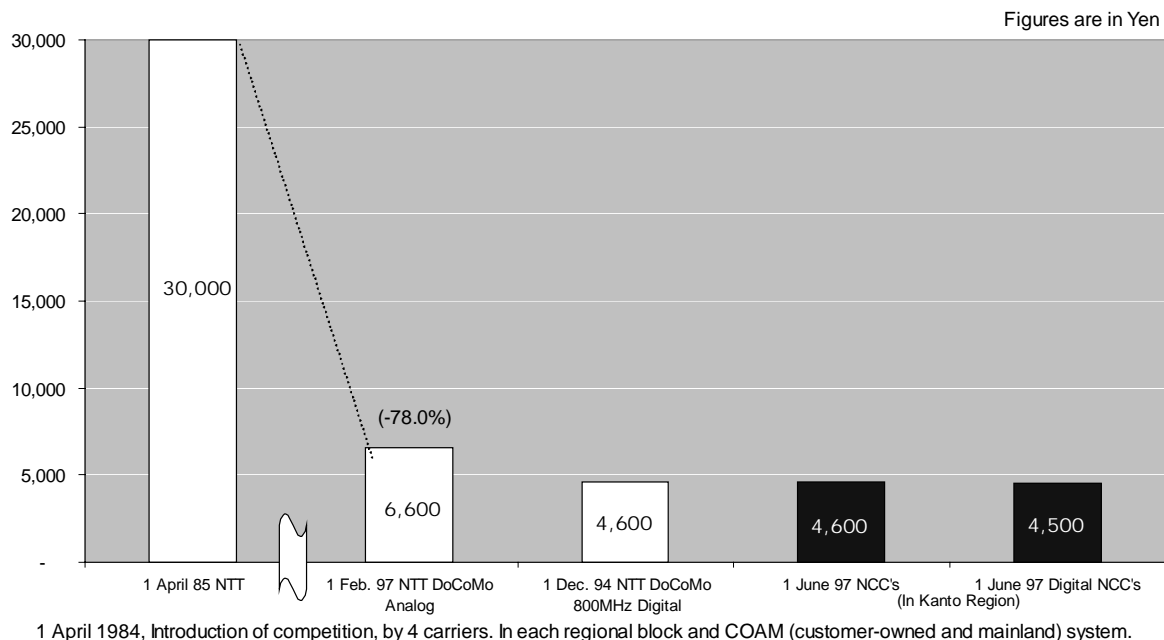




**c) Leased circuit service**  
**(Tokyo-Osaka [500 km]: 64 kbps)**



**d) Cellular phone service**  
**(Basic fee, or line charge up to 31 March 1994)**



**CHART 2**  
*FDI in Japan by Industry (based on investments notified)*

(Units: US\$ million, %)

	FY 1995	FY 1996	FY 1997					1 <sup>st</sup> half FY 1998					Total for FY 1950-1997	
	Value	Value	No. of investments		Value	% share	% change	No. of investments		Value	% share	% change	Value	
				Annual change					Annual change					% share
Manufacturing	1,464	2,762	189	- 22	2,179	39.4	- 21.1	97	6	801	18.8	7.3	25,209	50.1
Chemicals	1,132	617	54	- 5	603	10.9	- 2.2	13	- 6	146	3.4	- 5.4	7,802	15.5
Machinery	191	1,383	56	- 17	1,184	21.4	- 14.4	61	31	582	13.7	12.3	11,977	23.8
(Electrical )	119	744	29	- 9	843	15.3	13.4	n.a.	--	n.a.	--	--	1,587	3.2
(Ordinary)	66	174	26	- 7	106	1.9	- 39.3	n.a.	--	n.a.	--	--	280	0.6
(Transport equipment)	4	465	1	- 1	235	4.2	- 49.5	n.a.	--	n.a.	--	--	699	1.4
Foodstuffs	43	3	7	4	18	0.3	506.3	--	- 7	--	--	- 100.0	627	1.2
Textiles	24	8	12	9	15	0.3	82.8	2	- 6	2	0.1	- 71.3	138	0.3
Rubber/leather products	22	95	3	- 4	153	2.8	61.5	2	2	35	0.8	--	560	1.1
Petroleum	20	73	31	- 3	47	0.8	- 35.7	13	- 1	1	0.0	- 95.1	1,279	2.5
Metals	1	468	3	- 7	2	0.0	- 99.5	2	--	--	--	--	1,571	3.1
Glass/earth/stone products	0	0	3	2	6	0.1	2580.6	--	- 1	--	--	- 100.0	180	0.4
Others	31	115	20	- 1	151	2.7	31.5	4	- 6	34	0.8	113.0	1,075	2.1
Non-manufacturing	2,373	4,079	1,112	19	3,348	60.6	- 17.9	627	70	3,462	81.2	154.1	25,083	49.9
Finance/insurance	1,044	243	86	36	1,317	23.6	442.5	67	32	1,973	46.3	1,054.0	5,027	10.0
Trade/commerce	706	1,477	588	- 22	812	14.7	- 45.1	276	- 22	672	15.8	72.1	9,882	19.6
Services	503	2,095	357	16	723	13.1	- 65.5	212	26	661	15.5	65.0	6,316	12.6
Telecom	56	19	25	- 4	27	0.5	43.0	21	11	88	2.1	448.5	453	0.9
Real estate	16	235	33	- 11	392	7.1	67.0	25	12	49	1.1	- 87.2	1,883	3.7
Transport	13	9	10	--	3	0.1	- 66.4	14	7	4	0.1	43.5	259	0.5
Construction	1	0	6	2	3	0.1	577.0	--	- 4	--	--	--	122	0.2
Others	34	1	7	2	71	1.3	4,919.1	12	8	15	0.4	1,708.6	1,141	2.3
Total FDI in Japan	3,837	6,841	1,301	- 3	5,527	100.0	- 19.2	724	76	4,262	100.0	102.2	50,293	100.0

Source: Same as Table 23

Notes: 1. Percentage change on previous year (same period). Some percentages do not match due to rounding of fractions.

2. Statistics from FY 1996 onwards have been released only in yen, and so are converted into US dollars by JETRO at the interbank period average rate from Bank of Japan.