

TRADE POLICY REVIEW

JAPAN

Report by the Secretariat

This report, prepared for the fourth Trade Policy Review of Japan, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement Establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from the Government of Japan on its trade policies and practices.

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CONTENTS

	<u>Page</u>
SUMMARY OBSERVATIONS	
(1) Introduction	x
(2) Institutional and Legal Framework	x
(i) WTO Participation	x
(ii) Bilateral and Regional Agreements	xi
(3) Trade Policy Features and Trends	xi
(i) Recent evolution	xi
(ii) Type and incidence of trade policy instruments	xi
(iii) Sectoral policies	xiii
(4) Trade Policies and Foreign Trading Partners	xv
I. ECONOMIC ENVIRONMENT	1
(1) Overview	1
(2) Major Features of Japan's Economy	3
(3) Recent Economic Performance	5
(4) Trade and Current Account Situation	6
(i) Composition of trade	9
(ii) Geographic pattern of trade	11
(5) Foreign Direct Investment	13
(6) Outlook	16
II. TRADE POLICY OBJECTIVES AND INITIATIVES	17
(1) General Policy Direction	17
(2) Multilateral Policies	18
(i) The Generalized System of Preferences	23
(3) Regional dimensions	24
(i) APEC	25
(ii) ASEM	26

	<u>Page</u>
(4) Bilateral Issues	26
(i) Japan-US bilateral relationship	26
(ii) Japan-European Union bilateral relationship	29
Annex II.1 Decision-making process in Japan in trade-related policy areas	31
Annex II.2 Trade Disputes and Consultations: cases under GATT or WTO Provisions, January 1995-July 1997	33
 III. POLICY DEVELOPMENTS AFFECTING TRADE AND INVESTMENT	 37
(1) Main Features	37
(2) Tariffs and Trade-related Taxes and Charges	37
(i) Tariffs	37
(ii) Trade-related taxes and charges	44
(3) Other Policies Directly Affecting Trade	46
(i) Customs procedures	46
(ii) Licensing and approval requirements	48
(iii) Trade controls, prohibitions and sanctions	49
(iv) Trade defence mechanisms	52
(v) Origin criteria and related requirements	52
(4) Policies Influencing Investment, Growth and Trade	53
(i) Standards and regulations, sanitary and phytosanitary procedures	53
(ii) Subsidies and other financial assistance	58
(iii) Import and inward investment promotion measures	60
(iv) Government procurement measures	67
(v) Competition policy measures	70
(vi) Distribution measures	78
(vii) Intellectual property	80
 IV. TRADE POLICIES BY SECTOR	 85
(1) Overview	85
(2) Agriculture, Forestry and Fisheries	87
(i) Overview	87
(ii) Uruguay Round implementation	89
(iii) Structural developments	92
(iv) Policy orientation	98
(v) Sectoral issues	99

	<u>Page</u>
(3) Energy and utilities	102
(i) Overview	102
(ii) Petroleum	103
(iii) Electricity	104
(iv) Gas	105
(4) Industry	105
(i) Overview	105
(ii) Motor vehicles and automobile parts	110
(iii) Electrical machinery and equipment	115
(iv) Pharmaceuticals and cosmetics	117
(v) Iron and steel	119
(5) Services	120
(i) Introduction	120
(ii) Construction	122
(iii) Telecommunications services	124
(iv) Financial Services	129
(v) Transportation	139
(vi) Other services	145
REFERENCES	147

CHARTS

	<u>Page</u>
I. ECONOMIC ENVIRONMENT	
I.1 Real GDP growth rates, industrial countries, 1990-97	1
I.2 External transactions and the real effective exchange rate of the Yen, 1988-96	8
I.3 Product composition of Japan's trade, 1993 and 1996	10
I.4 Intra-industry trade of Japan by region, 1985-96	11
I.5 Merchandise trade by main origin and destination, 1993 and 1996	12
II. TRADE POLICY OBJECTIVES AND INITIATIVES	
AII.1 Annex Chart: Decision-making structure for trade-related policies	32
III. POLICY DEVELOPMENTS AFFECTING TRADE AND INVESTMENT	
III.1 Range of applied tariffs, FY 1997	38
III.2 Tariffs on agricultural products, 1997 and 2000	39
III.3 Tariffs on manufactured products, 1997 and 2000	40
IV. TRADE POLICIES BY SECTOR	
IV.1 Inter-sectoral comparison of labour productivity in Japan, 1987-94	86
IV.2 Causes of the disparity between domestic and overseas food prices, and efforts toward cost reduction	96
IV.3 Price differences from world levels for Japanese agricultural commodities, 1990-96	97
IV.4 Rice stockpiling in Japan, 1990-1996	101
IV.5 Trend in conversion of urban-area agricultural land, FY 1980-95	102
IV.6 Labour productivity in Japanese manufacturing, 1985-1993	109
IV.7 Motor vehicles production and export trends for Japan, 1989-96	111
IV.8 Overseas production of Japanese automobiles, 1989-96	111
IV.9 Sales of imported cars in Japan (passenger car market), 1989-95	112

TABLES

	<u>Page</u>
I. ECONOMIC ENVIRONMENT	
I.1 Major features of Japan's economy, 1990-96	4
I.2 Japan's economic performance, 1990-96	5
I.3 Current account summary, 1992-96	7
I.4 Foreign direct investment (FDI) by source and destination, selected years	14
I.5 Foreign direct investment (FDI) by activity, selected years	15
II. TRADE POLICY OBJECTIVES AND INITIATIVES	
II.1 Principal notifications under WTO Agreements as at October 1997	22
II.2 Main beneficiaries of Japan's GSP scheme, 1995-96	24
II.3 Major arrangements between Japan and the United States	27
III. POLICY DEVELOPMENTS AFFECTING TRADE AND INVESTMENT	
III.1 Systems for reduction, exemption, refund and repayment of customs duty, April 1996	44
III.2 Revenue from national taxes, FY 1996	45
III.3 Revised liquor tax rates, 1997-2001	46
III.4 Import volume of foreign access zones (FAZs), selected years	48
III.5 Import quotas on fisheries products, FY 1993-1997	50
III.6 Recent export restraint measures maintained by Japan	51
III.7 Major standards and technical regulations in Japan, 1996	55
III.8 Simplification of import procedures under the Food Sanitation Law	57
III.9 Subsidies notified under WTO provisions, FY 1993-95	59
III.10 Overview of Japan's import promotion policy, 1997	61
III.11 Measures for promoting foreign direct investment into Japan, FY 1996	64
III.12 Number of merger and acquisition notifications, FY 1992-95	67
III.13 Procurement composition by product and by origin, 1995	70
III.14 Enforcement statistics related to competition policy, FY 1992-96	75
III.15 Industries monitored by the JFTC with respect to a "monopolistic situation", 1991-97	76
III.16 Recent government actions regarding intellectual property	82
III.17 Patent, utility model, design and trademark applications filed and registered, 1990-95	83
III.18 Suspension of imports likely to infringe intellectual property rights, 1990-96	84
IV. TRADE POLICIES BY SECTOR	
IV.1 Major indicators for Japanese agriculture, FY 1980-95	88
IV.2 Special safeguard (SSG) actions in agriculture by Japan, FY 1995-1996	91
IV.3 Changes in average farm size by farm activity, FY 1980-1995	94
IV.4 Set-aside and subsidy levels for rice, FY 1990-96	99
IV.5 Composition of Japan's primary energy supply, FY 1990-95	103
IV.6 Manufacturing output and share of value added in Japan, 1990-95	106
IV.7 Employment in manufacturing, value added per employee and wages per employee in Japan, 1990-95	107
IV.8 Share of imports of intermediate goods imports in Japan's domestic manufacturing	108
IV.9 Type designation approvals for cars imported into Japan, 1987-96	113
IV.10 (a) Designated motor vehicle testing institutes, 1997	
(b) Establishment of foreign liaison offices	114
IV.11 Financial institutions in Japan, March 1997	130

APPENDIX TABLES

	<u>Page</u>
I. ECONOMIC ENVIRONMENT	
AI.1 Current account developments, 1992-96	155
AI.2 Imports into Japan by product category, 1985-96	156
AI.3 Exports from Japan by product category, 1985-96	157
AI.4(a) Japan's intra-industry trade with the world, by WTO Tariff Study Categories, 1985-96	158
AI.4(b) Japan's intra-industry trade with East Asia, by WTO Tariff Study Categories, 1985-96	159
AI.4(c) Japan's intra-industry trade with the European Union (15), by WTO Tariff Study Categories, 1985-96	160
AI.4(d) Japan's intra-industry trade with the Canada and the United States, by WTO Tariff Study Categories, 1985-96	161
AI.5 Imports into Japan by origin, 1985-96	162
AI.6 Exports from Japan by destination, 1985-96	163
II. TRADE POLICY OBJECTIVES AND INITIATIVES	
AII.1 Quota ceilings under Japan's GSP scheme, FY 1997	164
III. POLICY DEVELOPMENTS AFFECTING TRADE AND INVESTMENT	
AIII.1 Tariff escalation and tariff ranges in Japan, FY 1997	166
AIII.2 Estimates of bound and applied tariffs, FY 1996 and 2000	169
AIII.3 Non- <i>ad valorem</i> tariffs applied by Japan, FY 1996	170
AIII.4 Current and minimum access commitments by Japan under the Uruguay Round	177
AIII.5 Tariff quotas in Japan, FY 1996 and 1997	182
AIII.6 Other end-use tariff concessions in Japan, FY 1997	184
AIII.7 Countervailing and anti-dumping duty cases	186
AIII.8 Japan's notifications under the WTO Agreement on Technical Barriers to Trade, 1995-97	187
AIII.9 Other laws and regulations related to mandatory technical regulations	189
AIII.10 Japanese Industrial Standards (JIS) established, revised or abolished during FY 1996	191
AIII.11 Number of overseas JIS mark approvals, March 1997	192
AIII.12 Recent trends in implementation of Japan Agricultural Standards (JAS) regulations	193
AIII.13 Japan's SPS notifications, 1995-97	194
AIII.14 Animal quarantine arrangements in Japan, 1997	197
AIII.15 List of the plants prohibited for import	198
AIII.16 Sectors of Designated Inward Investors, 1997	202
AIII.17 Notifications of acquisitions, FY 1992-95	204
AIII.18 Merger notifications, FY 1992-95	205
AIII.19 JFTC surveys and reports related to competition policy	206
AIII.20 Revision of exemptions from application of the Antimonopoly Act	207
AIII.21 Trends in JPO regular staff, 1990-95	211

Page

IV. TRADE POLICIES BY SECTOR

AIV.1	Access commitments tariffs and imports, FY 1995-96	212
AIV.2	Above- quota imports (FY 1995) of products subject to tariff quotas under the Uruguay Round Agreement on Agriculture	213
AIV.3	Supply and demand for animal products, FY 1980-1995	214
AIV.4	Changes in agricultural structure, FY 1980-1995	215
AIV.5	Changes in income structure of farm households, FY 1980-1995	216
AIV.6	Administered prices set for Japanese agricultural commodities in Japan, FY 1990-97	217
AIV.7	Producer and consumer subsidy equivalents for selected Japanese agricultural commodities, 1990-96	218
AIV.8	Rice imported under Japan's minimum access commitment, FY 1995-96	219

SUMMARY OBSERVATIONS

(1) Introduction

1. Since Japan's last Trade Policy Review in April 1995, its economic situation has not improved. Various packages of fiscal and monetary stimulus during 1995 sustained moderate economic growth, but led to a worsening in public finances; the overall fiscal deficit of central and local government rose to over 5 per cent and gross government debt to over 100 per cent of GDP. A policy reversal towards fiscal consolidation from mid-1996 onwards, culminating in an increase in the consumption tax in April 1997, seriously dampened domestic demand and from the second quarter of 1997, there has been a downturn in the domestic economy, with export demand the only source of growth.

2. During the same period, Japan's financial sector has been severely affected both by internal structural problems, with the collapse of a major bank, a major securities company and emergency mergers of some banking firms, and by the economic crisis since mid-1997 in other Asian economies, particularly Thailand and Korea which are substantial recipients of Japanese investment.

3. In November 1997, the Government announced a new series of proposed measures aimed at reducing regulatory barriers to business and stabilizing financial markets; these measures are aimed at providing a framework for domestic-led recovery without significant negative fiscal implications. The package included proposals for deregulation in the telecommunications, trucking, domestic airlines, job placement and petrol station sectors; proposals for a number of changes in regulations on land use and disposal, including removal of limits on prices of land transactions, modification of land use regulations in urban areas, revision of terms for housing leases, conversion of agricultural land into other uses, including residential, and finance for construction of suburban "weekend houses"; and proposals for stabilization of financial markets, improved protection of investors and depositors, and deregulation of the securities

market. The Government also announced that there would be a review of Japan's tax system relating to corporate, financial and land taxes "from the viewpoints of creating an internationally attractive business environment, effective land use and further stimulating private initiatives". Further measures announced in mid-December included a ¥10 trillion package in support of the banking sector and a new income tax reduction amounting to ¥2 trillion for FY 1997.

4. Some of the measures proposed are directly "pump-priming" in nature; the Government has estimated that the direct effect of the November economic package is expected to be some 6 trillion yen per year (about 1 per cent of GDP). Others, such as the tax policy review, are geared to the longer term.

5. The financial and structural crisis in other East Asian economies, expected to reduce growth in the region considerably, is likely to affect Japan more severely than other major industrialized countries, because the structure of Japan's trade and investment has become increasingly concentrated in East Asia. A substantial volume of manufacturing output by Japanese-owned firms, destined both for export and domestic markets, has been delocalized to other parts of East Asia, in search of lower costs and dynamic markets; East Asia's share of Japan's exports and imports has thus continued to grow, reaching 43 and 36 per cent respectively in 1996 (compared to 30 and 28 per cent in 1990).

(2) Institutional and Legal Framework

(i) WTO Participation

6. Japan is an original signatory to all the WTO Multilateral Trade Agreements and to the Agreement on Government Procurement. Japan applies MFN treatment to all but six countries and customs territories: Albania, Equatorial Guinea, Lebanon, Nepal, the Democratic People's Republic of Korea and Viet Nam.

7. Consistency of domestic and external policies is sought both at the Cabinet level and through a number of organizations under the Prime Minister or Cabinet. Japan is party to the Negotiations on Basic Telecommunications, the Declaration on Trade in Information Technology Products (the "Information Technology Agreement") and the recently completed Financial Services negotiations. Japan also participates in the WTO Working Groups on Trade and Investment and Trade and Competition Policy.

8. Japan has been actively involved in the WTO dispute settlement provisions, both as complainant and respondent. To date, Japan has requested consultations on four and received complaints on eight cases, and has been involved as a third party in six cases. The rulings of a Panel on alcoholic beverage taxation have been confirmed by the Appellate Body, and the authorities have indicated their intention to implement its recommendation. Consultations between the parties are continuing on other cases.

(ii) Bilateral and Regional Agreements

9. Japan has a number of bilateral agreements, arrangements or understandings, mainly with the United States, on increasing market access or reducing trade barriers; these cover, inter alia, automobiles and automobile parts, semiconductors, financial services and insurance. Japan does not belong to any customs unions or free-trade areas; on the other hand, it is a leading member of the Asia Pacific Economic Cooperation (APEC) and the Asia-Europe Meeting (ASEM).

(3) Trade Policy Features and Trends

(i) Recent evolution

10. Recent economic policy has aimed at further strengthening market mechanisms through structural reform and deregulation, and the reorientation of the economy towards greater reliance on domestic, rather than export

demand. The Deregulation Action Program, first announced in March 1995 and revised annually since, has sought to clarify and reduce the scope of government regulations, especially in financial services, telecommunications and domestic transport. Agriculture, construction and international transport have, however, largely been exempted from these moves to deregulation. Concerns have, in this light, been expressed regarding the process of structural reform.

11. Japan added 14 former Soviet Union states to the coverage of its GSP scheme in 1995-1996. Japan has never "graduated" any developing country from the coverage of its GSP scheme; however, the Trust Territory of the Pacific Islands was removed from the scheme in 1997 when the trust ended.

(ii) Type and incidence of trade policy instruments

Tariffs

12. There have been no major changes in Japan's tariff structure since its last Review. The simple average rate was 9.4 per cent in 1997; some 60 per cent of tariff lines are rated at 5 per cent or below. Tariff peaks occur in agriculture, food manufacturing, textiles and footwear, rising to some 920 per cent (the ad valorem equivalent of a specific rate) on some vegetable products (konnyaku tubers). Substantial tariff escalation occurs in a number of sectors, mainly between semi-processed and fully-processed items, particularly in food manufacturing and petroleum refining.

13. The simple average tariff on industrial products (defined as Harmonized System (HS) Chapters 25 to 97) was 4.9 per cent in 1997. Various tariff cuts, including the elimination of applied tariffs, were made either autonomously or under existing agreements, including on certain chemical products, textiles and non ferrous metals; in FY 1996, WTO-related reductions in bound tariffs were implemented ahead of schedule for 697 mining

and manufacturing items under Japan's APEC commitments. The tariff quota system on fattening cattle for beef, oats, hi-test molasses, rum and tafia was abolished. Under the Declaration on Trade in Information Technology Products, Japan has pledged to reduce bound tariffs to zero for 57 per cent of lines included: virtually all such lines already benefit from duty free treatment *de facto*.

Import procedures

14. Port and customs procedures for imports have been accelerated, leading to a reduction in clearance times, which nevertheless remain lengthy by developed-country standards. The authorities state that they are working towards further acceleration of such procedures through an extension of computerization. Four new Foreign Access Zones (FAZ), centralized locations for import-related operations and facilities to streamline the distribution of imported cargo, has been approved.

Import limitations

15. A total of about 120 tariff lines at the HS nine-digit level, including fishery products, certain wood products and petroleum, remain unbound and import quotas apply to some items. State trading remains in rice, wheat and barley, milk products, raw silk, salt, leaf tobacco, industrial alcohol and opium. The import cartel covering imports of silk from China was abolished and replaced by an import quota system in 1996; annual consultations are held with China regarding imports of silk yarn and fabrics. Surveillance is also in force on some other products, including VERs by China on garlic and ginger. Japan has notified to the Textiles Monitoring Body a phase-out programme for its prior confirmation and customs confirmation system on silk product imports from the Republic of Korea.

Technical barriers

16. Japan seeks increasingly to coordinate domestic technical and sanitary regulations and standards with international norms. The number

of Japanese industrial standards (JIS) corresponding to such norms has grown since 1995, with a target of 1,000 standards to be aligned in three years, and the scope of permission for foreign testing, certification, and factory approval has also increased somewhat. Mandatory technical regulations (in some cases implementing otherwise voluntary standards) are in force notably on food, pharmaceuticals, fertilizers, electrical goods, and products covered under safety regulations for road vehicles, though little information on the total number of such regulations is available.

Government procurement

17. In 1996, Japan introduced operational guidelines to apply the 1994 Action Plan for greater fairness and transparency in government procurement. In that year, the share of overseas products in procurement valued above SDR 100,000 was some 18 per cent. Since 1995, the share of selective and single tendering has fallen in favour of open tendering.

Contingency measures

18. Anti-dumping investigations were initiated and definitive duties were imposed on cotton yarn from Pakistan in 1995. Following reviews in 1996 and 1997, these duties were reduced or eliminated. Japan has never used countervailing actions or GATT safeguard measures.

Import and investment promotion measures

19. Japan's import and investment promotion programmes include substantial government incentives, yet it is not evident that these programmes fully address the obstacles encountered; to date, most measures have focused on assisting with existing procedures, rather than attempting major structural improvements. Import promotion measures, including tax incentives and financial measures, have been extended at least until March 1998. Promotional measures for inward direct investment, mainly comprising tax incentives,

financial support and technical assistance, were also expanded.

Export restrictions

20. Under WTO provisions, Japan is reducing the number and scope of restrictions on exports. The only remaining "voluntary" export restraint is the monitoring arrangement on car exports to the European Union, which is to be eliminated in 1999. Nine of 11 export cartels have been abolished since 1995. Remaining export cartels, related either to protection of quality or intellectual property, or to import monopolies in partner countries are to be abolished by end-1999.

Measures relating to the domestic market

21. Changes have taken place in Japan's competition law under the Anti-Monopoly Act (AMA). AMA exemptions allowing retail price maintenance on designated cosmetics and over-the-counter medicines were revoked in 1997. The number of permitted ("exempted") cartels has declined steadily. Easing of obstacles to mergers and acquisitions are regarded as official priorities. Concern remains about the effects on foreign access to Japan of horizontally and vertically integrated groups (kigyo-shudan and keiretsu).

Intellectual property

22. Japan is a founding member of the World Intellectual Property Organization (WIPO), and a signatory to most major treaties regarding intellectual property rights. Recent legislative amendments include a reduction in the time required by the patent office to treat patents cases and the introduction of a post-grant opposition system; thus, the average approval time for patent and utility model applications was reduced to under 24 months by end-1995. To combat violations of industrial property rights at the border, the Copyright Law was amended and fines for infringement were tripled in 1996.

(iii) Sectoral policies

Agriculture

23. Japan's agricultural productivity remains low, reflecting the rapid aging of the agricultural population and the extremely small average size of farms. The agricultural self-sufficiency ratio fell to 42 per cent in FY 1995, and agriculture accounted for some 20 per cent of Japan's merchandise imports in 1996. High tariff peaks and tariff escalation, together with substantial end-use tariff concessions for domestic processing, are prevalent and the overall level of support to agriculture remains well above the OECD average. The high cost of agricultural inputs has been an important factor in encouraging Japan's food processing industries to relocate offshore.

24. Japan's implementation of tariffication requirements under the WTO resulted in a significant increase in the number of specific rates. Tariffication of quantitative restrictions often implies, as in other WTO members, prohibitive duty levels. Tariff quotas have frequently been underutilized and there is no system for reallocation of unused quotas. Japan has triggered Special Safeguards under the WTO Agreement for a number of products subject to tariffication. Rice imports are not currently subject to tariffication; the question of continuation of special treatment agreed in the Uruguay Round is to be negotiated in the year 2000.

25. Though some progress in distribution has been made, such as the abolition in 1995 of the requirement that all rice producers should sell their output to the Government, agriculture has to date largely been excluded from Japan's deregulation efforts. Over-production of rice remains a chronic problem and set-aside provisions for rice land have continued to be the Government's primary response to the issue.

Energy and utilities

26. More than 90 per cent of Japan's primary fuels are imported; thus, stable supply has been the major objective of Japan's energy policy and regulations have tended to discourage efficiency. As a result, the price of energy has generally been higher than in other developed countries. However, there are signs of a change in policy direction; recent steps to deregulation have incorporated certain competition-enhancing measures, including the liberalization of petroleum product imports in March 1996 and the introduction of competition in wholesale sales of electric power to the utility companies. Some relaxation in regional monopoly arrangements for city gas companies has also been introduced.

Manufacturing

27. Manufacturing generates about 24 per cent of Japan's GDP, a high share compared to that of other developed economies. In 1996, exports of manufactures were some 7 per cent lower than in 1995. Japan's outward foreign direct investment in manufacturing has also continued to increase. Tariffs on most manufactures are generally low by comparison to both historical and international levels; however, exceptions include textiles and clothing and leather and leather products.

28. Primarily as a result of the 1995 Japan-U.S. Autos and Auto Parts Consultations, Japan undertook, inter alia, to increase access and sales opportunities, on an MFN basis, for competitive foreign autos and auto parts. A certain number of "critical parts" have been deregulated in this connection. As noted above, voluntary export restrictions remain on Japan's car exports to the European Union.

29. A new consultative framework on semiconductors between the United States has been established, both at government-to-government level and in the private sector. After the expiry of the 1991 Japan-U.S. Semiconductor Arrangement, the two

Governments agreed to establish the Global Government Forum at the government level and the World Semiconductor Council at the private-sector level; Governments and producers from the European Union and the Republic of Korea are also involved in these arrangements.

30. Recent changes in Japan's policy towards pharmaceuticals and cosmetics include the reclassification of certain vitamins, herbs and minerals as food products (easing access to these products), some organizational changes in the review system for new drug application, and relaxation of regulations on parallel imports of cosmetics. Japan participates in the International Conference on Harmonization of Technical Requirements for Registration of Pharmaceuticals for Human Use (ICH) to harmonize quality, safety and efficacy requirements of pharmaceuticals.

31. The iron and steel industry has been designated as one of the sectors that may apply for government assistance, such as low interest loans, loan guarantees and tax breaks, in the framework of the Law on Temporary Measures to Facilitate Business Innovation. The Government guarantees national treatment in the application of the law.

Services

32. Private services generated some 64 per cent of Japan's GDP and some 68 per cent of employment in 1996. It has often been pointed out that Japan's services sector has lower productivity than manufacturing; with services accounting for about two-thirds of GDP, it is clear that productivity growth in services is a determining factor in Japan's living standards. This is particularly the case for "input" services such as financial services, telecommunications and transport, where productivity gains can significantly cut costs in other sectors.

33. Concerns have been raised on the close links between complex regulations and low productivity in service sectors. Legislation in

certain areas of the financial, telecommunications, air and maritime transport services sectors allows a high degree of discretion to the authorities. Recent initiatives show a sign of change in the direction of policy; along with general deregulation, Japan is gradually reducing its traditional reliance on government intervention and control, for example in moving toward eliminating the "demand-supply adjustment" provisions that limit competition in many areas.

34. *Recent developments in financial services and telecommunications, if fully carried through, may enhance the prospects for productivity growth in these sectors. New amendments to the Foreign Exchange and Foreign Trade Control Law, announced in 1996 as part of structural reform measures (the Japanese version of the "Big Bang") on financial services, further liberalization initiatives in telecommunications, and other deregulation measures listed in the Deregulation Action Program will open these services to greater competition. Bilateral agreements with the United States on insurance banking, and other financial services are to be applied on an MFN basis to all WTO members; all the major elements of these agreements, together with other concessions relating to insurance and foreign exchange trading, will be bound by Japan in the WTO financial services negotiations. However, unilateral reform measures taken by Japan in the air and*

maritime transport sectors have been mainly confined to domestic services; protective policies also remain in some professional services.

(4) Trade Policies and Foreign Trading Partners

35. *Since the last Trade Policy Review, Japan has been active in implementation of the Uruguay Round Results. Trade liberalization initiatives taken in the Asia Pacific Economic Cooperation forum (APEC), are also to be implemented on an MFN basis. However, the increased concentration of trade and investment in the Asian region has made Japan more directly vulnerable to the financial and economic crisis in the region than are other major industrialized economies.*

36. *Some steps have been taken towards greater deregulation and structural reform in Japan's economy; however, these are still partial in scope and several sectors, including agriculture, construction and certain services, especially financial, remain subject to restrictive regulations that affect both foreign market access and better allocation of domestic resources. Firm continuation of the deregulation process would therefore be an essential element in stimulating the domestic market, as the authorities seek, and encouraging improved market access.*
