In pursuance of the CONTRACTING PARTIES' Decision of 12 April 1989 concerning the Trade Policy Review Mechanism (L/6490), the Secretariat submits herewith Volume A (Text) of its report on Japan. Volume B (Tables and Appendices) is presented in document C/RM/S/30B.

The report is drawn up by the Secretariat on its own responsibility. It is based on the information available to the Secretariat and that provided by Japan. As required by the Decision, in preparing its report the Secretariat has sought clarification from Japan on its trade polices and practices.


NOTE TO DELEGATIONS

Until further notice, this document is subject to a press embargo.
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SUMMARY OBSERVATIONS

(1) Japan in World Trade

1. Japan remains the world's third largest trading entity both in terms of imports and exports, next to the European Communities and the United States. Japan's share in world merchandise exports and imports remained largely unchanged in 1991 at 8.9 and 6.5 per cent, respectively.

2. Japan's recent trade performance, particularly as regards imports, has been adversely affected by the domestic economic downturn that followed the collapse in 1991 of the "bubble economy". In 1991, the value of imports grew by less than 1 per cent, while import volume grew by only 2.5 per cent, partly in response to the domestic recession and the lagged impact of the real effective depreciation of the yen from 1988-90. At the same time, growth in the U.S. dollar value of Japanese exports more than doubled, while the volume of exports slowed from 5.6 per cent in 1990 to under 3 per cent in 1991. In the first half of 1992, the value of imports declined, partly reflecting price factors and partly the domestic recession. Exports, by contrast, rose sharply, leading to a considerable increase in the overall merchandise trade surplus.

3. In August 1992, the Japanese authorities introduced an economic stimulation package comprising, inter alia, public investment, tax concessions and measures relating to the financial sector. It is reported that total expenditure under the package is equal to some 2.3 per cent of GDP and that import-related measures may lead to an additional US$5 billion of imports over the next 18 months.

4. Lacking fuels and many raw materials, the Japanese economy remains highly import-dependent, and manufactured exports continue to be an important driving force behind the country's economic growth. Japan's
merchandise trade to GDP ratio increased marginally from 17 to over 17.5 per cent in the period 1989-91, remaining comparable to those of other major developed economies.

5. Largely reflecting the capacity of the Japanese economy to adjust to structural change and external shocks, Japan's commodity pattern of trade has continued to show rapid change. For example, Japan's energy demands have been reduced following a successful shift towards energy-saving products and manufacturing techniques. In 1991, manufactured goods accounted for over half of total imports, compared with under one-third in 1985. Exports of consumer goods have declined in relative importance to those of capital and intermediate goods, partly in response to demand by overseas subsidiaries of Japanese companies. These developments are reflected in a steady increase in Japan's intra-industry trade ratio from 1985 to 1990, albeit from a relatively low base.

6. Japan's merchandise export base remains concentrated in broad areas where it possesses strong comparative advantage. Motor vehicles, machinery, office equipment and telecommunications apparatus account for half of the value of exports. Office equipment and machinery (both electrical and non-electrical) continue to be the most dynamic export categories.

7. South-east Asia, the United States and the European Communities remain Japan's largest trading partners, both for exports and imports. But the regional pattern of Japan's merchandise exports has changed, with South-east Asian markets accounting for 31 per cent, overtaking the United States (29 per cent) in 1991, for the first time, as the major destination, followed by the EC (19 per cent). The surge of exports to South-east Asia reflected not only strong economic growth in regional markets, but also demand created by Japanese overseas investment.
8. Japan's current account surplus increased from a low of US$35.8 billion in 1990 to US$72.9 billion in 1991, equivalent to just over 2 per cent of GNP. In the first half of 1992, the current account surplus again increased strongly, reaching a level believed to be around 2.8 per cent of GNP. As a share of GDP, this level of surplus does not appear to be uncharacteristically high, being slightly above the Japanese average since 1977, when surpluses first began to consistently emerge, and well down on the peak level in 1986 of 4.1 per cent.

9. Since 1989, the outward flow of foreign direct investment from Japan has fallen sharply by well over one-third, to US$41.6 billion in 1991. The bulk of this investment was in the areas of finance, insurance and real estate; about one-fifth of the stock of Japanese overseas assets in 1991, estimated at US$310 billion, was in manufacturing, especially machinery, transportation equipment and chemicals. Much of this was accumulated during the 1980s, partly in response to import barriers or pressures in foreign markets, and partly in an effort to restructure towards lower-cost production in the face of rapid appreciation of the yen between 1985 and 1988.

(2) Institutional Framework

10. The institutional and legal framework for Japanese trade policies is largely unchanged since the last Trade Policy Review. However, Japan has taken institutional steps to encourage import promotion. These include the establishment, in 1990, of the Import Board and the impending creation of "foreign access zones" to improve Japan's import-related infrastructure around major airports and ports. The 29-member Board reports to the Trade Conference, chaired by the Prime Minister, on general matters related to import expansion and facilitation. It comprises both Government and industry representatives, including ten from foreign-affiliated companies in Japan, and has met three times to date.
11. The Government continues to consult closely on trade issues with the private sector through a large number of advisory bodies. Interactions between these advisory bodies and the Government remain largely informal and not generally subject to public scrutiny, thereby strengthening the discretionary powers available to the Government. Japanese producers, including farmers' representatives, are much more strongly represented in the advisory bodies than are consumers.

12. The Customs Tariff Council, attached to the Ministry of Finance, is responsible for advising on all customs matters, including tariffs and import quotas, as well as the imposition of anti-dumping and countervailing duties. Members are appointed by the Finance Minister.

13. There remains no independent statutory or official body responsible for public review of the provision of government assistance to sectors and the overall economic cost of such policies.

(3) Trade Policy Features and Trends

(i) Recent evolution

14. Japan continues to express keen interest in completing the Uruguay Round. During the past two years, dispute settlement, together with rule-making areas such as anti-dumping, countervailing duties, subsidies, intellectual property and services, has continued to receive priority attention from the Japanese Government.

15. In March 1992, Japan submitted a comprehensive draft list of market access commitments, which included offers to reduce bound tariffs on a wide range of manufactured and agricultural products. The tariff offer would reduce bound tariff levels substantially more than applied rates since, for many products, bindings currently exceed the rates actually in force. The list also reaffirmed Japan's position that rice, as a basic food, and
products under the purview of Article XI:2(c)(i) should be exempted from tariffication.

16. Japan continues its strong support for the m.f.n. principle. It extends m.f.n. tariff treatment to all except two contracting parties to the GATT. The only tariff preferences provided by Japan are those accorded to developing countries under the GSP scheme which was extended, essentially unchanged, for 10 years from 1 April 1991.

17. While continuing to pursue closer regional cooperation with its Asian and Pacific neighbours, for example through the Asia-Pacific Economic Council (APEC), Japan remains critical of preferential trading arrangements on the grounds that they may create exclusive economic and trading blocs. It does not belong to any customs union, free-trade area or other preferential trade agreement.

18. The Japanese government continues to attach high priority to reducing trade frictions, particularly with its major trading partners, the United States and the European Communities. Such frictions have again intensified recently in line with Japan's increasing bilateral current account surpluses with these economies. Confronted with bilateral pressures, especially from the United States, the Japanese Government has responded by taking additional market-opening measures, most of which follow commitments announced prior to the previous Trade Policy Review of Japan.

19. Moreover, Japan has strengthened the financial incentives provided under its import promotion measures for a three-year period in an attempt to meet external criticisms and encourage Japanese firms to increase imports of a wide range of capital and intermediate goods that are duty free. Such incentives may succeed in the objective of reducing general trade frictions by promoting imports; however, they may also have resource allocation implications for the domestic economy and may also assist in increasing exports by reducing costs of production.
20. In this connection, Japan has been a ready partner to enter bilateral agreements with the United States concerning Japanese imports of certain sensitive products. Most such bilateral agreements, even where relating to products in which U.S. firms might have a comparative advantage, carefully avoid discriminatory treatment: thus, the 1991 semiconductor arrangement, for example, refers to expectations that a "foreign" market share of 20 per cent can be achieved by the end of 1992. However, recent arrangements in the automobile sector appear to go further by giving Government endorsement to specific bilateral objectives, set in the framework of voluntary industry-to-industry agreements, covering purchases by Japanese firms of automotive parts from U.S. suppliers.

21. The Japanese Government has also demonstrated its continued willingness to manage sensitive exports through maintaining "voluntary" export restraints and export monitoring arrangements on products where Japan is highly competitive. Since the last review, while the restraint arrangements on machine tools and voluntary export restraints on automobiles exported to the United States have been extended, the voluntary export controls on steel exports to the United States have been terminated. This has reduced the share of Japanese exports covered by export restraints from 12.5 per cent in 1989 to 7.7 per cent; however, Japan faces new anti-dumping actions on steel in the United States. A new consensus on exports of passenger motor vehicles has been concluded with the European Communities. Maintenance of export restraint arrangements, like any other trade-restrictive measure, prevents resources from being used most efficiently by reducing competitive pressures for industrial restructuring in the importing country and inhibiting the growth of efficient exports.

22. The tendency for major trading partners to press for, and Japan's readiness to agree to, management of specific trade problems as a means of addressing bilateral imbalances could, if left unchecked, subject the multilateral system to potentially damaging pressures. Even the perception by other Governments that such trends may be occurring risks undermining
confidence in the trading system, as third countries increasingly feel that their trading opportunities are being adversely affected. A number of Governments have publicly claimed that recent bilateral arrangements between Japan and the United States have already harmed their export interests.

(ii) Type and incidence of trade policy instruments

23. The trend towards opening of the Japanese market for industrial products has continued in the past two years. Tariffs are low, averaging 5.2 per cent on manufactured goods; rates have recently been reduced on 1,004 tariff lines bearing relatively low duties. Most import quotas on manufactured products have long been removed, and those remaining, mainly in the areas of chemicals, pharmaceuticals, firearms and explosives, are predominantly for non-protective reasons. Import quotas on coal were removed in March 1992.

24. Relatively high tariffs, however, remain in some important areas of domestic production. Tariff peaks of up to 60 per cent exist as above-quota rates on certain treated leather and leather footwear, and up to 20 per cent in other areas, including leather and wood products, and items of textiles and clothing. Japan does not make use of the provisions of the Multifibre Arrangement.

25. Concentrating "temporary" tariff reductions on manufactured goods with relatively low rates has, according to Secretariat estimates, reduced the average tariff by about one-fifth, but increased overall tariff dispersion by one-quarter. Numerous tariff concessions, especially end-use provisions, increase tariff dispersion and escalation.

26. Some 90 per cent of all Japanese tariff lines are bound. The scope of tariff bindings is higher for manufactured products than for agricultural items; less than two-thirds (59 per cent) of agricultural tariffs are bound, compared with 97 per cent of industrial tariff lines.
27. Ad valorem tariffs are in force on agricultural products such as certain dairy products and beef. However, differential duties apply on imported pigmeats; levies on sugar; and alternate duties on a number of products. Seasonal tariffs, ranging up to 60 per cent, affect certain fruits. Pursuant to its GATT undertakings, Japan has terminated a number of import quotas, including those affecting beef, fresh oranges and orange juice. Tariffication of certain quotas, most notably beef, represents a positive change in trade policy direction, although the measured level of assistance may have increased in the short-term.

28. The main assistance to agriculture and fishing is, however, still delivered through a range of non-tariff measures. These include a comprehensive, and at times complex array of administered domestic prices, covering over two-thirds of agricultural production, supported by deficiency payments and import controls. Non-tariff measures, such as exclusive State-trading rights for major cereals and import quotas, restrict imports to the level necessary to meet shortfalls in domestic production, including an effective prohibition on rice imports. Japan also maintains strict health and quarantine regulations on most agricultural commodities.

29. Liberalization of most import quotas on agricultural products by Japan has been made in accordance with commitments announced prior to the last review. Japan has also complied with most of the recommendations of the 1988 GATT Panel by removing import quotas on most foodstuffs covered by the decision. However, import quotas remain on a number of products, especially dairy products and starches, where Japan does not agree with the interpretations made by the Panel: in this connection, Japan has stated that measures to be taken will depend on the outcome of the Uruguay Round.

30. Both central and prefectural governments continue to provide adjustment assistance to industry under various legislative arrangements. These include payments under the general structural adjustment law, as well
as industry-specific schemes, such as for textiles and coal where production has fallen by almost half since 1987. In the case of coal, the Government has indicated that the current extension to the scheme, to run until the year 2000, represents the last structural assistance for the industry; the combination of this with the abolition of the import quota represents a significant reduction in barriers to trade.

31. Substantial assistance is provided for research and development, as well as through special schemes designed to help mainly small and medium-sized firms. Some eighty per cent of R&D expenditure in Japan is financed by the private sector; Government support is given through taxation concessions, such as tax credits and accelerated depreciation.

32. Agricultural sectors, including fishing and forestry, benefit from infrastructure facilities and services provided at subsidized prices. Agricultural production is also assisted directly by various deficiency and other official payments under the various stabilization schemes. The balance of budgetary payments has shifted towards infrastructure.

(iii) Temporary measures

33. Japan is currently conducting its first ever anti-dumping investigation, to determine whether imports of ferro-silico-manganese from China, Norway and South Africa are entering Japan at "dumped" prices. The Government has until 29 November 1992 to make its decision.

34. Japan has never imposed countervailing duties nor taken Article XIX safeguard action.

(iv) Sectoral trade policies

35. The main sectoral assistance policies pursued in Japan relate to agriculture. Despite the recent and significant termination of import
quotas, inward-looking trade policies in certain important areas of agriculture still contrast with Japan's progressive and successful liberalization of trade in manufactures.

36. Japan remains overall the world's largest food importer, and share of output and employment in agriculture continues to decline. However, Japan's agricultural policies continue to concentrate on food security in selected areas, in particular, through achieving self-sufficiency of rice, and to maintain parity between farm and non-farm income. Japan's agricultural sector continued in 1991 to be one of the most highly assisted among industrialized countries.

37. Japanese farm assistance policies raise domestic food prices well above international levels. Prices were, on average, double world levels, ranging up to between four and five times the border price for rice and milk products, and well over three times for sugar. Through such higher prices, consumer transfers to farmers were estimated by OECD at some ¥3.5 trillion in 1991: an implicit tax on food consumption of around 11 per cent. The transfers, combined with Government payments, raised incomes of Japanese farmers in 1991 by ¥4.2 trillion, equivalent to some ¥1.2 million per farm household.

38. As formal barriers to trade have fallen in manufacturing, international concern in recent years has shifted to the impact of other measures, including possible informal barriers. Trading partners continue to focus on Japan's Government procurement practices, regulations on standards and testing requirements, customs procedures, administrative guidance, antimonopoly legislation, the distribution system, keiretsu and other business practices. Considerable improvements appear to have been made in a number of these areas.

39. The extent to which practices such as keiretsu and the distribution system inhibit imports is difficult to ascertain. Available evidence
suggests that the restrictive impact of these arrangements may be less important than often claimed. One recent survey by the American Chamber of Commerce in Japan, for example, ranked these matters well behind other factors such as high fixed costs and staffing difficulties.

(4) Trade Policies and Foreign Trading Partners

40. Japan has continued to open its markets in industrial products. However, despite recent liberalization in significant areas of agricultural markets, Japanese farming remains highly protected from international competition, reflecting various domestic objectives including food security and revitalization of the rural economy. By retaining scarce resources in internationally uncompetitive farming activities, Japan's agricultural assistance policies tax the rest of the economy; the annual cost to Japan's economy of these policies has been put at more than one per cent of GNP. Continuing agricultural reforms should benefit the Japanese economy through improved resource-use efficiency, reduced inflationary pressures and higher disposable incomes for households.

41. Outside agriculture, a hard core of protection continues to exist in certain industrial sectors, especially leather and leather footwear, textiles and clothing. Trade liberalization in these areas would also promote structural adjustment in Japan and benefit trading partners, especially developing countries.

42. Japan's market-opening measures have been partly taken in response to external pressures to reduce the trade and current account surpluses accumulated by Japan during the 1980s. Further trade liberalization, while it will alter considerably the structure and levels of Japanese imports, should be pursued by the Japanese Government for its own benefit, including long-run economic competitiveness rather than seen as a fix for bilateral imbalances. Beyond the short run, developments in the trade and current account will be largely determined by more fundamental factors, such as the
balance between the traditionally high, but declining, level of savings in Japan and its investment performance, as well as macro-economic policies and structural policies followed by major trading partners.

43. Japan continues to stand outside, and to criticize regional and bilateral approaches to trade as undermining the multilateral trading system. However, its readiness, when confronted by such pressures, to accept bilateral solutions for trade problems, including voluntary export constraints and market-opening agreements, continues to give the impression of a country which, while seeking to reduce frictions with all trading partners, favours the growth of grey-area measures and of managed trade in certain sensitive areas. Such bilateral solutions to trade problems, unless fully consistent with the principles of the multilateral trading system, including non-discrimination, contribute to the erosion of confidence in the system and of the system itself. Correspondingly, Japan's trading partners facing competitive pressures at home should seek multilateral import relief through internationally-accepted safeguard procedures, rather than seeking "voluntary" bilateral undertakings.

44. Japan, as an efficient exporter in many product areas, has been one of the major beneficiaries from the multilateral trading system. In view of its status as one of the leading trading nations, Japan has a major responsibility for the health of the multilateral trading system. Japan would benefit further under a successful Uruguay Round, to which it could make a considerable contribution by introducing further market-opening measures, especially in hitherto largely untouched areas of agriculture.

45. Moreover, more active reliance on multilateral rules and a greater readiness to make use of the GATT framework, including the use of international dispute settlement procedures, would help Japan to resolve trade problems in an appropriate multilateral context, and to make a contribution to the functioning of the international trading system which is commensurate with its importance in world trade.
I. THE ECONOMIC ENVIRONMENT

(1) Recent Economic Performance

1. In 1989-91, Japan’s economic growth rate, as measured by real GDP, remained well above the OECD average. It rose to over 5 percent in 1990, declining to 4.5 per cent for 1991 (Chart I.1). Throughout 1989-90, domestic demand, fuelled particularly by private investment, continued as the major impetus to growth (Table I.3), with the contribution of merchandise trade being negative, as import growth outstripped that of exports. From mid-1991, these trends reversed; domestic demand growth slowed and net exports, increasing rapidly, began making a positive contribution to growth for the first time since 1985 (Chart I.2).

2. The rapid growth of GDP, together with the effects of Japan's emerging labour shortage (exacerbated by the aging of the Japanese population, shortages of both skilled labour and workers prepared to undertake dirty or dangerous jobs, as well as, on the policy side, by agricultural support that helps retain resources, including labour, in the farm sector) put considerable pressure on the Japanese labour market during 1989-91. This led to wage increases, especially in terms of starting salaries, as the number of job offers exceeding the number of job-seekers peaked at 50 per cent.²

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¹Table I.1 presents the main features of the Japanese economy. Table I.2 summarizes Japan’s recent economic performance.

Chart I.1
Growth of real GDP in Japan and in the OECD area, 1985-92*

(Percentage change)

Source: OECD, Economic Outlook.

Chart I.2
Real GNP growth and contribution of domestic demand and net exports 1985-91

Source: Ministry of Finance.
3. The Japanese economy thus experienced relatively high wage and price inflation during 1989-91, reflecting over-full employment of factors of production during that period. Unemployment fell from 2.3 per cent in 1989 to 2.1 per cent in 1990 and 1991: real wages rose by over 3.5 per cent on average in the period. However, because of growth in productivity, unit labour costs rose by less than 3 per cent annually.\textsuperscript{3}

4. At the same time, asset prices, both for land and equities, had increased to extremely high levels by 1990. The consumer price index, which had risen by less than 1 per cent in 1988, increased by 2.3, 3.1 and 3.3 per cent in 1989-91, respectively.

5. One factor underlying the inflationary pressures was the low level of nominal interest rates maintained up to early 1989, which contributed to excess demand and overheating of the economy. To combat inflation, the Bank of Japan twice raised the discount rate in 1990, to 6 per cent. However, partly reflecting the marked differential between Japanese and overseas interest rates in the period, the yen continued to depreciate in real effective terms up to the third quarter of 1990 (Chart I.3).

6. The collapse of Japan's "bubble economy" in 1991 was heavily influenced by higher domestic interest rates, securities market scandals and the imposition of restrictions on real estate lending. The immediate effects were declines in stock market prices of about 15 per cent in 1990 and 16 per cent in 1991. A decline in average land prices of 4.6 per cent in 1991 soon followed, highlighted by falls averaging 11.6 per cent in the major urban centers of Tokyo, Osaka and Nagoya.\textsuperscript{4} Overall, the wealth effect of falling asset prices helped push the Japanese economy into its current "growth recession".

\textsuperscript{3}IMF (1992), World Economic Outlook, Washington, D.C.

Chart 1.3
Export volume, import volume, real effective exchange rate (REER) and market rate, quarterly, 1989-91

Note: For the market rate and REER, an upward movement indicates appreciation.


7. In attempting to regain "sustainable non-inflationary growth", the Bank of Japan reduced the discount rate three times in 1991 (July, November, and December), and again in April and July 1992, to its current level of 3.25 per cent. With growth in real household disposable income of 3.9 per cent in 1990 and 3.2 per cent in 1991, and the economy virtually at full employment, the Bank saw further discount rate cuts as not advisable, despite mounting pressures for additional reductions.

8. Japan's fiscal policy in 1989-90 continued to be one of restraint, motivated partly by the expected costs to the budget of Japan's aging population. Successful efforts were made to eliminate bond issues for financing current consumption, and to reduce the overall percentage of Government debt in terms of GNP (estimated at 44.7 per cent for FY 1992).\(^6\)

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\(^5\)The net cost of social security is expected to rise dramatically as the non-working population increases: in addition, the propensity to save is expected to fall while income tax receipts would also be expected to decline.

\(^6\)The 1990 Budget was the first in 15 years not to rely on bond issues to support current consumption expenditures. Throughout this report, the Japanese fiscal year refers to (Footnote Continued)
The task was helped by sharply rising revenues from taxes on income and capital gains throughout the late 1980s.

9. Continued budgetary reform became more difficult in FY 1991. Tax revenues declined, while interest payments on central government debt (16.8 per cent of budgetary expenditure for FY 1992) remain the highest among the developed countries. Fiscal year 1991 also marked the start of expenditures for Japan's major 10-year ¥430 trillion infrastructure investment programme (to be financed by capital spending bonds) under the Structural Impediments Initiative (SII) with the United States.7

10. Although Government efforts from the mid-1970s to the mid-1980s to reduce dependence on deficit financing could have influenced savings and investment balances, the high level of household savings - and relatively lower levels of domestic corporate and household investment - continue to be the dominant factors (Table I.4).8 The small decline in the savings rate from the early to late 1980s can be largely attributed to the rising financial assets of households and improvements in social security funding. As a result of the current economic slowdown the trend has since reversed, however, on what is predicted to be a temporary basis.9

11. The original budget for the current (1992) fiscal year was described as only mildly stimulative.10 Total expenditures were projected to increase by 2.7 per cent in nominal terms (according to initial budget figures), despite an expected 4.5 per cent increase in public works expenditures. While the central Government budget was to be in overall surplus if social security contributions were included, the deficit between actual tax receipts and expenditures was officially forecast to rise to approximately 10 per cent, to be covered by bonds issued for capital spending (Table I.2).

(Footnote Continued)

the period from 1 April to 31 March, and is indicated, for example, in the case of the 1990 fiscal year, by either FY 1990 or 1990-91.

7A trillion is defined as a million million.

8As mentioned in the previous Trade Policy Review on Japan, Government fiscal policies from the late 1970s to the second half of the 1980s were generally designed to strengthen the public account. Consequently, a peak net public borrowing requirement of 5.5 per cent of GNP in 1978 turned into a net surplus of 0.5 per cent of GNP in 1987. For 1988 through to 1991, the figures were net surpluses of 1.5 per cent, 2.4 per cent, 3.1 per cent and 2.4 per cent, respectively. For 1992, the OECD estimate is 1.9 per cent. OECD (1992), Economic Outlook No. 51, Paris.


10Japan Center for Economic Research (1992), Quarterly Forecast of Japan's Economy, Tokyo.
12. However, in March 1992, the Japanese Government announced a series of emergency measures to deal with the domestic economic downturn. These included frontloading 75 per cent of public works spending into the first half of the 1992 fiscal year (with local governments adopting a similar pattern), increases in previously planned investment spending by utility companies (together with frontloading), and new financing for labour-saving investments by smaller companies.

13. In August 1992, the Japanese Government announced a new macro- and micro-economic package aimed at stimulating economic growth. The package comprises additional public expenditure of some ¥10.7 trillion (US$86 billion), principally devoted to public works; tax measures to stimulate investment; provisions to encourage private consumption; and postponement of some privatization. Specific import-related measures are estimated by MITI to lead to an increase of US$5 billion in imports over the next 18 months.

(2) External Performance

14. Japan remained the world's third largest trading entity in 1990-91 (both in terms of imports and exports), after the European Communities and the United States. In 1990, the U.S. dollar value of merchandise exports grew by 4.3 per cent, while that of imports grew 11.4 per cent. For 1991, the value of exports increased by 9.6 per cent, of which 4.7 percentage points was attributed to the Southeast Asian market, while the value of imports rose by 0.8 per cent.

(i) Current account

15. Japan's current account surplus peaked during the 1980s at US$87.0 billion in 1987, then dipped to a low of US$35.8 billion by 1990 before rising again to US$72.9 billion for 1991. The ratio of the current account surplus to GNP, which reached 4.2 per cent in 1986, shrank to 1.2 per cent by 1990 before increasing to approximately 2.1 per cent for 1991 (Chart I.4).

16. The merchandise trade surplus was US$96.4 billion in 1987. By 1990, it had fallen to US$63.5 billion, before rising again to US$103.0 billion in 1991. Japan's deficits in services (including net investment income and transfers) have expanded far more rapidly, from US$9.4 billion in 1987 to US$27.8 billion in 1990. For 1991, the figure reached US$30.1 billion, primarily due to Government transfers concerning the Gulf conflict (Chart I.5).
17. Overall, one-third of the decline in the current account surplus between 1986 and 1990 resulted from the increase in the services account deficit. For 1991, however, in addition to the slowing domestic economy, the Gulf War cut overseas travel by Japanese in the first quarter, temporarily reducing the travel deficit as well. At the same time, another notable characteristic of the services account has been the failure of net investment income to expand significantly, until recently, despite the massive increase in overseas foreign direct investment (FDI). As these investments mature, however, rates of return are expected to rise.

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11 See Chapter III.

18. For 1991, the nominal increase in Japan's current account surplus is primarily attributed to improved terms of trade (due to lower prices for oil and other commodities), the "J-curve" effects of higher dollar-based export prices resulting from yen appreciation, declining gold imports for investment purposes, and reduced imports of luxury consumer items. In volume terms, both exports and imports in 1991 expanded at approximately 3 per cent. Concerning the previous year's current account surplus, many of the same factors had been working in the opposite direction, leading to the conclusion that the reduction in the surplus for 1990 may have been overstated.  

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13 According to the Bank for International Settlements (BIS), the reduction in the 1990 merchandise trade balance "can be entirely explained by a significant deterioration in the terms of trade. In volume terms, by contrast, there were signs that the merchandise surplus was rising." The analysis continues by stating that "The sharp depreciation of the yen from late 1989 to April 1990 appears to have brought the reduction of Japan's real external surplus to a halt." The BIS also notes that export volumes continued to grow even after the yen later appreciated, a factor which can probably be explained by the slowing domestic economy. BIS (1991), 61st Annual Report, June.
(ii) Capital movements

19. In 1991, the Japanese economy recorded a surplus on the external long-term capital account for the first time in 11 years, totalling US$37.1 billion (US$40.4 billion for the fiscal year) (Chart I.6). The major factors involved were a slump in Japan's overseas FDI and a large increase in overseas purchases of Japanese securities of US$115.3 billion (US$101.4 billion in FY 1991) due to attractive prices in the depressed domestic stock market and a revival in Japanese corporate bond issues on the Euromarket.

20. The flow of short-term capital also reversed in 1991, to a US$25.8 billion outflow (US$14.6 billion for the fiscal year), as Japanese companies made efforts to pay off Euroyen impact loans (essentially loans borrowed overseas from Japanese banks involving capital originating from Japan).

21. Counterbalancing the dual surpluses on current and long-term capital accounts, Japanese banks have repaid short-term overseas borrowings on a massive scale, totalling US$93.5 billion in 1991 (US$121.3 billion in FY 1991), partly in an effort to meet BIS capital-adequacy requirements (Chart I.6). These outflows were expected to end in the second or third quarter of 1992.\(^\text{14}\)

\(^{14}\)The Economist, 16 May 1992, p. 108.
Chart 1.6
Balance of payments for Japan, 1986-91
US$ billion

<table>
<thead>
<tr>
<th>Year</th>
<th>Outflows</th>
<th>Inflows</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986</td>
<td>-200</td>
<td>150</td>
</tr>
<tr>
<td>1987</td>
<td>-150</td>
<td>100</td>
</tr>
<tr>
<td>1988</td>
<td>-100</td>
<td>50</td>
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<td>1989</td>
<td>-50</td>
<td>0</td>
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<tr>
<td>1990</td>
<td>0</td>
<td>50</td>
</tr>
<tr>
<td>1991</td>
<td>50</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: Positive figures indicate capital inflows, negative figures indicate capital outflows.

Source: Ministry of Finance.

(iii) Commodity pattern of trade

22. Since 1985, the effects of yen appreciation, trade liberalization and the temporary rise of the "bubble economy" have brought major changes in the commodity structure of Japan's imports and exports. Imports of manufactures in 1991 (US$120 billion), for example, accounted for 50.8 per cent of total imports, compared with 31 per cent (US$40 billion) in 1985. Export emphasis, meanwhile, has shifted from consumer goods to capital goods and intermediate products, in parallel with increasing overseas FDI.

23. The changes in Japan's import composition stem in part from the rapid growth in intra-industry trade (although this remains rather low compared with other developed economies, even allowing for natural resource endowments - Chart I.7). At the 4-digit SITC level, the change between 1985-90 has been quite substantial, rising from 16.6 per cent to nearly 27 per cent (Table I.5).
24. A related characteristic is a sharp rise in imports from Japanese subsidiaries abroad. According to the Bank of Japan, exports to Japan from overseas subsidiaries as a proportion of total sales were about 8 per cent in FY 1989, double the amount for FY 1986. For FY 1991, such imports to Japan from overseas plants were estimated to have been over US$10 billion, or approximately 4.3 per cent of total imports.

25. Imports of consumer goods, capital goods and intermediate goods accounted for over 60 per cent of the post-1985 merchandise import expansion. In the same period, raw material imports have stagnated or declined, "reflecting the change in Japan's industrial structure focusing more on high value added and energy saving". Beginning in the middle of 1991, however, imports of consumer goods stagnated as the economic slowdown took effect. Among the most heavily affected have been sales of luxury goods, especially automobiles, works of art, etc., which grew by only 5.1 per cent in 1991 and have since continued to weaken.

Chart I.7
Intra-industry Japanese trade
by region, 1985-91

![Chart I.7](chart)

Source: Ministry of Finance.

26. By product, Japan's five most significant import categories in 1990 (at the 3-digit SITC level) were: crude petroleum (13.4 per cent of total imports), petroleum products (4.4 per cent), fresh fish (4.1 per cent), natural gas (4.0 per cent), and clothing not containing fur (3.6 per cent). Between 1985 and 1990, however, the greatest gains in import share were made by road motor vehicles (from 0.6 per cent of Japan's total imports to 3.1 per cent); clothing not containing fur (1.4 per cent to 3.6 per cent), works of art (0.2 per cent to 1.8 per cent), precious stones (0.6 per cent to 1.5 per cent) and office machinery (1.2 per cent to 2.3 per cent). As expected, the greatest declines in import share between 1985 and 1990 were in crude petroleum, natural gas, and coal (Table I.6).

27. The major trend in the composition of Japan's exports has been the growth in exports of capital and intermediate goods induced by the rise in Japan's FDI in recent years. Between 1988 and 1990, the increase in total export volume (12.4 per cent) was matched by the increase in the export volume of capital goods, including parts. On the other hand, there has been a relative decline in exports of consumer goods as offshore production has expanded.

28. On the export side, the five most important categories in 1990 were road motor vehicles (22.3 per cent of Japan's total exports), followed by electrical machinery (7.8 per cent), non-electrical machinery (7.4 per cent), office machines (7.2 per cent) and telecommunications equipment (6.2 per cent). The high degree of export concentration is highlighted by the fact that these five categories alone constitute 50.9 per cent of total exports. Between 1985 and 1990, Japan's most dynamic export categories were office machines (up from 4.4 per cent to 7.2 per cent of Japan's total exports), electrical machinery (4.0 per cent to 6.2 per cent), and non-electrical machinery (4.0 per cent to 6.1 per cent). The greatest declines occurred in such product categories as telecommunications, sound recorders and road motor vehicles, the last two due primarily to offshore production (Table I.7).

(iv) Regional pattern of trade

29. Southeast Asia accounts for the largest share of Japan's imports (approximately 25 per cent in 1991), followed by the United States (23 per cent) and the European Communities (13 per cent). For Japan's exports, Southeast Asia (31 per cent) overtook the United States (29 per cent) as the largest market in 1991, followed by the European Communities (19 per cent).

30. The recent surge in exports to Southeast Asia (up 16 per cent in 1991) reflects both the strength of economic growth in the area, and the importance of trade flows linked to Japan's foreign direct investment.
Since the Plaza Agreement of 1985, however, trade with Europe has shown the most rapid growth. The European Communities' share of Japan's imports jumped from approximately 7 per cent in 1985 to 13 per cent in 1991, while exports to the EC have risen from approximately 12 per cent of total exports in 1985 to 19 per cent, largely resulting from the trade effects of German unification (Table I.8).

(3) Outlook

31. As of August 1992, the Japanese Government expects that GNP will grow at an annual rate of 3.5 per cent in FY 1992. According to this forecast, the current account surplus is estimated at US$71.0 billion for FY 1992, with the merchandise trade surplus expected to be about US$96.5 billion for the same time period. According to other Japanese forecasts, as well as those of the OECD, however, growth is likely to be somewhat lower and the current account surplus significantly higher than the Government forecasts. For the short to medium term, Japan's current account surplus is expected to stabilize in the range of 2.0-2.5 per cent of GNP.

32. Together with the weak recovery in the United States and stagnant European economies, the current economic climate in Japan has dampened hopes for a rapid domestic recovery. Over the longer term, however, the Government's newly published 5-year economic plan projects average GNP growth of 3.5 per cent annually. The plan also calls for continued financial stringency in order to reduce new government bond issues, as well as improvements in housing and reduced working hours to 1,800 annually.

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16 The OECD is forecasting real Japanese GDP growth of 1.8 per cent for calendar year 1992, together with a current account surplus of US$92.6 billion (2.6 per cent of GNP). See OECD (1992).

17 Published by the Economic Council, an advisory panel to the Prime Minister (June 1992).
II. TRADE POLICY REGIME: OBJECTIVES AND FRAMEWORK

(1) Overview of Developments since the Last Review

32. Japan's basic policy structures related to trade, as well as the fundamental policy making process, have remained essentially unchanged over the past two years. However, two significant changes have recently been made to the import promotion process, in a further attempt to improve foreign access to the Japanese market.

33. An important modification was made to the policy making process with the establishment in 1990 of the Import Board, composed of 19 government and industry representatives, and 10 representatives from foreign-affiliated companies resident in Japan. To date, the Import Board has held three meetings, in April and November 1991, and July 1992.

34. A new law, entitled "The Law on Extraordinary Measures for the Facilitation of Imports and Foreign Direct Investment into Japan" was passed by the Diet in March, 1992. The law provides for the establishment of "Foreign Access Zones" in an effort to improve Japan's import-related infrastructure.

35. In April 1992, Japan's remaining import quotas on coal were repealed, eliminating the last residual import restriction in the area of mining and manufactured products. Still remaining are a number of import restrictions in agriculture, which were judged by a GATT Panel in 1987 to be inconsistent with Japan's obligations under Article XI (Chapter VI).

36. Japan has continued to participate in the Uruguay Round, with rule-making and dispute settlement among the areas of greatest interest. Other high-priority issues are anti-dumping regulations, countervailing duties, rules concerning subsidies, intellectual property and services.

37. Discussions concerning trade issues have been held on an informal basis with European nations and others as part of efforts by the Japanese Government to help reduce trade frictions. The Structural Impediments Initiative (SII), involving the United States and Japan, was revived on the

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2With respect to the remaining restrictions on dairy products and starch, Japan maintains its position of not agreeing with the interpretation of Article XI:2(c)(i) adopted by the GATT Panel, and feels therefore that it is extremely difficult to implement measures in the accordance with the Panel's conclusion based on such an interpretation. The Japanese authorities state that Japan has taken steps to improve market access for these products and will consider measures in the light of the outcome of the Uruguay Round.
basis of annual "follow-up" meetings. The first follow-up report was published in May, 1991.

38. The Government has continued involvement in the Asia-Pacific Economic Cooperation (APEC) regional forum. Ten projects are currently being promoted, including infrastructure and human resource development, on a non-exclusionary basis (in regard to non-APEC members).

39. In 1991, Japan's GSP scheme was extended for a period of ten years. In 1992, the Czech and Slovak Federal Republic and Namibia were added to the list of beneficiaries.

40. The twelfth five-year plan published by the Economic Planning Agency in July 1992 calls for reduced annual working hours, and a substantial increase in public works spending, among other measures.

(2) Structure of Trade Policy Formulation

(i) Institutional structure

41. As reported in the previous Trade Policy Review on Japan, there are no general laws which set out the legal framework and the main objectives of trade policies. Rather, within the framework of existing laws, the Cabinet, in close cooperation with the ruling political party, decides upon major trade policy objectives relevant to specific trade problems. (Chart II.1).
42. The Ministries most frequently involved in trade policy formulation, and their main trade-related functions, are as follows:

- Ministry of International Trade and Industry proposes trade policies, co-ordinates their implementation and holds the legal power to control exports and imports;

- Ministry of Agriculture, Forestry and Fisheries is responsible for agricultural policies, including those affecting exports and imports;

- Ministry of Finance is responsible for the Government budget, tariff scheme and other charges;

- Ministry of Foreign Affairs coordinates trade policies and represents the Japanese Government in negotiations with foreign Governments;
Economic Planning Agency is responsible for formulating and promoting long-term economic plans, and co-ordinating the basic economic policies and plans of other Ministries.

Fair Trade Commission oversees, under the Antimonopoly Act, trade measures and practices from the viewpoint of maintaining competition (Chart II.2).

Chart II.2
Organisation of the Japanese government

Note: Commission and Agencies marked with asterisks (*) are external organs of the Prime Minister's Office and headed by Ministers of State.

Source: GATT Secretariat, because on information supplied by the Government of Japan.

43. Inter-ministerial conferences and offices have been established to deal with major economic and trade issues involving more than one Ministry. The Councillor's Office on External Affairs in the Prime Minister's
Cabinet, for example, co-ordinates policies on specific international issues, including trade matters. Other examples are the Trade Conference, chaired by the Prime Minister, and the Ministerial Conference for Economic Measures. These structures act as intermediaries between the Ministries concerned and the Cabinet.

44. The Japanese Government and the ruling party (or parties) have often formed "joint headquarters" to deal with major economic and trade issues. In 1989, for example, the Government-Ruling Party Joint Headquarters for Adjustment of Price Differentials between Domestic and Overseas Markets was created to promote comprehensive policy measures for the adjustment of price differentials from a consumer-oriented standpoint.

45. The Ministries are also advised by various affiliated advisory councils, committees and study groups. Members include private business leaders and academics. The Economic Council, for example, established under the Economic Planning Agency, advises on long-term or major economic policies; the Customs Tariff Council, under the Finance Minister, is concerned primarily with modifications in tariff rates; the Industrial Structure Deliberation Council, under the Minister for International Trade and Industry, advises on industrial policies.

46. The Import Board, created in 1990 and reporting to the Trade Conference, is exceptional in that it includes representatives from foreign-affiliated companies resident in Japan as voting members. Participation by non-Japanese in other government advisory bodies is typically limited to expert testimony. The mandate of the Import Board is to "report on general requests and opinions related to import expansion and facilitation."

(ii) Independent review bodies

47. In Japan, there is no official independent body which is charged to review trade policies of the Government. As part of their advisory function, however, the advisory councils, committees and study groups mentioned above conduct reviews of policies under the jurisdiction of the Ministries to which they are attached.

(3) Trade Policy Objectives

(i) General trade policy objectives

48. As reported in the previous Secretariat report, the first Maekawa Report (in 1986) called for Japan's transformation from export-led economic
growth to domestic-demand-driven growth, transformation of the trade and industrial structure, further improving market access and encouraging imports of manufactured goods.

49. The second Maekawa Report, following one year later in April 1987, suggested specific measures for implementing the objectives of the original report. These included:

- Financial support and tax incentives for home buyers;
- Changes in land use, including agricultural land;
- Measures to invigorate provincial economies and to decentralize urban areas;
- Promotion of adequate wages, of price stability, and of the yen appreciation pass-through to customers;
- Reduction of annual working hours to 1,800 and the provision of 20-day vacations by the year 2000;
- Reform of the distribution systems for the petroleum, construction, telecommunications, and agricultural industries;
- Increased overseas development assistance and a larger Japanese role in the resolution of the debt crisis; and
- Increased participation in international scientific undertakings and reform of the educational system thorough participation from abroad.

50. Many of the above recommendations have been reflected in recent Government legislation (see below) and proposals for administrative reform, in the five-year plans of the Economic Planning Agency, and in the joint Structural Impediments Initiative (SII) with the United States.

51. The twelfth five-year plan of the Economic Planning Agency, for example, emphasizes reduced working hours, higher public infrastructure spending, improved housing and environmental measures. A major objective

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3 The report of the Advisory Group on Economic Structural Adjustment for International Harmony was submitted to the Prime Minister in April 1986.

is again to promote increased domestic demand and restore greater import growth relative to exports.

(ii) Resolution of trade disputes

52. While supporting the multilateral trading system, Japan has often opted for bilateral solutions in recent years in dealing with its trade disputes, without recourse to GATT dispute settlement procedures or import relief measures under the GATT (safeguard actions, anti-dumping and countervailing duty actions, etc.). However, in recent years, Japan has become somewhat more active in this regard.

53. Inclination towards bilateralism is particularly evident with respect to Japanese export practices, namely the frequent recourse to voluntary export restraint measures. The first Maekawa Report called for prudent behaviour by private companies in view of "the strong possibility of friction caused by the behaviour of private companies which tend to pursue expanded market share at all costs".

54. Japan's export restraint measures are characteristically described as "transitional, temporary and exceptional steps" to avoid "sharp and disruptive increases" in exports. Domestic laws provide the basis upon which the Government can enforce export restraints upon private firms.

(iii) Objectives in the Uruguay Round

55. Japan continues to express keen interest in the Uruguay Round. Over the past two years, rule-making and dispute settlement have remained areas of the highest priority, together with anti-dumping regulations, countervailing duties, rules concerning subsidies, intellectual property and services. Japan has expressed strong concern, as well, in strengthening prohibitions against unilateral retaliatory measures and measures which are not GATT-consistent. In agriculture, the Government has expressed reservations over the scope of tariffication proposals.

56. Japan was among only 15 countries to submit a comprehensive draft schedule covering agricultural and non-agricultural products (including suggested tariff reductions) in time for the March 1992 deadline. The Government has also expressed official concern over the state of play in the negotiations between the European Communities and the United States. Japan, in its lists of commitments, has expressed its official view that

5These concerns were apparently taken up with U.S. and EC officials in two confidential letters sent by the Japanese foreign minister. See Financial Times, 16 April 1992.
there are elements to be appropriately modified in the Draft Final Act on Agriculture, including the issue of comprehensive tariffication, maintaining that rice and those products under the purview of GATT Article XI should be exempted.

(4) General Trade Laws and Trade Legislation

57. As noted in the first Secretariat report, the GATT is regarded by the Japanese Government as a treaty and, as such, has direct effect domestically. Obligations under the GATT take precedence over those of domestic laws or ordinances. The Protocol for the Accession of Japan to the GATT, providing for provisional application of the General Agreement, was signed by the Japanese Government and approved by the Diet in 1955. The 1965 Protocol Amending the GATT to introduce Part IV on Trade and Development was approved by the Diet in 1965.

58. The principal law which establishes basic rules for foreign trade is the Foreign Exchange and Foreign Trade Control Law. The law was fundamentally revised in 1980 to change from a basic policy of "prohibition in principle" to "freedom in principle" for foreign exchange, foreign trade and other external transactions. The law was again revised in April 1991 to make the procedures related to foreign direct investment in Japan more open and transparent.

59. In accordance with the Foreign Exchange and Foreign Trade Control Law, the Export Trade Control Order provides for detailed administrative rules and conditions for the export approval system. The Minister of International Trade and Industry is designated as the administrative authority under the Order.

60. With respect to the import licensing system, including the allocation of import quotas, the Import Trade Control Order specifies administrative rules and conditions in accordance with the Foreign Exchange and Foreign Trade Control Law. The Minister of International Trade and Industry is again designated as the administrative authority under the Order.

61. The Export and Import Transaction Law aims at preventing unfair export transactions (violation of patents, false marks of origin, etc.) and at establishing "order" in both export and import transactions. The Law provides the legal basis for private firms to form export or import

6This section summarizes the information presented in the previous report on Japan's main trade laws.
cartels. Many voluntary export restraints have been administered under these measures (Chapter IV).

62. Japanese customs duties are levied under the Customs Law, the Customs Tariff Law and the Temporary Tariff Measures Law. The Ministry of Finance administers the laws pertaining to customs duties, including the annual revision of the temporary rates in consultation with other Ministries, and with advice from the Customs Tariff Council which is affiliated with the Ministry.

63. The Law on Extraordinary measures for the Facilitation of Imports and Foreign Direct Investment in Japan was approved by the Diet in March, 1992. The law is designed to help improve Japan's import infrastructure, especially for consumer goods, by establishing "Foreign Access Zones" and related distribution facilities near international airports, harbors, etc.

(i) Administrative guidance

64. Administrative guidance has been considered by the Government of Japan as an effective tool to administer various policies, including industrial and trade policies. Export cartels, for example, have often been formed under the Export and Import Transaction Law following administrative guidance from the Ministry of International Trade and Industry.

65. The Government of Japan announced in its report for the SII talks with the United States that it would ensure that administrative guidance is not intended to restrict market access nor to undermine fair competition. Administrative guidance would be implemented in writing as much as possible and, unless good reasons exist not to do so, would be made public when implemented.

(5) Trade Agreements

66. Japan acceded to the GATT in 1955. The General Agreement applies between Japan and all other contracting parties, except for two Article XXXV cases (Botswana and Lesotho). Japan grants m.f.n. treatment to all contracting parties, except for Botswana and Lesotho, and to all countries which apply the GATT on a de facto basis, apart from Equatorial Guinea, Namibia and Swaziland. Japan is a signatory to all Tokyo Round Agreements and Arrangements, and to the Arrangement regarding International Trade in Textiles (the MFA).

67. Japan is a member of the International Commodity Agreements on coffee, cocoa, jute, natural rubber, wheat, sugar and tropical timber, as well as the International Study Groups on nickel, cotton, rubber, lead and zinc. It is expected soon to join the Group on copper, and participates in the International Cotton Advisory Committee and the International Sericultural
Commission. Japan has also signed and ratified the Agreement on the Common Fund for Commodities.

68. Japan maintains bilateral trade and navigation treaties with a number of countries. It does not belong to any customs unions, free-trade areas, or other preferential regional agreements. Rather, Japan continues to be critical of regional agreements on the grounds that they might lead to exclusive economic blocs.

69. Japan is one of the promoters of closer regional cooperation among the countries in Asia and the Pacific region. Various initiatives for regional economic cooperation and promotion of specific projects have been taken by the Japanese Government, but they do not constitute binding international agreements. No preferential trade advantage, except GSP, is accorded to these countries.

(6) The Generalized System of Preferences (GSP)

70. Japan was among the first to institute a generalized system of preferences for the developing countries, beginning in August 1971. In 1981, and again in 1991, Japan extended the application of the scheme for a 10-year period. The Japanese GSP scheme covers most industrial products (except for crude petroleum and some other products, such as certain textiles, plywood, furskins and footwear included in a negative list), and about one half of dutiable agricultural products (defined at the 4-digit HS level), which are contained in a positive list. Quota ceilings apply to many eligible industrial products.

71. The GSP scheme is reviewed every year. In recent years, a number of steps have been taken to enlarge the product coverage and the number of beneficiaries (Chapter IV). Currently 131 countries and 25 territories are beneficiaries of the scheme, with the Czech and Slovak Federal Republic and Namibia the newest additions. The least-developed countries receive special treatment (duty-free entry without any quota ceilings). No developing country has been suspended from the Japanese GSP scheme.

7Japan maintains treaties on commerce and navigation with 27 countries (or regions) as well as trade agreements with 37 countries (some countries are signatories to both the treaties and agreement).
III. TRADE-RELATED ASPECTS OF THE FOREIGN EXCHANGE REGIME

(1) Exchange Rate Movements and Trade

72. Exchange rates of the yen against other currencies are market-determined. The authorities intervene in the markets when they deem it necessary in order to counter disorderly exchange market conditions. Authorized banks may freely carry out spot and forward exchange transactions with customers, non-resident banks and among themselves.

73. The nominal exchange rate of the yen (calculated on an annual average basis) against the U.S. dollar appreciated by some 85 per cent over the years 1985 to 1988; subsequently it depreciated by 7 per cent in 1989 and by 4.5 per cent in 1990, before again appreciating by 7.2 per cent in 1991. In the years 1985 to 1991 as a whole, the annual average rate appreciated by 76 per cent. However, both the nominal and real effective exchange rates appreciated by lesser amounts, of 38.5 and 20.7 per cent respectively, over the period 1985 to September 1991, primarily because currencies of the other industrialized countries appreciated against the U.S. dollar (Charts III.1 and III.2). As of mid-1992, high interest rates have kept most European currencies strong against the yen.

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1Japan formally accepted the requirements of Article VIII of the IMF Articles of Agreement in 1964. Sections (1) and (2) draw on IMF (1991), Exchange Arrangements and Exchange Restrictions, Annual Report, Washington, D.C.

2The end-of-year exchange rate of the yen against the dollar appreciated by 87 per cent in the period 1984 to 1990. Against the German mark, the annual average rate of the yen showed virtually no appreciation, on a cumulative basis, in the period 1985 to 1991. Similarly, the end-of-year rates (1984-1990) were largely unchanged on a cumulative basis.

3The effective exchange rate is a trade-weighted index of the exchange rates between a country and its trading partners; the real effective exchange rate (REER) adjusts the nominal effective exchange rate (NEER) for differences in inflation rates between the country and its trade partners.
Chart III.1
Yen market rates, nominal effective exchange rate (NEER) and real effective exchange rate (REER), 1985-1991

Note: The data are on an annual average basis. An upward movement indicates appreciation. For NEER and REER, 1991 = QIII.

Chart III.2
Real effective exchange rates for Japan, Germany and the United States, 1985-1991

Note: The data are on an annual average basis. An upward movement indicates appreciation.
The depreciation of the yen against major currencies in 1989 and early 1990 was attributable to several factors, including an earlier rise in international, particularly German, interest rates relative to those in Japan (Table III.1) and a temporary resurgence of the dollar. Other relevant factors included the economic and political uncertainty generated by steep declines in Japanese share prices and the resignation of two prime ministers in 1989.

During 1991 and continuing into early 1992, additional stock market declines, accentuated by incidents involving suspect business practices by securities firms, were factors behind the relatively moderate real effective appreciation of the yen despite a renewed increase in Japan's current account surplus. Other elements included pessimism generated by Japan's economic slowdown, in contrast with relative optimism for economic recovery in the United States, as well as short-term capital outflows (Chapter I).

Empirical evidence suggests a lagged positive relationship between Japanese import volumes and movements in the yen's real effective exchange rate (Chart III.3). After initially trailing the yen's real appreciation through 1986, the volume of imports subsequently expanded more rapidly, and continued to grow despite the real effective decline of the yen in the period 1988 to 1990. In this latter period, strong domestic demand was one of the major factors in import growth. Between 1985 and 1990, import volume grew by almost 70 per cent. However, in 1991 the average growth rate of imports slowed to 2.5 per cent in 1991, reflecting the domestic economic slowdown and the lagged effect of the previous real effective depreciation of the yen (Table III.2).

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5 Information from the Ministry of Finance suggests a lag in the initial import response to exchange rate changes of approximately six months, with the full effect felt within one year.
Chart III.3
Export and import volumes and the real effective exchange rate, 1985-1991

Note: The data are on an annual average basis. An upward movement of the REER indicates appreciation.


77. In the initial period of yen appreciation, from 1985 to 1987, Japanese export volume stagnated, but it grew by about 4.5 per cent in 1988 when the yen appreciated in real terms by 7 per cent (Chart III.3). Subsequently, in 1988 to 1990, export volumes rose by almost 11 per cent, reflecting in part the 16.5 per cent real effective depreciation of the yen. In 1991, when the yen again appreciated in real terms and the growth of world output turned negative, the rate of increase of Japanese export volume slowed to less than 3 per cent. Overall, in the period 1985 to 1991, export volume grew by some 17 per cent, although the real effective exchange rate of the yen appreciated by about 20 per cent (through to the 3rd quarter of 1991).

78. Explanatory factors for the growth of export volume at the time of real yen appreciation include the willingness of Japanese exporters to accept significantly lower profit margins and reduce yen-denominated prices (Chart III.4). This reflected efforts to retain market share, as well as reduced yen costs of imported materials.

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IMF (May 1992), World Economic Outlook, Washington, D.C.
Chart III.4
Unit values of exports, imports and the real effective exchange rate, 1985-1991

Note: The data are on an annual average basis. An upward movement of the REER indicates appreciation.


79. An additional factor in countering the effects of exchange rate appreciation on export volume was the concerted move after the Plaza Agreement to reduce domestic production costs and improve overall productivity in export-related industries. Other measures included a shift to domestic production of higher value added products, especially increased capital goods exports to equip Japanese factories locating abroad. Pressure to rationalize production costs was an element in the mid-1980s surge in foreign direct investment (FDI), primarily in Asia, where labour costs were lower.

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8The Plaza Agreement of 1985, in which the G7 nations expressed approval of the decline in the REER of the U.S. dollar and the rise in the REER of the yen, was followed by the Louvre Agreement in February 1987 that stated the exchange rates had achieved a rough equilibrium.

9OECD (1990-91) and the Economic Planning Agency of Japan.
(2) **Foreign Exchange Allocation**

80. Among Japan's remaining exchange controls are limits on the overall currency positions of authorized foreign exchange banks, with each bank facing an individual limit on its spot-forward exchange position. Under the authorized foreign exchange bank system, approval is also needed for residents, other than banks in the system, to engage in foreign currency transactions or to lend foreign currencies. Further, most overseas deposits by residents, other than authorized banks, require prior approval, with qualified Japanese enterprises in insurance, transportation and securities permitted to maintain such deposits under blanket licensing.

81. Approval is also required for special settlement methods for imports. In particular, approval is needed for payments taking place more than two years before an import declaration is made and for payments occurring more than two years after customs clearance. Such approval is normally granted automatically. Imports of items restricted by quotas and other measures require authorization from the Ministry of International Trade and Industry (MITI), followed by application to an authorized foreign exchange bank for an import licence (given automatic approval).

82. A screening system is in place for securities issued overseas by residents, for foreign currency bonds issued in Japan by non-residents, and for Europe-yen issues. Prior notice and a 20-day waiting period are normally required. Prudential guidelines apply to capital transactions by financial institutions, generally limiting these institutions to holdings of foreign currency denominated assets equivalent to 30 per cent of their total assets. Generally acquisition of securities for portfolio purposes can be freely made through designated securities firms.

83. Controls, including prior notification requirements, are in place for certain foreign direct investments (Section (4) below). Acquisition by overseas investors of shares totalling 10 per cent or more of a company's outstanding shares is subject to direct investment regulations. Foreign banks are permitted to operate in Japan subject to domestic regulations; they are free to obtain resources from inward foreign currency remittances and to access Japan's money markets.

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10 Defined as a bank's net outstanding foreign assets or liabilities, including forward positions, converted into dollars.

11 However, residents and non-residents may maintain foreign currency deposits with authorized banks and freely transfer such amounts in any currency.
(3) **Foreign Direct Investment from Japan**

84. Annual outward foreign direct investment (FDI) by Japanese firms grew more than five-fold in the fiscal years 1985 to 1989, to reach US$67.5 billion in the latter year. However, paralleling Japan's domestic economic slowdown, the outflow of FDI in FY 1990 declined to US$56.9 billion, and fell by a further 27 per cent in fiscal year 1991, to US$41.6 billion (Chart III.5). The sharpest declines in the latter two years occurred in the areas of finance, insurance and real estate.

![Chart III.5](chart.png)

**Outward foreign direct investment flows of Japan, 1985–1990**

Note: Regional breakdown not available for fiscal year 1991.

Source: Ministry of Finance

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12 The appreciation of the yen between 1985 and early 1989 made outward FDI increasingly attractive as a cost-saving measure, especially in locations such as Southeast Asia. FDI was also relied upon to pre-empt, or even undercut, threats of increasing protectionism, particularly in the United States (motor vehicles, etc.) and Europe (where local manufacturing has been seen as providing assured entry to the broad EC/EFTA market).

13 Not included in the above figures are foreign investments financed within Japan, which are estimated to be as much as 50 per cent of total investments. OECD (1989/90), *Economic Surveys: Japan*, Paris.
85. As of March 1991, the stock of Japanese FDI amounted to some US$310 billion, of which about 26 per cent was in manufacturing, 21 per cent in finance and insurance and 10 per cent in commerce. In manufacturing, the leading investment sectors were electrical machinery (7 per cent of total FDI), transportation equipment (4 per cent) and chemicals (4 per cent). By region, North America accounted for approximately 44 per cent of Japan's FDI stock, followed by Europe (19 per cent), Asia (15 per cent) and Latin America (13 per cent) (Table III.3).

86. Expansion of Japanese foreign direct investment has significantly increased Japan's intra-industry trade in the period since 1986. FDI added to Japanese exports of capital goods, parts and other intermediate materials. Concurrently, overseas Japanese affiliates have substantially increased their shipments to Japan, particularly of consumer goods (Chart III.6). However, in the longer run, foreign direct investment is expected to substitute for a significant share of exports from Japan.\footnote{Economic Planning Agency, Economic White Paper, August 1991. The substitution effects on Japanese exports, together with increased imports into Japan from foreign subsidiaries of Japanese firms, are expected to more than offset the export-inducing effects.}
The average yield on Japanese overseas FDI fell, from approximately 7 per cent in 1980 to 2.5 per cent in 1990. High start-up expenses and the effects of slow economic growth in host markets were important factors. Due primarily to Japanese stock market declines and the corresponding difficulty of raising new equity-linked finance, funding costs for new investment have now risen considerably, contributing to the current levelling-off of overseas FDI.

Despite the generally high levels of outward FDI by Japan during much of the 1980s, the level of overseas production by Japanese multinationals remains quite low on a comparative international basis - less than 10 per cent of their overseas sales. Considering the overall trend of Japanese

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In addition, "It may also be the case that direct investment designed mainly to circumvent protectionist barriers -- potential as well as actual -- is not very profitable." Bank for International Settlements (1991).
corporations toward overseas production in search of lower labour costs, renewed expansion is considered highly likely in the medium term, but at a more moderate pace than in the 1980s.  

(4) Foreign Direct Investment into Japan

89. Foreign direct investment into Japan is now generally unrestricted. Prior to January 1992 all inward FDI required notification to the Minister of Finance, with approval automatically granted in most cases. Since January 1992, the notification system for industries on a positive list published by the Government, has been replaced by an ex post facto reporting requirement. Concurrent with the revised regime, technology imports were also liberalized, to a similar ex post reporting system for most of these imports.

90. Investments in four specific sectors, as well as in industries related to national security, are reserved under Japan’s conditions of adherence to the OECD Code on Liberalization of Capital Movements. The four specified sectors are agriculture, forestry and fisheries; oil; mining; and leather and leather products. The industries where investment is restricted on a national security basis are air and maritime transport, and those related to public order. Separate national laws regulate investments in telecommunications and financial services.

91. In January 1992, the number of sectors subject to restrictions on technology imports was reduced from twelve to five, all related to national security: aircraft, arms, explosives, manufacturing atomic power and space development. For both inward FDI and technology imports within the reserved and restricted sectors, the approval procedures according to the authorities usually take no longer than two weeks.

92. Primarily as a result of the SII talks with the United States, a number of recent changes have been made to encourage FDI into Japan. The take-over bid (TOB) reporting system was liberalized in June 1990, legislative approval was given for a rule requiring disclosure of share holdings of 5 per cent or more in a particular company (also in June 1990),

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18 Under the TOB system, foreign investors were required to give 10-days advance notice to the Government of their intention to attempt a take-over of a Japanese company.
followed by the elimination of most prior notification requirements in April 1991.

93. In April 1992, the Japanese Government implemented further measures to promote FDI into Japan. These included increased spending for informational programmes by the Japan External Trade Organisation (JETRO), preferential tax treatment, expanded eligibility for low-interest loans, loan guarantees and special credit facilities for small and medium-sized Japanese companies involved in transactions with foreign-affiliated firms (Table AIII.1).

94. Revision of the Foreign Exchange Law in 1980 was followed by an upsurge of foreign direct investment flows into Japan. However, gross inward FDI has declined slightly since 1988, partly reflecting the appreciation of the yen (Chart III.7). Despite historically large inward flows during the 1980s, the present stock of FDI in Japan (based on initial costs) is still less than one-fifteenth of Japanese direct investment abroad, and small by comparison to total productive capacity in Japan.

19 Following Japan's entry into the OECD, the Government gradually liberalized FDI, such that by 1980, under the revision of the Foreign Exchange Law, foreign equity participation of up to 100 per cent was permitted in most Japanese corporations. In general, liberalization was initiated first in competitive industries, such as consumer goods, and delayed for "strategic" and less competitive industries. Yoshitomi et al. (1991), as found in Japanese Direct Investment in Europe: Motives, Impact and Policy Implications, Avebury, Aldershot.

20 Exact investment figures are difficult to obtain, because approximately three-quarters of FDI into Japan is financed locally, due to differences in capital costs. OECD (1989/90)

21 On the basis of current valuation, the difference in the stock of FDI narrows as many investments in Japan date back to the 1950's and beyond. According to MITI, foreign affiliates in 1990 accounted for 0.5 per cent of employment in Japan, 0.9 per cent of total assets and 1.2 per cent of sales. For the United States, the figures were 3.8, 20.4 and 16.5 per cent, respectively.
95. Most foreign direct investment in Japan is in manufacturing, particularly machinery and chemicals (including pharmaceuticals). In recent years, almost one-half of total investment has been attributable to U.S. firms.

96. The reasons for the comparatively low level of FDI into Japan are complex. The Bank for International Settlements has noted that "a number of rational economic considerations may also explain the low level of inward FDI - the intense competition among domestic manufacturers makes Japan an unprofitable location for most foreign manufacturers; the high price of land can make investment very risky and so on". In addition, the overall effect of Japan's previous investment prohibitions, and relatively late liberalization, should also be considered.

Note: Cumulative investment valued at historical cost, commencing fiscal year 1950.

Source: Ministry of Finance

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97. In a survey of foreign affiliates in Japan conducted by the Japan External Trade Organization, "only 4.4 per cent cited 'unduly strict restrictions on foreign affiliates' as obstacles to doing business in Japan". These results were generally consistent with those from a 1991 survey conducted by the American Chamber of Commerce in Japan, which showed the major factors currently inhibiting increased foreign investment in Japan to be high costs (especially for land), the difficulty of recruiting qualified personnel and the complexity of doing business in Japan. Well down the list, ranked sixth and eighth respectively, were Japanese Government regulations and non-tariff barriers.


24 American Chamber of Commerce in Japan (1991), Trade and Investment in Japan: The Current Environment, Tokyo, p.52. Informal barriers and restrictions covered by the survey included distinctive business practices such as keiretsu, a complex distribution system, and cross-shareholding patterns leading to difficulty in buying Japanese firms outright.
IV. TRADE POLICIES AND PRACTICES BY MEASURE

(1) Overview

98. Japan's tariffs are, on average, low. Nearly all industrial tariffs and somewhat less than two-thirds of its agricultural tariffs are bound under GATT. The average (unweighted) tariff on all products in fiscal year 1991-92 (which has not changed substantially since) was 6.9 per cent; 13.9 per cent on agricultural commodities and 5.2 per cent on industrial goods. Tariff reductions have been made in recent years on a number of manufacturing items with already low ad valorem tariffs. Thus, although these changes have lowered both the manufacturing and overall tariff averages, they have also increased tariff dispersion, both within the industrial sector and compared to the agricultural sector (where initial tariffication of some import quotas may, in some cases, have increased protection in the short run). There are also numerous end-use tariff concessions, including those implemented as tariff quotas on agricultural products.

99. Relatively high ad valorem tariffs continue to apply to a range of industrial and agricultural goods. Tariff peaks of up to 60 per cent are applied as above-quota rates on certain treated leather and leather footwear; up to 35 per cent are applied in other areas of leather products, while the textiles and clothing sector bears rates of up to 20 per cent. Many imported foodstuffs bear import duties, including seasonal tariffs, of over 15 per cent. Non-ad valorem duties, comprising specific, alternate, sliding scale duties and differential rates, applied to some imports protect significant elements of domestic production.

100. The Japanese system of import licensing, including prior confirmation, enables imports of sensitive products to be monitored. Import quotas on major agricultural products, such as rice, wheat, barley and dairy products, underpin extensive State-trading activities with exclusive importation rights as part of Japan's comprehensive system of stabilizing supply of foodstuffs and supporting farm prices and incomes. Import quotas on beef (replaced by a relatively high tariff, currently standing at 60 per cent and due to decline to 50 per cent from 1 April 1993), orange juice and coal have been terminated since the last Trade Policy Review.

101. It is recognized that formal trade barriers on industrial products are now generally low. The attention of Japan's trading partners has thus shifted to conditions covering Government procurement practices, regulations on standards and testing requirements, customs procedures, administrative guidance, antimonopoly legislation, the distribution system, keiretsu and other business practices.
102. The Japanese Government has made substantial improvements in a number of these areas, such as in government procurement practices and standards and testing requirements, and has also taken steps to open up, and clarify, such areas as administrative guidance, the distribution system and the rôle of keiretsu groups in the economy.

103. Japan has, in recent years, implemented a number of import promotion measures designed to assist Japanese firms in increasing imports of a wide range of intermediate and capital goods free of duty. These incentives - particularly those given as tax breaks - may, along with their import-promoting effects, provide a degree of export subsidy for Japanese firms which gain access to subsidized inputs. Moreover, the Japanese Government has entered or supported bilateral arrangements with the United States that are designed to encourage foreign imports of semi-conductors and automotive products.

104. Japan has also continued to use "voluntary" export restraint arrangements with major trading partners on sensitive products as a means of reducing trade frictions associated with rapid export growth. Although the steel agreement with the United States has been terminated, two other arrangements with the United States - on machine tools and passenger motor vehicles - have been extended. The proportion of Japanese exports covered by export restraints is estimated to have fallen from 12.5 per cent in 1989 to 7.7 per cent following the termination of the steel agreement on 31 March 1992. Japan has also concluded a new consensus on trade in motor vehicles with the European Communities for the period up to 31 December 1999.

105. Both central and prefectural governments continue to provide substantial budgetary assistance to Japanese industries. Adjustment assistance is provided to a number of industries under various legislative arrangements. These include payments under the general Law on Temporary Measures for Facilitating Structural Adjustment, as well as industry-specific schemes, such as for textiles and coal. Substantial assistance is also provided for research and development, as well as through special schemes designed to help mainly small-and-medium-sized industries.

106. Rural areas benefit from substantial public expenditure on providing infrastructure facilities and services at subsidized rates. Major agricultural sectors are also assisted directly by various deficiency and other government-funded payments to underwrite the various stabilization schemes operated by the Government to maintain stable producer incomes and
food supply, albeit with prices well above international levels. Little information is available on the extent to which assistance from the central Government is supplemented at the prefectural level.

(2) Measures Directly Affecting Imports

(i) Registration and notification requirements

107. Under general reporting and notification requirements stipulated in the Foreign Exchange and Foreign Trade Control Law, importers must furnish to the Ministry for International Trade and Industry (MITI) an Import Notification when proceeds are paid to the exporter through a foreign exchange bank. A copy of the commercial invoice must be submitted to MITI when goods clear customs.

(ii) Tariffs

108. The basic legislation in Japan covering Customs administration is the Customs Law. It provides for customs duties to be levied in accordance with this and other legislation, especially the Customs Tariff Law. The Customs Tariff Law, which has appended to it the Customs Tariff schedule, contains the main provisions relating to the application of tariff rates, customs valuation, exemptions and refunds, anti-dumping, import prohibitions and the operations of the Customs Tariff Council.

109. The Japanese Customs Tariff Schedule is classified according to the Harmonized System (HS) and is divided into approximately 8,600 nine-digit tariff lines. It comprises four types of tariff rates. These are "General" rates based on the Customs Tariff Law; "GATT" or bound rates; "Temporary" rates, generally below general rates, which provide for widespread exceptions to general rates to enable tariff reductions in response to short-term industrial and economic changes; and preferential tariff rates under Japan's GSP Scheme. Where applicable, a preferential rate will supersede all other rates, followed by a temporary rate. However, the GATT bound rate is always applied if it falls below the general or temporary rates of duty. General rates are operative for some 15 per cent of all tariff lines.

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1In this connection, data provided by the Japanese authorities show that the total budgetary support associated with agriculture has fallen by 8 per cent since 1985: the share of the total devoted to price support has fallen from 21.4 to 12.9 per cent while that for public works associated with agriculture has risen from 36.3 to 45.1 per cent.
110. With the exception of imports from developing countries receiving preferential tariffs under Japan's Generalized System of Preferences, Japan applies the same tariff levels to imports from all sources, except for six non-GATT members to which Japan does not provide m.f.n. treatment. These are Albania, Andorra, Lebanon, Nepal, North Korea and Vietnam. Also excluded from m.f.n. treatment are the recently joined GATT members of Botswana and Lesotho, which apply Article XXXV against Japan. Equatorial Guinea, Namibia and Swaziland, which apply the GATT on a de facto basis, are also excluded from m.f.n. treatment. Tunisia was accorded m.f.n. treatment by Japan from 19 August 1990.

(a) Average tariff levels

111. Due largely to substantial reductions implemented following the Tokyo Round, Japan currently has, on average, low tariff levels. The unweighted average m.f.n. tariff in FY 1991-92, including where applicable temporary rates, was 6.9 per cent (Table IV.1).  

112. Japan implemented its Uruguay Round offer to reduce tariffs on certain tropical products from 1 April 1989. Subsequently, ad valorem tariffs ranging from 2-6 per cent were suspended on 1,004 industrial items and were reduced on a further four items, mainly affecting machinery but also covering chemicals, photographic equipment, chemicals and rubber products, from 1 April 1990. Changes since then have been relatively minor. Tariffs of 4.6 per cent on five chemicals were removed from 1 April 1991 and comparatively small reductions were made in the specific rates applied to a handful of petroleum products from 1 April 1992. Tariff revisions in Japan are considered annually by the Customs Tariff Council and changes implemented through legislation on a fiscal year (1 April) basis (Note IV.1).

2 Unweighted (simple) tariff averages are given to avoid the downward bias inherent in using import-weighted averages due to the weight (i.e. import values) reflecting the restrictive impact of the tariff.

3 In calculating these averages, for specific-type rates (i.e. specific and composite rates, etc.), the ad valorem equivalent for 1991 was used. For alternative tariffs, the ad valorem alternative rate was used.
Note IV.1 Procedures for Revising Customs Tariffs in Japan

The Customs and Tariff Bureau of the Ministry of Finance plays a leading role in determining and revising tariff rates in Japan. The Bureau requests relevant ministries, especially MITI and MAFF, to submit a report on tariff changes for the following financial year. From late September, these proposals are negotiated by the Bureau with the relevant ministry, taking into account price differentials between domestic and international levels, supply and demand conditions and the prospects for domestic rationalization. Agreed proposals for tariff changes are referred to the Customs Tariff Council.

Attached to the Ministry of Finance, the Customs Tariff Council investigates tariff proposals and submits a report on tariff changes to the Minister of Finance, normally at the end of December. Under the Customs Tariff Law (Article 22), the Customs Tariff Council is responsible for examining tariff revisions and any other matters on which the minister seeks advice. It comprises 35 members appointed by the Minister, and is divided into four groups:

- The Planning Group to plan and examine policy relating to the tariff system;
- The Research Group to consider revisions to individual tariff rates;
- The Special Customs Group to deliberate on such measures as anti-dumping and countervailing duties; and
- The Tariff Quota Group to determine import quotas to be applied under the tariff quota system.

Amendments to the Customs Tariff Law and the Temporary Tariff Measures Law incorporating these tariff changes are prepared by the Customs Tariff Bureau. These legislative changes are submitted to the Diet for approval and the revised tariff rates implemented on 1 April, the commencement of the financial year. Tariff revisions are normally considered and implemented annually as part of the budgetary cycle.
113. Tariff changes since the last review have concentrated on manufactured products, with tariffs on most agricultural goods remaining largely unchanged. Indeed, tariffs have been substantially increased on a few agricultural products, mainly beef, to replace import quotas. Tariff averages at the sectoral level therefore continue to be highly uneven - the unweighted average tariff rate for agricultural products of 13.9 per cent is more than double the level of 5.2 per cent for industrial goods. Relatively high tariffs, often underpinning domestic marketing and price-support arrangements, apply to a wide range of agricultural goods, including meat and meat products, fruits as well as sugar.

114. The Japanese Government has offered under the Uruguay Round to halve, and in some cases eliminate, m.f.n. tariffs (based on bound rates, where applicable) on a wide range of manufactured products, including transport equipment, machinery, sheet glass and certain non-ferrous metals, such as refined copper. Japan also submitted its Lists of Commitments on Agriculture on 4 March 1992.

(b) Form of tariffs

115. Japan applies mainly ad valorem tariffs, covering some 95 per cent of all tariff items. Nevertheless, there are some important exceptions, and non-ad valorem tariffs, including specific, alternate, sliding and differential duties, operate on a number of products (Table AIV.1).

116. Unlike ad valorem tariffs, which set maximum levels of industry assistance that can only be increased by raising tariff rates, non-ad valorem tariffs set no ceiling on assistance levels, which vary automatically and inversely with changes in import prices. Domestic producers are therefore progressively cushioned against lower-priced import competition.

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4 Currently, applied rates are often considerably lower than bound levels: for example, the applied tariff on motor vehicle parts is zero while the bound rate is generally 4.8 per cent. The offer thus binds existing "temporary" tariff cuts in some cases and, in others, may reduce bound rates more than existing applied rates.

5 By providing non-uniform ad valorem tariff equivalents, these arrangements distort domestic production patterns and trade flows more than ad valorem rates and thus are likely to induce a less efficient allocation of resources. Specific tariffs, for instance, provide disparate levels of assistance for similar goods by taxing more heavily imports of cheaper product lines. By changing relative prices in favour of the more expensive product line, consumption patterns may be distorted away from lower-priced articles towards the dearer alternative. Domestic manufacturers are encouraged to produce less expensive product lines where the level of protection against imports is greater. Non-ad valorem tariffs therefore contain some of the distortive features normally associated with import quotas and are clearly inferior to ad valorem tariffs in economic terms.
117. Specific tariff rates in Japan apply to a range of imported products, including vegetable oils, such as safflower, cotton-seed, maize and sesame oils; foodstuffs like pasta; alcoholic beverages such as vermouth, sake, cider, brandy, some spirits like certain whiskies, and liqueurs; petroleum products; primary plastic forms like polyethylene and polypropylene; and base metals of mainly copper, lead zinc, antimony, nickel as well as certain of their alloys.

118. Alternate duties in Japan almost exclusively apply the higher, and not the lower, of the two alternative duties. These asymmetrical duties go one step further than specific rates in protecting domestic producers since while applying a minimum ad valorem tariff rate, no maximum level is set by the specific component of the alternative minimum duty. Alternate duties apply to products such as egg products; vegetable oils; sugars; sweetened fruit juices, such as citrus; low alcohol drinks; woven woollen and cotton fabrics; cotton yarns and products; footwear and some metals, such as unwrought lead (containing by weight antimony as the other principal element). For some products, especially leather footwear other than sports shoes, alternate duties represent the above-quota rates.

119. The lower of the two alternative duties is applied to imports of certain alcoholic beverages and nickel products. In the case of imported wines, the maximum ad valorem rate imposed by the alternative tariff is subject to a minimum specific duty which, in practice, means that the ad valorem equivalent will rise at lower import prices.

120. Tariff rates on imports of onions, and a wide range of basic metal products of copper, lead, zinc and magnesium, have a three-tiered structure that provides higher assistance against cheaper imports. Products imported below a nominated price attract either a specific or ad valorem tariff while imports above a specified price are allowed to enter duty-free. Moreover, imports within the price range are usually dutiable at a sliding duty whereby the ad valorem equivalent declines as prices approach their duty-free limit. Special composite tariffs, which relate the duty to the lactose content of the product, also apply to imports of certain animal feeds.

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6 For antimony trioxide, the tariff duties comprise a two-tiered structure.
121. Seasonal ad valorem tariffs apply to imports of fresh or dried and provisionally preserved oranges and grapefruit, fresh bananas and fresh grapes. Under these arrangements, relatively high tariffs are charged in the high season (by as much as double low-season rates for oranges and preserved grapefruit). High-season m.f.n. rates range between 20 per cent on grapes and 50 per cent on bananas. The higher "in-season" tariffs are the most appropriate rates for examining the distortive impact of tariffs on production and imports, since it is these rates that protect and determine the size of the domestic competing industry.

(c) Tariff escalation and dispersion

122. Japan's applied tariff structure is relatively disparate, with some 12 per cent of tariff lines subject to tariffs of 15 per cent or above (Chart IV.1). Peaks of up to 60 per cent in some areas coexist with duty-free access in others. This non-uniform structure is expressed in a dispersion index of 140. Although the sectoral average rate for agricultural products is higher than that for industrial goods, the degree of dispersion is lower, indicating a more uniform, but higher, structure of tariff protection (Table IV.1).

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7 Since bananas qualify for reductions in duty under GSP, the rates actually applied are 10-20 per cent out of season and 20-40 per cent in season.

8 The dispersion index is the coefficient of variation which is constructed from the standard deviation - a statistical measure used to determine the dispersion between items within a frequency distribution. The coefficient of variation measures relative dispersion by dividing the standard deviation by the average tariff rate. The larger the standard deviation relative to the tariff average, and hence the larger the coefficient of variation, the greater the degree of dispersion. The lower the dispersion in tariff rates, the less will decisions by producers and consumers be distorted in the tariff system.
123. At the finer product level, substantial disparities exist in operative tariff rates, often between very similar products. Examples include wide differentials in the tariff rates applied within and between alcoholic and non-alcoholic beverages; vegetables and fruits. Since many of these products tend to be highly substitutable in production and consumption, changes in relative prices induced by such tariff rate differentials may be a source of distortions in trade and domestic production patterns.

124. Recent tariff reforms on manufactured products have concentrated on reducing low to medium tariff rates, leaving mainly untouched those items with high tariff levels. The positive impact of recent tariff reforms on overall levels of protection in manufacturing industries may thus have been partly mitigated by a widening of the spread in tariffs within the manufacturing sector, as well as between manufactured and agricultural goods (see following section on temporary tariffs).

125. Substantial tariff peaks of up to 60 per cent are applied as above-quota rates on certain treated leather and leather footwear other than sports shoes (see below). Apart from these, relatively high tariff peaks of 20 per cent are found on several leather and wood products, such as certain vanity cases, handbags and wallets as well as wood marquetry.
Relatively high tariffs of up to 18 per cent apply to a range of textile and clothing articles. In agricultural products, where the incidence of higher tariffs appears to be far greater, products with tariffs of above 15 per cent, and up to 60 per cent, include a number of foodstuffs, such as meats, fruits, coffee and tea extracts, sugar and confectionery, as well as beverages, spirits and dairy products. A number of these products, such as certain fresh fruits and pigmeat, are subject to high seasonal tariffs or differential tariff duties (see below).

126. Tariff escalation provides domestic processing industries with higher protection compared to suppliers of raw materials. A high degree of tariff escalation is inconsistent with maximising resource-use efficiency, since distorted production incentives encourage domestic processing, thereby drawing resources away from more lightly assisted activities. In Japan, relative tariff escalation occurs on semi-manufactured products, the average tariff on these being almost double the average rate on raw materials. Tariff escalation at the semi-processed stage appears to be more pronounced for manufactured products, where the unweighted average tariff of 6.4 per cent is over 5 times the average for raw materials (Table IV.1). Agricultural products are also affected by tariff escalation, with semi-manufactured products on average being dutiable at 26.7 per cent, over four times the average of 5.9 per cent for raw materials.

(d) Temporary tariffs

127. Japan operates a comprehensive system of temporary m.f.n. tariffs. These are, at least in principle, subject to annual review; however, over 90 per cent are simply rolled-over from one year to the next, sometimes at reduced rates. Temporary duties are contained in the Temporary Tariff Measures Law and, with only a few minor exceptions, are set on a yearly basis. Temporary duties have become an integral part of Japan's tariff system as a means of implementing tariff changes according to varying economic conditions.

128. Since temporary rates were introduced in 1960, their coverage has increased. Currently, approximately 80 per cent of tariff lines are subject to temporary tariffs, the incidence being much higher in manufacturing than for agricultural products (Chart IV.2). Virtually all

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9 When the ad valorem equivalents for the numerous agricultural products subject to specific-type tariffs are included, the tariff peak rises to as high as 125 per cent in the case of sugars (Table AV.4).

10 Under the Law, temporary tariffs may be fixed for a period not exceeding two years.
Tariff changes in Japan since the Tokyo Round, including the reductions associated with the Action Programme in 1986 and the more recent Uruguay Round reductions on tropical products, have been implemented through temporary tariffs. Temporary duties also cover the phased tariff reductions on imported beef introduced following the termination of import quotas. Tariff quotas on a range of products have also been implemented as temporary duties (see section below).

![Chart IV.2
Temporary tariffs in Japan distributed by sector, 1991](image)

<table>
<thead>
<tr>
<th>Percentage of tariff lines</th>
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</thead>
<tbody>
<tr>
<td>Agriculture</td>
</tr>
<tr>
<td>Manufactured</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>


129. Temporary tariffs are normally set below general rates. Some 73 per cent of temporary duties reduce tariff levels. Overall, therefore, temporary duties have lowered the unweighted applied tariff average.

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11 In some cases, such as cotton yarns and woven fabrics, temporary tariffs comprise alternate duties that limit the extent to which operative tariffs may be lowered by imposing a minimum ad valorem duty.
However, since most temporary tariff reductions are applied to items already with relatively low tariffs, they have increased tariff dispersion. The average unweighted tariff rate would increase overall by some one-fifth if existing temporary duties were removed, while the dispersion index would fall by about one-quarter (Table IV.2).

130. Temporary duties are, however, set above the alternative general rates for one per cent of tariff lines (Chart IV.3). Moreover, although most temporary tariffs are ad valorem, some are not. Temporary duties, sometimes of a specific nature, on imports of certain live horses, fruits like bananas and animal feed preparations such as dog and cat food, for example, would appear to exceed the general m.f.n. tariff rate. In over one-quarter of all items, such as imported cotton yarns and woven fabrics, temporary rates, although below the general rate, are largely superfluous by being set equal to the bound tariff rate that would apply without the temporary duty. Temporary duties are most pronounced in manufacturing industries.

Chart IV.3
Temporary tariffs and their impact on Japanese tariff levels, 1991

<table>
<thead>
<tr>
<th>Percentage of tariff lines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
</tr>
<tr>
<td>Increase</td>
</tr>
<tr>
<td>5.0</td>
</tr>
<tr>
<td>0.5</td>
</tr>
<tr>
<td>1.0</td>
</tr>
</tbody>
</table>

131. A special legislative safeguard clause exists for those temporary tariff rates cut by 20 per cent in 1986 as part of the Action Programme. These rate reductions can be fully reversed immediately to safeguard domestic industries where it is felt that rising imports are causing or threatening substantial injury. This safeguard clause has never been used to date.

(e) Tariff bindings

132. Some 90 per cent of all tariff lines are bound. The percentage of industrial tariff lines bound, at 97 per cent, is substantially above the share for agriculture of 59 per cent (Chart IV.4). Apart from a few exceptions for agricultural products, all tariff lines covered by bindings are fully bound.12

![Chart IV.4: Bound tariffs in Japan, 1991](image)


12 Although the overall share of tariff items bound was hardly affected by the conversion from the CCCN nomenclature to the HS tariff, it appears that the proportion of agricultural items may have declined slightly. The share of bindings for agricultural items prior to HS was 63 per cent (see GATT, Trade Policy Review – Japan, Geneva, 1990).
133. Ad valorem tariff bindings apply to some 96 per cent of bound items. Non-ad valorem tariff bindings, including both alternative and specific duties, apply mainly in the product areas of animal fats and vegetable oils; cane and beet sugar; wines and spirits; petroleum spirits and gases; primary chemicals of polyethylene and polypropylene; woven cotton fabrics; refined copper and copper alloy products; basic metal products such as nickel, lead, zinc, antimony; and sound records.

(f) Generalized system of preferences

134. Japan extended its GSP Scheme for a third decade on 31 March 1991. Beneficiaries are designated by Cabinet Order from countries or territories requesting preferential treatment and meeting specified conditions. Currently, 131 countries and 25 territories are eligible for GSP treatment. Of these, 41 countries classified as least-developed countries by the United Nations, receive special treatment; eligible imports are duty free and exempt from quota ceilings.

135. The only change made in extending the Scheme was to raise the restrictive quota ceilings applied to GSP imports on specific mining and industrial goods. The base year of imports used under the Scheme to determine quota ceilings was updated from 1982 to 1989. Furthermore, quota ceilings on more sensitive imports covered by the Scheme, which are determined by applying fixed annual growth factors of either 6, 3 or zero per cent to the base year ceiling depending on the domestic industry competitiveness, were increased by applying special one-off growth rates in 1991-92 of either 50, 30 or 10 per cent to those items normally subject to 6 per cent growth. Although these changes increased ceiling quotas substantially by some 35 per cent to ¥1.3 trillion in 1991-92, ceilings may

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13 These are that the economy must be in the process of development; it must be a member of UNCTAD; it must have its own tariff and trade system; it has requested preferential treatment; and it must be prescribed in a Cabinet Order as a country or territory to which such benefits may appropriately be extended. Countries classified as least developed countries by United Nations Resolutions are eligible for Special LDC Measures.

14 The number of countries actually receiving preferential treatment in 1990 was 91, of which 17 were least developed countries. A further 18 countries exported ineligible goods to Japan, while a further 30 countries failed to benefit from the Scheme because its exports, although eligible, were duty free on an m.f.n. basis. UNCTAD (1991), Generalized System of Preferences, Replies Received From Preference-Giving Countries: Japan, Trade and Development Board, TD/B/C.5/PREF/45, 16 August, P.2.

15 Quota ceilings on products thought to entail less difficulties for domestic industries are updated annually, by adding to the level of imports from preference-receiving countries (excluding from least-developing countries) in 1989 one-tenth of Japan's total imports from non-preference-receiving countries of two years before. For more sensitive products, specified annual growth rates not exceeding 6 per cent, and in many cases zero, are applied to the base level of imports.
remain restrictive on some products. Aggregate imports of goods covered by quota ceilings were ¥1,065 billion in 1991-92.\textsuperscript{16}

136. Quota ceilings are applied amongst beneficiaries on a global basis. However, for some products, maximum country amounts of one-quarter of the total quota apply.\textsuperscript{17} M.f.n. duties are generally applied after the total import quotas or maximum country amounts are exceeded.\textsuperscript{18} For a number of products not thought to be posing a threat of injury to domestic industries, however, flexible administration of quota ceilings and country amounts may lead to these limits being exceeded without any loss of preferential treatment.\textsuperscript{19} Import entitlements are administered on a first-come-first-served basis subject to daily control or monthly control, or on a prior allocation system whereby the ceiling is allotted to importers each year (Table IV.3).\textsuperscript{20}

137. In agricultural products, both the product coverage and the depth of tariff cuts under the GSP Scheme is much lower than for manufactured goods. The positive list of agricultural goods covered by the Scheme contains only about one-half of dutiable agricultural products (defined at the 4-digit HS level), and provides tariff cuts ranging from 10 to 100 per cent of the m.f.n. rate. In contrast, the negative list of industrial goods excludes a negligible percentage of industrial production from GSP treatment and applies duty-free treatment on industrial goods, with the exception of certain specified products.\textsuperscript{21}

\textsuperscript{16} Some four fifths of product groups covered by quota ceilings under the GSP Scheme are subject to specified annual growth rates of below 6 per cent. Of these, about half have zero rates applied and a further one-quarter are subject to growth rates of 3 per cent. In view of the restrictive application of growth rates under the Scheme, most ceilings expressed in value terms (the majority) are likely to have declined in real terms prior to their expansion in 1991-92.

\textsuperscript{17} Preferential treatment is suspended for products originating from a particular country if eligible imports from that country exceed one-quarter of the quota ceiling set for that product.

\textsuperscript{18} For 39 sensitive product groups, imports are computed on a daily basis and preferential treatment suspended two days after the limit has been filled. Monthly controls are exercised for 82 product groups and preferential treatment suspended on the first day of the second month after the ceiling has been reached.

\textsuperscript{19} This procedure applies to ceilings of 46 product groups and maximum country amounts of 82 product groups.

\textsuperscript{20} Some 39 product groups are subject to daily control, 83 to monthly control and 24 to prior allotment. Groups covered by prior allotment include citric acid, fur skins, textiles and umbrellas.

\textsuperscript{21} About half of the manufacturing 4-digit tariff items covered by the GSP Scheme are subject to quota ceilings. All manufacturing items eligible for the Scheme are admitted duty free, with the exception of 67 selected 4-digit ceiling items, such as leather, which receive a preferential tariff margin of 50 per cent.
138. Sensitive agricultural products like cereals, milk and milk products, meat and meat products as well as sugar are excluded from GSP treatment. Manufactured goods excluded from GSP treatment include mainly petroleum oil and gases, leather apparel, certain furskins, plywood, non-leather footwear as well as certain types of textiles, especially yarns and fabrics of cotton and silk. Most textiles and clothing, however, are included in GSP treatment.

139. Safeguard measures enable preferential treatment to be suspended on all agricultural goods and manufactured goods not subject to quota ceilings.22 Particular beneficiaries may, by Cabinet Order, be excluded from receiving preferential treatment for certain eligible products, when deemed necessary in view of the exporter's international competitiveness and its adverse effects on domestic industries. However, these safeguard or escape clauses have not been used to date.

140. To be eligible for GSP treatment, goods must satisfy certain rules of origin. Under special "Donor Country Content Rules", Japanese exports of materials used by beneficiaries to manufacture goods exported to Japan are considered to originate in the preference-receiving country. Similarly, ASEAN countries benefit from being treated as a group by applying Rules of Cumulative Origin.

141. Almost half of all Japan's merchandise imports are sourced from developing countries. Some 10 per cent of imports from beneficiaries received preferential GSP treatment in 1990.23 This share mainly reflects the combined effects of binding quota ceilings on eligible imports, ineligibility under rules of origin and goods subject to free m.f.n. rates. About one-half of imports covered by GSP treatment received preferential treatment.24 The main product categories receiving GSP treatment included, in agriculture, seafood, bananas, vegetables, palm oils, and coffee and tea extracts. In manufacturing, the major products are basic metals, such as aluminium, steel and copper, as well as clothing and plastic products.

22As imports from least-developed countries are exempt from quota ceilings, the safeguard provisions apply to all imports from LDCs.

23On the basis of dutiable imports, the share of beneficiary imports receiving preferential treatment was 14 per cent. The main beneficiary suppliers in descending order were the Republic of Korea, China, Taiwan, Brazil, Hong Kong, Thailand, Philippines, Indonesia and Chile. The top three accounted for over half of preferential imports in 1990.

142. To the extent that products are excluded, or quota ceilings applied with different degrees of restrictiveness among products, the benefits of Japan's GSP scheme are likely to be spread unevenly, and in a differentiated manner, across beneficiaries. Developing countries heavily reliant on agricultural and/or textile and clothing exports would receive, for instance, relatively small benefits compared with countries having a more diversified industrial structure. Moreover, (as in all such schemes), the incentives which may be provided by the Scheme for developing countries to concentrate on the production of industrial products subject to preferential access to the Japanese market, may run counter to their best economic interests (Note IV.2).
Note IV.2 Assessing the Effects of Japan's GSP Scheme on Resource Allocation

The impact of the GSP Scheme on Japan's resource-use efficiency largely depends upon whether the Scheme is predominantly trade diverting or trade creating. Trade diversion (when imports from preferential sources displace non-preference receiving imports) would leave production incentives unchanged and domestic industries largely unaffected. On the other hand, trade creation would subject domestic producers to increased market pressures through competition from lower-priced imports.

A number of studies conducted during the 1980s attempted to quantify the extent to which increased Japanese imports under GSP contributed to an overall increase in Japan's imports. Most studies concluded that the Japanese Scheme had been essentially trade creating. For example, Karsenty and Laird (1987) estimated that the GSP Scheme had increased beneficiary exports to Japan by US$740 million in 1983, mainly through trade creation. These findings were supported by Brown (1987) who, using a general equilibrium trade model, concluded that the Scheme was mainly trade creating, raising beneficiary exports to Japan based on 1976 trade by US$103 million.

The small scale of trade creation is hardly surprising, given the large number of exempt products, especially in agriculture and certain textiles, combined with the binding quotas applied to more competitive imports. These limitations primarily in areas where Japanese production is least efficient, would be expected to reduce the possibilities for trade creation.

A full assessment of the effects of the GSP Scheme on Japan's resource-use efficiency would need to take into account the impact of the Scheme on Japan's structure of protection and production incentives. If the operation (coverage and tariff reductions) of the Scheme results in a reduction in levels of protection afforded to competitive industries, it may widen disparities in effective assistance between more competitive and less competitive industries. For example, uncompetitive industries producing goods not covered by the Scheme will receive increased effective assistance to the extent that they use inputs produced by competitive industries whose assistance levels have been reduced. Wider disparities could thus worsen resource allocation by encouraging resources into less efficient industries.

Moreover, benefits accruing to beneficiaries through increased exports under the GSP scheme may need to be offset against the consequences of encouraging developing countries into production of goods which are eligible for GSP treatment, but in which, in the absence of the benefits, they may not have a comparative advantage.
(g) **Concessional rates**

143. Tariff concessions, covering exemptions, refunds and repayments, are provided for in Japan by the Customs Tariff Law and the Temporary Tariff Measures Law. Duty concessions cover mainly imported commodities like pork and sugar; certain materials used in the manufacture of exports; goods subject to re-importation or re-exportation; and materials used in special uses, including end-use provisions (Chart IV.5). In 1990-91, tariff concessions in Japan were estimated to amount to ¥48,800 billion in revenue foregone, mostly as a result of tariff exemptions or reductions on imported materials consumed either according to special end-use provisions or to manufacture exports.

144. General tariff concessions for imported materials include blanket exemptions for materials used in atomic energy research, space development as well as aircraft and parts thereof.

145. Several tariff concessions also specify duty-free entry (at the 9-digit HS level) for imported inputs, depending upon their use. Product areas benefiting from end-use tariff concessions in Japan are vegetable and cereal seeds for sowing; groundnuts for oil extraction; cotton-seed oil used in exported canned fish or shellfish; manioc, banana powder, maize, sorghum and certain other cereals for animal feed purposes; wheat or meslin flour for making monosodium glutamate; molasses used for feeding purposes and in making mainly glutamic acid and its salts and yeasts; petroleum oils used in primary industries and the manufacture of specified petrochemicals and gases; silicon doped for use in electronics; nickel used in making vacuum tubes, alkaline accumulators, welding fluxes and powder metallurgy; and aluminium alloy sheets and plates used in roofing and aircraft construction (Table IV.4).

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25 Tariff concessions for individual user industries can increase the distortions built into any tariff structure. By widening tariff escalation in particular sectors, they are likely to increase effective protection for user industries, thus making the structure of protection more disparate.
Chart IV.5
Tariff concessions in Japan, 1991

A. Permanent

<table>
<thead>
<tr>
<th>Customs tariff law</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unconditional reduction of and exemption from customs duty</strong></td>
</tr>
<tr>
<td><strong>Conditional reduction of and exemption from customs duty (General)</strong></td>
</tr>
<tr>
<td><strong>Conditional reduction of and exemption from customs duty (Restrictive)</strong></td>
</tr>
<tr>
<td><strong>Refund of duty</strong></td>
</tr>
<tr>
<td><strong>Reduced rates (Art. 20-2)</strong></td>
</tr>
</tbody>
</table>

- **Unconditional reduction of and exemption from customs duty**
  - Reduction for corruption and damage (Art. 10-1)
  - Reduction and exemption for commodities, products, etc. (Art. 12)
- **Conditional reduction of and exemption from customs duty (General)**
  - Exemption for special uses (Art. 15)
  - Exemption on goods for diplomats (Art. 16)
  - Exemption for re-exportation (Art. 17)
  - Reduction for re-exportation (Art. 18)
- **Conditional reduction of and exemption from customs duty (Restrictive)**
  - Reduction and exemption on raw materials for use in manufacturing (Art. 13)
  - Reduction and exemption on raw materials for use in goods (Art. 19)
  - Reduction when products made by duty paid materials are exported (Art. 19-2)
  - Reduction on goods to be exported with no change in nature or form since importation (Art. 19-3)
  - Refund for claimed merchandise (Art. 20)

- **Unconditional exemption (in a narrow sense) (Art. 14-1, 10-18)**
- **Unconditional exemption for re-importation**
- **Reduction and exemption for re-importation**
- **Reduction for goods exported for processing or repair (Art. 11)**
- **Exemption for re-importation (Art. 14-3, 11, 13 and 14)**
- **Reduction for re-importation (Art. 14-2)**
- **Reduction and exemption for marine products caught/collected abroad**
- **Exemption on goods for diplomats (Art. 15)**
- **Exemption for goods manufactured from domestic raw materials**
Chart IV.5 (cont'd)
Tariff concessions in Japan, 1991

B. Temporary

Temporary Tariff Measures Law

- Unconditional reduction of and exemption from customs duty
- Condition reduction of and exemption from customs duty (Restrictive)
- Repayment of duty
- Reduced rates (Art. 8-7)

1. Excluding automobiles, liquors and tobacco.

Source: Customs administration in Japan, Customs and Tariff Bureau, Ministry of Finance, 1991.
146. Duty-free end-use tariff concessions are used mainly to enable user industries to import materials not produced locally, or to alleviate the costs of agricultural protection on inputs for selected industries, such as imported maize used by animal feed manufacturers. Petrochemical producers and some other manufacturers also benefit from repayment on their materials of the customs duty collected from refiners on imported crude oil.

147. Additional end-use tariff concessions operate on agricultural products as tariff quotas that enable imports for use in specified purposes to receive a concessional rate (usually free), while imports for other uses attract a higher above-quota tariff rate (see Section below on tariff quotas).

148. Japanese exporters benefit from several tariff concessional arrangements. A duty drawback scheme exempts from customs duty some imported materials used in manufacturing exports. Moreover, tariffs have been fully rebated, since 1988, on certain imported goods re-exported within one year of the date of importation. In 1990-91, some ¥700 million was refunded in customs duty on re-exports alone.

(h) Tariff quotas

149. With the important exceptions of almost all footwear and fuel oils, tariff quotas in Japan mainly cover agricultural products. No new tariff quotas have been introduced since 1990.

150. Most tariff quotas in Japan have end-use provisions which permit certain user industries to import a nominated level of agricultural inputs free of duty, without eroding farm assistance accorded by domestic marketing arrangements. Quota ceilings, determined by the Government usually on the basis of expected shortfalls in domestic production, minimize import competition for farm produce. Shortfall arrangements cover all tariff quota goods except dyed and undyed bovine and equine as well as dyed goat and sheep leather, and footwear other than sports shoes. Of these, only oats, malt and preserved pineapples do not have end-use

26 These include bovine animals raised as beef cattle; natural cheese used as materials for processed cheese; maize for making starch, animal feed and corn flakes, ethyl alcohol or distilled alcoholic beverages; oats; molasses for making alcohol; undenatured ethyl alcohol used in distilling alcohol for making beverages; malt; unsweetened cocoa preparations used to manufacture chocolate; tomato paste and purée used to make tomato sauces; preserved pineapples and tanned and processed leather.
provisions (Table IV.5). Combining tariff quotas with end-use and/or shortfall provisions distorts the tariff structure. 27

151. Tariff quotas are often combined with mixing arrangements whereby domestic processors must use imported inputs according to a specified share of domestically-sourced inputs. For example, manufacturers of high fructose corn syrup were, until 1991, required to use domestic potato starch and starch from imported maize in the ratio of one to nine. In 1992 this proportion was changed to one to ten for duty free maize: above-quota maize can be imported by processors at a minimum alternate ad valorem duty of 50 per cent without meeting these blending requirements.

(iii) Regional and bilateral trade

152. Japan does not belong to any preferential trading arrangements.

(iv) Customs valuation and clearance

153. The Japanese legislation and administrative procedures regarding customs valuation are consistent with the GATT Customs Valuation Code. The basis of customs valuation in Japan is the c.i.f. price of imports which is normally taken to be the "transaction value" of the import.

154. The importer is required to lodge an import declaration form accompanied by the necessary documents, such as the sales invoice, freight and insurance certificates, certificate of origin and any required import licenses. After verification of documents and physical examination of goods where required by Customs, an import permit is issued on payment of duty. Duty is self-assessed by the importer and a system of post-clearance control operates as a check on the accuracy of self-assessments. Payments of customs duty may be delayed for up to three months under a Deferred Payment System, provided securities are lodged.

155. Recent survey results provided by Japanese authorities indicate that the average time from cargo arrival to release is still some 6.2 days for sea cargo, and 2.2 days for air cargo where the incidence of perishable goods is much greater (Chart IV.6). 28 Air cargo clearance is facilitated

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27 Import competition is restricted to below-quota imports (or shortfall levels) through a combination of high tariffs on above-quota imports and also, it appears, from "voluntary" undertakings from domestic users not to import levels above either their own requirements and/or the quota ceiling.

28 These results are taken from a survey conducted in February 1992. According to an earlier survey conducted in February 1991, the corresponding periods were 7.0 and 2.3 days. These survey results seem to conflict with previous information supplied to the Secretariat that the average time taken to clear imports through customs was 2 hours (see GATT, Trade Policy Review - Japan, Geneva, 1990.)
by the Nippon Automated Customs Clearance System for Air Cargo (Air-NACCS) which links together customs authorities, brokers, banks and airlines. Maritime cargo has been processed by a similar system (Sea-NACCS) since 1 October 1991.

Chart IV.6
Customs clearance times in Japan, 1991 and 1992
Number of days

Sea Cargo

<table>
<thead>
<tr>
<th>Item</th>
<th>1st Survey</th>
<th>2nd Survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cargo arrival</td>
<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Carrying into Hozei Area</td>
<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>Declaration to customs</td>
<td>5.9</td>
<td>5.4</td>
</tr>
<tr>
<td>Release</td>
<td>7.0</td>
<td>6.2</td>
</tr>
</tbody>
</table>

Air cargo

<table>
<thead>
<tr>
<th>Item</th>
<th>1st Survey</th>
<th>2nd Survey</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cargo arrival</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Carrying into Hozei Area</td>
<td>0.4</td>
<td>0.4</td>
</tr>
<tr>
<td>Declaration to customs</td>
<td>2.1</td>
<td>2.1</td>
</tr>
<tr>
<td>Release</td>
<td>2.2</td>
<td>2.2</td>
</tr>
</tbody>
</table>

Source: Government of Japan.
156. Although import clearance times for sea cargo have been reduced, further improvement would facilitate imports. It appears that Customs inspection procedures, especially for bulk cargo such as iron ore and chemicals, remain slow, and that a preliminary pre-delivery examination system introduced in 1988 to facilitate customs clearance procedures, by enabling processing of import documents up to four days in advance of cargo arrival, did not greatly reduce customs clearance times. An improved Pre-Arrival Examination System was introduced in April 1991.

157. A further factor often cited, including in the SII programme, for the relatively slow clearance times is inadequacy of import infrastructure in Japan. Development of airports and seaports has not apparently kept pace with recent import demand. Efforts are currently being undertaken by the Japanese Government to expand import facilities in order to remove many of the bottlenecks that are thought to be hampering importation. Japan is establishing "Foreign Access Zones" - designated areas located near international airports and ports where import facilities and activities are to be concentrated - aimed at facilitating the distribution and importation of foreign goods, and the necessary legislation, called "The Law on Extraordinary Measures for the Facilitation of Imports and Foreign Direct Investment into Japan", was passed by the Diet on 27 March 1992.

158. Complaints concerning customs valuation and procedures must initially be filed with the Director-General of Customs (Article 89-93 of the Customs Law) within 2 months from the date of importation. Protests to the Minister of Finance must be made within 1 month of the Director-General's decision. If still dissatisfied, complainants may seek judicial proceedings within 3 months from the Minister's decision under Article 14 of the Administrative Case Suit Law. In 1990, there were eleven protest cases to the Director-General (of which eight were dismissed and three withdrawn) and two appeal cases which were both dismissed; in 1991, two complaints were filed with the Director-General, both of which were dismissed, and no appeal cases were sent to the Minister. Matters of complaint may also be registered for investigation by the Office of Trade and Investment Ombudsman (OTO). The Customs Counsellor exists within Customs to handle initial complaints regarding Customs matters. In discharging its tasks, it cooperates closely with ministries and attempts to resolve matters involving an investigation within a week.

(v) Variable import levies and similar measures

159. Japan has no variable import levies, according to the authorities. However, on certain pig and pigmeat products differential tariff duties apply that behave in a similar way to variable levies. These duties can insulate the domestic industry from international competition, by setting tariff duties on imports at less than administered prices according to the difference between the world price and the domestically-set price, as part
of the marketing arrangements operating to assist pig farmers.\textsuperscript{29} Imports at higher than administered prices bear an ad valorem tariff rate of 5 per cent.

160. Imported raw sugar is subject to a system of levies and surcharges by the Japanese Raw Silk and Sugar Price Stabilisation Corporation on top of specific tariff duties, as part of the sugar price stabilization scheme (see Chapter V).

(vi) Levies and other charges

161. Excise and related taxes continue to apply to a number of products under special laws. The main products affected by specific taxes are liquor, tobacco, petroleum products, including gasoline. The Liquor Law was substantially revised in 1989 following the GATT Council ruling to, inter alia, abolish the "grading" system and reduce the tax differentials between types of liquors, especially across whiskies/brandies and domestically-produced "shochu".

162. Substantial variations still exist in the specific tax rates applied to individual liquor types that may favour the consumption of sake and shochu compared to other alcoholic beverages. Current tax rates on sake (15 per cent alcohol) of ¥133.7 per litre or Group A shochu (25 per cent alcohol) of ¥119.8 per litre compare with rates of ¥982.3 per litre on whisky/brandy (40 per cent alcohol) and ¥331.4 per litre on all other spirits (37 per cent alcohol).\textsuperscript{30}

163. In April 1989, Japan introduced a general consumption tax of a value-added type on all goods and services, the main exceptions being medical, educational and social welfare services. The tax is currently levied at 3 per cent, except for motor vehicles which are taxed at 4.5 per cent. In domestic transactions, the tax is levied on each step of

\textsuperscript{29} According to data supplied by the Japanese authorities, ad valorem rates have been imposed on 90 per cent of imports of pig and pigmeat products. The standard import price has fallen from ¥690 per kg in 1985 to ¥482.5 per kg in 1992. The number of pig farmers has declined from 83,000 in 1985 to 36,000 in 1991, and imports increased from 190,000 to 442,000 tonnes. Domestic pork production, of 1.025 million tonnes in 1991, has nevertheless remained at just below the 1985 level.

\textsuperscript{30} The extent to which these differential specific tax rates discriminate in favour of the domestically-produced beverages will depend on the extent to which they distort relative liquor prices, and the elasticity of substitution by consumers between alcoholic beverages. Varying specific tax rates in themselves do not necessarily imply distorted relative prices, since given different wholesale liquor prices, such differences in specific tax rates may be necessary to maintain uniform ad valorem tax equivalents, and hence unchanged relative prices. The degree of substitution between liquors is essentially an empirical question that is likely to change over time. However, the GATT Panel ruling concluded that "all distilled liquors (including whisky, brandy, vodka, shochu A and B) are directly competitive or substitutable products (i.e. similar), and should therefore be taxed similarly so as not to afford protection to domestic production."
production, wholesale and retail trade, with provision for avoiding cumulative taxation by deduction of tax on purchases. For imports, the tax is levied on the delivery price (including customs duties and other selective consumption taxes), but the amount of tax at importation, as well as tax credits on purchases in domestic transactions, are deducted from the tax paid. Therefore, the tax does not discriminate between domestically-produced and imported goods.

(vii) **Import prohibitions**

164. The Customs Tariff Law lists four categories of prohibited imports. These are narcotics, imitation currencies, books and other articles considered contrary to public security or morality as well as articles likely to infringe patent or similar rights.

165. Japan also bans imports of species listed in Appendix I of the Convention on International Trade in Endangered Species of Wild Flora and Fauna, such as trade in ivory and ivory products, except imports of species for scientific purposes, species taken before the establishment of the Convention and species which were bred in captivity or artificially propagated. Japan permits whaling for research purposes under the International Whaling Convention.

(viii) **Import licensing**

166. Authority for the import licensing system in Japan stems from the Foreign Exchange and Foreign Trade Control Law. Under the Law the Minister of International Trade and Industry can, in the interests of promoting sound development of foreign trade and the national economy, require by Cabinet Order prior ministerial approval for certain goods to be imported (Article 52).

167. The Import Trade Control Order (Article 4) requires licence approval from the Minister to import goods subject to Japan's international arrangements, such as any commodities covered by its membership of international commodity and bilateral agreements. Imports using special methods of settlement, such as payment more than two years after the date of importation, also require a licence.

168. Imports originating from certain countries or shipping regions require prior approval. These include mainly whale and whale products from non-members of the International Whaling Treaty; salmon and sea trout, and their products from Taiwan, China or North Korea; fish caught outside of Japan's territorial waters by foreign vessels and transferred to Japanese vessels at sea for import to Japan; all goods from Iraq; raw thread; silk-related items; and relevant animals and plants from countries which lack management authority under the Convention on International Trade In Endangered Species (CITES).
(ix) **Import quotas**

169. Japan operates, as part of its import licensing system, quotas to control the level of imported goods entering the domestic market. The system of import quotas is administered by the Ministry of International Trade and Industry (MITI), which issues eligible importers with a certificate of import quota allocation, normally with a validity of four months. Importers must also obtain a certificate of import approval from an authorised foreign exchange bank (valid for six months) each time goods are imported. About six thousand licences are issued every year by MITI, which regularly publishes the items subject to import quotas and the levels to be applied. 31

170. Japan currently maintains import quotas on a wide range of products, especially on agricultural and fishing products (see Table IV.6). Several quotas on agricultural commodities, such as rice, wheat, barley and some dairy products underpin State-trading activities in these areas. The main manufacturing products covered by import quotas are certain organic chemicals, pharmaceuticals, explosives, rubber adhesives, military equipment and firearms.

171. Several products have been removed from import quotas since the last Trade Policy Review. As of 1 April 1991, import quotas were abolished for oranges and tangerines (fresh or and those provisionally preserved), as well as fresh and frozen meat of bovine animals. In the case of bovine meats, import quotas were replaced by a tariff of 70 per cent, to be reduced uniformly to 50 per cent over two years. Japan terminated import quotas for orange juice and, following the completion of the Eighth Coal Plan, for coal on 31 March 1992. 32

172. Japan continues to maintain import quotas on milk and skim milk powder and starch; these are fundamental to its domestic price-support arrangements for these industries. The maintenance of these quotas, along with numerous others which have been progressively terminated since 1988, was found to be GATT-inconsistent by a GATT panel. 33

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31 Details are published in the Official Gazette, the MITI Official Bulletin and the International Trade Bulletin.

32 Import quotas on fresh oranges and tangerines as well as orange juice were abolished as part of the 1988 bilateral trade agreement with the United States. The beef import quota was abolished as part of the 1988 trade agreement with the United States and Australia. A GATT Panel on Japanese beef restrictions, agreed to by Council following complaints from the United States, Australia and New Zealand, was never established in view of Japan's decision to liberalize beef imports.

33 The products liberalised by the removal of import quotas following the GATT panel report were processed cheese; other sugars and sugar syrups (excluding lactose); fruit puree (Footnote Continued)
173. All import quotas, with the exception of preferential bilateral quotas on fish products from the Republic of Korea, do not discriminate between sources and are applied on a global basis. Decisions on the sourcing of imports are left entirely to the licensed importer. Quotas are determined according to domestic supply and demand, and allocated on a six-monthly basis according to either previous import performance and/or equal allocation, with no maximum limits being applied to individual importers. Penalties are not imposed for underusage of import entitlements and unused quota entitlements may not be carried over to the next period. However, there are no hard and fast rules in this regard and the situation varies between commodities.

(x) Import surveillance

174. For some products, such as imports of silk fabrics, silk-worm cocoons, tuna, marlin, seaweed, whales, prepared edible fats, all live animals and certain species listed in Appendices II and III of CITES, beans and peas for seed, microbial vaccines as well as, since April 1992, coal which can be used as steam coal, prior confirmation is required from the Minister for International Trade and Industry or other relevant Ministries.

175. A number of plants and animals require confirmation when imported into Japan. Animals and plants, for example, covered by CITES require an export permit issued by a Management Authority of the exporting country; special birds must be accompanied by an export certificate from the exporting country; and poppy and hemp seeds must be cleared by narcotics control.

176. The system of prior confirmation operates, not only to collect data concerning imports, but also to monitor and confirm that imports are for specific uses (for example, minimized animal serum for disease examination). It also aims at securing practical effects of relevant domestic regulations, such as ensuring that the dairy content of cocoa and

(Footnote Continued)

and paste; fruit otherwise prepared and preserved; non-citrus fruit juices; tomato juice, ketchup and sauce; food preparations consisting mainly of sugar; and prepared and preserved meat and meat products of bovine animals and pigs. For additional details, see GATT Document L/6389, Japan - Restrictions on imports of certain agricultural products, 12 September, 1988.

34 Quotas for Korean products include cod, yellowtail, mackerel, sardine, jack mackerel, saury, scallops, adductors of shellfish and niboshi.

35 When determining allocations in subsequent years, continued underusage of past import entitlements by an importer may result in a reduction in his quota allocation.

36 Import surveillance is also operated through the customs confirmation system, which requires the confirmation of specified documents with the customs authorities, such as visa documents for silk fabrics covered by the bilateral agreement with Korea (Chapter V).
butterfat mixtures for industrial use does not exceed the informal limit of 20 per cent (Chapter V).

(xii) State trading

177. State trading in agricultural products in Japan is used by the Government as a means of stabilizing supplies to consumers and controlling imports to assist domestic producers of rice, wheat, barley and milk products. Additional State trading exists in salt, opium, alcohol and raw silk as a means of controlling supply and stabilizing prices as well as protecting consumers' interests. Since the last review, State-trading activities in beef have been abolished following the termination of the beef import allocation system on 1 April 1991.

178. State-trading entities generally work by controlling import competition on the domestic market through restraining imports only to the level necessary to meet any shortfall in domestic production, or to specialized products that do not compete directly with the domestically produced good. Insulating domestic producers from world competition using State trading entities with import monopolies, just like an import quota/prohibition, enables domestic prices to be set largely independently from international levels.

179. State-trading activities in Japan are underpinned by domestic legislation that reserves importation rights to a Government body, or a nominated agency. For example, monopoly import rights for salt and cereals, especially rice, are exclusively held by Japan Tobacco Inc. and the Government Food Agency, respectively. Although tobacco leaf imports were liberalized in 1985, effective monopoly control over trade continues to be exercised by Japan Tobacco Inc. through its sole rights as a processor of tobacco products.

180. Some State-trading entities also have monopoly rights over production and distribution. This applies to the activities of the Japan Tobacco Inc., in salt and processed tobacco products as well as the Ministry of International Trade and Industry in industrial alcohol. In the case of opium, the Ministry of Health and Welfare has monopoly rights over both imports and exports.

181. All products, except raw silk, subject to State trading are covered by import quotas in order to ensure stable supplies, by filling the gap between estimated domestic production and demand. However, for some of these products imports have been substantially below the quota ceilings. The Japanese authorities state that, for these products, quotas are set higher to secure flexibility for imports.
182. The rôle played in Japan by administrative guidance exercised by MITI and other ministries in implementing trade-related policies, has received widespread international attention. The term "administrative guidance" covers informal regulation by the Government which seeks to persuade private enterprises to cooperate in achieving a particular policy objective. While this exists to some extent in all countries, it is alleged that its role and influence in Japan has been especially strong.

183. Administrative guidance works through persuasion and, being informal and not legally enforceable, cannot generally be challenged by private parties. A number of reported cases illustrate how the practice has been used. In the Lions Oil Case, for example, informal reports suggest that MITI requested financial institutions to stop supplying finance to Lions after the company, despite admonition from MITI, "reported" its intention to import gasoline commercially. 37

184. Other reported cases indicate that administrative guidance may be applied to influence the level or direction of imports, under quota arrangements or even where tariffs are the only formal trade measure in force. Examples are the use of administrative guidance to allocate past beef quotas as between the United States and Australia (Chapter V) and, more recently, reported "guidance" by MAFF to leading beef importers and processing companies to restrain beef imports. 38

185. However, not all administrative guidance has been aimed at restricting imports. 39 Intense consultation between the Government and industry representatives often involved administrative guidance to industries to restructure in the face of declining assistance so as to boost international competitiveness. Much of MITI's guidance to industry involved market-conforming initiatives which were generally supported by industry. Where this was not the case, MITI's proposals often met with stern resistance and were never implemented. Guidance often stressed to firms that assistance was not to be permanent, and policies were generally guided, with a few exceptions, by market signals (Industry Commission 1990).


38 Nihon Keizai Shimbun, 17 January 1992: the same paper reported on 23 January that the two largest processors of Australian beef were to sharply reduce shipments due to "oversupply".

39 As part of the recent import promotion measures undertaken by the Japanese Government, MITI is encouraging firms to implement voluntary plans to increase imports.
186. Much administrative guidance exercised by ministries enables Japan to meet concerns raised by major trading partners. Import and export guidance has, reportedly, been used to ensure that Japanese firms do not inflame trade frictions with trading partners, or to encourage firms to fulfil bilateral trading undertakings.

187. In order to foster greater transparency in the rôle of administrative guidance and to meet its commitments for administrative reform under the SII programme with the United States, Japan established on 31 October 1991 the Provisional Council for Promotion of Administrative Reform. In January 1991, a Sub-council on "Fair and Transparent Administrative Procedure" was formed. New legislation, called the Administrative Procedure Law, is due to be passed in late 1992 which will stipulate revised procedures for issuing administrative guidance. This legislation contains extensive transparency provisions and will require guidance to be given in writing, except where business secrets are involved. All guidelines from ministries on administrative guidance must be published (in both Japanese and English).

(xiii) **Import cartels**

188. Although Japan's Antimonopoly Act prohibits cartels in general, the Export and Import Transaction Law may permit import cartels to be formed if certain conditions are met. Import cartels are exempted from the Antimonopoly Act only if authorized by the Ministry of International Trade and Industry and the Fair Trade Commission. The conditions under which such exemptions may be granted include, *inter alia*:

(a) where foreign exports are substantially constrained, such as by state-trading entities or an export cartel;

(b) international agreements exist between the Japanese and foreign Governments for Japan to import agreed levels, such as VRAs implemented by the Japanese Government; and

(c) pooling of import demand is considered necessary for the exploitation of natural resources in a foreign country.

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40 For example, it has been reported that "MITI, anxious to avoid trade friction, issued administrative guidance (in 1990) curbing Japan's numerically-controlled lathe exports to the United States when the U.S. demand for them fell away in the latter half of the year". See Japan Economic Almanac 1991, the Nikkei Weekly, p.116.

189. Authorised import cartels have seldom been used in Japan. The number of such cartels has fallen from four in 1981 to one in 1990. The only existing legal cartel, covering the importation of silk products from China by the Japan Textiles Import Association, was formed in 1976. Unauthorized or hidden import cartels, as for other cartels not exempt from the Antimonopoly Act, may be challenged as an "unreasonable restraint of trade".

(xiv) **Countertrade**

190. Japan is not involved in any countertrade arrangements.

191. A large share of Japan's overseas aid to developing countries was hitherto tied to Japanese exports. Currently, Japan provides around three-quarters of its overseas development assistance as untied aid. The proportion of overseas aid contracts awarded to Japanese companies declined substantially from about two-thirds in 1986 to under two-fifths in 1989. At the same time, the proportion of contracts awarded to United States' firms more than doubled from 7 to 16 per cent.

(xv) **Standards and other technical requirements**

192. Many specific domestic laws have the possibility to prohibit or restrict the importation of certain products by controlling the standards and certification of products. Although these laws do not appear to discriminate between imported and domestically-produced goods, they may have trade effects to the extent that they impose non-transparent internationally stringent standards and testing procedures. The Japanese Government is continuing its policies of rationalizing its standards and certification procedures in an effort to remove trade impediments. As identified in the previous review, the Government is committed to improving the transparency of its standards and certification procedures and harmonizing these, where possible, to international norms. There are some 25 such laws.

193. The Pharmaceutical Affairs Law, for example, requires persons wishing to import or manufacture approved drugs to be licensed. Only firms resident in Japan are permitted to hold an importer's licence; foreign manufacturers can file a direct application to the Ministry of Health and Welfare through an assigned caretaker representative in Japan. To be approved, drugs must satisfy certain standards stipulated by the Ministry of Health and Welfare, such as those drugs listed in the Japanese Pharmacopoeia (JP). Certain JP drugs designated by the Minister are exempt from approval and only an importer's licence is needed. All other drugs must be approved.

194. Drug approval applications are first submitted to the local prefecture for clearance and forwarding to the Ministry for processing.
However, some categories of non-prescription drugs, quasi-drugs and medical devices, are approved at the prefectural level. Minimum approval standards, including specifications and testing methods, apply to JP drugs. Drugs containing new ingredients or certain designated ingredients (such as cold medicines, antipyretics and analgesics) are subjected to special examination and testing. Foreign manufacturers are permitted to collect clinical data from trials held in Japan.

195. All cosmetics fall under the Pharmaceutical Affairs Law and must be licensed before being imported or manufactured. Where cosmetics contain hormones, the product must also be approved by the Minister of Health and Welfare. Applications for both approval and licensing are submitted through the prefectural government. Where the cosmetic contains ingredients not previously approved, test data must be submitted vouching for its safety. The same licensing rules and procedures apply to both imported and domestically-produced goods.42

196. Cosmetic ingredients must satisfy specifications contained in the Japanese Standards of Cosmetic Ingredients (JSCI); the Japanese Standards of Food Additives (JSFA); the Japanese Pharmacopoeia (JP); and, other ingredients, separate non-JSCI specifications. Licensing procedures for cosmetics were simplified with the introduction of the CLS (Comprehensive Licensing System of Cosmetics) system in 1986. This allows applicants already possessing a licence for particular categories of cosmetics to manufacture or import other products of the same category, provided advance notification is submitted.43

197. A number of regulations affecting manufactured goods have been relaxed in the past two years. In the case of household electrical goods covered by the Electric Appliance and Material Control Law, for example, full harmonization was completed with the adoption of an additional 15 standards compatible with those of the IEC, and the adjustment of a further 117 standards to conform with IEC requirements. Consideration is currently being given to greater harmonization with ISO standards of those stipulated by the Consumer Product Safety Law.

198. International harmonization of some standards covered by many domestic laws is currently impossible, however, due to the non-existence of

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43 There are 35 categories divided into six parts. Part I contains 7 categories, such as liquid perfumes, powdered perfumes, cosmetic soaps and nail enamels; Part II, 5 categories, including lipsticks and shampoos; Part III, 6 categories, of which eyeliners, eyeshadows and hair care products are three; Part IV, 7 categories, including face powders, creams and milky lotions; Part V, 5 categories, including skin lotions, suntan and sunscreen lotions and shaving lotions; Part VI, 5 categories, including cosmetic oils, suntan and sunscreen oils and bath preparations.
accepted international norms. Where no international standard exists, the Japanese Government is examining overseas national standards to determine acceptable regulations. In the case of the Mine Security Law, for example, the Government has decided to accept goods passed by reliable foreign inspection organizations, subject to some additional examination on different parts. In many cases, however, foreign national standards are currently not accepted in Japan.

199. Many standards on manufactured goods are covered by the Japan Industry Standards (JIS) included in the Industry Standardization Law. A further 376 standards have been recently deleted from the JIS list, and the number of JIS standards coinciding with international norms has been increased from 1.4 per cent in 1988 to 5.2 per cent. However, this low level of compatibility reflects mainly the fact that almost one-quarter of JIS standards have no international counterpart. Attempts are currently underway to harmonise remaining differences with available international norms on a case-by-case basis.

200. The time taken to approve imports subject to technical standards and testing procedures in Japan varies according to the type of products. Most approvals, including JIS permission, are granted within a standard processing period of three months. Longer delays are experienced for some products, such as five months for electrical goods covered by the Electric Appliance and Material Control Law.

201. Apart from manufactured products, the Government, through the Ministry of Health and Welfare, is beginning a review of food standards falling under its control by comparing these with international norms contained in the Codex Alimentarius Commission. Under this review, which is expected to take some years, remaining departures of national standards from international ones will be examined to determine whether they are warranted by scientific considerations.

202. Standards and testing procedures for imported foods are covered by the Food Sanitation Law. All imports covered by the Law, with the exception of certain specified products, must be issued with an import notification prior to importation. For imports of meat and meat products and globe fish, a sanitation (health) certificate issued by an official organisation of the exporting country is mandatory for obtaining the import permit. Processed foods imported for the first time must be accompanied by a full description of the ingredients along with the manufacturing processes involved.

44 Import notifications are not required for salt (unrefined), copra, animal or vegetable oils and fats used in processing edible oils and fats, crude sugar, alcohol, molasses, rapeseed, malt and hops.
203. A number of changes aimed at simplifying inspection procedures for food imports have been made recently. Provisions exist to enable planned and continuous imports of the "same food items" over a period of one to three years to enter without requiring subsequent import notifications, provided the initial shipments were cleared. Furthermore, inspection results conducted in recognised foreign official laboratories will be accepted and the cargo exempt from further inspections, unless the items are of the type considered susceptible to non-sanitary contamination during transportation.

204. Under the Food Sanitation Law, special standards and testing procedures are prescribed for approving food additives. Approval of food additives is handled by the Ministry of Health and Welfare on the basis of a report submitted by the Food Sanitation Council. Japan subscribes to the general principles on using food additives advanced by the Codex Alimentarius Commission, and accordingly approves all food additives recognised as scientifically safe. Substances already approved for use in Japan are being re-evaluated and tested in accordance with methods stipulated under the Food Sanitation Law. These testing procedures cover the determination of such factors as toxicity levels, as well as the biological and physiological effects of using the food additive.

205. Japan maintains rather stringent health and quarantine regulations on imports of animal and animal products as well as fruits, such as the phytosanitary conditions imposed on fresh apples that have effectively prohibited apple imports into Japan (see Chapter V).

206. Japan's efforts to reform its system of standards and certification procedures are reflected in the work of the Office of Trade and Investment Ombudsman (OTO). As at May 1992, 475 complaints had been received by the OTO, of which about half were from foreigners. Well over half of total complaints received concerned six laws; the Food Sanitation Law (representing 18 per cent of total complaints), the Pharmaceutical Affairs Law (12 per cent), the Customs Law (7 per cent), the Plant Protection Law

\[\text{Goods subject to continuous importation that require yearly import notification procedures, provided the imports have a clean import record for the previous three years, include bean jam, seaweed, cocoa products, grains, chocolate, margarine, frozen fruits and frozen vegetables. To be counted as the same food items, they must be produced in the same country by the same manufacture, using identical materials and processing/manufacturing methods.}\]

\[\text{Official laboratories will only be accepted if they are recognised by the Ministry of Health and Welfare as meeting a number of specific requirements, such as being capable of conducting inspections in accordance with methods prescribed by the US Association of Official Analytical Chemists. There were 1,984 recognised organisations covering 48 countries as at December 1990.}\]

\[\text{The number of complaints was 50 in CY 1990, 26 in CY 1991 and 9 for the first five months of 1992.}\]
(6 per cent), the High Pressure Gas Control Law (4 per cent) and the Road Vehicles Act (4 per cent). Of the 50 complaints received in 1990, 14 covered the Food Sanitation Law. Improvements facilitating imports had resulted in almost 60 per cent of all cases processed by the OTO.

207. In processing complaints, the OTO examines the possibilities of reducing Government intervention, including introduction of self-certification systems and reduction of individual standards; harmonizing Japanese standards with international norms; accepting foreign test data; clarifying and quantifying standards; simplifying and expediting inspection procedures; and enhancing the transparency of the Japanese system of setting and enforcing standards (see Chart IV.7). Japanese standards have been adjusted or clarified in well over one-third of all processed cases. Furthermore, in again over one-third of all cases, inspection procedures have been simplified and expedited.

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48 The next two laws subject to the most complaints were the Domestic Animal Infectious Diseases Control Law and the Customs Tariff Law.
Chart IV.7
Complaints processed in Japan by the Office of Trade and Investment Ombudsman (OTO), 1991

Per cent

**By decision**

- Ministry of International Trade and Industry: 36.4%
- Ministry of Health and Welfare: 34.4%
- Ministry of Finance: 14.6%
- Ministry of Agriculture, Forestry and Fisheries: 11.7%
- Ministry of Transport: 6.8%
- Other: 14.1%

**By responsible Ministry or Agency**

- Import-promoting improvement: 30.4%
- Import-promoting way, 25.4%
- Clarification of misunderstanding: 36.4%
- Unprocessed: 8.4%
- No change: 24.8%

As at 4 October 1991. Some complaints have been allocated to more than one Ministry.

208. There is no agency in Japan for co-ordinating Government procurement. Each government agency has authority to handle its own procurement in accordance with the Accounts Law of 1947 and related cabinet orders and ministerial ordinances. Although procuring agencies are free under the Law to specify their own qualification requirements concerning eligibility of firms to participate in open and selective tenders, these arrangements, streamlined in 1988, are now applied equally between foreign and domestic suppliers.

209. Selective tendering for Government procurement is only to be used when open tendering is not deemed to be needed due to the small number of suppliers or when the use of open tendering is considered to be inappropriate. There is no margin of preference. According to the authorities, both domestic and foreign suppliers are invited to participate in selective tendering procedures. Where contracts are awarded other than to the lowest bidder, the law requires the agency concerned to make a decision based on criteria established in consultation with the Ministry of Finance, and to submit to the Board of Audit and the Ministry a report on the tendering procedures used.

210. Procurement under the Tokyo Round Code, which covers all Government entities and 21 Government-related entities, amounted to SDR6.5 billion in 1990, of which SDR3.7 billion represented contracts above the threshold level provided for in the Agreement. Procurement from Japanese suppliers accounted for 86 per cent of contracts awarded above the threshold; the next largest sources were the United States (6 per cent) and the EEC (3 per cent). The proportion of contracts above the threshold covered by open tendering has been increasing, and was 42 per cent in 1990. Some 19 per cent was let by single tendering. Data on the total value of procurement of all governmental agencies, or that of local authorities, are not available.

49 Each procurement entity maintains its own list of registered suppliers. Applications from suppliers must be supported by a summary of the firm's operations along with its history; a registration certificate; a tax payment certificate; and a copy of financial statements. In 1990, the total number of suppliers registered with all entities covered by the GATT Code as eligible for Government contracts was 176,564, of which 1,126 were foreigners.

50 When selective tendering procedures are used, a notice is published in the Official Gazette containing, in addition to the information to be given for open tendering procedures in accordance with the Customs Valuation Code, conditions for eligibility to be invited to participate in the selective tendering procedures.
211. The Government implemented several voluntary changes from 1 April 1992, based upon its 1985 Action Programme with the United States, designed to increase market access opportunities for overseas suppliers competing for procurement contracts. The main changes included increasing the number of additional government-related entities voluntarily using GATT-consistent procurement procedures by 28 to 44; lowering the threshold value for such procurement from SDR130,000 to SDR100,000; and extending the minimum bid time by 10 days to 50 days.

212. As part of these changes, the Japanese Government implemented "Measures Related to Japanese Public Procurement of Computer Products and Services", with the aim of increasing market access opportunities for foreign suppliers competing for procurement contracts. These measures reaffirmed the Government's commitment to the Tokyo Round Government Procurement Code and are to be implemented consistent with the Code. All entities covered by the Code are required to apply these measures to ensure fully non-discriminatory, transparent and open competitive opportunities for overseas suppliers. The measures were introduced on computer products from 1 April 1992 and on computer services from 1 October 1992.

213. Under these arrangements, aggrieved suppliers may complain to the Procurement Review Board established to help ensure that individual procurements are made in accordance with the measures. The Board may report the case to the Fair Trade Commission where it finds that there is a significant likelihood that the Antimonopoly Law may have been violated. The Board may recommend appropriate remedies, such as re-tendering of the contract or ordering that another supplier be awarded the contract.

214. These measures do not cover procurement of supercomputers, which continue to be covered by the "Procedures to Introduce Supercomputers" introduced in 1987 as a result of consultations between the United States and Japan implemented, according to Japanese authorities, on an m.f.n. basis. At the end of 1991-92, fourteen procurement contracts for supercomputers had been concluded since the introduction of these procedures. No Government procurement of supercomputers was made prior to 1991.

51 The measures covered such factors as ensuring that all tender information is available to foreign suppliers on a non-discriminatory basis; that impartial specifications are set; exceptional use is made of single tendering; that bids are evaluated impartially and in a transparent manner; and requiring procuring entities to take appropriate actions to address anti-competitive practices in line with the provisions of the Antimonopoly Act.

52 Those Government-related entities which are not covered by the Action Programme that voluntarily apply Code-consistent procedures, are to implement the measures on computer services as from 1 April 1993.
(xvii) Anti-dumping and countervailing duty actions

215. Japan's first ever anti-dumping investigation is currently being conducted into whether imports of ferro-silico-manganese from China, Norway and South Africa are being dumped on to the Japanese market. The investigation followed a petition from the Japan Ferroalloy Association alleging material injury to domestic suppliers from low-priced imports. According to the applicant, imports from these markets, with dumping margins estimated at from 55 to 76 per cent, have depressed domestic price and profitability levels and eroded the home producers' market share from 49 per cent in 1989 to 34 per cent in 1990.

216. The Government decision on whether to take anti-dumping action must, under Japanese legislation, be completed within one year from when the investigation was initiated, namely 29 November 1991.

217. Japan has never imposed countervailing duties.

(xviii) Import promotion measures

(a) General measures

218. In recent years, the Japanese Government has taken several steps designed to increase the level of manufactured imports entering Japan. Many of these measures have taken the form of providing comprehensive financial incentives for Japanese importers to raise imports. The financial incentives appear to have been successful in promoting imports. Manufactured imports covered by the tax incentives, for example, increased by 18 per cent in FY 1990 over the previous fiscal year, compared with an increase of 8 per cent for ineligible manufactures.

219. The rationale behind using financial incentives to promote duty-free manufactured imports is, according to the authorities, to help correct the external imbalance by substantially reducing the tremendous costs and risks that accompany the expansion of manufactured imports. However, like using import restrictions to correct for trade deficits, introducing import subsidies to correct for external surpluses would appear questionable on resource-efficiency grounds (Note IV.3).

53 Ferro-silico-manganese is used in the steel industry as a deoxidant and desulphurizing agent as well as an additive for increasing the toughness and flexibility of steel.

54 This is only the fourth anti-dumping petition even in Japan, the previous being in 1988.
Note IV.3 Effects of Import Promotion on Efficiency of Resource Allocation

Largely in response to concerted pressures exerted on Japan by its major trading partners, especially from the United States, Japan has introduced and recently strengthened financial and tax incentives aimed at promoting imports. The objective of the schemes - which are intended to be temporary in nature - are to assist in reducing Japan's large and growing merchandise trade surplus by promoting imports. This raises important questions concerning the economic rationale for such measures, and their likely impact on Japan's resource allocation.

Just as import restrictions ultimately tax a country's efficient exporters, import incentives in the end subsidize exporters. Where these schemes extend tax concessions to duty-free capital and intermediate goods, exporters are able to purchase overseas inputs at prices below world levels. While industries benefit from these arrangements, firms producing competing products are penalized by having to compete against subsidized imports.

Such measures are, therefore, likely to be inconsistent with maximizing resource allocation. As well as encouraging resources into existing and newly emerging exporting activities, access to subsidized inputs by more highly assisted manufacturing industries could perversely affect Japan's structure of effective assistance and production incentives - thereby potentially worsening resource-use efficiency in Japan. The best policy on resource-efficiency grounds would be to expand foreign competition by removing existing impediments to imports.

Moreover, import promotion measures may even increase Japan's trade surplus to the extent that access to lower-cost imports contributes to stimulating exports.
220. Tax incentives, in the form of accelerated depreciation provisions and tax credits, were implemented for three years from 1 April 1990. To receive assistance, manufacturers - including foreign affiliates - must increase their value of qualifying manufactured imports, from any source, over the base year by 10 per cent or more. Such manufacturers may elect for either a tax credit (equal to 5 per cent of the increased value of imports) or accelerated depreciation rates on machinery and equipment (20 per cent for machinery and equipment qualified by MITI, and 10 per cent for others) purchased in the taxable year or the preceding two years. In addition, wholesalers and retailers whose qualifying imports in the taxable year are at least 10 per cent more than the highest qualified imports in the previous years since April 1989, may deduct 20 per cent of the difference between the two figures for placing in reserve. One fifth of the reserved amount is to be added back to the income every year for the following five years.

221. Many duty-free manufactured imports (whether under temporary or general duties) falling between the fifth and eighth sections of the SITC classification are eligible for the tax incentives. About three-quarters of the items covered are intermediate and capital goods (including semiconductors, computers, electric motors, machinery, parts, synthetic rubber and tyres), the rest being consumer durables like electrical appliances, automobiles and sporting goods. About half of Japan's imports of manufactured goods, representing in excess of US$52 million in FY 1991, are covered by these measures.

222. Concessional loans are provided by the major public financial organisations to assist imports of eligible manufactured products. Concessional loans for imports to Japan are also available to foreign companies from the Export-Import Bank of Japan, as well as from the Japan Development Bank to finance import facilities in Japan. In FY 1991, loans for importing manufactured goods from these two institutions alone amounted to around US$1.7 billion.

223. In addition, the Japan External Trade Organization (JETRO) conducts numerous import promotion activities designed to help foreign companies gain access to the Japanese market. JETRO's activities include providing information to Japanese firms on the benefits and opportunities of

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55 The base year is the accounting period with the highest value of qualified imports since the accounting period which includes 1 April 1989.

56 The value of the benefits are capped under the programme. Tax credits cannot exceed 10 and 15 per cent of the corporate tax for large and small-to medium-sized firms respectively, and the maximum depreciation allowed is 50 per cent of the increase in qualifying manufactured imports.
importing by, for example, maintaining "local internationalization centres" in all prefectures. JETRO also engages in overseas activities aimed at improving awareness, through holding seminars and missions using trade and product specialists, amongst foreign exporters on market opportunities available in Japan. The budget allocation to JETRO for import promotional activities has grown continuously since 1990 from US$7 million to an estimated US$50 million in 1992-93.

224. Additional import promotional measures foreshadowed by Japan in the Global Partnership Plan with the United States are being implemented. Foreign access zones - with the passing on 27 March 1992 of the necessary legislation - are to be established in Japan to accelerate the development of import infrastructure and help overcome infrastructural bottlenecks around major airports and ports. The Japan Import Board (see Chapter II) is to be strengthened, and the Export-Import Bank introduced on 13 March 1992 an "Import Promotion Credit Line" to assist firms that have established their own import expansion plans. Furthermore, special legislation in effect since 31 January 1992 exempts shops with floor area smaller than 1,000 square metres used exclusively for imports from the co-ordination procedures required by the Large-Scale Retail Store Law. Under the Business Global Partnership Initiatives, MITI is also encouraging leading Japanese firms, including Japanese affiliates abroad, to implement voluntary plans to expand imports, increase local purchases abroad, and further cooperative working relationships with foreign firms.

(b) Bilateral arrangements

225. Largely in response to efforts initiated by major trading partners, especially the United States, aimed at improving access to Japanese markets as one means of reducing Japan's current account surplus, Japan has agreed to several bilateral arrangements covering importation of nominated products. These include an agreement to increase access opportunities for foreign semiconductors; to implement testing and evaluation procedures for amorphous metal transformers in Japan in line with those used by public utilities in the United States, and for Japanese utilities to purchase 32,000 amorphous metal transformers before 31 March 1993; as well as the arrangements concluded between President Bush and Prime Minister Miyazawa in January 1992 on motor vehicle parts as part of the Global Partnership Plan.

226. In the semi-conductor agreement, implemented for five years from 1 August 1991, the Japanese Government recognized "that the U.S. semiconductor industry expects that the foreign market share will grow to more than 20 per cent of the Japanese market by the end of 1992 and considers that this can be realized. The Government of Japan welcomes the
realization of this expectation." However, the arrangement also states that "The two Governments agree that (these) statements constitute neither a guarantee, a ceiling nor a floor on the foreign market share". The Agreement, which includes in the market share calculations imports from all foreign sources - and not only from the United States - specified that regular government-to-government semiconductor consultations are to be held three times per year, unless the two Governments otherwise agree. This agreement, together with the one on amorphous metals, followed negotiations originally initiated within the context of Section 301 provisions by the United States against Japan.

227. Targets for purchases of United States’ motor parts were also announced by Japanese vehicle manufacturers in the context of the Global Partnership Plan (see Chapter V). Although voluntary undertakings made by Japanese firms at the request of American manufacturers, the arrangements - issued as part of the Global Partnership Plan - have been supported by both Governments. Japanese automobile producers have stated that they will increase their purchases of U.S.-made components from about US$9 billion in the 1990 financial year to about US$19 billion in 1994. An agreement was also reached to facilitate sales of American cars in Japan, through

57 Japan-United States Arrangement Concerning Trade in Semiconductors, 1991, p.4. The Agreement specified two formulae to be used for measuring the market share of foreign-based semiconductors in Japan.

58 Interpretation of the precise status of the 20 per cent market-share figure seems to vary between the two countries concerned. Japan believes that the agreement provides no market share guarantees while the United States has strongly expressed the view that failure to meet the figure would violate the agreement, and may allow the possibility of the United States implementing retaliatory measures against Japan. Japanese and U.S. industry officials recently announced an agreement aimed at further increasing access opportunities for foreign semiconductors. The agreement, reached between the Japanese Electronic Industries Association and the U.S. Semiconductor Industry Association, provides for Japan’s ten largest semiconductor users to take “emergency” actions to increase purchases of foreign semiconductors over the next six months. These firms have agreed to submit to foreign suppliers lists of additional purchases, and the Japanese industry group is seeking pledges from its members to observe the semiconductor trade pact, promote purchases of high-value, custom-designed foreign chips and to raise foreign orders faster than any future overall market growth in Japan. A number of trading partners, such as the EC, have expressed concern that such agreements could favour U.S. suppliers at the expense of other exporters.

59 Under the agreement on amorphous metal transformers with the United States, both Governments “recognize these steps by entities within their respective private sectors and will make efforts to encourage the implementation of these steps by the relevant private parties”. The U.S. Government also stated that “as a part of the successful resolution... Allied-Signal will not refile its petition of 5 March 1990 under Section 301 of the Trade Act of 1974, as amended”. Joint Announcement by the Governments of Japan and the United States on Amorphous Metal Transformers, 22 September 1990.

60 Although the precise interpretation and implementation of the agreed targets, committing Japanese auto-makers to buying a fixed amount of parts from U.S. suppliers regardless of price and quality, are still being discussed, it appears that the increased purchases of parts would be met largely by Japanese-affiliated car producers in the United States sourcing more components locally. To the extent that this happens, the arrangements, by effectively requiring U.S.-based Japanese car producers to raise local content, would assist U.S. component suppliers in much the same way as would a local content scheme.
Japanese distribution channels. Furthermore, Japanese auto firms established in the United States indicated their intention to increase the share of inputs produced in the United States from 50 to 70 per cent. Unlike earlier agreements between the United States and Japan which did not explicitly cover United States exports, the recent one on motor vehicle parts refers only to U.S. exports to Japan.\(^{61}\)

(ixx) **Other matters**

(a) Procompetitive regulation

228. Japan has recently strengthened its antimonopoly measures and their enforcement, as well as the activities of the Fair Trade Commission (FTC). This partly reflects a recognition by the Japanese Government of the increased role of anti-monopoly activities in making the Japanese market more open and in protecting consumer welfare. Japan has also been criticized by major trading partners claiming that anti-competitive behaviour, encouraged in Japan by relatively weak competition policies, has restricted imports.\(^{62}\) Note IV.4 gives a summary of the main provisions of the Japanese Antimonopoly Act. Note IV.5 surveys the relationship between market-opening and procompetitive regulations, including anti-trust arrangements.

229. As noted above and in Section (3)(iv), import and export cartels may be authorized under the Export and Import Transaction Law. Many other cartels are, however, also exempt from the Antimonopoly Act. These include cartels established under the Act covering depression and rationalization cartels; those established under the Exemption Act, which covers transactions in accordance with legislation, such as the Small and Medium Sized Enterprise, etc. Cooperative Act; and cartels justified under a number of other individual laws, such as the Act Concerning the Organization of Small and Medium-Sized Enterprise Associations.

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\(^{61}\) Several third-country component suppliers are reported to have already expressed concern over these arrangements. Australian component suppliers, for example, have alleged that they have lost export orders with Japanese firms since these agreements were made. According to an article in The Japan Times, "Now at least eight Australian auto-parts manufacturers have had extra business with Japanese vehicle makers abruptly terminated. The Japanese manufacturers, while not admitting it, seem to be switching sources for new orders to American parts suppliers". See The Japan Times, 19 March 1992.

\(^{62}\) The United States, in particular, has repeatedly called on Japan to enhance its Antimonopoly Act and its enforcement. In addition, the U.S. Justice Department has recently announced that it is to change its policies and start applying its anti-trust provisions to anti-competitive conduct outside the United States that is seen to be restricting U.S. exports (3 April 1992). U.S. officials have stated that this is not intended to "single out" any particular country.
230. The number of such exempted cartels has declined substantially since the 1970s. "Depression" and "rationalization" cartels have been abolished and the number of cartels corresponding to the 30 exempted cartel systems authorized by the competent agencies and the FTC has declined to 219, as at 1 April 1992, compared with 1,079 in 1975. Most (around 70 per cent) of all cases are longstanding cartels concerning small enterprises. The rest cover mainly export-restraining cartels whose primary objective is to alleviate Japan's trade frictions with major trading partners.

231. In July 1991, a report reviewing the exemption system for cartels was released by the FTC. The Study Group on Government Regulations, etc. and Competition Policy recommended that the system of exempting cartels from the Antimonopoly Act needed to be tightly scrutinized and that such exemptions should be kept to the barest minimum. By limiting competition and restricting the functioning of the market mechanism, the Group concluded that exempting cartels from the antimonopoly provisions should be strongly discouraged to protect consumer's interests, to maintain producers' vitality and to stop the expansion of anti-competitive behaviour among entrepreneurs.

63 These include mainly restrictions on equipment use in the textile industry under the Act Concerning the Organization of Small- and Medium-Sized Enterprise Associations, and controls over barbers' charges and business methods under the Act Concerning Proper Management of Businesses Related to Environmental Sanitation.

64 Published in Fair Trade Commission of Japan, FTC/Japan Views, No. 12, September 1991.
Note IV.4 Major Features of Japan's Antimonopoly Act

The Antimonopoly Act prohibits the following practices:
- private monopolization (Section 3);
- unreasonable restraint of trade (Section 3);
- unfair trade practices (Section 19);
- anti-competitive activities of trade associations (Section 8); and
- anti-competitive mergers, stockholdings, etc. (Section 9-17).

The Act is administered by the Fair Trade Commission (FTC), an independent agency attached to the Prime Minister's Office. Composed of a Chairman and four Commissioners, it has powers to conduct investigations and hold hearings. Any person or firm, including foreigners, may lodge a complaint of any practices which are suspected of violation of the Act with the FTC. Where the FTC finds a violation to the Act, it uses a cease and desist order to eliminate such violation. The FTC also issues warnings in cases where suspicious conduct exists. In 1991, 33 warnings and 24 cease and desist orders - compared with 17 in 1990 - were issued.

Penalties for offences include surcharges in the case of cartels pertaining to price that have been found guilty of practising anti-competitive behaviour. The rates of surcharge were increased to 6 per cent and 3 per cent of sales revenue during the cartel period for large and small-scale firms, respectively. Lower rates of 1 per cent apply to wholesalers and 2 and 1 per cent, respectively, for large and small-scale retailers. During 1991, the FTC ordered 52 entrepreneurs involved in 9 cartel cases to pay ¥12.2 billion in surcharges.

The Act also provides for criminal penalties; the Act to amend the Antimonopoly Act aiming to raise maximum fines against firms or trade associations from ¥5 million to ¥100 million was submitted to the Diet in March 1992, and is now under its consideration. The FTC's current policy is actively to enforce criminal proceedings with the Public Prosecutor's Office against serious violations to the Act. The Commission currently has charges against eight manufacturers (including 15 executives and employees) of polyvinyl chloride stretch film for practising cartel behaviour to raise prices.

Any party injured by private monopolization, unreasonable restraints of trade or unfair trade practices may file damage suits with the Tokyo High Court provided the FTC's decision has been final and conclusive (Sections 25, 26 and 85). The FTC is required to provide to the High Court an estimate of the amount of damages caused by the illegal action (Section 84). The FTC, in May 1991, published its policy measures to reduce the plaintiff's burden to prove the existence of violation and damage, including submission of the FTC's opinion on the methodology for determining the amount of the damages. In addition, any person injured by the acts in violation of the Antimonopoly Act may file damage remedy suits under Article 709 (Tort) of the Civil Code with the Local or Summary Court.
Considerable pressure has been exerted on Japan, especially by the United States, to strengthen its antimonopoly provisions as a means of combating anti-competitive behaviour which is seen to restrict imports. This pressure has coincided with considerable rethinking, including within the OECD, on the appropriateness of procompetitive regulation and growing support for the need to relax such arrangements in favour of import-opening measures as the most effective way of controlling anti-competitive practices. Given the considerable debate that surrounds the appropriate role and effectiveness of procompetitive regulations, and the increasing recognition that anti-trust policies are "second-best" to deregulation, differences between countries are hardly surprising. What are perceived by some as weaknesses in a country's procompetitive regulations may be seen by others as addressing legitimate economic concerns.

Policies promoting competition include deregulation designed to achieve competitive markets, such as removing regulatory barriers for new entrants or cutting tariffs to promote import competition, and procompetitive regulation, mainly through laws governing anti-competitive behaviour. Deregulation designed to make markets genuinely contestable, by allowing unrestricted entry and competition, including foreign investment, generally is the most effective method of promoting economic efficiency. In markets subject to import restrictions or other government measures assisting existing producers, vigorous enforcement of strong anti-trust policies may be essential. However, reliance on such procompetitive regulation to control abuse of privileged positions established through government interventions is less efficient than removing the underlying causes of market power by deregulating the market so as to allow open competition. In turn, a country which opts for free trade and unrestricted investment flows should have little need for other national anti-trust policies (Blackhurst, 1991).

However, if in practice markets are not fully contestable and do not eliminate anti-competitive behaviour, are the resulting inefficiencies sufficient to justify the costs of procompetitive regulatory measures? Administering and enforcing procompetitive regulation is expensive, and may only be justified by demonstrating that the economic and social benefits from these arrangements outweigh their cost. Moreover, procompetitive regulation, if applied inappropriately, may actually weaken, not strengthen, competition. Defining "unfair" or "anti-competitive" behaviour requires delicate judgements on matters such as the size of the market and the degree of current competition. An excessively intrusive anti-trust régime which defines these concepts too rigidly or narrowly may undermine competition and economic efficiency. Furthermore, there is a growing recognition that many regulations, whose professed rôle is to ensure "fair" competition, are very vulnerable to being used to interfere with legitimate competition (Blackhurst, 1991).

The economic costs of allowing greater concentration of industries may well be outweighed by the costs of regulation, especially where markets are contestable and the potential entry of new firms acts to limit the abuse of market power by existing firms. Restrictions on mergers and acquisitions,
if applied too severely, for example, may prevent market-dictated rationalization from enhancing economic efficiency. Moreover, such rationalization may be essential, for example, if domestic industries are to improve their competitiveness with lower-priced imports following trade liberalization.

In the application of procompetitive legislation, dynamic elements must be fully taken into account. Australia's Industry Commission has noted that an approach based predominantly on a static model of competition, ignores many of the dynamic sources of competition and the potential gains in economic efficiency attainable from practices which have traditionally been deemed anti-competitive (Industry Commission 1992). If this view is correct, then it is plausible that a milder application of procompetitive regulations - perhaps better reflecting these dynamic considerations - may contribute to, rather than detract from, market rationalization and economic efficiency.

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232. The Antimonopoly Act outlaws a number of restrictive business practices that are considered "unreasonable restraint of trade" or "unfair trade practices". New guidelines have also been released covering distribution systems and business practices covered by the Act, including sole distributorships, group boycotting of new entrants and vertical price fixing arrangements. Such practices are prohibited under the Antimonopoly Act when considered to be promoting anti-competitive behaviour. Threshold market shares are stipulated in some cases as a basis for determining the likely impact of anti-competitive behaviour. A number of business practices, such as retail price maintenance and boycotts, are in principle illegal under the Act as an "unreasonable restraint of trade" or "unfair trade practice".

233. Sole distributorships involving major suppliers (having no less than 10 per cent market share or ranked within the top three) are covered by the guidelines, which provide details on "unreasonable" obstructions on parallel imports. Parallel imports are seen under the guidelines as an important means of promoting intra-brand competition on the domestic market. A prior consultation system concerning distribution systems and business practices has been established by the FTC to assist businesses in determining what are acceptable arrangements.

234. Both the activities of, and the resources available to, the FTC have been increased, thereby enabling more rigorous application and enforcement of the Act. Investigative functions have been increased accordingly. In addition to making formal recommendations concerning remedial measures, the Commission has published all warnings other than in exceptional cases since October 1990. Criminal proceedings are also available under the law (Note IV.4).

65. These are producer-user transactions, including customer allocation arrangements and boycotts; manufacturer-distributor transactions on consumer goods, such as resale price maintenance; and sole distributorship arrangements, such as exclusive dealerships and obstruction to parallel imports.

66. The success of anti-trust laws in promoting economic efficiency by outlawing certain so-called restrictive business practices is mixed. "It is far from clear that allowing vertical restraints is more harmful to consumers than attempting to ban them" (Flaith 1991). This partly reflects the immense difficulties of distinguishing in practice between those vertical arrangements that enhance economic efficiency from those that reduce efficiency by being anti-competitive. It is important that anti-trust laws do not become "a barrier to vertical collaboration between buyers and sellers that is so integral to the innovation process. Vertical activities should not be generally impeded unless they unduly exclude other competitors from access to customers" (Porter 1990). Furthermore, many of the perceived inefficiencies associated with these arrangements would be reduced (or possibly eliminated) if markets were made contestable through unrestricted import competition and market entry.
(b) Keiretsu

235. An aspect receiving considerable attention internationally has been the perceived rôle played in Japan by major corporate groups or keiretsu. A frequently expressed view outside Japan is that these groupings provide special advantages that exclude competitive imports from the Japanese market.

236. Examining the rôle and efficiency of keiretsu groupings in Japan has proved difficult and controversial. Even simply defining keiretsu remains contentious. For example, the term is often used to cover the six major Japanese industrial groupings of Mitsui, Mitsubishi, Sumitomo, Fuyo, Sanwa and Dai-Ichi Kangyo. These groupings, often assembled around a major bank and/or a common trading company, involve formal and informal links that frequently include cross-shareholding among member firms. However, keiretsu also covers vertical relationships, often stretching from the production of raw materials, through manufacturing, to tied wholesale and retail distribution outlets. Such continuous links are found particularly in automobiles, consumer electronics, cosmetics, pharmaceuticals and photographic equipment.

237. The view that, through such relationships, large Japanese groups impose conditions on their "in-group" affiliates and thereby make it harder for newcomers to penetrate Japanese markets, is difficult to assess. Any assessment would need to distinguish discrimination against competing imports by group affiliates extending preferential treatment to each other - which is clearly trade restricting - from commercial decisions whereby more competitive home products are used instead of imports.

238. From one point of view, keiretsu groups are simply a relatively efficient form of vertical integration that has developed in industries where substantial economic benefits are possible from close cooperation with affiliated suppliers. The extent to which keiretsu behaviour can

67 This has been the view taken by the United States in the on-going Structural Impediments Initiative with Japan. Furthermore, although not referred to in the Global Partnership Plan, there is a view that it is a factor behind the emphasis given in the Plan for the Japan Fair Trade Commission to conduct surveys, from the viewpoint of competition policy, into competitive conditions existing in major Japanese industries.

68 Clearly this decision will depend upon both price and non-price factors. Even if imported products are price competitive with similar-quality home products, there could still be commercial reasons for choosing the domestic one. Sourcing locally often provides added non-price advantages to the user, such as stability of supply, quicker delivery times, and closer contact with suppliers that eases problems of ensuring quality control and that components meet the necessary specifications. Gains from using domestic suppliers, such as in facilitating sub-contracting arrangements and the "design-in" of products as well as so-called "just-in-time" production techniques, for example, have been documented as representing efficient production techniques that other foreign producers have been trying to emulate. Furthermore, keiretsu groups are one means by which economies of common governance (such as reduced transportation costs as well as other efficiency and cost savings accruing from working closely together in a group) can be achieved.
distort trade is, on this argument, largely determined by the competitive conditions of the markets in which they operate. To the extent that markets are highly competitive and contestable, such groupings are more likely to be based on commercial considerations and less likely to be discriminatory.

239. Certain keiretsu, initially based on banking and financial linkages, appear to have emerged and grown under conditions of regulated domestic product and financial markets that restricted import competition. Intense competition in product markets, both domestically between different keiretsu producers and in export markets, may nevertheless have placed some constraints on these actions. There is a view that keiretsu groups have weakened in line with deregulation of financial and product markets in Japan.

240. A recent study by the Fair Trade Commission concluded that although the six major corporate groups' position in the Japanese economy is as large as it used to be, "the stockholding and personnel relations among group firms are not strong and growing weaker" and... "transactions between groups and outside firms are widely conducted and the ratio of intra-group transactions is declining. Thus, it cannot be said that there is such a preference" (for intra-group trade). According to the study, "keiretsu-hopping" by Japanese firms appears to be increasing and foreign firms, in line with Japan's recent policies of derestricting inward foreign investment, are becoming increasingly involved with keiretsu-affiliated firms.

(c) Distribution system

241. It is alleged that the wholesale and retail sectors in Japan are characterized by inefficient practices that raise retail prices in Japan

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69 A number of researchers have highlighted the important rôle played by fierce competition between domestic Japanese producers from different keiretsu groups in creating efficient export industries. Porter, for example, suggests that domestic rivalry in Japan's internationally successful industries was unmatched in any other nation (Porter 1990).

70 As a major reason for entering a keiretsu group was initially to gain reliable access through the "mother" bank, to credit that, under the regulated financial system was not readily available through normal markets, deregulation of the financial system has lessened the need to maintain these links.


72 Saxonhouse supports the view that keiretsu ties are often exaggerated. "If keiretsu ties are relatively weak, if such ties have been made still weaker by financial deregulation, and if reciprocal purchasing by keiretsu member firms is a relatively minor matter, it is hard to believe that Japan's distinctive trade structure can be explained by Japan's trading companies exercising what market power they have to protect their fellow keiretsu members by discrimination in their purchases against competitive imports" (Saxonhouse 1991).
and discriminate against imported products, partly because of exclusive keiretsu distribution systems between manufacturers and wholesaler/retailers and other unique trading practices and regulations. Price differentials between Tokyo and other major cities are often used in support of this argument. However, available price evidence is sketchy, and is far from suggesting that the Japanese market is unusually impervious to imports.

242. A major regulation on retailing in Japan was the Large-Scale Retail Store Law which actually restricted new entrants, both domestic and foreign. The Law assisted small shop owners by controlling the entry of large shops, such as department stores and supermarkets. Prior to the amendment of the Law, any store of more than 500 square metres had to be discussed by a committee of the Council for Coordination of Commercial Activities. Under these complicated arrangements and practices, it was often necessary to get the agreement of neighbouring stores prior to submitting an application for a building permit. This resulted in major delays being incurred in processing applications. "...it became not uncommon to take more than two years after a submission of a plan (to) receive final approval. In essence, the law and its implementation can virtually stop the construction of a large retail store if the neighbouring stores oppose it."

243. It is commonly suggested that this law had discriminated against imports by restricting construction of large stores that traditionally import products directly. However, the exact impact on trade of this law

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73 Although price comparisons between domestic and imported products are often used to indicate the degree of market openness, the price differentials often quoted in this regard, such as those monitored by MITI as part of the SII arrangements, are plagued with problems. For a start, they are conducted at the retail level, where substantial international price differences would clearly be expected, reflecting such factors as differences in commodity taxes, distribution margins, higher real estate and other non-traded costs - like wages - as well as in consumer tastes. Therefore, differences at the retail price level tell little about the openness of the Japanese market - world import prices at the border may simply escalate to higher prices at the retail level as they pass through the distribution system. Irrespective of the efficiency of the Japanese distribution system, these factors alone could make both imported and domestically-made products more expensive in Tokyo. More revealing would be price comparisons between the ex-factory price of goods produced in Japan and the border price of imported substitutes.

74 Drawing conclusions from the official price surveys conducted by MITI, despite its scrupulous efforts to obtain comparable retail price data, is very difficult. Quite apart from the conceptual problems involved in internationally comparing retail prices (see above footnote), the products included in the survey are a negotiated list of goods between the United States and MITI - which was only finally agreed the day before the survey started - and therefore is in no sense a random survey of prices. Not surprisingly, therefore, the available price comparisons tell a very mixed story and do little to clarify the situation.

75 T. Ito and M. Maruyama in, Trade With Japan: Has the Door Opened Wider?, edited by P. Krugman, NBER, 1991, p.159. In this article, it is claimed that the "time required to build and operate a large-scale retail store... can be anything between two and one-half years to ten years."
is difficult to evaluate. It has been suggested that, even without this law, Japan would still have an abundance of small stores because of the limited storage space in most Japanese homes and the low re-order costs of retailers. Moreover, even if it did create an inefficient distribution system, such inefficiencies should affect both imported and domestically-produced goods (Note IV.6).76

A number of studies have concluded that, despite the entry restrictions imposed by the Large-Scale Retail Store Law, the Japanese distribution system operates efficiently. See, for example, report of the Economic Research Institute of the Economic Planning Agency of Japan (1991), International Comparison of Distribution Systems, August.
Note IV.6 Responsiveness to Changes in Import Prices

Some indication of the extent to which informal barriers in the distribution system, etc. may be restricting imports is to examine the sensitivity of Japan's import patterns to changes in import prices. A useful period to examine is 1986 to 1989 when, following the Plaza Agreement, the yen appreciated substantially over a sufficiently long time period to enable lags and "J-curve" effects to work through, including consumers and exporters, in response to the cheaper import prices.

Over the period 1986 to 1989, the yen appreciated in real terms by a cumulative 40 per cent against major trading partners. At the same time, Japanese manufactured imports doubled in both value and volume terms. This provides evidence to indicate that Japanese purchasers are responsive to price changes and that cheaper imports from the yen's appreciation was a factor behind the import growth.

These results have been interpreted by Lawrence ( ) and others as indicating that existing informal barriers behave as tariffs, not as quotas, thereby allowing import competition at the margin. This is important since it implies that the efficiency losses to Japan of such restrictions, to the extent that they do exist, are considerably reduced.

However, the responsiveness of imports to price changes may also call into question the very existence of the informal barriers themselves as serious trade barriers. It could well be that foreign exporters, who are genuinely competitive and prepared to devote the necessary resources and marketing efforts to satisfy consumers' demands, are able to establish themselves in the Japanese market.
244. A number of changes have been made to the Law since the last review designed to simplify coordination procedures. In May 1990, MITI took deregulation measures for appropriate implementation of the law and the coordination processing period became less than one and a half years. Moreover, in January 1992, the law was amended and the procedures reformed. As a result, the Council for Coordination of Commercial Activities was replaced by the Large-Scale Retail Store Council. However, no details are available of the criteria to be used to assess applications.

245. These changes have considerably reduced the time taken to approve applications, and according to officials, it is now down to one year. This has resulted in a marked rise in the number of applications for large shop constructions being processed. In 1991-92, some 2,300 cases were processed, compared with between 400 and 500 previously. According to the Japanese authorities, foreign applications are treated in the same manner as local applications and there are no other restrictions, including foreign investment controls, on the entry of foreign firms into Japan's distribution system. These developments are likely to improve the efficiency of Japan's distribution system.

(3) Measures directly affecting exports

(i) Export prohibitions

246. Prohibited exports are listed in Attachment II of the Export Control Order. These include endangered animals and plants specified in international treaties; narcotics; false currencies and other products which constitute criminal offences in Japan; and national treasures and other important art works.

(ii) Export controls

247. Export controls may be imposed on certain goods by the Minister of International Trade and Industry in the interests of maintaining international peace and security or promoting the sound development of foreign trade and the national economy (The Foreign Exchange and Foreign Trade Control Law). Restricted goods and export destinations are contained in Attachments I - controls for security reasons - and II - controls for economic reasons - of the Export Control Trade Order.

248. Japan, as a member of COCOM, maintains export controls for security reasons on industrial goods classified to the revised International Industrial List adopted by COCOM countries on 1 September 1991. Japan has removed export controls from those goods decontrolled by the introduction of the new list. A number of other products, such as nuclear-power materials covered by the Non-Proliferation Treaty, are subject to export controls for security reasons.
249. Exports to all countries of a number of products, such as silk cocoons, rice, wheat, barley, bran, combination fodder, wood in the rough of certain varieties and fertilizers, require approval to ensure adequate supplies are maintained for domestic consumption. However, there have been no substantial exports of most of these commodities in recent years, reflecting the internationally uncompetitive nature of Japanese production, supported by the Government to meet domestic requirements.

250. Most export controls, however, are imposed by Japan on efficient exports at the request of foreign Governments. These requests have occurred in sensitive industries where Japanese import competition has been seen by foreign governments as subjecting their own countries' industries to intolerable competitive pressures (see following Section).

(iii) Export restraint arrangements

251. Japan's policies of avoiding trade disputes with Governments of major export markets, especially the United States and the EC, have resulted in a number of voluntary export restraint arrangements to control Japanese export levels. Resort to these measures has undermined the transparency and effectiveness of the world trading system (Note IV.7). Assessing the exact impact of these arrangements is made difficult by their non-transparent nature, and often erroneous differences in opinion over what constitutes a voluntary export restraint.

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77 Export Trade Control Order, 1992. Export controls applied to tungsten ore were terminated from 1 November 1991.

78 From an economic perspective, the problem of defining what is a voluntary export restraint become largely irrelevant. Any voluntary restraint arrangement that operates in the exporting country to restrict imports to particular countries, whether or not directly involving the Government of the exporting country, would have similar economic consequences and would therefore be counted as a voluntary export restraint. The word "voluntary" is, of course, itself a misnomer - these arrangements are generally undertaken at the insistence of importing countries which threaten retaliatory action if such restrictions are not enforced by the exporting country. They are therefore used by Governments of importing countries as a means of managing trade to protect sensitive domestic industries through the exporting countries restricting import competition.
Note IV.7 Voluntary Export Restraints

A voluntary export restraint (VER) is a measure by which the Government or an industry in the importing country arranges with the Government or the competing industry in an exporting country for a restriction on the volume of the latter's exports of one or more products to the importing country. By this definition, the term VER is a generic reference for all bilaterally agreed measures to restrain exports. Strictly speaking, a VER is unilaterally taken and administered by the exporting country and is "voluntary" in the sense that the country has the formal right to eliminate or modify it. But, usually a VER arises because of direct or perceived pressure from an importing country; it can be thought of as voluntary only in the sense that the exporting country may prefer it to alternative trade barriers that the importing country might use.

A VER by its very nature is an instrument of selective trade control, in contradiction to the principle of non-discrimination that has served as the cornerstone of multilateral trade rules since the Second World War. Non-discrimination in economic terms means that a given level of protection for domestic producers can be achieved at minimum cost to domestic consumers and the rest of the world. It also protects the interests of smaller trading nations and helps to ensure the access of new entrants to the international marketplace. Its role in multilateral trade rules lends transparency and predictability to international trade relations and to domestic decision making.

A typical VER, as shown in the accompanying chart, raises prices in the importing country, leads to trade diversion, and gives rise to economic rents, welfare losses and global as well as national resource misallocation in both the exporting and especially the importing country. VERs also tend to spread, carrying the risk of fragmenting the trading system into a series of market-sharing arrangements, dominated by the major trading nations. In addition, VERs can create vested interests in both the importing and exporting country, which can work against the removal of VERs.

VERs normally seek to provide relief for industries adversely affected by foreign competition. As such they serve as substitutes for safeguard actions under GATT, with governments often finding VERs more convenient to negotiate. A GATT safeguard action may eventually require compensation for, or lead to retaliation by, the exporting country, with possible adverse effects on the exports of the importing country. By contrast, VERs have built-in compensation for the foreign supplier in the form of economic rents and provide a degree of certainty in market access. Further, in negotiating a VER, the foreign country is seen to be directly supporting the affected industry, while often avoiding a domestic and multilateral debate in which the costs of protection become clear.
Some economic effects of VERs

Notes:  $S_1$ is the importing country’s supply curve; $S_{12}$ is the aggregate supply curve of the importing country and a partner country; and $D_1$ is the importing country’s demand curve. Under free trade, the price is $P_0$; $Q_0$ is produced by the importing country, and its imports are $Q_0Q_4$, of which $Q_0Q_1$ is supplied by the partner country. Under a VER of $Q_0Q_3$, imposed under the assumption that trade with partner country remains free, the price in the importing country rises to $P_1$, its production increases to $Q_1Q_4$ and its imports decline to $Q_1Q_3$; but imports from the partner country increase to $Q_1Q_2$ owing to trade diversion. Economic rents that accrue to restrained exporters are $DFGE$; additional producer rents in the importing country are $P_0P_1BA$, and in the partner country they are $ABDC$. Welfare loss in the importing country is $ABFH$. Global welfare loss is $DCE$ plus $FGH$, of which $DCE$ is the global resource misallocation loss.

252. The major known voluntary export restraint arrangements currently applied by Japan are listed in Table IV.8. The export restraints apply to manufactured products and are heavily concentrated on exports to the United States, the EEC as a whole and the United Kingdom. Although no new export restraint arrangements or similar undertakings have been, according to the Japanese authorities, introduced since the last Trade Policy Review, two agreements have been extended; the export restraints on machine tools and passenger motor vehicles to the United States. The export restraint agreement with the United States on steel was discontinued on 1 April 1992, and transitional monitoring arrangements introduced pending completion of the Multilateral Steel Agreement.\(^79\) Mainly, as a result of these changes, MITI has estimated that the proportion of Japanese exports covered by export restraints (excluding purely monitoring arrangements) has fallen from 12.5 per cent in 1989 to currently 7.7 per cent.\(^80\) Recently, a new consensus on trade in motor vehicles with the EC has supplanted previous member-State-based restrictions (Chapter V).

253. Most existing export restraint measures are administered by MITI, requiring formal export approval under the Export Trade Control Order (such as export restraints on machine tools and textiles). For some others, including those operating on exports of pottery and chinaware to the United States, Canada and the United Kingdom, MITI administers voluntary export restraint through the formation of export cartels based on the Export and Import Transaction Law.

(iv) **Export cartels**

254. Export cartels, if formed in accordance with the Export and Import Transaction Law for the purposes of preventing "unfair" export practices or establishing order in export practices, may be exempt from the Antimonopoly Law provided MITI is notified in advance. MITI is empowered to impose similar export restraints on Japanese firms refusing to join the export cartel. Export cartels that involve domestic sales by Japanese firms are exempt only if authorized by MITI and the Fair Trade Commission.\(^81\)

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\(^79\) Following the recent removal of restraint arrangements on exports to the United States, Japanese exporters are already facing anti-dumping action due to complaints from major US steel producers that Japanese steel is being dumped. The U.S. International Trade Commission recently ruled that there was reasonable evidence that U.S. steel producers were suffering material injury due to steel imports from twenty nations, including Japan, South Korea and Mexico. (Financial Times, 12 August 1992.) Japanese exports to the EEC have been unrestricted since 1991 when the export restraint measure was lifted.

\(^80\) A price surveillance undertaking on D-RAMs, concluded in 1990 by Japanese producers with the EC under anti-dumping procedures, also remains in force.

\(^81\) The Minister of Trade and Industry can order the modification or termination of such cartels if it is felt that they are contrary to the national interest.
255. Export cartels are generally subject to annual review. The number of export cartels exempt from the Antimonopoly Act has continued to fall from 42 in 1990 to currently 28 cases. All remaining export cartels controlling exports cover voluntary restraint measures imposed by Japan on sensitive products to meet trade concerns expressed by major trading partners, especially the United States. The additional five export cartels previously covering domestic sales and the three formerly operated by exporters' cooperative associations have been abolished.

(v) Export promotion

256. Public funding of export promotion and marketing assistance in Japan is handled by JETRO providing market research, motivation programmes, informational services, foreign buyer programmes and trade fairs. Since the early 1980s, JETRO has been focusing on import promotion; currently about one-half of JETRO's activities are concerned with this field.

257. Some two-thirds of JETRO funding is provided by the Government; the rest coming from the private sector. In 1991-92, JETRO's total budget was ¥21.6 billion.

(vi) Export finance

258. Long-term official export credits for capital goods and services are handled by the Export-Import Bank of Japan (Eximbank). However, the provision of export credits has declined in importance over recent years. In 1989, export credits accounted for 8 per cent of Eximbank's total financing commitment of ¥1,694 billion, compared with 40 per cent in 1985.

259. An estimated 2 per cent of Japan's exports receive export credit assistance. Export credits provided by the Bank meet the terms and conditions of the OECD Arrangement. Standard forms of export credit extended by Eximbank are supplier credits, buyer credits and bank-to-bank loans.

260. Eximbank also provides "technical services credit" to assist Japanese exports of technical services, including engineering and consulting services and construction activities. Long term credits are provided to suppliers, buyers or buyers' banks in accordance with the OECD Arrangement.

(vii) Export insurance

261. MITI, through its Export-Import Insurance Division, operates standard insurance schemes to protect exporters against risks not covered by existing private insurance institutions. In 1989, exports of US$58 billion, corresponding to one-fifth of Japan's total exports, were insured by MITI. Annual liability ceilings are set according to the type of insurance.
(4) Measures Affecting Production and Trade

(i) Adjustment assistance

262. Japan actively promotes the transfer of resources throughout the economy to ensure that they move from declining industries into growth sectors areas in accordance with market principles. Since 1987, most structural adjustment assistance has been provided under the Law on Temporary Measures for Facilitating Structural Adjustment, 1987-96. Its objectives are to facilitate the disposal of surplus equipment, to stabilize regional economies and to create new employment opportunities.

263. This scheme provides general financial assistance to reinforce market developments by rationalizing excess production and/or regional production patterns. Both manufacturing and mining enterprises are covered by the Scheme. To be eligible, a firm must be in a region must be designated by a Cabinet order as suffering from economic problems. Enterprises must submit detailed "equipment disposal plans" for approval by the relevant Minister. Firms completing these plans are also entitled to carry forward losses resulting from equipment disposal under the Special Taxation Measures Law.

264. Financial assistance for facilitating adjustment is provided by concessional loans, loan guarantees and equity capital infusions under the Facilitation Fund for Industrial Structural Adjustment (FFISA). In 1990-91, loans to facilitate business conversions and grants totalled ¥2.7 billion and ¥750 million, respectively, compared with corresponding amounts of ¥5.1 billion and ¥550 million in 1989-90. Additional interest rate subsidies on loans to assist regional industries, totalling ¥408 million and ¥270 million, were provided in 1990-91 and 1989-90, respectively.

265. Past schemes providing financial assistance to designated structurally depressed industries, such as steel, shipbuilding, aluminium refining, paper and petrochemicals, have been largely wound back over recent years.

266. A major exception is the continued provision of assistance by way of concessional loans and grants to the textile industry to promote structural improvements under the Law on Extraordinary Measures for Structural Improvement of the Textile Industries. Introduced in 1989, the programme, administered by the Textile Industry Rationalization Agency, has aided small to medium textile producers to modernise their facilities to upgrade quality and productivity. Thirty-five projects have so far been financed at a cost of ¥11.7 billion. Grants amounting to ¥285 million were extended in 1990-91 and total loans outstanding at the end of 1990-91 stood at ¥1.3 billion. The programme is due to expire on 30 June 1994.
267. A number of industries, such as shipbuilding, aluminium and coal, have experienced major reductions in production. Coal production has, for example, entered the final phase of its structural adjustment through the 1990s with the adoption of the Future Coal Policy in April 1992.\(^{82}\) These structural adjustment policies have facilitated the downsizing of the coal industry which has halved in terms of both output - currently 8 million tons annually - and employment during the period of the Eighth Coal Policy (FY 1987 - FY 1991). Coal subsidies are being wound-back ¥15.2 billion in 1991-92 compared with ¥16.7 billion in 1990-91 - and are financed from the duties collected on imported crude oil and oil products.\(^{83}\)

268. Similar policies have lead to the virtual closing of the aluminium smelting industry in Japan. Annual production has fallen from 264,000 tons to 34,000 tons in 1991.

269. Assistance to small and medium-sized industries by way of accelerated depreciation provisions and tax credits under the Mechatronics Investment Promotion Tax System has decreased from an estimated revenue foregone of ¥55 billion in 1991-92 to an expected ¥52 billion in 1992-93.

270. Several agricultural sectors benefit from structural adjustment assistance designed to control output (Chapter V). Major measures include expenditure to encourage farmers to divert land from rice production to woodland or other crops that are not overproduced, as part of the production controls on rice growing (¥213 billion in 1991-92); land retirement programmes for citrus production (¥99 billion in 1991-92); and various concessional agricultural loans provided mainly under the Agriculture, Forestry and Fisheries Finance Corporation (AFFFC) and the Agricultural Modernization Loans Mechanism. Total agricultural loans outstanding under these arrangements stood at ¥739.7 billion in 1991-92, of which well over half were AFFFC loans. The interest rate subsidies met by the Government totalled ¥100.1 billion in 1991-92.

(ii) Research and development

271. Research and development activities in Japan continue to be predominantly financed by the private sector. Government funding has declined in relative importance, and currently accounts for some one-fifth

\(^{82}\)Implementation of the new policy involved the revision of eight laws covering coal mining, including the Law on Extraordinary Measures for the Rationalization of the Coal Mining Industry.

\(^{83}\)Japan has provided full information to the International Energy Association on its subsidies to facilitate structural adjustment to the coal industry.
of total R & D expenditure (Table IV.9). In 1989-90, gross Government funding of R & D by way of grants, loans and equity capital infusions amounted to ¥50.4 billion. Government R & D expenditure is directed mainly at correcting for market failure in areas of basic research generating substantial external benefits where there is likely to be underprovision by the private sector.

272. Public funding of industrial R & D in Japan is mainly handled by MITI through the activities of its Agency of Industrial Science and Technology (AIST). Both ordinary and designated research projects are financed by AIST. The major designated projects are the "Sunshine" and "Moonlight" projects - concerned with developing alternative energy sources e.g. solar power and energy conservation; the Large-Scale Project - research and development of new technologies; and the Project on Basic Technologies for Future Industries - developing innovative basic technologies in the areas of superconductivity, new materials, biotechnology, electronics and software (see Table IV.10). The only new project introduced recently was the Micromachine Technology project which was added to the the Large-Scale Project in 1991.

273. Ordinary projects are mainly conducted in AIST laboratories while a major portion of the research work on designated projects is contracted-out to participating private enterprises that work closely with national laboratories and academic institutions. The results of such projects are made publicly available. A number of projects are open to foreign participation.

274. The Japanese Government is involved with Boeing Corporation in conducting research into civil aircraft design and construction. The budget was ¥1.4 billion in 1991-92 and ¥1.8 billion in 1990-91. The project promotes the international joint development of civil aircraft.

275. To encourage R & D by the private sector, the Government provides taxation incentives for eligible R & D expenditure. The basic Tax Incentives Scheme allows a tax credit equal to one-fifth of any increase in eligible R & D expenditure over the accounting period with the largest R & D expenditure since 1 January 1967, and covers expenses directly incurred for testing and research in manufacturing technologies. For small and medium-sized enterprises, a tax credit of 6 per cent is allowed,

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84 Grants and equity infusions amounted to ¥22.1 billion and ¥23.3 billion, respectively.

85 It is argued that such basic research would be under-provided if left entirely to the free market.
optionally, for R & D expenditure in place of this scheme. In addition, a tax credit, of 7 per cent, is allowed for R & D expenses incurred to acquire specific assets for the development of fundamental technologies, including technologies on the application of materials, bio-science and electronics. Revenue foregone under the scheme in FY 1989 amounted to an estimated ¥95 billion.

276. The Financing for the Promotion of Industrial Technological Development Scheme, which is administered by the Japan Development Bank, provides concessional loans for the commercialization of important industrial technologies. The Scheme also covers expenditure on the construction of buildings for advanced basic research. In 1990-91, loans totalling ¥75 billion were made for these purposes.

(iii) Production subsidies, taxation concessions and other budgetary measures

277. According to the authorities, Japan's industrial policy is based on the provision of minimal government financial assistance and there are no "product-specific" manufacturing or mining subsidies, apart from structural adjustment measures.

278. However, the Japanese Government does provide a range of budgetary measures that assist manufacturing industries in general. While there are no comprehensive data available in Japan on the provision of manufacturing subsidies, authorities are currently assembling such information as part of the work by the OECD Industry Committee. This exercise, which covers the years 1986-87 to 1989-90, classifies budgetary measures into grants, loans, equity capital infusions, guarantees and insurance as well as tax measures (Table IV.11). According to details of this study supplied by Japanese authorities, total gross Government budget expenditures to manufacturing industries in Japan were estimated at ¥2.216 trillion in 1989-90, up from ¥1.902 trillion in the previous year. Some 90 per cent of this expenditure, which comprised over 3 per cent of total Government outlays in 1989-90, was made up of loans. Small and medium-sized enterprises are by far the major beneficiaries of budgetary outlays — receiving over two-thirds of total expenditures, predominantly by way of loans.

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86 The amount of deduction for these two schemes combined in any given year cannot exceed 15 per cent of the firm's corporate tax liability; or 10 per cent under the basic tax incentives scheme.

87 As explained in the footnotes to Table IV.12, these figures measure the gross expenditures and hence substantially overstate their net cost and the amount of budgetary assistance provided. According to the Japanese authorities, net budgetary expenditures for 1988-89 and 1989-90 were ¥162.7 billion and ¥145.9 billion, respectively.
279. Agricultural subsidies assist farmers as part of the numerous price and income support arrangements maintained on major commodities. Financial support from the Government helps maintain domestic prices well above international levels. Sums paid in 1990-91 totalled ¥304 billion, and covered the operating costs of the Food Agency on transactions in rice, wheat and barley (¥249.3 billion) as well as the Japan Raw Silk and Sugar Price Stabilization Agency on sugar (¥16.4 billion); deficiency payments by the Livestock Industry Promotion Corporation on milk for processing (¥26.6 billion) as well as payments to producer's associations on soybeans (¥11.1 billion) and rape (¥0.127 billion).

280. The Japanese Government finances the provision of substantial infrastructure facilities, such as the construction of irrigation/drainage networks and rural roads, as well as aiding land consolidation and the construction of agricultural marketing facilities. In 1990-91, expenditure on infrastructure development amounted to an estimated ¥1,100 billion. Infrastructural expenditure is shared between the central, prefectural and local Governments, with the central Government normally financing the majority (up to 65 per cent in the case of irrigation and drainage facilities) and the rest being shared equally between the prefectural and local Governments.

281. Regional development in Japan is mainly encouraged through concessional loans and special taxation measures, such as accelerated depreciation provisions. In FY 1989, regional assistance comprised loans totalling ¥70 billion and foregone revenue of ¥28 billion from tax incentives.

282. Japan encourages private oil exploration and development activities through the operations of the Japan National Oil Corporation and the special provisions for mining income (depletion allowances).

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88 These programmes have been notified to the GATT pursuant to Article XVI:1. Two additional programmes also notified, covering cocoon and raw silk as well as sweet and white potatoes, have involved no Government subsidies in recent years. See GATT document L/6805/Add.2.

89 The following two special measures are provided:

(a) The amount credited to the prospecting costs reserve by a mining corporation may be deducted as an expense in computing the taxable income for the accounting period concerned. The amount deductible shall not exceed 13 per cent of the proceeds from sales of minerals, or 50 per cent of income (before deduction of corporation tax) derived with respect to the above-mentioned sales. The amount credited to the overseas prospecting costs reserve by a domestic mining corporation may also be deducted as an expense. The amount deductible shall not exceed 50 per cent of income (before deduction of corporation tax) derived with respect to minerals received from foreign corporations; and

(b) When a corporation bearing overseas prospecting costs reserve discharges new overseas mineral deposits prospecting costs, the tax deferment provided by (a) above may be converted into an exemption from taxable income.
(iv) Agricultural pricing and marketing arrangements

283. In order to promote price stabilization and improve farm incomes, the Japanese Government has traditionally intervened extensively in the agricultural sector to maintain domestic marketing and price-support arrangements to heavily assist key commodities. These arrangements are seen as strategic elements of Japan's agricultural policies of promoting food self-sufficiency and security (see Chapter V).

284. Products currently covered by these arrangements include mainly cereals of rice, wheat and barley; milk and milk products; sugar; oilseeds of soybeans and rape; and vegetables. All told, it is estimated that commodities covered by price and income support policies account for some three-quarters of Japanese agricultural output.

285. Although the assistance arrangements vary substantially between individual products, a central feature of these schemes is the enforcement of marketing arrangements to support administered domestic prices set by the Government, largely on a cost-of-production basis (Table IV.12). These arrangements are underpinned by comprehensive import restrictions and controls and are administered by statutory marketing boards or a state-trading agency, such as the Government's Food Agency which has monopoly rights over rice importation. Producers are assisted by these arrangements sheltering Japanese farmers from international competition and maintaining domestic prices well above world levels.

286. As well as transferring income from Japanese consumers to farmers through relatively high domestic prices, considerable additional assistance is provided by taxpayers in the form of Government subsidies paid to offset marketing losses incurred from the board's transactions and to finance deficiency payments (see Section (iv) above).

(v) Other measures

287. Agricultural extension services are provided by the national Government in collaboration with the prefectural governments. The national Government finances the activities of the extension staff, including their training. Expenditure incurred by the national Government on extension services was ¥49 billion and ¥48.6 billion in 1990-91 and 1991-92, respectively. Additional schemes provide for expenditure on a wide range

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90 According to the Japanese authorities, consumers benefit from these arrangements through having a steady supply of essential foods at "reasonable" prices. However, as shown in Chapter V, "reasonable" prices have, in practice, meant prices for most foodstuffs which are several times international levels.
of infrastructural, extension and advisory services for technological improvement of agricultural production generally, and more specifically in the livestock industry. Total expenditure in 1990-91 amounted to ¥110 billion, of which ¥73 billion related to livestock production. Relatively minor expenditure (¥0.4 billion in 1990-91) was spent on promotion of soil conservation and low-input farming.

288. The Government also helps fund a Farmers' Pension Scheme designed to secure the livelihood of aged farmers and help accelerate retirement. Retiring farmers are paid a pension, one-half of which is met by the Government. The Farmers' Pension Fund buys or rents farmland from those wishing to retire from farming and sells it or rents it to those wishing to expand their farms. Government expenditure on the Scheme was ¥105 billion in 1990-91 and ¥119 billion in 1991-92.

289. The Government subsidizes about half of the premiums paid by farmers under the agricultural insurance scheme. Under this scheme, insured farmers suffering damage from natural disasters are liable to receive compensation of up to 70 per cent of their estimated income loss. Insurance is voluntary for all farmers except rice growers. The cost of the Government subsidy on insurance premiums in 1991-92 was ¥80 million, and is projected to increase slightly to ¥81 million in 1992-93.
V. TRADE POLICIES AND PRACTICES BY SECTOR

(1) Overview

290. As in many developed countries, there are marked differences between Japan's trade policies in the industrial field and those applying to the agriculture and food manufacturing sectors. Most elements of manufacturing industry in Japan (29 per cent of GDP in 1990) have been steadily opened to imports, a process which has continued in the past two years. Average rates of tariffs on manufactured goods are low (some 5 per cent), and most non-tariff barriers have been lifted.

291. Japan's increasing openness in industry during the period under review has been fundamentally driven by the wish to maintain internationally competitive industries. However, external pressure has also played a significant role in encouraging Japan to open its markets, while the threat or actuality of protection in major trading partners has been one factor leading Japanese firms to invest increasingly in production facilities in its main developed-country markets (Chapter III).

292. Since the last Trade Policy Review, Japan has continued its programme of phasing-out quantitative restrictions in certain agricultural and food products, announced in 1988. In 1992, only twelve HS four-digit headings remained subject to quantitative restrictions. Such restrictions apparently have now been replaced by tariffs (in some cases, giving higher protection) on all such products, including beef, fresh and provisionally preserved oranges and orange juice. Japan had previously responded to the recommendations of a GATT Panel regarding restrictions on agricultural products by eliminating quantitative restrictions on seven agricultural products. Other restrictions remaining in force, concerning dairy products and starch, the removal of which had been recommended by the Panel, are subject to a reservation by Japan (Chapter VI).

293. Japan remains the world's largest food importer overall, with US$27.5 billion imports in 1990. Japan's overall food sufficiency has been declining gradually: in FY 1987 it fell below 50 per cent for the first time and stood at 47 per cent in 1991. The value of total foodstuffs, beverages and tobacco imports rose by 1.8 per cent from US$31.0 billion in 1989 to US$31.6 billion in 1990: within this total, imports of beverages

1Processed cheese; other sugars and sugar syrups (excluding lactose); fruit purée and paste; fruit, otherwise prepared or preserved; non-citrus fruit juices; tomato juice; tomato ketchup and tomato sauce; and food preparations mainly consisting of sugar. (See GATT (1990), Trade Policy Review - Japan, p. 188.)
(especially spirits), feedstuffs and fish imports grew most rapidly in value, while those of fruits, vegetables, cereals and coffee declined.

294. Nevertheless, in contrast to the situation in manufacturing, other elements of Japan's agricultural production (overall, accounting for 3 per cent of GDP in 1990) continue to be sheltered from external competition by a complex array of trade and regulatory measures. These are justified by Japan in the context of its overall agricultural policy objectives of food security, raising of farm productivity, and parity between farm and non-farm incomes and the provision of food to consumers at stable prices. It is estimated that around three-quarters of agricultural output may be insulated from international competition through price supports underpinned by import controls. Tariffs on agriculture, nevertheless, average nearly 14 per cent, well over double the average for industrial products (Chart V.1).

2 These changes reflect both price and quantity trends: for example, imports of coffee grew by 3 per cent in tonnage and fell by 28 per cent in dollar value.

3 OECD (1987) estimated that in 1984, price support policies covered some 80 per cent of the value of agricultural output. Although PSE and CSE estimates by the OECD for 1991 cover only 57 per cent of agricultural production value, the main exclusions - notably fruit and vegetables, which together account for about one-quarter of farm production, are largely covered by similar, albeit less restrictive, arrangements.
# Chart V.1
Tariff levels in Japan by product category, 1991

<table>
<thead>
<tr>
<th>Industry</th>
<th>Tariff Study Category</th>
<th>Per cent</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>5</td>
<td>Textiles and clothing</td>
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<tr>
<td></td>
<td>1, 15</td>
<td>Leather, footwear and travel goods</td>
</tr>
<tr>
<td></td>
<td>13</td>
<td>Transport equipment</td>
</tr>
<tr>
<td></td>
<td>6, 7, 8</td>
<td>Minerals and metals</td>
</tr>
<tr>
<td></td>
<td>11, 12</td>
<td>Machinery</td>
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<tr>
<td></td>
<td>9</td>
<td>Coal and natural gas</td>
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<tr>
<td></td>
<td>10</td>
<td>Chemicals</td>
</tr>
<tr>
<td></td>
<td>3, 4</td>
<td>Wood, pulp and paper products</td>
</tr>
<tr>
<td></td>
<td>2, 14, 16-23</td>
<td>Others</td>
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<tr>
<td></td>
<td><strong>Industry total</strong></td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Agriculture</th>
<th>Tariff Study Category</th>
<th>Per cent</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>32</td>
<td>Tobacco</td>
</tr>
<tr>
<td></td>
<td>29</td>
<td>Beverages and spirits</td>
</tr>
<tr>
<td></td>
<td>30</td>
<td>Dairy products</td>
</tr>
<tr>
<td></td>
<td>24</td>
<td>Foodstuffs</td>
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<tr>
<td></td>
<td>27</td>
<td>Oilseeds</td>
</tr>
<tr>
<td></td>
<td>26</td>
<td>Meat</td>
</tr>
<tr>
<td></td>
<td>25</td>
<td>Grains</td>
</tr>
<tr>
<td></td>
<td>31</td>
<td>Fish</td>
</tr>
<tr>
<td></td>
<td>28, 33, 34</td>
<td>Others</td>
</tr>
<tr>
<td></td>
<td><strong>Agriculture total</strong></td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Total</th>
<th>All products</th>
</tr>
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</table>

Source: Tables AV.1-AV.18 and GATT Secretariat estimates.
295. Although much has been done to adjust the overall structure of agriculture in Japan, through reallocating farm land to other uses and through the decline in farm population, Japan's agricultural policies tax its internationally efficient manufacturing industries by retaining scarce resources in farming. The burden of the assistance falls unevenly across other sectors of the economy (Note V.1). Some observers have estimated that the annual cost to Japan's economy of its farm policies may be more than one per cent of GNP.4

4Anderson and Tyers (1987)
Note V.1 Domestic Resource Implications of Japan's Agricultural Policies

Japan is the world's largest importer of agricultural commodities. Food imports remain influenced, however, by policies originally developed to promote self sufficiency for food security reasons, as well as to maintain parity between farm and non-farm household incomes. Over time, some significant liberalization has taken place. With the modernization of the economy, the share of the labour force employed in agriculture has declined markedly. Nevertheless, Japan's agricultural policies, which in some areas insulate farmers from international competition with a view to meeting the Government's objectives, deliver high levels of assistance.

Pursuit of such objectives has economic costs. Assistance to one sector imposes a burden on others and reduces national welfare overall. Sub-optimal allocation of resources results from factors of production being attracted to less efficient activities whose returns have been artificially increased by assistance.

The economic costs to Japan from the resource misallocation induced by agricultural protection policies are likely to fall mainly on efficient manufacturing industries. To the extent that scarce resources, such as land and labour, are held in agriculture, efficient manufacturing industries will be penalized through having to pay higher wages and rents.

Various studies have attempted to measure the economic costs of Japan's agricultural policies. Vincent (1989), using a general equilibrium model to simulate the gains to the Japanese economy, found that the removal of agricultural supports could increase Japan's export earnings by some 3 per cent (equivalent to annual gains of ¥1,200 billion at 1985 prices). Vincent estimated that Japan's agricultural policies could curtail manufacturing output by between 0.3 and 2 per cent and reduce manufacturing employment demand by from 0.4 to 4 per cent. Similarly, Anderson and Tyers (1987) estimated the domestic welfare costs of Japan's agricultural assistance to be some US$20 billion annually (in 1985 prices), equivalent to over one per cent of Japan's GNP.

Part of the gains to the Japanese economy from agricultural reform could come from reductions in the price of farm land. Although in the main rice-growing areas paddy land prices have fallen since 1988, nationally prices have continued to rise. Higher land prices benefit existing holders of farmland, but inhibit the opportunities for transferring land to more economically-productive alternative uses. Recent legislation on urban
planning and agricultural promotion may assist in redefining land utilization.

Despite high levels of assistance, the number of full-time farmers has fallen rapidly, reflecting the changing structure of Japan's economy. Over four-fifths of farmers are part-time, and for two-thirds of these non-farm income is by far their predominant source of income. Moreover, farm support policies may be inequitable in two respects. First, they are regressive to the extent that they raise food prices and thus affect poorer households most. Second, through policies based on the maintenance of producer prices, it is likely to be the larger, and generally wealthier farmers who receive the bulk of the transfers.

The question - for Japan as for other economies - may be asked whether the maintenance of high-price agricultural production is the most efficient way of promoting "food security", particularly in an economy which is heavily dependent on imports for supplying essential farm inputs, such as petroleum and feed grains. Winters (1988) has suggested that a combination of storage of essential grains and of agricultural inputs (including "rested" land to conserve natural fertility) may be a less costly alternative to price supports. Similarly, alternative policies such as income transfers may be a less distortive means of ensuring income parity.
(2) Agriculture

296. Agricultural production (including fishing) accounted for some 3 per cent of GDP in 1990 and 6 per cent of employment in 1991, both down from some 4 and 13 per cent in 1980. The number of farm households has declined by almost 15 per cent since 1985, and the average farm size, although rising, remains relatively small at around 1.18 hectares in 1991. Part-time farmers, three-quarters of whom receive the bulk of their income from non-farm activities, exceed the number of full-time farmers by four to one; and about 90 per cent of farmers producing rice depend on non-farm activities for more than half of their income.

297. Japan's principal agricultural policy objectives are food security (safeguarding of basic food supplies), and maintenance of parity between farm and non-farm incomes. Important additional objectives include the maintenance of employment opportunities in regional areas where alternative employment opportunities are limited, improving the rural infrastructure, conservation of natural land and the environment, and the revitalization of rural communities.¹

298. In an attempt to achieve these objectives, much of Japanese agricultural production is assisted through administered domestic prices supported by import controls and Government-funded deficiency payments (Note V.2). Secondary measures, such as exclusive State-trading rights, import quotas and high tariffs, help to shelter farmers from import competition.

¹For example, the Japanese Government has stated that a major reason for maintaining import quotas on starch and inulin (contrary to the GATT Panel recommendation) is to protect the livelihood of farmers in the extreme northern and southern regions of Japan, where potatoes and sweet potatoes constitute important rotational crops and alternative employment opportunities are bleak. See GATT (1990), Trade Policy Review - Japan, p.222.
Note V.2  Price Support Policies in Japan: An Illustrative Analysis

Japan's price stabilization schemes generally combine government intervention in the market, through State-trading and administered prices, with import controls. The aim is to stabilize supply in the market, through maintaining stable producer prices. These are generally set at well above international levels. Imports generally fill the gap between domestic production and consumption. In the case of rice, imports are effectively banned. In some other cases, such as beef, where import quotas were removed in April 1991, and pigmeat, import competition is controlled through tariffs.

Partial equilibrium analysis, using supply and demand functions, provides a useful means of analysing the effects of these schemes on the assisted commodity, and their implications for resource allocation. Although this approach has limitations, it provides a basis for evaluating the economic impact of Japan's agricultural arrangements.

In the diagram, the stabilized domestic producer price for the commodity, say butter, $P_d$, is set above the world price, $P_w$. SS and DD represent, respectively, the projected domestic supply and demand curves for butter on the basis of which the Government sets the administered prices for the forthcoming season. By setting the administered prices at $P_d$ rather than at the unassisted level, $P_w$, domestic production of the good expands from
Q1 to Q2, and demand contracts because of the higher price from Q4 to Q3, such that imports fall from (Q4-Q1) to (Q3-Q2).

The effects of government intervention are therefore twofold. First, resources are encouraged into the production of a commodity that could be imported more cheaply. The costs associated with this resource misallocation, of having additional resources employed in producing the assisted commodity, are captured in the diagram by the triangle bde. Second, since consumption is reduced at the higher price, consumers demand less of the assisted commodity. This loss is given in the diagram by area fgh. The combined deadweight economic loss imposed on the community from the assistance is the sum of these two triangular areas, bde and fgh.

By guaranteeing to underwrite the administered price, Pd, through compensation for shortfalls in the actual price below the administered level, the Government can adjust returns to offset for market developments not adequately reflected in its forecasts. For example, assume that the domestic price falls below the projected level to Pd°. To maintain the producer price at Pd, the Government must underwrite the stabilization price by making a deficiency payment to the stabilization fund equivalent in the diagram to the area PdPd°bc. Producers continue to receive total assistance given by PdPwdb which, under the initial forecast, would have been entirely financed by consumers paying higher prices of Pd-Pw.

Domestic resource inefficiencies induced by such agricultural assistance policies are increased by the criterion used for setting the administered price, Pd. Administered prices in Japan are, in most cases, based on costs of production. Setting administered prices that mainly reflect movements in the production costs of farmers and processors, in some cases using a fixed formula, lessens market disciplines on farmers and processors; cost inefficiencies can be passed on to consumers in the form of the higher administered prices which are made possible by increased assistance.

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299. Detailed estimates of assistance to Japanese agriculture, using the concepts of producer and consumer subsidy equivalents and of nominal assistance coefficients have been reported for a number of years by the OECD (Appendix V.1). These estimates, which cover well over half of Japan's agricultural output (the main omissions being fruit and vegetable growing), illustrate the levels of assistance provided to Japanese farming (Table V.1).

300. The estimated average PSE and CSE for Japanese agriculture in 1991 were estimated to be 66 and -46 per cent, respectively. Total transfers to Japanese farmers amounted to ¥4.2 trillion, of which over four-fifths, or ¥3.5 trillion, was financed by consumers paying above world prices for foodstuffs. Producer transfers in 1991 amounted to additional annual income of some ¥1.2 million per farm household. Assistance was also provided by Japanese taxpayers indirectly through direct Government payments under stabilization schemes, subsidized crop insurance premiums and general services provided at concessional charges (Chart V.2).

301. Levels of assistance are uneven among agricultural activities. The average nominal assistance coefficient on production (indicating the proportion by which producers' returns are increased above the unassisted level) is estimated to have risen marginally from 2.64 overall in 1990 to 2.67 in 1991. The 1991 estimates range from 1.13 on poultry to 5.05 for rice; 5.66 for milk products; 7.12 for barley and up to ten times for wheat (Chart V.3). On average, returns to farmers were increased by five times the unassisted level for crops, and by under two times for livestock products.
302. Japanese food prices are, as a result, well above international levels. An indication of the extent of the gap between domestic consumer prices compared with border prices of imports is also provided in Chart V.3. This shows that Japanese consumers in 1991 paid, on average, around double world levels on both crop and livestock products, and that this gap had increased marginally from 1990 levels. On individual food products, consumers are estimated to have paid between four and five times the border price for rice and milk products, and of well over three times for sugar.

303. As a result of these higher prices, Japanese households are reported to spend a larger share of their disposable income on food than those in other OECD countries. Consumer transfers to producers through higher prices for food are estimated to have amounted in 1991 to some ¥103,000 per average household; based on the average annual food expenditure per household in Japan of ¥960,000, this represents an annual tax on food consumption of around 11 per cent.

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6. Japanese consumers are estimated to spend over 30 per cent of disposable income on food, compared to about 20 per cent for Americans or Germans (Financial Times. Survey of Japan, 15 July 1992). Higher costs of food also generally represent a regressive tax on society as poorer groups tend to spend a higher proportion of income on food.
304. Japan's agricultural policies also rely on supply controls to avoid surplus production in certain areas. Self-sufficiency ratios are 100, 98 and 91 per cent for rice, eggs and vegetables respectively. The rice-land diversion programmes have effectively contained potential surpluses in recent years by reducing production by as much as one-fifth.

305. Japan's domestic market is part of the world market. With its diversion programmes Japan has been able to avoid unduly distorting world markets by disposal of excess production at subsidized prices. However, this has often been achieved by diverting land to other, often assisted, crops, such as wheat, that replace imports. Also, to the extent that resources released by the diversion programmes have gone to other assisted cereals, the programmes may not have eased resource allocation costs associated with agricultural support policies.
Chart V.3
Nominal assistance coefficients (price distortions) on Japanese agricultural commodities, 1989-91
Percentage distortion above unassisted levels; World price=100

Livestock sector

(a) Dairy products (Table AV.1)

306. Dairying is the most highly assisted livestock activity in Japan, with average PSE and CSE in 1991 estimated at 88 and -62 per cent (Table V.1). Almost 90 per cent of assistance, equivalent to ¥588 billion in 1991, is provided by Japanese consumers through support prices underpinned by tight import controls; the rest is financed indirectly by taxpayers through public subsidies. Despite some recent changes in emphasis, the primary mechanism of assistance to dairying continues to be Government intervention designed to support, at internationally high levels, the returns of farmers and processors of milk and milk products.

307. Japan's level of self-sufficiency in dairy products overall is currently around 80 per cent. Government policies are directed to maintaining current milk production levels, which stood at some 8.3 million tons in 1991.

308. Imports of fresh milk, although free from import quotas and state-trading restrictions, are subject to a 25 per cent tariff. Moreover, imports are subject to regulations concerning sanitary conditions for fresh milk under the Food Sanitation Law. Imports of designated milk products (butter, skimmed milk powder, sweetened condensed whole milk and skimmed milk) are restricted to times of domestic shortages, mainly through import quotas and exclusive import controls granted through the LIPC. Tariffs range up to 40 per cent on processed cheese, 35 per cent on butter, natural cheeses (except for duty-free entry on imports intended for use as materials for processed cheese), and yogurt, while ice-cream is subject to a temporary duty of 28 per cent. Importation of milk powder is subject to State trading, while a tariff quota, with an above-quota rate of 25 per cent, applies to cocoa mixtures. Furthermore, the importation of butterfat mixtures is subject to prior confirmation under MITI's

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OECD (1987), National Policies and Agricultural Trade - Japan, p.50. The local industry also receives substantial natural protection in view of the high transportation costs associated with imports of fresh milk. More recently, however, this natural protection has been underpinned to a considerable extent by the import quotas operating on sterilized, frozen or preserved milk and cream (UHT milk).

8The Livestock Industry Promotion Corporation (LIPC) has monopoly importation rights over butter, skimmed milk powder, sugared condensed whole and skimmed milk, whole milk powder, buttermilk powder and whey powder.

9Imports of the designated products are dutiable at rates of up to 35 per cent: imports of skimmed milk powder used in animal feed and school lunch programmes and whey powder used in animal feed are duty-free. Imports of whey products used in infant formulas attract lower rates of temporary duty of 10 per cent.
jurisdiction to monitor and collect data concerning imports. The assistance provided by these import restrictions on milk products flows back mainly to farmers through higher farm gate returns for fluid milk used as manufacturing milk.

309. The LIPC intervenes in the market to support the "stabilization indicative price" (SIP) with a view to contributing to the stabilization of the consumption of designated dairy products. Set annually by the Government on the basis of annual market price research on individual products, this price takes into account several factors, such as the production conditions, the supply and demand situation for these products and other economic factors, with the objective of reducing the price difference between domestic and foreign products. Under the Deficiency Payment Law, the LIPC offers to purchase the designated products from the manufacturers or milk producers' associations when the market price falls below the SIP, and to sell it again when the price rises above the SIP.

310. A Deficiency Payment Scheme supports farmgate returns for manufacturing milk. The total value of payments under the scheme in 1991-92 was ¥27.7 billion (Table V.2). This scheme covers a guaranteed quantity of milk used in the manufacture of butter, milk powder and condensed milk. Payments are made to the eligible milk producers' associations as compensation for the difference between the "guaranteed price" and the "standard trading price" which, along with the "stabilization indicative price", are set annually by the Government following consultation with the LIPC. The level of payments under the scheme is capped by national ceilings or guaranteed quantities, maintained

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10 It has been reported that informal administrative guidance applies to imports of milk powder, cocoa mixtures and butterfat mixtures for industrial uses to ensure that trade volumes conform with government planning targets. The same report refers to a longstanding MAFF gazette notice whereby the Ministry imposes an informal limit of 20 per cent on the dairy content of imports of powder and milk fat mixtures for industrial processing and re-export. These restrictions are used to control the practice of processors importing these products duty-free as a source of manufactured milk. MAFF is currently considering permitting imported mixtures with up to 50 per cent dairy content.

11 In practice, a range is set around the "stabilization indicative price" whereby the LIPC buys when the market price falls below the administered price by 10 per cent, and sells when it rises above this price by 4 per cent.

12 Deficiency payments for processed milk have fallen continuously since 1986-87 when the level fell from ¥41.5 billion to ¥31.7 billion.

13 The "guaranteed price" for manufactured milk is based on an annual survey by MAFF of the production costs of the average farmer in Hokkaido, where some 85 per cent of all manufacturing milk is produced. In 1991, the average farm cost of milk production in Hokkaido rose by ¥6.8 per kg, compared with increases of ¥7 per kg in each of the two previous years.
In recent years at 2.4 million tonnes, set by the Government and allocated among dairy associations.

311. A separate payment scheme under the Cheese Production Promotion Fund was established when the Government removed milk used in cheese production from the Deficiency Payment Scheme to improve the competitiveness of local natural cheese production against imports. This scheme for milk used in cheese production, due to expire in 1991-92, has recently been extended for two years at a reduced rate of ¥10 per kg of milk. The payment rate had been gradually reduced from its introduced level of ¥15 per kg in 1986-87 to ¥11 per kg in 1990-92. The present rate is expected to maintain milk production for cheese manufacture at about existing levels of 240,000 tonnes.

312. Previous steady reductions in the level of guaranteed farm returns for manufactured milk were halted recently when MAFF announced that farmgate returns in 1992-93 were to remain at 1991-92 levels (Table V.3). In 1992-93, the "stabilization indicative price" paid by manufacturers of ¥65.4 per kg is to be supplemented by a Government deficiency payment of ¥11.35 per kg. This yields a guaranteed farmgate price on manufactured milk in 1992-93 of ¥76.75 per kg.

313. In response to the recommendations of a GATT Panel, Japan has removed import quotas on processed cheese, frozen yogurt and ice-cream, and whipped cream in pressurized containers, as well as expanding quota access for whey products and reducing to 40 per cent the tariff on processed cheese that had been increased to 60 per cent on April 1989. However, Japan has not, to date, altered existing controls on skimmed milk powder which, like those on butter and whole milk powders, are fundamental to the Japanese price support structure for dairying (Chapter VI). Domestic prices for dairy products are, on average, over four times as high as international levels, and Japanese dairy farmers receive returns for milk production almost six times as high as the unassisted level (Chart V.3).

314. Despite these recent market reforms, the level of overall assistance for dairying in Japan is, apparently, largely unchanged. According to OECD estimates, dairy assistance, after an initial fall in 1989, had increased

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14GATT, Basic Instruments and Selected Documents, 35th Supplement, pp. 163-245.
over the subsequent two years, so that by 1991 it had risen above 1988 levels. 15

315. Milk production is subject to annual output quotas set by the Central Council of Dairy Cooperatives under the supervision of the Government (MAFF). The quotas are allocated among prefectural cooperatives and, through them, to farmers. Farmers exceeding their production quota have their following year's quota cut by the excess, and a penalty of ¥40 per kg charged on the surplus amount. 16 Returns from manufacturing milk and the more lucrative fluid milk sales are pooled at the prefectural level by the prefectural cooperative and the farmer is paid an average return. 17 There are no legislative barriers to interprefectural trade in fluid milk, and according to the Japanese authorities, there are no informal arrangements controlling movement of milk between regions.

316. Strict enforcement of quota ceilings set by the Government on the volume of milk eligible for deficiency payments also helps to control milk production. A number of other schemes have been used in the past to control supply, such as the dairy cow buyout programme and several voluntary production adjustment schemes. According to the Japanese authorities, no such schemes currently exist.

317. Dairy farm incomes depend substantially (as much as 30 per cent) on sales of beef as a by-product. The reduction in farm incomes due to falling domestic beef prices following beef market liberalization (see below) has been partly met by the introduction in April 1990 of a stabilization scheme for dairy farm calf sales. Calf producers receive a "guaranteed standard price" of ¥165,000 per head, regardless of actual selling price, down to a "rationalization target price" of ¥138,000 per

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15 Since 1986, the deficiency payment rate has fallen for manufactured milk. Total deficiency payments fell from ¥41.4 billion to ¥27.7 billion in the period 1986-1990. Nevertheless, total measured assistance increased due to an increasing price gap between domestic and international prices, due to depressed international conditions for dairy products which, for example, saw world prices falling by one-fourth in 1990.

16 In practice, the penalty may be refunded (at the end of the following year) if the farmer observes his quota allocation in that year.

17 Pooling of returns potentially encourages increased production, as the farmer receives an average return which is higher (by virtue of the more lucrative fluid milk sales) than the marginal price given by the returns from manufacturing milk. However, any such increases may be limited by the production controls exercised by the Japanese Government. Pooling of returns may also reduce the incentive for farmers to improve efficiency.
head. Any shortfall in prices received by the farmer between these two set prices is met by the Government. For levels below the "rationalization target price", 90 per cent of the price differential is met from a Special Reserve Fund, which is half financed by the central Government and the rest shared equally between prefectural governments and producers. These arrangements have helped compensate dairy farmers for falling calf prices following beef quota liberalization. Although market prices have fallen from ¥200,000 per head to around ¥135,000 per head, farm returns have fallen less to marginally below the guaranteed price of ¥165,000 per head.

(b) Animals and products thereof (Table AV.2)

318. Apart from dairying, Japan's livestock industry comprises mainly beef, poultry and pigs. These activities combined accounted for some 18 per cent of the total value of agricultural output in 1991 (Table V.1). Beef production alone accounted for close to half of this total.

Beef

319. Imports have grown from 25 per cent in 1987 to some 50 per cent of Japan's beef consumption. In accordance with the Beef Market Access Agreement signed by the United States and Japan in 1988, beef import quotas were terminated on 1 April 1991 and replaced with a higher tariff - increased from 25 to 70 per cent - to be phased down in two equal steps to 50 per cent from 1 April 1993. Under the Agreement, Japan may impose an additional emergency tariff of 25 per cent if increased beef imports threaten to disrupt the domestic market. The tariff rate currently applied to beef imports has been reduced to 60 per cent with effect from 1 April 1992.

320. Prior to the initial beef quota expansion in 1987, import allocation arrangements by the LIPC controlled import competition. Despite expanding import quotas before FY 1988, mainly in line with growth of beef consumption in Japan, these restrictions maintained domestic beef prices

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18 The Agreement specifies that Japan may enter bilateral negotiations with any trading partner whenever Japan's imports threaten to exceed 120 per cent of the previous year's level. Should such negotiations fail, Japan is entitled automatically to impose an emergency additional tariff of 25 per cent on all beef imported during the remainder of the year. The pre-determined levels that can trigger the emergency action for 1992-93 and 1993-94 are 567,360 and 680,832 tonnes, respectively. These emergency provisions have not been used to date.
well above international levels. During the transitional arrangements, beef quotas were increased by 60,000 tonnes each year, from a base of 214,000 tonnes in FY 1987 (Table V.4). The import quota was filled in every year except 1990, when imports of 366,000 tonnes fell short of the corresponding quota level of 394,000 tonnes.

19 From FY 1980 until FY 1987, for example, beef import quotas expanded from 134,000 tons to 214,000 tons respectively, representing an annual average increase over the period of some 7 per cent. The first substantial annual increase in beef import quotas occurred in 1987, immediately prior to the arrangement, when quotas were increased by over 20 per cent to 214,000 tons.

20 The import quota for FY 1990 consisted of 384,000 tons plus 10,000 tons carried over from the previous year. Imports increased by 62,000 tonnes in FY 1988, 79,000 tonnes in FY 1989 and by 19,000 tonnes in FY 1990.
Note V.3 Japanese Beef Trade Liberalization

In the following diagram, SS represents the supply curve of Japanese beef and DD the domestic demand.

With an initial import quota of Q2-Q1, aggregate supply (domestic supply of beef supplemented by imports) equals domestic demand at domestic price Pd. Because of the scarcity of beef created on the domestic market by the import quota, Pd lies well above the world price level, Pw.

Historically, Japan also imposed a relatively low tariff of 25 per cent on beef imports, so that the tariff-inclusive price of Pwt was between Pw and Pd. Thus the tariff of 25 per cent was redundant as a protective measure; as domestic prices were set by the quota. The only effect of the tariff was to transfer to the Government, through revenue, a share of the quota rents associated with importing.

However, quota expansion under the transitional beef arrangements would have resulted in Pd gradually falling, thereby reducing domestic production and stimulating beef consumption. Indeed, the fact that the import quota was not fully used in 1990-91 raises the possibility that the tariff of 25 per cent may have been the operative trade instrument at the time (i.e. that the quota was not less than Q4-Q3).

The import quota was eliminated on 1 April 1991, and the tariff rate raised to 70 per cent. The higher tariff led to a domestic price well above Pwt, in all likelihood increasing assistance to the domestic beef sector, and lowering imports.
Subsequently, the tariff was lowered to 60 per cent on 1 April 1992, and will be further reduced to 50 per cent on 1 April 1993. Holding other factors constant, such as income and population, the gradual lowering of the tariff, leading to lower domestic prices, should lead to increased imports and reduced domestic production, thereby enabling resources to enter more productive alternative uses. However, the tariff may have to fall back substantially towards its previous level to re-achieve the level of assistance actually provided in 1990-91, prior to the termination of the import quota.
321. Despite expectations that beef imports would continue to expand following the termination of the import quota, imports declined in 1991. Weaker import demand in early FY 1991 partly reflected the substantial build-up of stocks which preceded the imposition of the 70 per cent tariff. Part of this fall was due to the release of stocks held by LIPC onto the domestic market in mid-year. It is believed that, in 1992, when LIPC stocks have been reabsorbed and tariff rates will decline to 60 per cent under the phased reduction programme, beef imports will be up on FY 1991 levels. OECD estimates show that assistance to the Japanese beef industry increased in 1991, as indicated by rises in both the nominal assistance coefficients on production and consumption from 5.4 to 5.7 and 3.9 to 4.2, respectively.

322. Japan maintains strict quarantine regulations on beef in accordance with the Domestic Animal Infectious Diseases Control Law. Imports from some major producing countries where outbreaks of foot-and-mouth disease occur, such as South American, African and Asian nations, are prohibited. Those prohibited areas are specified in the legislation; imports of meat products from areas not listed as "free from virulent infectious diseases" affecting animals must be treated in accordance with heat-processing standards. In some areas with high incidence of foot-and-mouth disease specified in the legislation, heat processing establishments must be designated by the Japanese authorities. Imports of live animals are possible from all countries unless expressly prohibited in the legislation. (Table V.5)

323. A wholesale price beef stabilization scheme is run by the LIPC, which intervenes in the market to maintain prices within set bands for certain steers (Chart V.3). Under the former import allocation system, high domestic prices maintained through the LIPC's operations had kept the

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21. GATT (1992), The International Markets for Meat 1991/92. The Japanese authorities note that while imports of beef fell in 1991, the consumption of imported beef rose (due to releases from stocks). Other observers estimate that imports may not regain their 1990 levels until 1993: in this connection, they estimate that the tariff of 70 per cent is likely to have increased protection for some cuts (notably U.S. striploin), beyond that provided in the final year of the quota system (see Note V.3), and that Japanese buyers accumulated stocks of certain cuts of imported beef in 1990, in anticipation of an increase in prices after the move to tariffs. (Australian Bureau of Agricultural Resource Economics (1991), Substitution relationships between beef and other meats in Japan, Technical paper 91.6, Canberra.)

22. Meat products requiring heat-processing imported from Singapore, Poland, Hungary, Romania, Yugoslavia, Germany, Switzerland, Austria, China and EC countries, except Italy, Luxembourg, Greece, Spain and Portugal, (apart from Denmark, Northern Ireland and Ireland whose products do not require heat-processing), may be processed in establishments designated by government agencies in the exporting country. All other imports requiring heat-processing must be produced in establishments directly approved by the Japanese authorities.
prices well above stabilized levels, and Government funding had not been necessary. However, in 1991, following the termination of the import allocation scheme, compensation payments of ¥36.5 billion were made to beef producers under the stabilization scheme to ensure stable beef calf prices and to alleviate the effects of the beef liberalization on domestic beef producers (Table V.2). With the removal of the import quotas and lowering of tariffs, compensation payments are likely to become a more important means of delivering assistance to beef producers.

324. The Government also maintains, jointly with prefectures and farmers, a beef-calf price stabilization scheme for feeder calves. The scheme funds, through compensation payments, 90 per cent of any shortfall in the average realized market price below the "rationalization target price" set by the central Government. Price differentials between the market price and the "guaranteed standard price", down to the target price, are fully met by the Government.23

Pigmeat

325. Pigmeat production in Japan is assisted by a specific differential duty (on a sliding scale) applied to imports, supporting domestic price stabilization scheme administered by the LIPC. The Corporation intervenes in the market to maintain domestic prices within a stabilization price band set annually by the Government (Table V.3). The differential tariff operates so that the duty-inclusive price of most imported pigmeats never drops below the central price of the stabilization band.24 The duty can be reduced or suspended during periods when the domestic price of pigmeats exceeds the upper band and the import price with customs duty and cost is higher than the wholesale price of domestic pigmeat.

326. As a result of these arrangements, domestic prices are estimated by the OECD to have exceeded world levels (based on U.S. prices) by 112 per cent in 1991 (Chart V.3). In that year, domestic consumers paid to pig farmers and the Government, through higher prices and tariff revenue, some ¥399 billion (the CSE) as a result of these assistance arrangements.

23 In 1992-93, the "guaranteed standard prices" for beef calves have been set at ¥304,000 per head (black and red breeds) and ¥214,000 per head (other breeds), compared to "rationalization target prices" of ¥267,000 per head and ¥183,000 per head, respectively.

24 The "standard import price" or "central stabilization price" is not set so high as to exclude imports. Because of the differential specific duty, mainly higher quality and priced pigmeats are imported so as to minimize the differential duty paid. The standard import price has been set, for customs purposes, at ¥482.5 per kg (skinned) for FY 1992 which is equal to ¥643.3 per kg (boneless cuts).
Of this transfer, producers received an estimated ¥288 billion (the PSE), equivalent to a percentage PSE of 47 per cent (Table V.1).

327. Pigmeat and related products are subject to health regulations, including the provisions of the Domestic Animal Infectious Diseases Control Law (Table V.5). Imports of chilled or frozen pork are prohibited from EC member States except Ireland, Northern Ireland, Great Britain, the Netherlands and Denmark. According to the Japanese authorities, Japan does not maintain stringent phyto-sanitary and sanitary regulations affecting meat imports, such as a zero tolerance policy with respect to chemical residues in livestock products and bacterial contamination for dried ham and sausages.

Poultry

328. Poultry production in Japan is no longer assisted by a stabilization scheme run by the LIPC. Domestic prices are supported by tariffs on whole poultry, of 5 per cent on turkeys, 10 per cent on ducks and 14 per cent on chickens.

329. As a result of these tariff arrangements, consumers were estimated by the OECD to have paid in 1991, through higher prices, some ¥50 billion (the CSE) to producers and, as tariff revenue, to the Government. Producers benefited by an estimated increase in returns (the PSE) of ¥47 billion, equivalent to 12 per cent (Table V.1 and Chart V.3).

(ii) Grains (Table AV.3)

330. Rice is by far the major cereal grown in Japan, followed by wheat and barley. In 1991, the combined output of these three cereals amounted to almost ¥2,780 billion, of which some 98 per cent was rice (Table V.1). Rice and wheat are sometimes used together for double cropping in paddy fields to get higher income from limited acreage.

331. All three cereals are subject to State import monopolies held by the Government Food Agency, and to import quotas. Rice, the traditional staple food, has been the main focus of Japan's farm self-sufficiency policies, for reasons of food security. By contrast, for wheat and barley, Japan is

25 According to the Japanese authorities, Japan partially amended their enforcement regulations to re-classify the Netherlands, Belize, Dominican Republic and El Salvador as clean countries on 25 June 1992 and also lifted the ban on imports of non-heated processed ham, such as parma ham, on 25 December 1991.
very far from self-sufficient, with 80-90 per cent of domestic consumption requirements being imported. All other cereals are almost entirely imported. Overall, Japan's self-sufficiency in grain is of the order of 30 per cent.

332. Imports of rice are not generally permitted under the Government rationale of the critical importance of rice and rice-farming in Japan and the need to maintain production controls. The Food Control Law designates the Government (the Japanese Food Agency) as the sole authorised importer, as well as buyer and seller of domestically-grown Government-marketed (GM) rice. Traders wishing to import rice must, in principle, obtain a Government permit from the Agency and are required to sell all authorized imports to the Agency at the contract price. Rice imports have been restricted to relatively small quantities of rice for special uses, such as the manufacture of Awamon (a type of alcoholic beverage) produced in the Okinawa prefecture. Rice exports, which are also controlled by the Agency, have in recent years been minimal, due mainly to stringent production controls over rice growing.

333. Production, distribution, wholesaling and retailing of rice are controlled. All GM rice is purchased by the Government from rice growers through designated collection agencies and sold to wholesalers licensed by prefectural governments, which in turn sell the rice to authorised retailers. The Agency's purchase and selling prices are set annually, according to quality and grade, in consultation with the Rice Price Advisory Council. Although retail prices are, in principle, no longer set, the "standard rice price" is set annually as a guide by the Government. The retail prices of VM rice reflect the supply and demand situation.

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26 Excludes rice authorized by Cabinet order or ministerial ordinance, such as that imported for experimental use, specimen or sample use, as well as that imported for use in processed exports.

27 Since 1969 an increasing share of rice, currently some two-thirds, has been sold as voluntary marketed (VM) rice, which is sold not to the Government but directly to wholesalers, through one of two designated bodies - the National Federation of Agricultural Cooperatives and the national Federation of Staple Food Collections. Although the price of VM rice is free from direct controls and is determined by tender at the VM rice exchange, which determines the price that VM rice trades for outside the exchanges, it nevertheless remains underpinned by the conditions applying to GM rice. Annual limits on sales of VM rice are set and monitored by the Food Agency. VM rice commands a substantial price premium over GM rice to reflect its higher quality, and its existence has therefore added an element of flexibility to Japanese rice marketing, whereby growers can respond to consumers demands for higher-quality rice.
334. The annual producer price for rice is set largely at a level which compensates growers for movements in their production costs and provides farmers with income parity with other sectors. The Government purchase price is calculated on the basis of the production costs of "core" farmers, whose cost efficiency is higher than the average in each agricultural region. The Government's selling price is set independently from, and recently above, the farmgate price. But the sum of the Government purchase price and the operation costs of the Food Agency is higher than the Government selling price, and the difference between the two is financed directly from the Government budget. The Government purchase and selling prices have been reduced since 1987. The Government subsidy on rice production amounted to ¥116.8 billion in 1991-92 (Table V.2).

335. To contain surplus rice production resulting from the domestic marketing arrangements (which, by raising domestic prices relative to international levels for rice, encourage production while discouraging consumption), Japan has operated production controls since 1971. The Government has also curbed the Government purchase price since the late 1970s and has substantially reduced it since 1987, the current level being somewhat lower than in 1976. Rice diversion programmes - currently the Rice Paddy Agriculture Establishment Programme, 1987/88 to 1992/93 - establish area quotas to achieve reduced production targets, and provide financial incentives for rice farmers to transfer land to producing other priority crops, such as wheat, barley, buckwheat and soybeans. Diversion payments, although scaled down over recent years, remain substantial, and amounted to ¥159 billion in 1991-92.

336. These programmes have reduced rice production sufficiently to have, for the most part, eliminated surpluses in recent years. It is estimated that the diversion policy has reduced the area sown to rice by about one-third and reduced rice production by about one-fifth. The existing arrangements assisting rice production are analysed in Note V.4, which suggests that, if trade liberalization were coupled with termination of the

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28. The Government selling price of rice has been above the Government purchase price since 1987.

29. The current diversion plan aims to reduce the area under rice cultivation, over the three years ending 1992-93, by 830,000 hectares to 1.97 million hectares. This, it is estimated, would be sufficient to remove surplus production above 1992-93 demand projections of 9.85 million tons.

30. Rice surpluses have in the past normally been disposed of through limited exports and food aid, or by sales of rice at lower prices for stockfeed or industrial uses. The Food Agency's losses in this connection have been financed by the Government. From 1979 to 1986, surplus rice production of some 6 million tons, costing the Government some ¥2 trillion, was disposed of through exports (3 million tons), industrial use (1.3 million tons) and stockfeed (1.6 million tons).
rice diversion programmes, domestic prices might be reduced substantially before affecting Japan's rice self-sufficiency.
**Note V.4 Effects of Trade Liberalization on the Japanese Rice Market**

Self-sufficiency in rice, the staple food of Japanese society, remains at the centre-piece of Japan's agricultural policies. To achieve it, Japan has effectively prohibited competing imports, to support production at high administered prices (up to five times above international levels according to OECD estimates). Nevertheless, partly to avoid surpluses, the Government has sought, for some years, to encourage farming away from rice and, to that end, has conducted diversification programmes which promote alternative cropping through payment of subsidies and other financial incentives.

The possible implications of trade liberalization for Japan's rice industry can be illustrated by conventional supply and demand techniques.

In the diagram, the domestic demand and supply curves for rice are DD and SS, respectively. An import prohibition supports the domestic price, \( P_d \), above the world price, \( P_w \). Without rice-land diversion programmes, domestic rice production would exceed the quantity demanded by \( Q_2 - Q_1 \) at price \( P_d \). However, the diversion programmes, illustrated by a leftward shift of the supply curve to \( S^oS^o \), reduce supply and eliminate the rice surplus.

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surplus. At the new equilibrium, point e, domestic production equals domestic demand. This has been the case for Japan in recent years. The diversion programmes are estimated to have reduced rice production by some 25 per cent.

Removal of the current ban on imported rice, with a tariff at a rate equivalent to the percentage difference between $P_d$ and $P_w$, should leave the level of production and consumption unchanged. Subsequent trade liberalization alone would reduce domestic production below the current level of $Q_1$, by lowering domestic rice prices and allowing imports. The extent of the reduction would depend on the degree of trade liberalization (the fall in the domestic price) and the elasticity of supply (the steepness of the curve $SS$).

The impact of rice market liberalization changes substantially if it is combined with a termination of the rice-land diversion programmes. In this case, the effect of domestic price reductions on rice production may be offset by the effect on incentives to farmers who, initially induced away from rice alternative crops, may now re-enter rice production. In other words, the supply curve shifts to the right and even possibly back to its original position, such that at lower prices the original, pre-diversification, quantity is again supplied.

In these circumstances, the domestic price of rice would need to fall by a substantial amount before rice production were reduced. Indeed, in these circumstances, rice production could initially expand beyond the existing level at all domestic prices above $P_d^0$. At domestic prices below $P_d^0$, the extent to which rice production falls would depend on the supply response (given unchanged demand conditions).
337. Domestic consumers pay substantially above the world price for rice. According to OECD estimates, Japanese consumers paid almost five times world levels in 1991-92, corresponding to a total transfer from consumers to producers (the CSE) of ¥2,465 billion. Producers’ returns in 1991 were increased by ¥2,483 billion (the PSE), corresponding to a more than 500 per cent increase in returns (Table V.1 and Chart V.3).

338. Like rice, wheat and barley importation is controlled by the Food Agency. However, unlike rice, the Government does not regulate the distribution of domestically-grown wheat and barley. The Government (MITI) sets annual import quotas to secure flexibility for imports and to cover shortfalls in domestic production, which only accounts for 15 per cent of domestic consumption in the case of wheat. All imports, in principle, must be sold to the Agency at prices determined by tender. The Agency therefore enters into transactions with importers, issues import permits and purchases the imported grain at port warehouses. As with all marketing arrangements in Japan, regulation of imports forms an important component of efforts to secure stabilized imports and to manage supply and demand.

339. Although farmers may market their produce privately, in practice, the high prices offered by the Food Agency mean that farmers sell most of their output to the Agency. Prices paid to farmers are set annually based on the production costs of major farmers. Selling prices to millers are such that losses are generally made on domestic sales: the Agency’s selling prices are usually only about 30-50 per cent of the producer price. This loss is generally financed by purchasers of imported wheat who pay to the Food Agency prices well above the import price. Any further shortfalls are financed directly from the Government budget. In 1991-92, subsidies on barley amounted to ¥0.9 billion (Table V.2).

340. As a result of these arrangements, domestic wheat prices exceeded world levels by almost three times in 1991-92 (Chart V.3). Associated

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31 In estimating assistance to Japanese rice farmers, the OECD reduces the measured price differential between the domestic rice price and the Thai export price by one-third to take account of the quality differences between Japanese and Thai rice (10 per cent broken). This means that on an unadjusted basis, domestic rice prices (Government selling price) in Japan exceeded Thai export prices in 1991 by over seven times.

32 As for rice, imports for experimental use, specimen or sample use, as well as wheat and barley imported for processing into exports, are excluded from these arrangements.

33 The purchase price aims at ensuring continuous production, taking into account production costs and other production conditions, supply and demand conditions for barley and wheat; commodity price movements; and other economic factors.

34 The Agency's operations for wheat and barley are almost fully met from profits earned on import sales.
transfers from consumers (the CSE) amounted to ¥228 billion in 1991-92 while producers' returns were increased by ¥130 billion, equivalent to a percentage PSE of 103 per cent and a tenfold increase in producer returns above their unassisted level (Table V.1 and Chart V.3).

341. Policies towards feedgrains reflect Japan's support for the livestock industry. Japan relies heavily on imports for its supply of feedgrains (mainly maize and sorghum) to the livestock industry; about 90 per cent of its feed concentrate needs are met from overseas. Cereals used in manufacturing compound animal feeds, as well as other animal or vegetable based ingredients such as skimmed milk powder and molasses, are exempted under Customs Tariff Law. In other cases, tariff quotas permit duty-free imports up to the amount of any expected shortfall in domestic production.

342. In order to stabilize feed costs of livestock producers, the Government underwrites jointly, with feed processors, a compensation project run by the Formula Feed Supply Stabilization Organization. The project shields certain livestock producers from extraordinary rises in international feed prices and, according to the Japanese authorities, contributes to the sustainable import of feed grain. This system has not operated since 1984.

(iii) Foodstuffs (Table AV.4)

343. This category covers a wide range of commodities, such as fruits, vegetables, tropical beverages, sugar, flour, preparations of cereals and certain animal products like eggs.

344. Tariffs on foodstuffs average 17 per cent on an m.f.n. basis, and range from free to 125 per cent on the basis of 1991 ad valorem equivalents for specific rates on sugars.

(a) Fruit and edible nuts - fresh, preserved or prepared

345. Citrus production, especially of urshu-mikans (a type of mandarin orange) and other domestic citrus varieties, is the main fruit-growing activity in Japan. Next to mikans, the most important fruit grown is apples.

346. Strict quarantine regulations cover imports of fruit. Japan, free from fruit fly and codling moth, admits imports from countries with these pests if they are approved as applying acceptable treatment and inspection procedures. According to the Japanese authorities, Japan's fruit quarantine regulations are necessary to adequately protect the Japanese fruit industry from damages caused by injurious pests from foreign countries. Fruit imports (except pineapples, coconuts and green bananas)
are currently prohibited from Europe (excluding lemons from Spain), the Middle East (excluding citrus from Israel), East Africa, Australia (excluding oranges and lemons), Hawaii (excluding papaya) and Brazil; and mainly apples, pears, peaches and plums from the United States, Canada, New Zealand and (including sweet cherries, avocados and mangoes) from China; plums and avocados from Taiwan; as well as mainly citrus, plums, avocados and mangoes from Hong Kong and South-East Asia (excluding mangoes from the Philippines and Thailand). A full list of prohibited countries and the corresponding fruits is provided in Table V.6.

347. A limited number of bans have been lifted in recent years, covering certain fruits from designated countries. To have the import ban lifted requires acceptance by the Japanese authorities of the foreign exporters' quarantine arrangements. Since 1969, 30 approvals, covering 15 fruit and nut products from 14 countries, have been made.\(^\text{35}\) Of these, eight have been made since 1987; these were nectarines from the United States and New Zealand; grapes from Chile; honei melons from China; and lemons from Spain in 1988; sweeties from Israel in 1990; kiwifruit from Chile in 1991; and lemons from Australia in 1992.

348. Import quotas were terminated on fresh oranges from 1 April 1991 and on orange juice from 1 April 1992. Relatively high tariffs restrict imports and assist Japanese fruit growers. Tariffs vary considerably between fruit types, ranging from free to 40 per cent and averaging 10 per cent. Although the tariff on many types of fresh fruit is 10 per cent, higher seasonal rates apply to competing imports of certain fruits during the marketing season. Seasonal tariffs of 40 per cent are applied to fresh and preserved bananas imported from October to March; 40 per cent on fresh and preserved oranges and 20 per cent on fresh grapes imported from March to October.

349. Fruit growing is assisted indirectly by relatively high tariffs, including tariff quotas applied to canned pineapples, on prepared and preserved fruits, such as canned and bottled fruits, jams, fruit juices and other fruit preparations. On average, about one-fifth of Japan's fruit production is processed in some form, mainly being canned or juiced. Tariffs on prepared fruit average 22 per cent, and range from free to

\(^\text{35}\)Countries and their fruits approved for importation into Japan include oranges and lemons from Australia; oranges, lemons and grapefruit from South Africa and Swaziland; sweet cherries from Canada, New Zealand and United States; papaya from Hawaii and Taiwan; mangoes from the Philippines, Taiwan and Thailand; ponkans, tankans and liutins litchi from Taiwan; and nectarines from the United States and New Zealand; grapes and kiwifruits from Chile; lemons from Spain; oranges, grapefruits and sweeties from Israel; honei melons from China and walnuts from the United States.
55 per cent; rates of either 20 per cent or 28 per cent apply to jams and a wide range of frozen fruits.

350. Japan, a major apple producer, conducts little trade in apples. Japanese production, equivalent to well over one million tonnes annually, is almost totally consumed at home. Only small quantities of imports (14 tonnes from Korea in 1991) have been recorded since 1986 because of the controlling effects of Japan's phyto-sanitary regulations. These regulations prohibit all apple imports from countries that do not meet Japanese quarantine standards. At the same time fresh apples attract a tariff of 20 per cent, while tariffs range from 15 to 40 per cent on processed apple products, including apple juice.

351. Assistance to apple growing in Japan is generally lower than that for other crops. The percentage PSE and CSE for apple growing were estimated at 46 and -39 per cent, respectively, in 1989 (the latest year available). Total transfers to producers, estimated by the OECD at ¥71 billion in 1989, were predominantly financed by consumers paying higher domestic prices - estimated to be almost double international levels and equivalent to total consumer transfers to producers of ¥61 billion - as a result of the rigid quarantine controls mentioned above (Table V.1). The rest is financed by the Government through infrastructural expenditure on orchard restructuring, interest rate concessions on loans for new plantings, crop insurance payments and relative minor deficiency payments made on juicing apples under the Processing Fruit Price Stabilization Programme. The programme, administered by prefectures and financed jointly with the central government, ensures that producers receive at least 90 per cent of the difference between the average market price and the guaranteed price set annually by associations consisting of farmers and users in each prefecture. Payments throughout the 1980s under the programme have been relatively small, less than ¥0.3 billion annually.

(b) Vegetables - fresh, dried or processed

352. Vegetables are an important part of Japanese agriculture; Japan is some 90 per cent self-sufficient, and vegetables account for around

36 OECD (1991), The Apple Market in OECD Countries. Japan is currently examining a request from New Zealand, the United States, Australia, Canada and France to decide whether technical measures proposed by those countries meet Japan's plant quarantine safeguards to enable apples to be imported from these countries.

37 In compensation for the removal of the import quota on apple juice from 1 April 1990, the tariff was raised from 35 to 40 per cent for sweetened apple juice (more than 10 per cent by weight of sucrose), and 30 to 35 per cent for unsweetened apple juice (more than 10 per cent by weight of sucrose).
20 per cent of total farm output. The main vegetables grown in Japan are cabbages, onions, tomatoes, carrots and potatoes.

353. Fourteen major vegetables are covered by the Vegetable Supply Stabilization Fund. Guaranteed base prices are set at the level of the average market prices (average of the market price for the previous nine years) multiplied by 0.9 every few years, for each vegetable according to designated production and consumption areas, and the grower is compensated for 90 per cent of the shortfall in the market price. However, the grower is not compensated for any part of the shortfall below the minimum base prices (set at the level of the average market prices multiplied by 0.5). The stabilization fund is 60 per cent funded by the central Government, the remainder being shared jointly between prefectural governments and growers.

354. Minimum grower returns for potatoes are maintained by requiring starch manufacturers to pay specified prices to growers in order for the Government to purchase surplus starch at the agreed price. This scheme, however, has become largely irrelevant in recent years as Government purchases have not been required. This has been partly due to more potatoes being sold on the more lucrative fresh market, and also results from the introduction of a tariff quota on corn imports providing duty-free entry of maize for starch manufacturers, who meet specified mixing requirements using domestic potato starch.

355. With the exception of import quotas applying to dried small red beans and certain dried leguminous vegetables, which are also dutiable at 10 per cent, tariffs are the main form of border assistance. Duties vary from free to 25 per cent for fresh and dried vegetables, averaging 7 per cent; and from free to 28 per cent, averaging 16 per cent, on prepared and preserved vegetables. A degree of tariff escalation exists; most fresh vegetables are dutiable at either 5 or 10 per cent, while on processed vegetables rates generally range from around 7.2 to 28 per cent. The tariff rate on fresh onions increases with lower import prices; from duty-free at prices above ¥73.7 per kg, it increases on a sliding scale to 10 per cent for a price of ¥67 per kg or below.

(c) Sugar and confectionery

356. Japan is one of the world's largest importers of sugar, importing about two-thirds of its requirements. No quantitative restrictions apply to imports. Japan's beet and sugar producers are assisted by high tariffs and the price stabilization scheme under the Sugar Price Stabilization Law of 1965. Sugar production, of some 1 million tons (raw sugar basis), is mainly (two-thirds) produced from beets. The nominal assistance coefficients on production and consumption were estimated by the OECD to be, respectively 3.32 and 3.34 in 1991, corresponding to total transfers
(the PSE) to sugar growers of ¥84 billion (Table V.1 and Chart V.3). With domestic prices, on average, over three times international levels in 1991, consumer transfers (the CSE) to the sugar industry and the Government through levies and duties imposed on imported raw sugar totalled ¥260 billion.

357. The aims of the Sugar Price Stabilization Law are consistent with the broader policy objectives for Japanese agriculture. They are to stabilize domestic sugar prices and to secure minimum producer prices for farmers. The stabilization fund is administered by the Japan Raw Silk and Sugar Price Stabilization Corporation which has a monopoly over domestically produced and imported sugar. Domestically produced sugar is protected by specific tariffs of ¥41.5 per kg (equivalent to 124.6 per cent ad valorem in 1991) and a complex system of levies and surcharges on imports. Imports of refined sugar, which is also more expensive to transport, are subject to a much higher specific tariff of ¥57 per kg, which is required, according to the Japanese authorities, to enable sugar refineries to compete with imported refined sugar.

358. All imported raw sugar must be sold by the importer to the Corporation at the average import price, set twice a month. It is then resold to the same importer at a price which is set to maintain the price of imported raw sugar at the annually-set "target price". Thus, the domestic consumer price is insulated from the world price and stabilized at a level several times above the world price (Chart V.3).

359. Imports of raw sugar are effectively limited to the level necessary to meet shortfalls in domestic production. Imports of raw sugar in excess of the quantity notified quarterly to importers by the Ministry of Agriculture, Forestry and Fisheries (MAFF) under its supply-demand projections are subject to a further surcharge which is determined taking into account the effects of oversupply on the domestic price.

360. Subsidies are paid by the Agency to millers, processors and growers. Cane millers and beet processors are obliged to pay growers the minimum

38 The Corporation's reselling price is defined in relation to the average import price (AIP), the target price (TP), based on target domestic production costs but also taking into account other factors such as rationalization of the domestic industry, and the floor price (FP). The formulae for calculating the reselling prices are as follows:

Where the average import price (AIP) is above the stabilization floor price,

\[ AIP + (TP - AIP) \times K \]  

where \( K \) is the rate of sugar self-sufficiency.

Where the AIP is below the FP,

\[ FP + (TP - FP) \times K \]

When average import prices exceed target prices, only the specific customs duty applies. (See OECD (1987), National policies and agricultural trade, Japan.)
producer prices. In return, the Corporation buys raw sugar from the cane
mills and beet processors at prices that cover their costs of purchasing,
collecting and processing, and simultaneously sells back raw sugar to the
processors at lower prices. The Corporation's deficit represents
deficiency payments to the millers and processors, which are made partly
directly by the Government, and partly from levies on imported raw sugar
(Chart V.4). In 1990, the amount of production subsidy paid by the
Government to millers and processors, and therefore indirectly to growers,
totalled ¥16.4 billion.

Chart V.4
Determination of import levies on sugar imports
into Japan

<table>
<thead>
<tr>
<th>Rebate</th>
<th>Maximum stabilisation price</th>
</tr>
</thead>
<tbody>
<tr>
<td>J</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Surcharge</th>
<th>Minimum stabilisation price</th>
</tr>
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<tbody>
<tr>
<td>E</td>
<td></td>
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</table>

<table>
<thead>
<tr>
<th>Levy</th>
<th>Import price</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
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</tbody>
</table>

Note: At an average import price A, levy AB is imposed by the Corporation and an
additional surcharge of BC. At an average import price of E, only the surcharge
of EF is imposed by the Corporation. At an average import price of H, no levy or
surcharge is imposed by the Corporation. At an average import price of J, a
rebate is paid by the Corporation to the importer.

Source: Australian Bureau of Agricultural and Resource Economics (1988),

361. High fructose corn syrup was included in the Agency’s price
stabilization régime from 1982. The Agency simultaneously buys and resells
corn syrup from manufacturers, levying a surcharge which varies are
inversely with the price of imported maize. The levy is used, along with
the surcharge on imported sugar, to stabilize the domestic sugar price.

362. Production of high fructose corn syrup is subject to quotas allocated
to manufacturers by MAFF according to its supply and demand forecasts for
sweeteners. Any manufacturer exceeding the production quota is subject to a further surcharge of ¥4,320 per tonne.

(d) Products of the milling industry

363. This category covers the manufacture of flour from cereals, malt, starches and preparations made from flour and cereals. Most flour in Japan is milled from imported wheat. The poorer quality of domestically grown wheat is mainly used in the production of noodles.

364. Tariffs range from 6 to 40 per cent, averaging 22 per cent. Rates of 20 per cent and over apply to imports of cereal flours; cereal groats and pellets; starches; as well as a wide range of cereal food preparations and some pasta products. Moreover, nearly all cereal flours, groats, pellets and starches are covered by import quotas.

365. A number of food preparations and some malts are covered by specific tariffs. Malt manufactured from locally grown barley is used in the manufacture of alcoholic beverages, mainly beer and whisky. Imports of malt enter duty-free under a tariff quota arrangement.

366. Another important industry in Japan is the manufacture of starch from home-grown potatoes and sweet potatoes. Starch manufacturers are protected by tariffs of 25 per cent and import quotas covering all starches and inulin. This assistance benefits potato growers, since mixing requirements specify that starch manufacturers must blend domestic potato starch with starch from imported maize in a ratio of one to nine, reduced from the ratio of one to 7.6 in 1987. Starch manufacturers are compensated, in return, by being able to import their maize requirements duty-free under a tariff quota arrangement; the above-quota alternate duty of 50 per cent or ¥12 per kg, whichever is greater. Starch is mainly used in the production of high fructose corn syrup, a sweetener competing with sugar (see above Section on sugar).

367. Japan has, to date, not fully removed the import quotas on starch and inulin, as recommended by the GATT Panel ruling of 1988 (Chapter VI). Japan has, however, taken measures regarding certain agricultural products following the GATT ruling, to improve the market access for maize used in industrial purposes. Under the Japan - U.S. agreement, annual import quotas have increased in recent years to more than 170,000 tonnes in 1990. Potato and sweet potato production, which have fallen by over half since 1965 to under 400,000 tonnes, have special regional significance in Japan, being centred respectively in the extreme northern and southern parts where alternative crops are scarce. Import quotas on starch are therefore considered by the Japanese authorities as a necessary part of their regional assistance policies.
(e) Other foodstuffs

368. The principal commodities falling in this group are eggs and prepared sauces, such as soy sauce, tomato ketchup. Egg production amounted to ¥573 billion in 1991. Japan is virtually self-sufficient in eggs, and trade is negligible.

369. Eggs, other than for hatching, are dutiable from 20 to 25 per cent. Relatively minor assistance has been provided in some years (the last in 1988) by the Government's financial contribution to the Egg Price Stabilization Fund. The Fund, which is largely privately financed, makes compensatory payments equivalent to 90 per cent of any shortfall in the market price below the subsidization level set by the Fund (Table V.2).

370. In 1991, these arrangements assisted egg producers in Japan by increasing their returns by an estimated 19 per cent, corresponding to a total transfer or PSE to them of some ¥109 billion. Consumers, by paying domestic prices some one-fifth above world levels, funded most of these transfers; the CSE was estimated by the OECD at ¥105 billion (Table V.1 and Chart V.3).

371. Tariffs on prepared sauces range from free to 35 per cent, and average 20 per cent. Tariffs of above 20 per cent apply mainly on products of ice cream, protein concentrates and a minimum ad valorem alternate rate of 35 per cent on certain sugar syrups. Manufacturers of tomato ketchup, which was subject to an import quota until its removal on 1 July 1989, when the tariff was increased from 20 per cent to its current level of 25 per cent, benefit from being able to import processed tomatoes, such as puree and paste, duty-free under a tariff quota arrangement which has an above-quota rate of 20 per cent.

(iv) Fish, shellfish and products (Table AV.5)

372. Japan's per head consumption of fish is among the highest in the world, and it is now the world's largest importer of these products. Fish processing, including for human consumption and processing into animal feed and fertilizer, accounts for some three-quarters of the Japanese catch.

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39Japan's trading position changed in the mid-1970's from being a major net exporter to a net importer. This turnaround partly reflected an expanding domestic market for seafood, as well as declining competitiveness of Japanese exports in foreign markets, mainly due to the effects of increased fuel prices experienced as part of the oil shocks during the 1970's which adversely affected their foreign fleet operations.
373. Japanese fisheries policies have developed mainly to maintain the industry and meet food security concerns. Entry provisions into coastal and foreign waters are controlled under legislation by the Ministry of Agriculture, Forestry and Fisheries. Entry is restricted through permits issued, for a fee, by the Ministry, usually specifying the fishing area and the type of fish to be caught. The only output or catch quotas imposed on Japanese fish operators are those imposed by foreign governments on Japanese fishermen operating in foreign waters, such as those of the United States, the CIS and New Zealand.

374. The contraction of distant water opportunities, following the adoption of exclusive economic zones by countries, has meant substantial adjustment for the Japanese fishing industry, involving major reductions in fleet size. The Japanese Government has encouraged and facilitated this adjustment by providing assistance in a variety of forms, such as concessional loans and promotional activities.

375. Tariffs on fish and fish products range from free to 15 per cent, averaging 8 per cent. The main restriction on imports competing with fish caught in coastal waters is, however, import quotas on a range of marine products, including sardines, mackerel, cod, pollock, herring, scallops and squid. The quotas are managed on a restrictive basis, giving full consideration to the supply and demand conditions for the fish concerned, to ensure that surplus catches of local fish are minimized, i.e. to meet shortfalls in domestic production. Import quotas for these products, administered jointly by the Ministry of International Trade and Industry and the Agricultural Ministry, are of three types. Global quotas are supplemented by quotas allocated to a large (around one hundred) group of countries specified by MITI. Further special quotas accord preferential treatment to the Republic of Korea.

376. Import quotas for fish are usually allocated on the basis of previous import performance. New entrants may participate in a number of the quota. By sheltering the high volume seafood market from import competition, common fish prices in Japan are likely to be higher than if the quotas were removed and the domestic market opened up to import competition. According to the Japanese authorities, import quotas avoid confusion in the domestic market that would be caused by a flood of imported fish.

(v) Beverages and spirits (Table AV.6)

377. This category covers both alcoholic drinks such as wine, spirits and beers, and non-alcoholic beverages like cordials, fruit and vegetable juices. Tariffs on these products combined range from free to 44.8 per cent, averaging 25 per cent.
378. Japan introduced changes to its Liquor Tax Law as from 1 April 1989 to implement the recommendations of a GATT Panel adopted by the GATT Council in November 1987. The main changes were:

- the abolition of the ad valorem tax on whiskies/brandies, wines and certain other alcoholic beverages, and of the "grading system" from these beverages as well as taxation according to the extract content of liqueurs, etc; and

- a considerable reduction in the existing differences between taxes on whiskies/brandies and "shochu", by reducing the rate of the specific tax on whiskies/brandies and by raising that on "shochu".

379. However, as noted in Chapter IV (Section 2 (iv)), the specific rates of taxation still vary substantially among liquor types, especially between alcoholic beverages of "sake" and "shochu" and other spirits. The extent to which these taxes alter relative retail prices by imposing varying ad valorem rates across substitutable beverages, remains unclear.

380. Tariffs on beer and spirits range from free to 44.8 per cent, averaging 22.9 per cent. For wine, tariffs range from 22.5 to 35 per cent and average 27.4 per cent. However these averages exclude the fact that trade and production patterns of most alcoholic beverages are subject to specific or alternative rates (Chapter IV).

381. Following the removal, from 1 April 1992, of the import quota on orange juice, non-alcoholic beverages are now mainly assisted by a mixture of ad valorem and specific (alternate) tariffs. On fruit and vegetable juices, rates range from free to 35 per cent ad valorem (on, for example, tomato juice), with an alternate rate of 40 per cent or ¥27 per litre, whichever is greater on apple juice. Tariffs average 25.9 per cent on these products. Imported waters containing added sugar or other sweetening or flavourings, and other non-alcoholic beverages, are dutiable at either 16 or 22.4 per cent.

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41 GATT document L/6465, February 1989.

42 Arguments that the specific excise tax rate should be set at a fixed level per alcoholic content to overcome this problem may not be a solution. Substantial variations in ad valorem rates between close substitutes may still arise since beverage prices are likely to reflect other characteristics apart from alcoholic content.
382. Most products in this category are subject to regulations contained in the Food Sanitation Law. Labelling regulations also apply.

(vi) Tobacco (Table AV.7)

(a) Unmanufactured tobacco

383. Although the number of tobacco farmers has fallen from a peak of around 90,000 to currently some 35,000, tobacco growing remains an important farming activity in Japan. The land area currently devoted to tobacco growing is estimated at 25,000 hectares.

384. All tobacco leaf produced in Japan is purchased at agreed prices by the Japan Tobacco Inc. (JTI), which has the sole right to manufacture tobacco products. Although tobacco leaf has been freely importable since 1985, when the exclusive import arrangements operated by JTI were terminated, effective monopoly control over trade continues to be exercised by JTI, which continues to be the only importer of tobacco leaf, through its sole rights as a processor of tobacco products. Japanese-grown tobacco is about three times as expensive as tobacco grown in the United States and Brazil.

385. Although JTI purchases tobacco leaf, including imported leaf, according to commercial considerations, it agreed with growers in late 1989 to source at least 50 per cent of its tobacco leaf requirements domestically.

(b) Manufactured tobacco

386. Since being privatized in 1985, JTI has taken steps to rationalize its production and improve efficiency. Staff numbers have been cut from 35,000 to 24,000, and the number of tobacco processing plants has been reduced from 34 to 27. A major impetus to this rationalization was the liberalization of imported tobacco products in 1987, when tariffs were suspended for imported cigarettes. This quickly eroded higher prices for cigarettes that had existed under the previous arrangements. Imported cigarettes have increased their market share substantially since liberalization, rising from around 9.8 per cent in 1987 to 16.5 per cent in 1991.

(vii) Oilseeds, fats and oils and their products (Table AV.8)

387. Tariffs on products falling in this category range from free to 35 per cent, but are generally low, with a simple average of 4.7 per cent.
Japan has very low self-sufficiency rates in oilseeds - about 7 per cent - and relies heavily on imports, especially of soybeans and rapeseed, which are both duty free.

388. A deficiency payment scheme applies to domestic production of soybeans and rapeseed. The scheme compensates domestic producers for any shortfall in the "standard marketing price" (the producers' average selling price net of marketing costs) below the "guaranteed price" set annually by the Government. However, as imports are free from restrictions, the market price for these products reflects international levels, thereby limiting the amount of financial assistance, which amounted to some ¥11.3 billion in 1991-92 (Table V.2), increasing producer's returns to well over twice world levels.

389. Groundnuts, an important rotational crop in southern Japan, are controlled by the Government through production arrangements. Imports are covered by quotas and a tariff of 10 per cent, unless used for oil extraction in which case end-use provisions enable duty-free importation.

(viii) **Other products** (Table AV.9)

390. These categories include cut flowers and and other agricultural products of animal and vegetable origin. A number of these products are covered by import quotas, such as cannabis resins and plants, poppy straw, opium and crude cocaine on health protection grounds. Other import quotas operate to protect domestic producers, such as those on cocoa leaves, edible seaweeds and tubers of konnyaku.

391. Tariffs for these categories average around 3 per cent. Higher tariffs of 20 per cent and above are found on imports of certain lacs, vegetable saps, coral and edible seaweed. Certain edible seaweeds and prepared dog and cat food are protected with specific rates that would appear to provide substantial ad valorem assistance. Imports of cut flowers are duty free.

392. Most items are subject to sanitary and phytosanitary regulations under the Plant Protection Law and other regulations. Imports of cut flowers are required to pass inspections regarding injurious pest contamination, and must often be fumigated for controlling common pests in both Japan and the exporting country. Cut flowers are often required to undergo secondary inspection in Japan, even though they have already been
Some improvements have been introduced recently in these areas following complaints processed by the Office of the Trade and Investment Ombudsman as well as efforts made by the plant quarantine authority, resulting in a substantial increase in imports of cut flowers.

Japanese production of cut flowers and ornamental plants expanded in the early to mid-1980s; between 1981 and 1987, the combined area devoted to the three major flowers - chrysanthemums, carnations and roses - increased by 15 per cent to 5,753 hectares, corresponding to a jump in the value of production to ¥107 billion.

(3) Industry

Japan's manufacturing sector contributed 29 per cent to GDP in 1990 compared with 28 and 35 per cent, respectively, in 1980 and 1970. The growth rate of industrial output has fallen steadily since the first quarter of 1991, partly as a result of the ending of the consumption boom in Japan itself and partly due to lower export growth stemming from recession in other developed markets. Inventories, which had accumulated in 1990 and 1991, have been reduced severely; a process which is expected to continue at least until the autumn. Latest figures suggest that industrial output in May 1992 was at a level 8.7 per cent lower than a year earlier.

The most important manufacturing industries, in terms of value added, are machinery and equipment; chemicals, fertilizers and mineral-based products; metal manufacturing; transport equipment; wood, paper and printing; and textiles and clothing. These groups together account for 90 per cent of manufacturing value added (excluding food, beverages and tobacco). Energy-based industries (petroleum refining and coal) account for a further 1 per cent (Table V.7).

The structure of exports, however, is quite different. Machinery and equipment account for 43 per cent of exports as against 31.6 per cent of

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43 According to Japanese authorities, secondary inspections carried out by Japan are consistent with the procedures authorized under the International Plant Protection Convention.

44 MITI, reported in Financial Times Survey of Japan, 15 July 1992; the same article quotes Salomon Brothers Asia as expecting the inventory adjustment to continue until spring 1993.
value added; professional and scientific equipment for 6.6 per cent of exports and 1.6 per cent of value added; transport equipment for 27 per cent of exports and 11.4 per cent of value added. Together, five sectors - machinery and equipment, professional and scientific instruments, transport equipment, iron and steel, industrial chemicals and textiles - make up 89 per cent of Japan's exports of manufactures.

397. Generally, tariffs on most industrial products are low, although relatively high tariffs apply to certain products in the chemicals, wood manufactures and textiles sectors, and silk manufacture and leather goods are heavily protected, while the raw silk industry is assisted by a variety of measures, including State-trading and bilateral import quotas. All motor vehicles and parts enter Japan duty-free. Non-tariff measures (including inspection and type approval requirements) have been eased in recent years (Chapter IV).

398. Market-opening measures have been agreed upon, or are under active discussion between Japan and the United States in a number of areas, including sheet glass, motor vehicle parts and semi-conductors. On the other hand, Japan's exports of machine-tools, video equipment, and automobiles remain subject to various types of "voluntary" export restraints in main markets, principally the United States and the European Communities. Since the first review of Japan, new arrangements have been concluded with the United States on semiconductors and automobile parts and a new "consensus" with the EC on motor vehicles.

(i) Machinery and equipment (Table AV.10)

399. This category, which covers both electrical and non-electrical machinery, accounts for nearly one-third of value added in manufacturing (Table V.7). In 1990, total output in the sector was valued at US$633 billion.

400. Imports accounted for just under 10 per cent of consumption, and about one-sixth of production, or US$122 billion, was exported. For a variety of products, such as office machines, audio-visual equipment and semi-conductors, Japan is the world's leading exporter.

401. Tariffs on all electrical and non-electrical equipment are virtually free. No quantitative restrictions apply to imports. Many products are covered by the import expansion measures recently undertaken by the

45GATT Secretariat estimates based on statistics from United Nations' COMTRADE data base.
Japanese Government, and have been the topic of recent bilateral arrangements with the United States, such as on semi-conductors.

402. Japanese exports have been hampered by a number of voluntary export restrictions, implemented in response to pressures from major importing countries. Notable examples include arrangements concerning exports of machine-tools and video-cassette recorders to the United States and the European Communities. The agreement with the United States on machine tools was recently extended for two years, beginning in 1992. Under the extension, export restraints are to be phased out over two years on a number of products, such as machining centres, computer-controlled lathes, punching, milling and shearing machine tools. The restrictions on non-computer-controlled lathes, as well as on non-computer-controlled punching, shearing, and milling machine tools, under the previous arrangements expired on schedule on 31 December 1991.

The Semiconductor Arrangement

403. Under the new five-year semiconductor Arrangement signed with the United States on 1 August 1991, the Japanese Government is encouraging domestic firms to increase market access opportunities in Japan for foreign capital-affiliated semiconductor companies, in the hope that imports of semiconductors will reach, by the end of 1992, the figure of 20 per cent foreign market share mentioned in the Agreement.\(^{46}\) (The arrangement makes explicit the informal 20 per cent foreign market share figure contained in the previous 1986 arrangement.) As well as covering market access opportunities in Japan for foreign semiconductors, the five-year arrangement, which may be terminated after three years by mutual agreement, also includes measures concerning injurious dumping.

404. Both Governments have committed themselves to encouraging domestic industries to "make further efforts to increase market access opportunities in Japan for foreign capital-affiliated companies" and to improve long-term relationships between Japanese users and foreign suppliers. The Government of Japan "recognizes that the U.S. semiconductor industry expects that the foreign market share will grow to more than 20 per cent of the Japanese market by the end of 1992". The Arrangement further specifies "that the two Governments agree that the above statements constitute neither a

\(^{46}\) In a "Joint Agreement on Market Access Activities" annexed to the arrangement, the Government of Japan stated "that it is the policy of the Government of Japan to impress upon the Japanese users of semiconductors the need to make further efforts to increase market access opportunities in Japan for foreign capital-affiliated firms...." In this connection, Japan encourages firms to establish "an explicit non-discriminatory purchasing policy towards foreign products as compared with domestic products".
guarantee, a ceiling nor a floor on the foreign market share"; and that
the Japanese Government "considers that this can be realized" and "welcomes
the realisation of this expectation". The Arrangement also stipulates that
in assessing progress achieved, particular attention should be given to
market share. U.S. officials have repeatedly stated that they view the
achievement of a 20 per cent foreign market share as an important part of
the arrangement, and that appropriate corrective steps would be pursued if
the arrangement was not properly implemented.

405. The two Governments reaffirmed their commitment to the Semiconductor
Arrangement in January 1992 in the Global Partnership Plan. The Plan calls
for further efforts for increased market access for foreign semiconductors
in Japan and for the development of long-term cooperative relationships
between Japanese and U.S. companies, through measures specified in the
Arrangement.

406. Since the initial 1986 semiconductor Arrangement, the market share of
foreign semiconductors in Japan (almost totally from U.S. suppliers) has
nearly doubled to the current level of 14.6 or 16.6 per cent, depending
upon which formula is used. Moreover, as part of bilateral discussions
under the current Arrangement, Japanese and U.S. industry associations are
reported to have recently agreed to implement emergency action raising
foreign purchases over the next six months. At the same time, Japanese
firms have pointed out that foreign market share growth has been hampered
by the recent downturn in domestic demand for computers. Several Japanese
computer firms have complained that foreign supplies are up to 50 per cent
more expensive than Japanese ones and suffer from long delivery times.

407. Under the new Arrangement, the Japanese Government, in order to avoid
"injurious" dumping by Japanese companies, has agreed to ensure that
semiconductor exporters collect and maintain company and product-specific

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47 Under the Arrangement, in making an overall assessment of progress, the two
Governments will take into account not only market share but also other important
quantitative and qualitative factors, including the development of foreign semiconductor
design-ins and long-term relationships between Japan and foreign companies.


49 These statements would appear to be consistent with a number of studies concluding
that the recent dominance of the Japanese computer industry in world trade reflects
efficiency and competitiveness advantages enjoyed by Japanese suppliers. Bowander and Miyake
have concluded, for example, that "Japanese competitiveness in computers is due to a
combination of favourable conditions in factor endowments, demand conditions, industry
structure and related industries, which are synergistic. Japanese firms have used mostly
market-confirming mechanisms and a variety of institutional approaches which have lower
transaction costs". B. Bowander and T. Miyake, An Analysis of the Competitiveness
costs and prices on products exported to the United States. If an anti-dumping action is initiated by the United States on these products, the Government of Japan is to encourage the relevant exporters concerned to provide the US the data within 14 days of being requested. The two Governments also reserved their right to take action against injurious dumping in a third country market, in accordance with the relevant provisions of the GATT and the Anti-Dumping Code.

408. On the entry into force of the new Arrangement, unilateral measures taken by the United States under "Section 301" against Japan were suspended. These had been introduced in 1987, on the ground that Japan had failed to comply with the previous arrangement's market access provisions. The measures had consisted of 100 per cent tariffs on Japanese laptop and high-performance desktop computers, electro-pneumatic hammers and colour televisions.

409. Under the suspension agreement on EPROM semiconductors which was extended following the new Arrangement, the United States can impose anti-dumping tariffs without conducting a full investigation, if the Department of Commerce judges that EPROM chips are sold at less than fair value. Japanese producers, which recently marketed a new type of "flash memory" chip, have disagreed with the decision taken last October by the U.S. Commerce Department to classify these chips as EPROMs. According to Japanese firms, this decision will effectively curb exports of flash memories to the United States.

(ii) Chemicals, fertilizers and mineral products (Table AV.11)

410. The sector contains all industrial chemicals, including organic and inorganic chemicals, pharmaceuticals, fertilizers, cosmetics and plastic products. Also included are mineral products, such as cement and glass manufacture. Overall, the sector contributed around 15 per cent of manufacturing value added in 1990 (Table V.7). About one-fifth of domestic consumption came from imports, and around 10 per cent of production was exported. Japan is a net importer of chemicals and chemical products.

411. The mainstay of the Japanese chemical industry, the petrochemicals industry, relies heavily on imported petroleum feedstock, especially naphtha, from the Middle East. Such imports enter into Japan under a duty-free end-use tariff concession. Ethylene production, buoyed by domestic demand, has increased in recent years and a number of new plants have been commissioned.

412. Tariffs on chemicals range from free to 25 per cent, but average a relatively low 4 per cent. Higher tariffs of above 10 per cent are restricted to a few products, such as 24 per cent on citric acid, and
alternative duties with minimum ad valorem rates of 22.4 and 25 per cent, respectively, on menthol and certain dextrines and starches.

413. Import quotas are maintained on several organic chemicals, medicaments and pharmaceutical products for animal and health protection. Import quotas also apply to fissile chemical elements and explosives for national security reasons.

414. Most chemicals are subject to either health or security regulations under the Poisonous and Deleterious Substance Control Law, the Law Concerning the Examination and Regulation of Manufacture, etc. of Chemical Substances and the Pharmaceutical Affairs Law. Japan has made considerable steps to improve its chemical certification and standards system, including cosmetics and pharmaceuticals. Domestic producers and importers of fertilizers are requested to have prior registration or notification of the quality of fertilizers to be produced or imported under the Fertilizer Control Law. Once the registration or, in the case of imports, the notification of a fertilizer has been accepted, there are no restrictions on its production or importation.  

415. Under the Law on Temporary Measures for Facilitating Industrial Structural Adjustment, excess capacity of about 10 million tons had been scrapped so as to increase the industry's competitiveness in the face of cheaper imports from South Korea and Taiwan. In May 1991, the Government rescinded the legislation. This led to considerable rationalization in the sector; two of the five marketing groups formed under earlier legislation were disbanded.

416. The Japanese market for sheet glass is dominated by three local producers, Asahi Glass Co. Ltd, Nippon Sheet Glass Co. Ltd and Central Glass Co. Ltd, with estimated market shares of around 50, 30 and 20 per cent, respectively in 1991. Some 5 per cent of the market is met from imports. Allegations have been made by one foreign flat glass manufacturer that imports are being effectively excluded by the tight controls exercised by these firms over domestic distribution networks.

417. This matter was discussed during the Japan-United States SII talks and was again raised in the context of the Global Partnership Action Plan in January 1992. The Japanese Government agreed to implement steps to substantially increase market access for competitive foreign firms making efforts to export flat glass to Japan, including in particular:

50Registration is usually completed within 45 days from application.
MITI to facilitate the efforts of foreign firms to increase exports to Japan;

MITI to encourage Japanese firms to increase imports of flat glass under the import expansion programme;

MITI and the Fair Trade Commission to encourage Japanese glass manufacturers to implement anti-monopoly compliance programmes by February 1992, aimed at ensuring that the Japanese distribution system is open to competitive foreign suppliers; and

an appropriate exchange of information between the two Governments.

418. As a follow-up to these agreements, the Fair Trade Commission is currently undertaking a survey of competitive conditions in the Japanese glass market, and the Ministry of Construction is taking steps to assist foreign exporters in meeting Japanese building standards for glass.

(iii) Ores, minerals and metals (Table AV.12)

419. The metal industries, taken together, contributed some 15 per cent to manufacturing value added in 1990 (Table V.7). Iron and steel contributed some 6 per cent, non-ferrous metals 2 per cent, and fabricated metal products a further 7 per cent. Having few natural resource endowments, Japan is relatively dependent on imports of processed and semi-processed mineral and metal products. In 1990-91, Japan imported almost all its requirements of ores and metallic raw materials, representing some US$42 billion.

Steel

420. As an efficient exporter of steel, Japan's tariffs on steel products are generally relatively low with only mild escalation present, ranging from free to 7.7 per cent and averaging 4.0 per cent. The share of imports of steel in domestic consumption has been some 8-9 per cent in recent years.

421. Japanese steel exports have been heavily influenced over many years by voluntary undertakings made at the request of major importing countries, such as the United States and the EC, as well as other trade barriers, such as anti-dumping actions, implemented by these and other parties. In 1990, Japanese exports amounted to US$12.6 billion; below the 1980 level. In volume terms, steel exports sank to their lowest level in 21 years, 17 million tons, in 1990-91. Japan's declining share of export markets has
recently been exacerbated by the recessions in most major markets. Annual production of crude steel was 110.3 million tons in 1990, an increase of 2.3 per cent as compared to the preceding year.

422. Although formal voluntary export restraints on Japanese exports to the European Communities and United States were terminated in 1990 and 1992, respectively, Japanese steel exports continue to be subject to potential obstructions. In the United States, termination of the voluntary export restraint arrangement has coincided with a surge in anti-dumping complaints from U.S. steel producers. The dumping suits claimed dumping margins on four products covering an estimated 40-50 per cent of Japan's steel exports to the United States - hot- and cold-rolled sheets, galvanized sheets and steel plates - ranging from 7.5 to 18.2 per cent.

423. Japan supports the formation of the Multilateral Steel Agreement and is keen to see these negotiations, currently hampered by a disagreement between the United States and the EC concerning production subsidies, concluded.

Non-ferrous metals

424. Production of non-ferrous metals in Japan consists mainly of smelting of copper, zinc and lead. Imports of non-ferrous metals, especially of aluminium ingots, have grown in importance over recent years, and account for over one-quarter of domestic consumption.

425. Ad valorem tariffs on imports of non-ferrous metals average 3.5 per cent, ranging from free to 11.7 per cent. However, with the main exception of aluminium, most imports of non-ferrous metals - copper, lead and zinc - bear specific tariff rates, including sliding scale duties, applied to imports below certain nominated import prices (Chapter IV). Ad valorem equivalents for 1991 ranged between 3.1 and 9.5 per cent.

426. The smelting industry in Japan has undergone somewhat of a resurgence since 1990 due to increased demand, mainly from electrical users for copper, and from the automotive industry for zinc-plated sheets. Production of copper ingots rose by 7 per cent in 1991 to just over 1 million tons, and zinc and lead ingots increased by 6 and 4.4 per cent, respectively. Non-ferrous producers have reacted by enlarging domestic smelting capacity, and have increased acquisitions of overseas mines. The international competitiveness of Japan's non-ferrous smelting industries,

51 Japan's world ranking as an exporter of iron and steel slipped to second position behind Germany in 1990.
which are intensive users of energy, is adversely affected by high electrical power costs in Japan.

427. This category also covers fabricated metal products, like cutlery, tools and containers, but not machinery. Tariffs on these products range from free to 8 per cent, and average a low 1.6 per cent.

(iv) Transport equipment (Table AV.13)

428. Production of transport equipment, mainly motor vehicles and ships represented some 11 per cent of manufacturing value added in 1990 (Table V.7). Exporting almost one-quarter of its production, Japan is the world's leading exporter of automotive products. Japan's shipbuilding industry is also one of the largest in the world, accounting for almost half of world production in recent years.

429. All transport equipment enters duty-free and free from quantitative restrictions.

Conditions in the automobile sector

430. Exports of automobiles from Japan increased in value by around two-thirds over the period 1985 to 1990. However, their share of world vehicle exports fell from 36 to 31 per cent. During this period, the share of Germany, the other leading exporter of motor vehicles, increased from 27 to 29 per cent, largely due to growth in intra-EC trade, while that of the United States declined from almost 9 per cent to well under 8 per cent.

431. Japan's impressive export performance in automotive products reflects its strong international competitiveness (Note V.5). Exports of motor vehicles by Japan have, probably more than in any other product group, been affected and conditioned by bilateral arrangements with major external markets. Automotive exports to the United States have been subject to voluntary export arrangements since 1981. These were initially requested by the U.S. Government as a means of protecting domestic industries; since 1985, they have been maintained unilaterally by Japan. A consensus was also reached in 1991 with the European Communities on a transitional régime for the import of motor vehicles from Japan, for the period up to 1999, which incorporates and builds on previous national restrictions or industry-to-industry agreements. The consensus foresees full liberalization of EC imports from 1999.

Export restraints to the United States

432. In the period under review, Japan maintained its voluntary export restraint on automobiles to the United States. The limit was maintained at 2.3 million vehicles (in force since 1985) up to fiscal year 1991/92. Reflecting declining exports to the U.S. market, MITI announced in March 1992 that the limit would be lowered to 1.65 million units for the fiscal year 1992/93. Export restraints were to be implemented through directives to individual companies, a monthly reporting system by the companies and, if necessary, through export approval under the Foreign Exchange and Foreign Trade Control Law.

433. Japan's decision to extend the VER reflected the Government's view that "the major U.S. automobile manufacturers are facing serious business difficulties". According to the Japanese Government, this decision was "based on the recognition that the automobile industry is one of the industrial pillars of both Japan and the United States, and that healthy development of the automobile industry in both countries is vital to advance further the good relationship between the two countries and maintain the overall free trade system".

434. The annual export ceiling for 1992-93 is below both the previous limit and the level of 1.73 million cars imported by the U.S. from Japan in 1991-92. Based on calendar-year 1991 sales in the United States, the new annual export ceiling of 1.65 million vehicles provides for a maximum market share for Japanese imports of 20 per cent.

435. Export entitlements are allocated by MITI based on a number of criteria, including historical export performances of companies. Under the new export ceilings for 1992-93, MITI increased export entitlements for Isuzu Motor Company, an affiliate of General Motors Corporation, and Fuji Heavy Industries Company, makers of Subaru vehicles, from 93,100 to 100,000 and from 51,158 to 70,000 cars, respectively. Export entitlements were reduced for all other exporters (Toyota, Nissan, Honda, Mitsubishi and Mazda).

436. In the "Global Partnership Plan" concluded between President Bush and Prime Minister Miyazawa in January 1992, bilateral concerns continued to be

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53 Whether this will result into a real tightening of the export restriction will depend largely on the growth in the market for vehicles in the United States. If, due to the recession, the market continues to contract, actual imports in 1992-93 may fall below this figure. However, if the market outlook improves or holds steady, it is likely that the export restriction will become binding. U.S. car producers benefit from the assurance of knowing that any substantial turnaround in the U.S. market would be reserved for them.
pursued by the United States with the Japanese Government, in an attempt to address Japan's substantial surplus on automotive products (which accounts for some three-quarters of Japan's overall merchandise trade surplus with the United States). Japan announced that it would expand and strengthen tax and financial incentives to promote imports, and foreign investments in the Japanese market, with a view to promoting the "Initiatives for Business Global Partnership". At the same time, the VER on vehicle exports from Japan is now mirrored by voluntary purchasing undertakings by Japanese manufacturers designed, inter alia, to boost U.S. exports to Japan, especially of automotive parts.

437. Voluntary announcements by Japanese automobile manufacturers or purchasers of U.S. auto parts were made on the premise that U.S. part suppliers will make their best efforts in return and that automobile production by Japanese affiliates in the U.S. would increase by 50 per cent from FY 1990 to FY 1994. The following specific objectives are included:

- Automobile parts procurement by U.S. manufacturing facilities of Japanese affiliates from U.S. suppliers is expected to more than double from about US$7 billion in FY 1990 to about US$15 billion (in real terms) in FY 1994;

- The share of local U.S. procurement in total purchases of parts is expected to increase from about 50 per cent in FY 1990 to about 70 per cent in FY 1994. By contrast, the percentage of imports from Japan is expected to decrease from about 50 per cent to 30 per cent;

- In making these procurements, special consideration will be given to the U.S. parts industry, which is currently under a difficult situation;

- Japanese imports of parts from the United States are expected to double from US$2 billion in FY 1990 to US$4 billion (in real terms) in FY 1994;

- Japanese automobile manufacturers, including some of those who have not handled U.S. automobiles so far, have expressed their willingness to help expand the sales of U.S. automobiles. They made it clear that, in addition to U.S.-brand automobiles, the
import of U.S.-manufactured Japanese-brand automobiles is estimated to rise substantially. 438. Both Governments have also announced the implementation of actions with these objectives in mind. The Japanese Government announced that it "will actively increase opportunities for the sale of foreign automobiles, through such measures as budgetary allocations (US$6.3 million in FY 1992) for example holding foreign automobile shows in Japan ... and expand and strengthen tax and financial incentives to promote imports and foreign investments in the Japanese market". The U.S. Administration, for its part, stated "that it was committed to an economically viable U.S. automotive industry and to increasing exports of U.S. vehicles and auto parts to Japan ... and recognized the benefits of cooperative efforts to promote trade of automobiles and auto parts in an effort to address trade imbalances".

439. The Global Partnership Plan of Action also referred to the resolution of standards and certification issues, under the Office of the Trade and Investment Ombudsman, concerning exports of U.S. cars. Six of the fourteen outstanding issues were resolved in bilateral talks prior to 1 January 1992. Another six are in the process of being resolved, while the remaining two are expected to be resolved. The Japan Fair Trade Commission is also conducting a survey into the competitive practices of the Japanese motor vehicle sector. 55

Consensus on automobile trade with the European Communities

440. In July 1991, Japan and the European Communities concluded a consensus with the expressed aim of "the progressive and full liberalization of the EC import régime on motor vehicles with avoidance of market disruption and, through an appropriate transitional period, to facilitate structural adjustments that may be required of EC manufacturers to achieve adequate levels of international competitiveness". 56

54 Global Partnership Plan of Action, Item XII. Other aspects dealt with in the plan include promoting design-in, expanding R & D centres in the United States and assisting U.S. parts suppliers to develop long-term business strategies.

55 An interesting aspect of Japan's motor vehicle registration requirements is that they allow left-hand drive vehicles to be registered without special arrangements.

56 GATT document L/6922, 16 October 1991. "Vehicles" include cars, off-road vehicles and light commercial vehicles. Germany separately communicated its reservations to the consensus, noting that its agreement was given on condition that: (i) all measures would expire on 31 December 1999; (ii) EC-wide monitoring would only be a statistical record; (iii) Japanese investment in the relevant fields would not be discriminated against; and (iv) car imports from other third countries would remain unaffected (GATT document L/6924). (Footnote Continued)
441. The consensus commits Japan, from 1993, to monitor total exports to the EC and to certain member States in order to ensure that Japanese exports to the EC in 1999 do not exceed 8.1 per cent of assumed total demand in that year (equivalent to a quota of 1.23 million units). This is below the volume of exports to the EC in FY 1991 of 1.25 million vehicles. The transitional arrangements are to be terminated at the end of 1999. On the basis of this agreement, the EC undertook to abolish, by 1 January 1993 at the latest, the residual national restrictions on the importation of motor vehicles from Japan, including measures authorized under Article 115 of the Treaty of Rome.

442. The consensus (full details of which have not been published) explicitly excludes any restrictions on Japanese investment or any limitations on vehicles produced in Japanese brand-name plants within the Communities. The Commission's "working assumption" is said to have been that, by 1999, Japanese brand-name plants within the Communities would be producing almost as many vehicles as would be imported from Japan.

(Footnote Continued)

22 October 1991). The United Kingdom Department of Trade and Industry has also given the view that, if the British Government did not wish VERs to remain in force for the U.K., nothing in the EC consensus would prevent this (Monopolies and Mergers Commission (1992), p.5).

57 Estimated 1999 export levels for Japan to the five markets in question are: France, 150,000 units (5.3 per cent of the market); Italy, 138,000 (5.3 per cent); Spain, 79,000 (5.4 per cent); Portugal, 23,000 (8.4 per cent); and the United Kingdom, 190,000 (7 per cent). The share of the remaining Community markets allotted to exports from Japan would be 12.5 per cent.

A number of studies have attempted to explain the factors behind Japan's success as a motor vehicle exporter. Some studies have concluded that, although Japan's comparative advantage in motor vehicles reflects a combination of factors, the most important was the development and refinement of more efficient production techniques enabling the realization of substantial cost economies. A study undertaken at the Massachusetts Institute of Technology (Womack et al. 1990) identified "lean" production techniques as significant advancements on the mass production system upon which the growth of the U.S. car industry was based. According to the study, lean production achieves the highest efficiency, quality and flexibility when all activities from design to assembly occur in the same area. Japanese producers have effectively combined "just-in-time" production systems as well as efficient links with component suppliers and other factors to develop lean production.

The MIT study confirmed that, despite substantial variation in productivity and quality levels between countries and plants, Japanese plants in Japan were, on average, superior in these respects to plants located in the United States, especially American-owned plants. The study also concluded that Japanese plants (both at home and in the United States) were noticeably superior to European plants. Japanese firms located in the United States performed, on average, about one-quarter less efficiently than Japanese firms in Japan, and about double the efficiency of U.S.-owned plants. Differences in quality control were also found, with Japanese firms, on average 5 per cent better than Japanese firms in the United States and double that of American firms.

The highly competitive nature of the Japanese car industry is also supported by studies that have attempted to compare the prices of identical cars sourced from various countries, including Japan. A recent study commissioned by the Monopolies and Mergers Commission of the United Kingdom, for example, compared list prices in the United Kingdom with the landed duty-free price of corresponding models imported from the United States and Japan. It concluded that, on average, U.S.-made Japanese cars imported into the United Kingdom were 17 per cent more expensive than those imported from Japan. Higher price differentials of 39 per cent were found between Japanese cars produced in the United Kingdom and those imported from Japan. Such differences in prices, as well as indicating the substantial price effects of export restrictions operating on the U.S. and EC markets, supports the view that Japanese manufacturers are, by and large, more competitive than their U.S. or EC counterparts.

Despite the relative competitiveness of Japan's motor vehicle industry, imports of European luxury cars have successfully penetrated the Japanese market, growing almost tenfold in value since 1985. BMW, for instance, entered the Japanese market in 1981 by establishing a sole agency in Japan. BMW exports to Japan have grown every year and, together with Mercedes-Benz, are the top cars imported into Japan.
Wood and paper products (Table AV.14)

443. Japan is one of the world's leading producers and users of wood-based products. In 1990, the wood, paper and printing sectors accounted for over 10 per cent of value added in manufacturing; almost 56 per cent of this was due to the printing industry (Table V.7). Imports of processed wood products (including paper and printed goods) amounted to US$10 billion and accounted for around 10 per cent of domestic consumption. The main export was paper products, equivalent to US$2 billion in 1990.

444. National forests in Japan are managed by the Forestry Agency. About one-third of Japan's forests are national forests; trees are sold to private loggers either by tender or through negotiations. The Agency is also responsible for administering private and public forests. Around half of Japan's total area of forests is in the form of plantations containing relatively young trees, due to mature early in the 21st century. National long-term planning of forest industries is implemented following demand and supply projections made in the framework of the Forestry Basic Law. Japan's forest and forestry policy is currently aimed at improving forest infrastructure, technology, distribution systems and workers' welfare. Government-related financing corporations provide concessional loans for forest planting and upgrading. US$43.1 billion was provided by the Agriculture, Forestry and Fisheries Financing Corporation in 1990-91.

445. Japan is the world's largest wood importer and some 70 per cent of its wood requirements are sourced overseas. Japan mainly imports relatively unprocessed wood, such as logs, woodchips and pulp, for further processing. The timber processing industry produces the fourth largest output of sawn timber in the world. Sawmills range from small rural concerns processing domestic logs, to large enterprises, located near major ports processing imported logs. The plywood industry, for example, processes hardwood logs imported mainly from South-East Asia. Import liberalization stemming mainly from Tokyo Round tariff cuts reduced the degree of tariff escalation and exposed the sector to greater import competition. The industry has undergone some rationalization as a result.

446. In the same context, protection to wood processing industries has also declined; in the past, there was substantial tariff escalation. Reduced tariffs on timber products have exerted considerable pressure for structural adjustment and industry rationalization. Government policies have in recent years aimed at facilitating these more fundamental changes through schemes aimed at improving the competitiveness of Japan's forestry sector. In 1991-92, some ¥427 billion (Government basis) was appropriated to the forestry sector to finance expenditure on erosion control, construct forest roads, afforestation projects and other activities designed to improve forest practices and productivity.
447. Nevertheless, tariff escalation by stage of processing is still present in some areas of the forest products sector. Wood in the rough enters duty-free. Wood sawn lengthwise and veneer sheets bear duties from zero to 10 per cent. Boards (particle board etc.) and plywood bear tariffs between 3.5 and 15 per cent. Builder's carpentry bears rates of up to 10 per cent. Pulp, paper and paperboard manufactures bear tariffs ranging from zero (for wood pulp) to 9.6 per cent.

448. Japan is one of the top world producers and consumers of pulp and paper. The industry developed based on imports of woodchips and market pulp. It currently suffers from overcapacities as a result of recent investments in new factories coming on-stream simultaneously with a slump in market demand for high-quality and coated papers. The depressed situation follows an earlier upturn which resulted in the pulp and paper industries being removed from the list of industries covered by the Temporary Measures Law for the Structural Adjustment of Specified Industries.

449. Given the country's dependence on imported timber, an aspect that is of particular concern to Japan is the growing tendency for major timber-exporting countries to apply export restrictions, including prohibitions, to promote greater domestic value added and, it is claimed, to contribute to forest conservation. Higher international log prices in response to reduced supplies on the world market and the possibility of lower world prices for certain processed wood products, are subjecting Japanese wood processors to greater competitive pressures.

450. Market access in paper products was discussed recently under the Global Partnership Plan. The Plan foreshadowed cooperative and intensive consultations between the Japanese and US Governments designed to agree on measures substantially to increase market access for foreign firms exporting paper products to Japan. In April 1992, a five-year agreement was concluded between the United States and Japan, in which an import expansion programme for foreign paper products was initiated. Moreover, the Japan Fair Trade Commission is currently conducting a survey on competitive conditions in the paper sector.

(vi) Textiles and clothing (Table AV.15)

451. Japan's textiles and clothing industry, which has undergone considerable contraction and restructuring over recent years, is currently experiencing a resurgence in some areas. In 1990, textiles and clothing represented almost 5 per cent of value added in manufacturing (Table V.7). Japan remains, however, a net importer of these products. Imports of clothing accounted for about one-fifth of consumption in 1990 and some
one-tenth for textiles. Combined imports of textiles and clothing amounted to around US$13.8 billion in 1990, with exports of some US$7.2 billion.

452. Tariffs on textiles average 10 per cent, the highest being 20 per cent on certain cotton textiles. Clothing tariffs average 13 per cent, with the highest rates being 16.8 per cent. Most textiles and clothing imports are covered by the GSP scheme, unlike in most other developed countries. Although Japan is a member of the Multilateral Fibre Arrangement (MFA), it has never invoked any unilateral measures or concluded bilateral agreements to restrict imports of textiles and clothing and maintains no quantitative restrictions under the MFA.

453. Prior to the 1970s, Japan was the world's largest exporter of cotton products and textiles was one of Japan's leading industries. However, with the emergence during the late 1960s and 1970s of newly efficient ASEAN producers and the advent of synthetic fibres, the Japanese textile and clothing industry contracted. Growing import competition from lower-wage ASEAN producers placed considerable competitive pressures for structural change on the Japanese textile and clothing industry.

454. Rather than following most other developed countries by retarding structural change through import restrictions under the MFA, Japan resisted considerable pressure from domestic producers and allowed greater import competition. Structural adjustment was, at the same time, facilitated by the provision of substantial restructuring assistance under various Structural Improvement Programmes. The current programme (up to 30 June 1994), administered by the Textile Industry Rationalization Agency, provides adjustment assistance through grants and concessional loans to small and medium firms wishing to modernize production facilities. Although structural assistance has continued for a long period, it has been combined with a high degree of import and domestic competition.

455. Raw silk and silk products are the main exception to Japan's liberal import policy for textiles, although silk clothes are liberally imported. The import control measures for raw silk, which operate so that imports match shortfalls in domestic production, aims at protecting both the raw silk manufacturing industry and domestic sericulture, which remains an important activity in mountain regions, and promoting the demand for raw silk.

456. Under the Raw Silk Price Stabilization Law, the Japan Raw Silk and Sugar Prices Stabilization Agency intervenes in the market to buy and sell raw silk to maintain the producer price within a pre-determined price stabilization band. The formula used to fix the annual price band takes into account several factors, the most important being movements in supply and demand, as well as production conditions. When the raw silk price
falls under the lower level, the Agency purchases raw silk from processors, who have guaranteed to pay cocoon producers the standard cocoon price. When the raw silk price rises above the upper level, the Agency sells raw silk to silk fabric manufacturers or wholesale traders.

457. The Agency also has centralized rights to import raw silk. The operation of the Agency is funded by the Government and the sericultural industry. Imports of silk-related items are controlled through long-standing bilateral agreements with China and the Republic of Korea which, at the request of Japan, maintain orderly export arrangements for silk and silk products sold to Japan. In order to secure implementation of such bilateral agreements, imports of silk and silk products are under certain import procedures, i.e. prior confirmation.

458. The protective arrangements for silk and silk products have significantly raised and stabilized domestic prices by effectively curbing imports of raw silk. The industry has continued to contract. Falling demand resulted in the closure of 155 raw silk manufacturers between 1981 and 1991, and a fall in the number of silk farmers from 150,000 to 44,000 in the same period, with farm incomes declining by 23 per cent. 59

459. Japan maintained a bilateral agreement under the MFA to limit exports of textiles and clothing. The latest agreement expired on 31 December 1991. It set aggregate export limits for six product categories. In addition, Japan maintains a number of voluntary export restraints on certain textiles and clothing under the Export Trade Control Order. They mainly include exports of certain clothing to Canada; and exports of certain fabrics made of synthetic fibres and cotton fabrics to the EC, and of accessories to the United Kingdom.

(vii) Energy products (Table AV.16)

Coal

460. The Japanese coal industry has declined steadily over many years, aided by successive assistance programmes to ease the resulting structural adjustment problems. The Eighth Coal Policy ran from 1 April 1987 to 31 March 1992. Under this programme, domestic coal production declined from 15 million tons to 8 million tons, the number of mine employees from

59 According to the Japanese authorities, domestic production of raw silk has been falling owing to changing fashion demands (e.g. falling demand for kimonos) and rising imports of silk textiles and clothing. The increase in price for raw silk is regarded as a minor element.
20,000 to 7,000, and the level of coal imports continued to rise to 11,300 million tons, accounting for over 90 per cent of Japan’s coal needs.

461. Import quotas, initially set at zero for steaming coal, have been steadily liberalized. As adjustment proceeded, import quotas were removed on coal types no longer produced domestically. For example, import quotas on heavy coking coal were lifted in 1964 and on anthracite in 1978. The last remaining quotas on imports of steam coal, which started in 1974, were terminated on 31 March 1992. Coal imports are now only covered by the prior confirmation system as a means of collecting data regarding coal imports.

462. To facilitate structural adjustment of the coal industry, the Government has financed a number of programmes, at a total cost of ¥15.2 billion up to 1991-92. Similar grants are expected to continue under the new Future Coal Policy, which has been referred to by the Government as the final stage in the adjustment of the coal industry, up to FY 2001. This has included the revival of eight laws relating to the coal mining industry, including the Law on Extraordinary Measures for the Rationalization of the Coal Mining Industry. These grants are funded from duties collected from imports of crude oil and related products.

463. The electric power generation industry is the main user of domestic coal. Coal prices are determined by negotiation between the coal companies and the power generating companies, taking into account guidelines set annually by Ministry of International Trade and Industry. In practice, prices follow these guidelines very closely and are set well above import levels. For example, the average price for domestically-produced steaming coal in 1990-91 was ¥17,170 per ton, compared with an average c.i.f. price of imported coal of ¥7,620 per ton. Based on current production of around 8 million tons, this implied an annual transfer in the vicinity of ¥80 billion from the electricity generating companies to coal mining firms.

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60 Before commencement of the first coal policy (FY 1962 - FY 1965) coal production was 54 million tons in FY 1961.

61 GATT document MTN/SB/RBN/11.

62 These have covered grants for modernization of coal pits (¥4.2 billion); grants for stabilizing the coal industry (¥5.7 billion); grants for safety measures (¥3.3 billion); grants for paying off interest on loans used to finance surplus coal stockpiles (¥2 billion); and grants for downsizing coal mines (¥0.02 billion).
464. Given the trend towards increased coal imports, Japanese companies are increasing their participation in overseas coal development. Japan's comparatively expensive domestic coal industry will continue to shrink and the development of diversified foreign coal reserves has become essential.

Petroleum

465. Japan has few petroleum resources of its own and is heavily dependent on imported petroleum raw materials. It is the world's largest importer of natural gas, and the second largest importer of crude oil. Low specific duties are applied to imports of crude petroleum and natural gas.

466. Japan's very limited production of crude oil is mainly of the heavy type, not suitable for refining but used as industrial oils by industries, such as power generation. Imported heavy fuel and raw oils, competing with domestically-produced crude and not intended for refining, are subject to tariff quotas of these products set based on demand and supply projections. Imports of these products are thereby limited to meet shortfalls in domestic production. This is assured by setting the above-quota tariff at a high rate of ¥3,780 per kl, as compared to in-quota rate ranging between ¥2,540 and ¥2,790/kl. As noted above, revenue from duties on petroleum has been used to finance adjustment programmes for coal.

467. Imports of certain petroleum products are also subject to special end-use provisions. Granting concessional duties to imports intended for special uses, such as the production of ammonia and other petrochemicals.

468. The Japanese petroleum industry is regulated under the Petroleum Business Law, so as to ensure stable marketing arrangements. Wholesale prices are controlled by MITI on a monthly basis, through approvals to engage in the oil-refining industry and notifications to import crude oil and processed petroleum products. These arrangements, together with MITI's administrative guidance, have protected the Japanese petroleum refining industry by limiting imports of refined petroleum products to the shortfall between domestic production and consumption, and therefore effectively excluding import competition.

469. Several cases have been reported where MITI has exercised administrative guidance to control imports of petroleum products. While importation of gasoline and other petroleum products may, in principle, be unrestricted, their importation is effectively precluded. Furthermore,

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63 e.g. Matsushita (1992).
following the Middle East crisis, petroleum companies have complied with MITI's wishes to reduce imports of refined products, in line with its decision to allow oil refiners to boost refining capacity for the first time in eighteen years.

470. Consumption of heavy oils used in agriculture, forestry and fishing industries is exempt from the petroleum tax of ¥ 2,040 per kl. Most of this concession - equivalent annually to ¥ 3 to 4 million - benefits the fishing industry.

471. Some recent steps have been taken to deregulate the petroleum industry. Production quotas on crude oil refining are to be terminated during 1992-93. Their removal will enable refineries to produce their own determined quantities, thereby increasing potential competition on the domestic market, albeit at regulated prices while still effectively controlling import competition.

(viii) Leather, footwear and travel goods (Table AV.17)

472. Production of leather products and footwear in Japan accounted for less than half of one per cent of manufacturing value added in 1990. Exports are minimal while imports, which account for over one-quarter of consumption, amounted to US$3 billion in 1990.

473. Domestic production of leather footwear is protected by tariff quotas on almost all imports. Above-quota alternate tariff rates of 60 per cent or ¥4,800 per pair (equivalent to 63.9 per cent in 1991), whichever is the greater, compare with duties of either 21.6, 27 or 30 per cent on footwear imported with the quota. Although import quotas have been increased substantially in recent years, significant (but declining) above-quota imports indicate that the quota remains operative. This suggests that the level of assistance is set, not by the lower in-quota tariffs, but by the much higher above-quota rate which, being an alternate tariff, is likely to be providing unequal assistance (minimum of 60 per cent) across differently priced footwear.64

64 The distortive impact of the tariff quota on Japan's production, consumption and trading patterns would be exacerbated by the extent to which so-called "quota migration" may be widening assistance disparities across different footwear types. The tariff quota arrangements could be encouraging more expensive shoes to be imported within the quota (where duties are the lowest), and increasing sale prices to a relatively greater extent for cheaper types of footwear imported outside the quota. This would tend to encourage resources into the production of relatively cheaper shoes, while consumption would be distorted towards higher price of footwear.
474. Japan unilaterally increased its tariff quota on footwear imports to 4.83 million pairs in 1991-92, compared with 4.12 million pairs in 1990-91. The quota level has been set at 5.796 million pairs for 1992-93.

475. Some of the assistance given to footwear manufacturers simply offsets the protection provided leather production in Japan. Treated leather in Japan is also assisted by tariff quotas with in-quota rates of mainly 20 per cent and above-quota rates of 60 per cent. Consequently, a substantial share of the assistance provided footwear manufacturers is likely to flow back, through higher hide prices, to hide processors and cattle farmers. Thus, the entire leather industry from the raw hide through to finished footwear, is assisted by these arrangements.

(ix) Other products (Table AV.18)

476. This heterogeneous category includes mainly rubber and rubber products, photographic and cinematography supplies, furniture, musical instruments and sound recording apparatus, toys, works of art, firearms, office and stationery supplies as well as other manufactured articles.

477. With the exception of firearms, where the average tariff is 8.6 per cent, tariffs for these product areas fall well below 5 per cent. Tariffs are nearly entirely ad valorem rates.

478. A number of products, such as rubber adhesives containing more than 5 per cent benzene, firearms and parts, are subject to import quotas. Many products are subject to health and safety regulations.
Producer and consumer subsidy equivalents have been developed by the OECD as standard quantitative techniques for measuring and monitoring levels of assistance provided to farmers by agricultural policies. The concept has recently been refined to provide the Nominal Assistance Coefficient, which gives a more complete indicator of the economic distortions created by agricultural assistance policies. This Annex provides a brief survey of these concepts and their use in assessing the economic effects of protection, including their relationship to the measure of Effective Rate of Assistance, developed as a means of assessing the resource efficiency implications of government assistance to industries.

1 Producer and Consumer Subsidy Equivalents

The producer subsidy equivalent (PSE) measures the value of the income transfers to producers generated by agricultural assistance policies. It covers transfers through market price supports (which normally cause domestic producer prices to be higher than world market prices) as well as transfers from taxpayers through direct and indirect government subsidies. It is therefore equivalent to the subsidy that farmers would need to be paid to maintain their gross revenue if all other assistance were removed. The higher the PSE, the more heavily assisted are farmers and the relatively worse off are consumers and/or taxpayers. The PSE (in the case of livestock, net of assistance on feedstocks) is:

\[
\text{PSE} = Q(DP - WP) + S - LV - FA, \quad \text{where}
\]

- \(Q\) = volume of production
- \(DP\) = domestic producer price
- \(WP\) = world price
- \(S\) = government subsidies (direct payments plus all other budgetary support)
- \(LV\) = production levies
- \(FA\) = feed adjustment (livestock only)

The PSE can also be expressed on a per unit of production basis, or as a percentage of the total value of production (valued at domestic prices) adjusted for direct payments and levies.

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1 For a detailed exposition of the PSE and CSE concepts, see OECD, Committee for Agriculture and Trade, Agricultural Policies, Markets and Trade: Monitoring and Outlook 1992, Assistance to OECD Agriculture, March 1992.
The consumer subsidy equivalent (CSE) is the value of transfers from domestic consumers to producers and to taxpayers (e.g. through tariff revenue paid on competing imports) resulting from agricultural assistance policies. It therefore measures the implicit tax imposed on consumers by agricultural assistance. For this reason, the CSE is usually expressed as a negative figure. The larger the negative number, the greater the implicit tax on users and the transfer from consumers.

The CSE is estimated as:

$$\text{CSE} = - QC(DP - WP) + OT,$$

where

$$QC = \text{volume of consumption and } OT = \text{consumer subsidies}$$

The CSE can also be expressed on a per unit consumed basis, or as a percentage of the total value of consumption (valued at producer prices).

Agricultural policies that raise domestic consumer prices above world levels enter both the CSE and PSE calculations. However, direct producer subsidies alone will be recorded in the PSE as raising producers' returns, but will not be reflected in the CSE estimate since they do not increase prices to consumers.

The PSE and CSE provide measures of the transfers from one group in the community to another. However, the economic loss to the community is not the transfers themselves, but the production inefficiencies associated with the misallocation of resources induced by the distorted structure of producer incentives. These resource inefficiencies impose "dead weight" losses on the economy. Protectionist policies that raise agricultural returns are likely to reduce overall national welfare, by encouraging resources into rural activities where their contribution to production is below what it would be if employed in more efficient alternative uses.

(2) Nominal Assistance Coefficients

The more disparate the structure of assistance among activities and sectors in an economy, the greater the inefficiencies likely to be induced by the assistance. In order to assess the likely effects of such inefficiencies on producer and consumer decisions, the OECD has developed the concept of the nominal assistance coefficient (NAC). The NAC on production is the ratio of the unassisted border price, plus the unit PSE, to the border price. The NAC on consumption is the ratio of the border price, plus the absolute value of the unit CSE, to the border price.

Nominal assistance coefficients on production and consumption indicate the price wedges created between domestic and world levels by the assistance structure, and hence the extent to which, producer returns and consumer prices have, respectively, been increased over the levels
prevailing without assistance. The greater and more disparate these nominal coefficients, the greater the distortions in consumption and production induced by these policies.

(3) Nominal Assistance Coefficients on Production and Effective Rates of Assistance

By measuring the price distortions caused by assistance policies, the nominal assistance coefficient (NAC) on production improves upon the percentage PSE as a measure of the possible resource inefficiencies associated with assistance. A further refinement is to estimate effective rates of assistance (ERA) which measure the percentage increase in value added resulting from protection in an activity, taking full account of the tariff and non-tariff measures affecting outputs and inputs. This measure represents a more comprehensive measure of net assistance, taking into account, in particular, the penalizing effects of higher input prices stemming from tariffs or other trade barriers assisting domestic production of these goods.

The ERA, being based on value-added rather than gross output (as in the NAC), yields a clearer indication of potential resource-allocation inefficiencies resulting from assistance. The lower the unassisted value added in the industry, the greater will be the difference between the NAC on production and the ERA. More importantly, the ranking of activities according to ERA is likely to differ considerably from that using NAC estimates, as the relations between value added and gross output vary among activities.

The larger the disparities in effective rates or nominal assistance coefficients on production, the more likely it is that the country's production patterns have been distorted from their more optimal market-determined levels, and hence the greater will the country's overall productive capacity fall short of its potential. Resources will tend to move from relatively lowly assisted - more efficient - activities into more highly assisted - less efficient - activities. Only by having its resources allocated to their most productive use will a country's national welfare be maximized. A relatively uniform and low assistance structure would normally be expected to allow resources to be allocated by market forces into their most productive uses, where the country has a comparative advantage.

\[2\]

\[2\]NACs on production, like effective rates of assistance, have less significance in absolute than in relative terms. Their main value comes from being able to rank activities according to levels of assistance in order to obtain an indication of the likely impact of assistance on resource allocation.
VI. TRADE DISPUTES AND CONSULTATIONS

(1) GATT Dispute Settlement

(i) Articles XXII and XXIII

478. As noted in the first Trade Policy Review of Japan, since its accession to GATT, Japan has been a party to seventeen procedures under GATT dispute-settlement provisions. Since the publication of the first review, there have been no new cases initiated against Japan: one case in which Japan was the complainant has resulted in the adoption of a Panel report (Table VI.1). This is the first case in which Japan has taken another GATT participant to formal dispute settlement proceedings under Article XXIII.

479. In ten of the sixteen cases against Japan, bilateral solutions were found or market-opening measures taken by Japan, so that complaints were withdrawn prior to the establishment, or finalization, of Panel proceedings. In one case, Japanese measures were found consistent with GATT provisions. In one further case, conciliation was undertaken by the Director-General.

480. In four panel cases, Japanese measures were found inconsistent with the GATT and Japan has taken steps to implement Panel recommendations. However, as a follow-up to the Panel report on restrictions on imports of agricultural products, in March 1991, the United States, joined by Australia in April, requested plurilateral consultations under Article XXII:1 with respect to remaining import restrictions in the dairy products and starch sector. Other interested parties included Argentina, Canada, Chile, the European Communities, New Zealand, Thailand and Uruguay. In the course of 1991, a number of plurilateral and bilateral consultations were held (Table VI.2).

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1°GATT (1990), Trade Policy Review - Japan, Part C, Chapter VI.
3°Concerning the implementation of the recommendation on dairy products and starch, Japan still maintains the position, which was stated at the Council Meeting of February 1988, that it does not agree with the Panel's interpretation of Article XI:2(c)(1) with respect to these items and it would be extremely difficult to implement measures in accordance with the Panel's conclusion on such an interpretation. The Japanese authorities state that Japan had taken steps to improve market access for these products and will consider measures in the light of the outcome of the Uruguay Round.
(ii) Disputes under the Tokyo Round Agreements

481. There have been no actions involving Japan under the Subsidies Code or the Government Procurement Code. Nor have any actions been taken, since the last consultation, against Japan under the Anti-Dumping Code.

482. Since 1990, three actions have been taken by Japan under the Anti-Dumping Code. Japan has had a couple of consultations with the Republic of Korea over its anti-dumping duties on polyacetal resins imported from Japan. On 21 April 1992, Japan requested consultations with the European Communities under Article 15:2 on the Communities' policy regarding the treatment of refunds of anti-dumping duties on products sold in EC markets by importers related to Japanese companies. As of the date of this writing, consultations were still pending.

483. Following a number of bilateral consultations with the European Communities, a meeting of the Committee on Anti-Dumping Practices was held on 9 July for conciliation under Article 15:3 of the Code between Japan and the European Communities, concerning the EC's anti-dumping duties on audio tapes and cassettes originating in Japan.

(2) Other Consultations

484. As has already been discussed extensively in Chapters IV and V, consultations between Japan and the United States have continued on a wide variety of trade-related matters. On-going annual follow-up talks under the SII programme launched in 1989 cover wide-ranging features of the Japanese economy and their possible trade implications. The Global Partnership Plan agreed between President Bush and Prime Minister Miyazawa in January 1992, as well as reaffirming many matters raised in the SII, extended the scope and nature of these bilateral consultations, highlighting market access issues in industrial sectors, such as auto and auto parts, glass and paper.

485. In the area of fisheries trade, regular meetings take place between Japanese and United States counterparts. Within the context of the Market-Oriented Sector Selective (MOSS) talks, periodic consultations are

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4 The imposition of anti-dumping duties by Korea (covering imports from the United States and Japan) is the subject of a complaint by the United States in the Committee on Anti-Dumping Practices. Japan is an interested third party to this case (GATT document ADP/M/36).


held by the United States with the Japanese Ministry of Health and Welfare on standards and market access for drugs and medical devices.
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