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To: Members of the Executive Board
From: The Secretary
Subject: Japan: Recent Trade Measures

There is attached for the information of Executive Directors a paper on recent trade measures announced by Japan.

Mr. Anjaria (ext. 8357) or Mr. Baumgartner (ext. 7307) are available to answer technical or factual questions relating to this paper.

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INTERNATIONAL MONETARY FUND

JAPAN

Recent Trade Measures

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Exchange and Trade Relations Department

(In consultation with other Departments)

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Recent Trade Measures Announced by Japan

This paper is prompted by actions taken by the Japanese Government over recent months in the area of international trade. It provides a background to the recent announcements, describes the main features of the actions and offers a preliminary assessment of their significance. 1/ The background described in Section 1 is limited to trade issues between Japan and the United States which have been the subject of considerable policy attention in recent months. As indicated below, however, Japan's recent measures are not taken in response solely to U.S. concerns but also affect other countries and, indeed, must be viewed in the broader context of overall trade policy formulation.

I. Background

Subsequent to the talks held on January 2, 1985 in Los Angeles between President Reagan and Prime Minister Nakasone, consultation committees comprising high-level officials from Japan and the United States were set up, and "Market Oriented Sector Specific" (MOSS) consultations began in four sectors: telecommunications, forest products, pharmaceuticals and medical equipment, and electronics. 2/ In the course of the "MOSS" discussions, several main issues were identified. In the telecommunications sector, the Japanese Government has been proceeding to privatize the state-owned telephone monopoly, the Nippon Telegraph and Telephone (NTT), and to deregulate the telecommunications business with the aim of promoting greater competition and efficiency. The principal issue has been the extent of residual government control over standards and entry into specific areas of business. In the forest products sector, the main U.S. request has been for a reduction of the current 15 percent tariff on coniferous plywood which the United States produces. In pharmaceuticals and medical equipment, the issues have been the acceptance of foreign clinical test data and the transparency of approval procedures. In electronics, the main issues have been the protection of copyrights for micro-chip design and software, and procurement practices.

While bilateral discussions relating to these four sectors of special concern were proceeding, President Reagan announced in March 1985 that the United States would not seek a further extension of voluntary export restrictions applying to Japanese exports of auto-

1/ The general features of such trade policy information notes were described in SM/85/225 (8/8/85).

2/ This approach was modeled after the working group of officials of the U.S. Treasury and the Japanese Ministry of Finance on yen/dollar exchange rate issues which, in the eyes of both sides, had proved a useful framework for resolving bilateral differences.

mobiles to the United States. Under the restraint arrangement beginning in April 1981, Japanese automobile exports to the United States were subject to a global ceiling of 1.68 million units during April 1981-March 1982. This ceiling was not changed in the two subsequent years, and was increased to 1.85 million units when the restraint arrangement was extended for a fourth year ending in March 1985. On March 29, 1985, the Japanese Government announced that automobile exports to the United States during April 1985-March 1986 would be limited to 2.3 million units, an increase of 450,000 units or 24.3 percent. 1/

The 24 percent increase in the export ceiling in 1985-86 should lead to a larger Japanese share in the U.S. automobile market. However, as this increase is below even the lowest estimate of the extent to which the voluntary restraint arrangement had reduced exports, price premia are likely to continue, albeit on a reduced scale. Tentative staff estimates suggest that export price declines for Japanese automobiles of 5-6 percent may result from the new arrangement. In spite of such a decline, the value of exports of automobiles to the United States, which amounted to about \$12.5 billion in 1984, may however increase (perhaps by some \$2 billion) in 1985 because of the higher export limit. 2/

II. The New Trade Policy Program

On April 9, 1985, Prime Minister Nakasone announced a program aimed at opening Japanese markets to imports; this was the seventh package of market-opening measures since late 1981. At the same time, the Government announced its endorsement of the report of the Advisory Committee

1/ The effects of the export restraint have been the subject of various investigations. These studies have revealed broadly similar results: restraint on Japanese exports has led to higher prices for both domestic and imported cars in the U.S. market; it has changed the mix of imported cars toward higher-priced models; and it has lowered the volume of sales. A Fund staff study estimated that the price of an average car sold in the United States was \$1,650 higher in 1984 than it would have been in the absence of the restraint measures; of this, \$1,025 represented the effects of model upgrading. The volume of automobile imports was estimated to be 1.5 million units lower in 1984 than it would have been in their absence. Other estimates of the impact on imports range upward from 750,000 units, with this low figure reflecting the constraint on exports resulting from small additions to production capacity in Japan because of export restraint. (Updated version of "The Effects of the Restraints on Exports of Japanese Automobiles to the United States" in United States - Recent Economic Developments, (SM/84/178, Supplement 1, 7/20/84)).

2/ Even if the yen were to strengthen considerably against the dollar, Japanese producers should be willing to supply this larger volume, because profit margins have widened substantially in recent years.

on External Economic Issues, the so-called "Okita Report", which contained a wide range of policy recommendations relating to the further internationalization of the Japanese economy. In particular, the Government accepted the basic approach suggested by the Committee--that "external transactions should be free in principle, with exceptions limited to the necessary minimum". With this basic guidance, the Government announced its intention to prepare an Action Program, an outline of which was presented on July 30, 1985, to guide liberalization efforts to be implemented over the coming three years.

1. Market opening measures announced in April 1985

Specific measures were announced in April in a number of areas, including the four sectors of special interest to the United States. Discussions between Japanese and U.S. officials covering these four areas are yet to be concluded, and the measures announced so far reflect the varying degrees of progress made in the consultations to date. In view of the timetable for deregulation of the telecommunications sector and the privatization of the Nippon Telegraph and Telephone company, which went into effect on April 1, 1985, priority has been accorded, and the greatest progress made, in this area.

a. Telecommunications

The measures announced in April include: (i) simplification and increased transparency of regulations including those covering the registration and notification of companies; (ii) foreign participation in the process of drafting technical standards, including provision for the participation in the Telecommunications Advisory Council of Japanese nationals serving foreign-affiliated firms; (iii) impartial, neutral, and independent approval of equipment for compliance with technical standards for foreign suppliers, based on foreign test data; (iv) provisions to prevent the cross-subsidization of telecommunications companies; (v) the availability of Export-Import Bank credit for imports of foreign communications satellites by the private sector; and (vi) an undertaking to amend the law should implementation of the new telecommunications laws reveal "serious and actual" barriers to market entry. Technical standards and requirements for terminal equipment have been simplified and a study is being made of the scope for further relaxation of technical standards.

b. Electronics

Measures were announced concerning the legal protection of copyrights of semiconductor chips and computer programs. In addition, the Japanese Government has proposed that the United States and Japan

simultaneously eliminate tariffs in the electronics sector. ^{1/} In accordance with an agreement reached with the United States, both countries eliminated tariffs on semiconductors with effect from March 1, 1985 on a most-favored-nation basis.

c. Pharmaceuticals and medical equipment

The new measures concerned two out of a number of points raised by the United States. These established (i) procedures to promote increased transparency in the approval/examination process for pharmaceutical imports and (ii) the acceptability of foreign clinical test data for approval of medical equipment and certain pharmaceuticals.

d. Forest products

The Japanese Government announced that measures will be taken in the course of the next five years to increase the demand for wood products, reduce the capacity of forest products industries and revitalize domestic forests and forestry. Along with the implementation of this program, the Government intends to consider tariff reductions for softwood and hardwood plywood and other panel products, from about the third year onward.

e. Other tariff reductions, and changes in the standards and certification systems

The April 1985 announcement foreshadowed changes in tariff policy and in standards and certification systems which were to be included in the Action Program. At the same time, a number of specific changes in standards, certification systems, and import-testing procedures were introduced to facilitate imports of food items, pharmaceuticals, medical devices, cosmetics, etc. In June 1985, the Government announced its intention to reduce or eliminate tariffs on some 1,853 primary and processed agricultural goods and industrial products.

f. Encouragement of imports of manufactured goods

The business community was requested to increase imports of manufactured goods. Other measures included support for import fairs; a reduction of the Export-Import Bank interest rate on credits for imports of manufactures; and an intensive campaign in the public media to promote imports of manufactured goods.

^{1/} Other issues still under discussion include: foreign participation in the development of industrial standards; acceptance of foreign test data; participation of foreign companies in research and development sponsored by the Japanese Government including access to the patent information developed; streamlining customs procedures; and speeding up of the patent process so that foreign companies can win design protection.

g. Export moderation

The authorities announced that efforts will continue to avoid concentrating specific exports in specific regions.

h. Enhancing economic cooperation and promoting investment

The authorities' plans in this area include efforts to continue to increase ODA steadily by setting a new medium-term target for the period after 1986 and improvements in the quality of ODA by expanding grants and technical assistance and responding positively to requests for contributions to international financial institutions. Industrial cooperation will be strengthened and direct investment in Japan encouraged.

2. Other aspects of the Advisory Committee Report

The Okita report issued in April 1985 sets the current trade frictions against an international and historical background. Three phases of intense trade frictions in the postwar period are identified-- 1969-72, 1976-78, and 1981-85. Factors common to each period have been the existence of large Japanese current account surpluses, including large bilateral imbalances, and corresponding large current account deficits in major partner countries. The Committee noted that added to this, the friction during the present phase has been exacerbated by a pattern of exchange rates which does not reflect the pattern of current account imbalances.

The Committee also noted that demands to improve foreign access to Japanese markets have partly replaced concern over Japan's rapid export growth as the main issue in current trade relations. It also noted that the sectoral and geographical coverage of frictions has widened to include the high-technology industries and to encompass the United States, Europe, and the ASEAN countries, in particular.

Reviewing past market opening packages, the Committee considered that, while they have been mainly reactive to foreign demands, they have also been unilateral in the sense that they have not involved demands for reciprocal concessions on the part of trading partners. Foreign reaction to these measures has been generally positive in principle. However, the report noted that there has also been considerable criticism: the measures were seen to be "too little too late" and involved "no change on crucial points nor ... significant results" (the United States and EC); they "were biased toward Europe and the United States" (ASEAN and Korea); and "not sufficiently toward the Pacific" (Oceania).

Against this background, the Committee recommended that Japan develop, on its own initiative, a medium-term strategy for further internationalization of the Japanese economy. With respect to external

policy action, the Committee called for better industrial cooperation through more direct investment and intensification of the exchange of technology; a new round of trade negotiations with Japan playing a leading role in its preparation; more support for developing countries through expanded aid and technical cooperation and improved market access; and intensification of an international dialogue at the industry level.

In the areas of domestic policies, the Committee noted that strong growth, based on domestic demand, was as important as improvements in market access in rectifying the external imbalances that create frictions. To this end, it called for an easing of regulations governing private sector activity; the general introduction of a five-day work week; an efficient upgrading of social overhead capital on a priority basis; and a review of the tax system to promote growth based on domestic demand. While emphasizing the effects of cyclical factors, exchange rate developments and low oil prices, the Committee noted that Japan's current account surplus is also partly a reflection of structural factors and that attention should be paid to Japan's structural surplus, particularly in the medium term.

3. The Action Program

"The Outline of the Action Program for Improved Market Access" released on July 30, 1985 was prepared on the basis of the recommendations contained in the Okita report which were endorsed by the Japanese authorities. It covers six broad areas of action: tariffs; import quotas; standards and certification requirements and import procedures; government procurement; financial and capital markets; and trade in services and import promotion. Prime Minister Nakasone has stated that the goal of the Action Program is to make the Japanese market one of the most open markets in the world. The following paragraphs summarize the main elements of the program. 1/

a. Standards and certification requirements and import procedures

The relaxation of the standards and certification requirements and import procedures is a central feature of the Action Program. The measures address practices which foreign exporters and trading partners believe constitute important obstacles to their exports to Japan. After reviewing 42 laws that set standards relevant to imported goods, and in light of over 200 complaints and requests pertaining to these standards, the Action Program sets forth 88 specific improvements in 23 laws. In addition, guidelines have been laid down covering procedures aimed at

1/ The Executive Director for Japan has made available to Executive Directors detailed documentation concerning the measures of April-July 1985.

further streamlining standards and certification requirements on an ongoing basis.

The 88 measures that have been announced in the Program are to be implemented over the next three years, for the most part by April 1987, and can be grouped in the following broad categories.

(1) Standards

Measures involve mainly the reduction or relaxation of the number of technical standards that a product must meet. Where standards are necessary, as far as possible, they will be adjusted to conform with established international standards. Transparency in the setting of standards will be secured by allowing representatives of foreign firms to participate in the councils, etc., that draft standards; foreigners will also be given opportunity to express their opinions while standards are being prepared.

(2) Certification

In many cases, firms will be allowed simply to verify and declare that their products meet official standards instead of submitting them for government testing and certification. 1/ In addition, many of those items now requiring individual approval will be shifted to a system of self-certification based on government-set standards. This will be the case for 37 out of 103 categories of medical equipment and for 15 categories of cosmetics. 2/

Standard processing periods will be set in advance for all government approval procedures. Certification procedures will also be simplified where possible to expedite official processing.

(3) Import procedures

Import procedures will be simplified for a number of items including foods and pharmaceuticals. For example, in the case of continuous imports of certain food items (30 percent of the number of food items), the requirement of import notification of each import transaction will be eliminated.

b. Tariffs

(1) Promotion of a new round of multilateral trade negotiations. Japan announced its readiness to reduce tariffs on industrial products to zero along with other advanced industrialized countries. As a first step, Japan proposes to negotiate with interested parties on the elimination of tariffs on high-technology products prior to a new round. Also in this connection, tariffs are to be unilaterally

1/ For example, the number of electrical appliances subject to self certification would be doubled during 1985 from the present level of 72, and efforts would be made to triple that number over three years.

2/ This is expected to reduce the required number of licenses by 60 percent for cosmetics over the three year period.

eliminated by April 1987 on approximately 30 products subject to tariff concessions of 2 percent or less.

(2) As announced in June 1985, tariffs on some 1,853 items will be reduced or eliminated beginning in 1986 or, in some cases, April 1987. In most cases, tariff rates are to be reduced by 20 percent. The reduction of tariff rates on softwood and hardwood plywood and other wood panel products will take effect in April 1987.

(3) Improvement in the Generalized System of Preferences (GSP). Some steps have been taken to improve the GSP, including reducing tariff rates on selected products (1986) and improving ceilings and expanding quotas (from April 1987). Japan also proposes to lead other countries in making further fundamental improvements in the GSP, such as freezing or reducing the number of products excluded from the GSP, accepting the principle that GSP tariffs should be zero, and providing particular consideration for the least-developed countries.

c. Government procurement

Important changes will be made in the Government's procurement procedures to ensure fair competition within the context of the existing legal framework, which calls for competitive bidding and no discrimination between national and foreign bidders. In response to some trading partners complaints about the award of many government contracts through single tendering, the Government will allow single tendering only in exceptional cases, which will be made public individually. Furthermore, to assist foreign bidders, time limits are to be extended. The qualification system that establishes the eligibility of bidders will be simplified and made uniform so as to facilitate government procurement from foreign firms.

d. Financial and capital market liberalization

Measures to further liberalize Japan's financial and capital markets were announced, which the authorities expect, in the long run, to contribute toward strengthening the value of the yen. The measures include the freeing of interest rates on large denomination bank deposits by the spring of 1987, and steps to enhance the efficiency of and expand the money and capital markets.

e. Trade in services and import promotion

(1) Services

Japan is ready to discuss the relaxation and dismantling of existing restrictions along with other countries in a new MTN round.

Specific measures are to be taken, inter alia, in the transportation sector, including the elimination of practices which prejudice foreign firms' access to Japan's trucking service, the increased use of

small aircraft for short-range commuter services, and the relaxation of restrictions on the number of flight engineers. Agreement is expected to be reached on the access of foreign lawyers in the course of the action program. Also, undertakings are made regarding continuation of national treatment of foreign insurance firms, more flexible application of licensing of new insurance instruments and services, and free transborder flows of data.

(2) Promotion of imports

The action program essentially reiterates the undertakings made in the April announcement. Subsequently, the number of leading firms requested by the Government to increase imports has been increased from 60 to 130.

III. Staff Assessment

Japan's recent trade decisions are the latest in a series of policy measures announced since 1981 that have included trade liberalization as a central element. Japan is the only major industrial country that has embarked on a systematic policy of opening its market. Against the general background of rising trade frictions and protectionist pressures, this is indeed welcome.

As to the extent of market opening in the latest set of measures, the proposed tariff reduction of 20 percent (equivalent to around 1 percentage point on average for manufactured products), while a welcome move, is likely to have a limited effect on the total value of imports. With the reduction, Japan's average tariff level on all industrial products--which was already among the lowest in industrial countries--would be reduced to some 3 percent. The other recent measures, actual and planned, in the field of nontariff barriers--such as in rules and practices on standards, certification, and import procedures--are intended to meet the concerns expressed by individual trading partners. The encouragement to imports that these improvements should provide is commendable. Nevertheless, the need remains for persistent further efforts to make the Japanese market fully open and receptive to imports. The trade barriers, particularly nontariff barriers, that will remain in place after full implementation of the new measures cannot be regarded as inconsequential. Most important, the latest measures leave untouched the heavily protected agricultural sector. A significant lowering of such protection would improve foreign producers' access to the Japanese market and help the Japanese economy as well.

On recent occasions, the staff has expressed general concern about the destructive effects a shift to bilateralism would have on world trade. It, therefore, welcomes the authorities' declared intention to apply the liberalization measures on a most-favored-nation basis. At the same time, the authorities plan to continue to exercise export

restraint, for example, on automobile exports to some of the major OECD markets. In the interest of greater multilateralism and liberalization of world trade, the staff suggests that such measures should be terminated soon. Further expansion of Japan's imports and exports on a nondiscriminatory basis would obviously be helpful for both Japan and the rest of the world.

Given the importance of Japan in world trade, its trade policy actions must also be judged by the contribution they make to easing trade frictions and defusing protectionist pressures more generally. While the recent measures no doubt make a contribution in this direction, they should not, of course, be expected by themselves to bring about a significant easing of worldwide protectionist pressures. Demands for protection abroad have risen as the size of Japan's current account surplus has grown. In particular, the size of bilateral trade imbalances is said to justify actions to "do something" on trade policy. Support for protectionist measures often involves a misunderstanding of the links between trade policy and macroeconomic developments. Trade policy actions cannot substitute for needed macroeconomic policy adjustments and, indeed, cannot be expected to contribute significantly to eliminating trade imbalances which stem from the constellation of macroeconomic factors in major industrial countries. For example, they cannot deal with the adverse impact of the high value of the U.S. dollar on the competitiveness of domestic industries, which has been a very important factor behind the current protectionist pressures in the United States.

The principal criterion for assessing the appropriateness of the trade policy stance of a large industrial economy such as Japan is the degree to which the economy is open to foreign competition, and not its bilateral or global trade balance. Against this background, the recent actions by Japan should be viewed as signaling Japan's awareness of the contribution that a more open economy can make to the interests of both Japan and the world at large.

The coexistence of impediments to imports in the Japanese market and rising protectionist pressures make it essential that the program of action outlined by the authorities be speedily implemented.