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WTO Trade Policy Review: Japan*

Note: This text provides brief description of the conditions foreign business will encounter in trade with Japan. It is based on a WTO Trade Policy Review for Japan, mid February 2009. Readers wishing for deeper analysis should turn to the original Trade Policy Review available on the WTO website. (www.wto.org/english/tratop_e/tp/tp311_e.htm)

Trade Policy Reviews are an exercise, mandated in the WTO agreements, in which member countries' trade and related policies are examined and evaluated at regular intervals.

• ECONOMIC ENVIRONMENT

In line with the global economy, Japan's economy has slowed down since its previous Trade Policy Review in 2007, when real GDP growth was 2.4%. While the economy continued to grow in the first quarter of 2008, it shrank in the second and third quarters. Growth in 2007 was led by external demand for Japan's exports and, to a slightly lesser extent, domestic demand, notably household consumption and private non-residential investment. Unemployment in Japan has been on a declining trend, reaching 3.9% in 2007. Downward pressure on prices remained in 2007; while this pressure appeared to have eased in early 2008, core inflation in October slowed for the second straight month, largely due to falling energy prices. Whether this heralds a return to deflation in the near future remains to be seen.

Economy-wide labour productivity in Japan lags behind that of other major industrialized countries. Data provided by the authorities indicate that labour productivity in non-manufacturing is stagnant compared with manufacturing; they attribute this to lower total factor productivity (TFP) growth in non manufacturing. Nevertheless, Japan's export competitiveness has apparently improved, as reflected in a continuing decline in unit labour costs, owing to sluggish wages.

Trade and trade-related policies continue to be integral to Japan's ongoing structural reform, particularly as trade plays an increasingly important role in the economy. The shares of exports and imports of goods and services were around 16% and 11% of GDP, respectively, in 2007 (15% and 11% in 2006). The faster growth in exports than in imports in recent years reflects the positive contribution of external demand to

Japan's economic growth, due in part to the openness of the multilateral trading system. Japan's current account surplus increased in 2007; this reflects a widening of the gap between gross national saving and gross domestic investment. By the end of August 2008, Japan's foreign exchange reserves had risen to US\$997 billion (up from US\$879 billion in August 2006), which was equivalent to about 21 months of Japan's imports.

Since March 2006, the Bank of Japan (BOJ) has continued its policy to "encourage" (e.g. by means of open market operations) the short-term call rate to remain around a specified rate; on 19 December 2008, the latter was lowered to 0.1% (following a reduction from 0.5% to 0.3% on 31 October 2008). It would appear that the recent appreciation of the yen is partly due to the unwinding of the "carry trade", which involves borrowing in yen to invest in higher-yielding assets abroad; the resulting large outflow of yen had contributed to a substantial nominal depreciation of the Japanese currency.

The fiscal deficit amounted to around 3.4% of GDP in FY2007 (2.9% in FY2006); consequently, public debt continued to increase, reaching about 170% of GDP. The Government's mid-term target for fiscal consolidation, as announced in July 2006, is, inter alia, to achieve a surplus in the central and local governments' combined primary balance by FY2011, and thus to ensure gradual reduction of the ratio of public debt to GDP between the early and mid 2010s.

• TRADE POLICY REGIME: FRAMEWORK AND OBJECTIVES

The only major change in Japan's government ministries and agencies responsible for the formulation, implementation, and evaluation of its trade policies since its previous Trade Policy Review was the abolition on 28 December 2007 of the Cabinet-level Japan Investment Council, and the establishment of the Expert Committee on FDI Promotion within the Cabinet Office.

Japan's trade policy priorities include strengthening the multilateral trading system, as embodied in the WTO. Nonetheless, Japan is of the view that its regional and bilateral free-trade agreements complement trade liberalization at the multilateral level. During the period under review, four additional agreements entered into force (with Chile, Thailand, Indonesia, and Brunei), and one was signed (with ASEAN). The agreements with countries that are significant exporters of agricultural products tend to exclude many of these products. They also exclude certain industrial goods, such as leather

products and footwear, which the authorities consider to be highly sensitive.

Japan has been a major participant in WTO activities, including negotiations under the Doha Development Agenda (DDA). It has been a party to three disputes since 2007, one as a respondent and two as a complainant.

Japan has continued to adopt measures to increase the transparency of its trade and trade related policies, practices, and measures, thereby enhancing the Government's accountability to the public. Since March 2007, administrative organs have been required to conduct ex-ante evaluation of regulations. A procedure for ex-ante regulatory impact analysis has been introduced since 1 October 2007; ex post evaluation is required under the Government Policy Evaluation Act of 2001.

Japan grants preferential treatment to products from certain developing and least developed countries under its Generalized System of Preference (GSP) scheme. On 1 April 2007, Japan expanded the coverage of the preferential (i.e. tariff-free and quota-free) treatment granted to 49 least developed countries, from about 86% to 98% of all tariff lines. The main beneficiaries of Japan's GSP are China, Thailand, Indonesia, the Philippines, and Viet Nam. The GSP scheme excludes many agricultural products and some industrial products.

Inward FDI in Japan remains substantially lower than outward FDI, and is relatively low compared with that in other large OECD economies. Against this background, Japan has continued to take measures to make itself a more attractive investment destination for foreign firms. On the other hand, for the first time under the current Foreign Exchange and Foreign Trade Law, the Government has issued a recommendation against an FDI proposal (for an electric utility) on the grounds of "public order, public safety, and national security".

• TRADE POLICIES AND PRACTICES BY MEASURE

Trade and trade-related policies continue to be key elements of Japan's ongoing structural reform; the extent of progress in this regard will determine Japan's success in achieving its economic and social objectives. Since its previous Trade Policy Review, Japan has introduced measures aimed at further liberalizing its trade and investment regimes. The authorities continue to promote regulatory reform and strengthen competition policy, which could, inter alia, help open Japan's econ-

omy to more competition and thereby create more opportunities for domestic and foreign businesses. It would appear that Japan has not introduced new trade measures to protect its market since the onset of the global financial crisis in September 2008.

The tariff is Japan's main trade policy instrument. Nonetheless, most imports enter Japan duty free or are subject to low tariff rates. In fiscal year (April-March) 2008, the simple average applied MFN tariff rate was 6.1%, down from 6.5% in FY2006, reflecting decreases in ad valorem equivalents of non ad valorem duties. Nearly 99% of tariff lines are bound and most applied MFN rates coincide with bound MFN rates, thereby imparting a high degree of predictability to Japan's tariff schedule. At the same time, non ad valorem duties are an important feature of the tariff, particularly for agricultural products. These duties, which account for 6.7% of all tariff lines, and are indicated in Japan's tariff schedule, tend to involve high ad valorem equivalents. Preferential tariff rates are offered to 141 developing countries and 14 territories under the GSP, including additional preferences for 49 LDCs. Whereas the simple average tariff rate under the GSP is 4.9%, that for LDCs is 0.5% (down from 3.3% in FY2006). Japan also grants preferential access to imports from Singapore, Mexico, Malaysia, Chile, Thailand, Indonesia, and Brunei under bilateral free-trade agreements. The simple average tariff rates under these agreements range from 3.3% (Malaysia) to 3.9% (Brunei).

Japan has few non-tariff border measures. Those currently applied involve some import prohibitions and quantitative import restrictions (for example, on some fish). In addition, imports of some goods are subject to licensing requirements to ensure national security, safeguard consumer health and well-being, or preserve domestic plant and animal life and the environment. Some import prohibitions are in place in accordance with United Nations Security Council resolutions.

Since its previous Review, Japan has used two anti-dumping measures. It has one countervailing measure in place; the measure was brought to the Dispute Settlement Body and its countervailing duty rate was reduced from 27.2% to 9.1% as of 1 September 2008 in response to the DSB decisions. It has not imposed any safeguard measures.

Japan maintains certain export controls on national security and public safety grounds and to ensure adequate domestic supplies of certain agricultural and other primary products. On the other hand, so as not to impede exports, a drawback scheme is used to refund import tariffs levied on inputs used in the production of goods for export. Export finance, insurance, and guarantees are also available. The Government has

recently been promoting agricultural exports, mainly by providing information to consumers overseas.

No preferences are granted to domestic suppliers with regard to procurement covered by the Agreement on Government Procurement. Nevertheless, the share of foreign suppliers in the total value of government procurement was 3.1% in 2006, the latest year for which data are available, down from 3.7% in 2004. The share of overseas goods and services, supplied by domestic or foreign suppliers, in total procurement declined to 8.7% in 2006 (from 9.7% in 2004) in terms of value. Open tendering accounted for 65.9% of the total value of procurement in 2006 compared with 60.6% in 2005. In March 2007, the Government adopted the Basic Policy for Public Procurement of Information Systems, whose main objective is to increase transparency.

About 96% of Japanese Industrial Standards (JIS) were aligned to their international counterparts in 2008 (compared with 93% in 2005).

Although Japan has relatively high statutory rates of both corporate and personal income taxes, the amount of taxes collected in relation to GDP is relatively low in comparison with other OECD countries. This suggests a need to broaden the income tax base, which would allow cuts in tax rates, thereby rendering the income tax system more neutral.

Various laws on intellectual property rights (IPRs) have been amended since Japan's previous Review to strengthen protection (e.g. by increasing penalties for infringement). The authorities have continued their efforts to reduce the time required for patent registration. Japan remains an active participant in multinational and regional discussions on agreements to promote international harmonization of regimes protecting IPRs.

In June 2007, Japan adopted a new Three-Year Programme for Promoting Regulatory Reform, which was further revised in March 2008. The programme aims to, inter alia, strengthen Japan's international competitiveness and thereby increase economic growth. Japan has also continued to implement regulatory reforms in selected regions under the scheme of special zones for structural reform.

The authorities intend to continue to strengthen competition policy. In this regard, a bill to amend the Anti-monopoly Act (AMA) has been submitted to the Diet. The bill seeks to, inter alia, introduce a surcharge (fine) in respect of practices involving exclusionary types of private monopolization, and a 50% increase in the surcharge on businesses that have

played a leading role in cartels and bid rigging.

Certain measures aimed at improving corporate governance became mandatory on 1 April 2008, for example, the implementation of internal control reporting systems and certification of annual reports by management.

• TRADE POLICIES BY SECTOR

Since its previous Trade Policy Review, Japan has continued to promote structural reforms, especially those pertaining to agriculture, energy, financial services, and air transport.

In agriculture, Japan has introduced measures to move further away from price support towards income support. However, the sector remains relatively protected from foreign competition. The average applied MFN tariff for agriculture (WTO definition) fell from 18.8% in FY2006 to 17.1% in FY2008 reflecting decreases in ad valorem equivalents of non-ad valorem duties. In 2007, Japan's total transfers to agriculture amounted to 0.9% of GDP compared with agriculture's 1.2% share in GDP (in 2006). As a consequence, the overall level of government assistance for agriculture (as measured by producer and consumer support estimates, for example) is well above the OECD average. Despite (or possibly because of) this assistance, labour productivity has remained less than one quarter of the national average. Food self-sufficiency in FY2006 was around 39% on a calories basis, a decrease of one percentage point from FY2005; thus, Japan is one of the world's largest importers of food.

During the review period, the authorities placed emphasis on the promotion of selected industries; for example, additional assistance was introduced for the production of aircraft. Nonetheless, Japanese manufacturing has, by and large, been much more exposed to international competition than agriculture and certain services. Tariffs on industrial products (HS 25-97) are usually low (averaging 3.6% in FY2008), non-tariff barriers (e.g. import licensing requirements) are few, and the sector, on average, receives relatively little financial support from the Government. Manufacturing has been the driving force behind Japan's rapid development during the past 60 years. The sector's contribution to GDP decreased slightly from 21.5% in 2005 to 21.3% in 2006 (the latest year for which data are available); manufacturing employed 17.4% of Japan's total labour force in 2006, up from 17.3% in 2004, which means that labour productivity in the sector is substantially higher than in the rest of the economy.

One of the main objectives of Japan's energy policy has been

a stable energy supply, reflecting its heavy reliance on imported energy: about 82.5% of its primary energy was imported in FY2005 (latest data available). Electricity prices in Japan have declined and are not necessarily higher than those in other developed countries. By contrast, gas prices for residential customers have remained relatively high by international standards. Since its previous Review, Japan has further liberalized its gas sector to promote competition. In 2008, the Government recommended against an FDI project in an electric utility company on the grounds of "national security, public order, and public safety".

Regulatory reform has continued in services, where labour productivity is considerably lower than in manufacturing. This is an important sector, not just for consumers, but for all kinds of businesses for which services are essential inputs and therefore a significant determinant of their international competitiveness. Reforms have progressed particularly in financial services, which are important for channelling savings into profitable investments across various sectors of the economy. Besides a substantial reduction of non-performing loans (NPLs), and restructuring of government-affiliated institutions, the Government has targeted improved transparency in the financial system (through, for example, the adoption of the "no action letter" system). Privatization of Japan Post commenced in October 2007, and the Japan Post Bank and Japan Post Insurance started operations. The Government's policy framework on telecommunications remained largely unchanged during the review period. In transport, liberalization measures have been introduced in bilateral air traffic with some of Japan's trading partners.

• OUTLOOK

According to the Government's official projections, announced in January 2008, the economy is forecast to grow by 2.0% in FY2008, with the CPI expected to increase by 0.3%, and unemployment to be about 3.8%. However, the latest quarterly estimates of GDP indicate that in the third quarter of 2008, real GDP declined by 1.8% quarter on quarter (on an annualized basis). The Bank of Japan revised its growth forecasts for FY2008 from 2.1% projected in October 2007 to 1.5% in April 2008, and then to 0.1% in October 2008, against the background of a slowdown in the world economy and downside risks. The Bank's forecast for FY2009 has also been revised downward from 1.7% projected in April 2008 to 0.6% forecast in October 2008.

Whether the Japanese economy can maintain its recovery in the more immediate term depends on external as well as internal factors. External factors include the pace of growth in the world economy (notably the United States, EC, and

China, Japan's main export markets) and the prices of energy and raw materials. As Japan's economic growth in recent years has depended substantially on external demand, the recent global economic downturn is likely to reduce Japan's growth rate. The adverse effects of the global slowdown on Japan's exports, and thus economic growth, is likely to be exacerbated by the recent appreciation of the exchange rate of the Japanese yen, partly due to the unwinding of yen carry trade. On the other hand, the appreciation of the exchange rate would tend to mitigate the effects of any increases in the prices of energy and raw materials on the prices of inputs, including those used for exports.

On the domestic front, Japan's medium- and long-term growth prospects will depend on its ability to strike a balance between monetary and fiscal policies in tandem with structural reforms. The latter include reforms geared towards reducing the cost of doing business and thereby increasing Japan's attractiveness to inward FDI, which should result in increased competition and, consequently, productivity. Improving productivity is particularly important due to the downside risks from Japan's rapidly aging population and the associated decline in the labour force. The Government believes in the need to intensify such structural reforms, which would contribute to reducing, if not removing, distortions to competition that impair economic efficiency. There is a risk of firms' misallocating capital due to the comparatively low cost of capital in a low interest rate environment.

At the time of completing this report, Japan's economy appeared to be on the brink of a recession. The IMF and the OECD, for example, expect Japan's economy to shrink by 0.2% and 0.1%, respectively, in 2009. The depth and duration of this looming recession remain to be seen.

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