

PREFACE

This volume is the fifteenth annual report by the Subcommittee on Unfair Trade Policies and Measures, a division of the Trade Policy Committee of the Industrial Structure Council. The Industrial Structure Council is an official advisory body to the Minister of Economy, Trade and Industry of Japan.

1. Objectives and Structure of this Report

1) Securing of Compliance with the WTO Agreement and Other International Rules

The primary approach of our report has been to base our analytical standards on the rules set forth in the WTO Agreements and other international agreements and to use them to achieve our main objective of creating a framework for dispassionate and constructive solutions to trade disputes that too often invite unnecessary tensions and conflict. As described later, this approach has won praise both inside and outside of Japan in the past fourteen annual reports.

At the same time, this report seeks to identify and analyze problems concerning the trade policies and measures of Japan's major trading partners (which are referred to as "economies" or "countries"), and to urge them to remove or otherwise remedy the problematic policies and measures. While, as described above, the original objective of presenting our basic approach has been achieved to a considerable degree, the aim of monitoring compliance with international rules has become increasingly important.

Among the factors behind such increased monitoring to ensure enforcement of and conformity with international obligations are Japan's expanding trade and investment, resulting in an increased reliance on international trade rules. Moreover, the increase in the number of economies, including developing countries, that follow international trade and commerce rules as a result of the establishment of the WTO Agreement, and the expansion and sophistication of such international rules as a result of such increase in the number of participating economies, has a profound impact on Japan.

This report is the only report to be published in Japan that monitors such compliance in a comprehensive manner.

2) Promotion of Further Understanding of the WTO Agreement and Other International Rules

The WTO Agreements are the basis for rules governing multilateral trade. Our report serves as a practical guide to the WTO Agreements and other international rules. Unfortunately, few members of the business community and even fewer members of the general public fully understand WTO rules and their role in the world economy. Therefore, Part II of this report provides a detailed explanation of the current rules and the basic principles under the WTO as they affect global trade in the context of actual cases and disputes. In addition, the section points out potential problems in the current rules, focuses attention on areas of possible improvements, and offers suggestions, albeit partially, for future direction. We hope that these descriptions, coupled with the analyses in Part I of the trade policies and measures of different countries under particular examples, will promote further understanding of the significance and potential of the WTO Agreements and other international rules.

The number of Free Trade Agreements (FTAs)/Economic Partnership Agreements (EPAs) and Bilateral Investment Treaties (BITs) (hereinafter all referred to as “EPAs”) has increased substantially in recent years across the world including Japan, in which rules, rights and obligations related to trade policy in countries function as new international rules to supplement the WTO agreements. Based on this movement, this report newly added Part 3 to introduce these rules in EPAs. This year, there is no measure reported with respect to the consistency of the EPAs Japan has concluded. (See Note.) However, we expect the number of such measures to increase as the number of EPAs Japan concludes increases, and we hope for further understanding of those rules by Japanese companies.

Note: Until last year, there was a measure reported in Part I which had the possibility of inconsistency with the Japan-Vietnam BIT (p 134, in 2006). Since this issue has been resolved, the report has no measure with respect to the consistency of EPAs this year.

3) Presentation of Basic Approach

In the early 1990s, when our first annual report was published, unilateral and results-oriented criteria were often used in evaluating trade partners’ policies and measures, adding to the difficulty of resolving international economic issues that were constantly becoming more varied and more complex. However, since the mid-1990s, when the WTO was established, cases involving unilateral criteria have dramatically decreased, while the number of cases involving compliance with the WTO Agreements and other international rules has increased. Such a change may be viewed as evidence that the objectives, concepts and methodologies of our report have become widely accepted.

Also, our report suggests the importance of utilizing the multilateral dispute settlement procedures under the WTO to address unfair trade policies and measures. It

is a great evolution in the system of international economic law that the reliability and effectiveness of the WTO regime has increased as a result of the dispute settlement procedures-centered appellate body used by many countries, including our major trading nations. In other words, it can be said that the WTO Agreements not only are reliable rules themselves, but also have a remarkable dispute settlement system. This is epoch-making progress in the system of international economic law. Therefore, we can also say that this is a successful experience of strengthening effectiveness, which comes from the effort of using this system in actual dispute cases by WTO Members.

In addition, our report contains a newly introduced section, Part III, which provides the specifics of major cases of investment arbitration under investment treaties. Since late 1990, the number of arbitration cases that were resolved by using arbitral proceedings under each treaty to prevent inconsistency with duties under investment treaties etc, has increased sharply while judicial precedents has accumulated at international arbitral bodies.

In general terms, whether international rules work depends mainly on awareness of compliance, and the practice and effectiveness of arbitral mechanisms. In view of this, regarding trade policies, viewpoints which should be judged under rules such as WTO Agreements, EPA/FTA, etc. have been shared internationally.

Of course, result-oriented approaches have not become extinct, nor have attempts ceased to solve trade issues by means of unilateral measures without going through the WTO dispute settlement procedures. There is always a risk of returning to such means when conditions in the world economy change in the future. With this in mind, and in order to contribute to a more stable world trade regime, it is important for this report to continue to present, both domestically and abroad, the basic ideal to which we subscribe.

2. Basic Viewpoint of the Report

Our basic perspective described below, which we have maintained since the publication of our first report, may now be generally accepted as a foregone conclusion. However, considering the risk of returning to past unilateral methods, it remains necessary to re-emphasize the substance of our perspective in this report.

1) What Are “Fair” Trade Policies and Measures?

From the very beginning, our report has consistently advocated the idea of analyzing trade policies and measures according to “rule-based criteria” as a means of determining their fairness.

What Are “Rule-Based” Criteria?

The “rule-based criteria” used in this report are based on existing international agreements. Following the rules is an essential part of handling matters fairly. Indeed, the first definition that the Oxford English Dictionary provides for “fair” is “in accordance with the rules”.

The first and most important set of rules used in this report is found in the Marrakech Agreement Establishing the World Trade Organization (WTO Agreement), which provides the most comprehensive international framework for international trade. It goes beyond the scope of its predecessor (GATT, which covered only trade in goods) to provide rules for new areas such as trade in services and protection of intellectual property rights.

The second set of rules we employ is found in other major international agreements and in the basic principles of international law. These disciplines, such as Plurilateral Trade Agreements in the WTO Agreements, are considered supplements to the WTO Agreements when we conclude them as disciplines to deal with areas covered by the Agreements, but to which not all Members are parties, such as plurilateral agreements and areas simply not covered by the Agreements.

Examples of these other rules and principles of international law include:

- Multilateral agreements that stipulate rights and obligations in specific fields such as the Paris Convention for the Protection of Industrial Property;
- Bilateral agreements governing bilateral economic and trade issues such as the Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership (JSEPA); the Bilateral Investment Treaty between Japan and the Republic of Korea; and the Treaty of Friendship, Commerce and Navigation between Japan and the United States; and
- International custom in the form of unwritten law. The general principles of international law may not be codified in treaties, but they nevertheless constitute rules which Japan and all other countries are supposed to observe.

In particular, as previously noted, though the role of EPAs/FTAs has been expanding relatively, we should basically contribute to the enlargement and deepening of fundamental international trade rules under the WTO system. Moreover, it is important to commit strongly to the establishment of area/bilateral orders through EPAs/FTAs. In addition, it is also important to ensure EPAs/FTAs’ consistency with WTO Agreements.

The third set of rules used in this report is found in the rules and mechanisms currently agreed upon as our yardstick. Where no established international discipline exists, we take the position that a discipline needs to be established before fairness or unfairness can be discussed.

Significance of “Rule-Based Criteria”

Three points must be kept in mind when considering the significance of the criteria applied. First, issues of fairness in market competition should not be focused on the results of competition, but on the rules under which competition takes place. As long as fair competition takes place under agreed-upon rules, challenging the fairness of individual results is not only misguided; it is also a violation of the obligations to uphold the agreed-upon rules. When complaints about results arise, the rational response is to ensure fairness by creating a medium in which to examine whether the rules have been designed to achieve the basic objective of international trade. It is important that we not depart from rules to focus on individual cases that are based on a misguided “results-based” approach.

Second, when countries reach agreement in international negotiations and commit to the fulfillment of mutual obligations, they should cite and seek remedies for the breach of those obligations. Such an approach is both justified and necessary to secure the effectiveness of agreements. Requests for fair treatment in this regard are certain to be backed with broad international approval.

Third, an effective means of avoiding needless misunderstandings and emotionalism over trade concerns, as well as of preventing trade friction from becoming a political issue, is to judge objectively whether criticism and complaints about a country’s trade policies and practices in fact have any basis under internationally agreed-upon rules. The WTO dispute settlement system was designed for this very purpose. If, for example, the United States invokes retaliatory measures under Section 301 of its Trade Act unilaterally by condemning a foreign country’s measure as a violation of the WTO Agreement without going through the WTO dispute settlement procedures, it would itself be in violation of the WTO Agreement; and so such an action cannot be accepted. As economic relations between Japan and other Asian countries have intensified, more problems have been occurring with regard to individual trade with these countries. In order to construct mature economic relations with these countries without it becoming a political issue, it is important to solve these problems in a calm and constructive manner according to rules, based on confidence in the WTO system. Also, many EPA rules procedures for mediation are based on international law, in the case of problems arising between investors and states as a result of investors’ submitting to arbitration against the host country, which function as a useful tool to secure the implementation of rules. One of the purposes of this report, which seeks to examine trade policies and practices in terms of rule-based criteria of fairness, is to provide a means under which something productive can evolve when trade friction occurs.

The first report cited “sharing awareness as “All are sinners” and promoting mutual efforts for solving problems” as one of the purposes of this report. The significance of the above-mentioned attitude should again be emphasized here.

2) Problems with “Result-Based Criteria”

Since the first annual report was published, this report has pointed out the problems of “result-based criteria” as opposed to the idea of “rule-based criteria”. Result-based criteria allow a country to brand as “unfair” or “unreasonable” the trade policies or measures of another country. A country that takes this approach may regard the trade policies and measures of trading partners as “unfair” if there is a large trade imbalance or if exports to that trading partner fall short of expectations. There are many problems associated with this approach.

Lack of Objectivity

The first problem with result-based criteria is its inherent lack of objectivity. The criteria by which the policies of trading partners are reviewed are adopted unilaterally and are not based on internationally agreed-upon rules. Therefore, criticisms that are based on these unilaterally set criteria and that are used to brand a trading partner as “unfair” lack objectivity. Behind the unilateral measures is the belief that a country is justified in making unilateral judgments when applicable international principles either do not exist or are ineffectively administered. However, as a framework for the dispassionate and constructive handling of trade friction, this approach offers little stability and, therefore, this report does not support it.

Lack of Causal Relationship

Second, result-based criteria are an integral part of a “result-oriented” approach toward trade. This approach contains a basic flaw. A country might perceive a specific policy or measure of its trading partner as having brought about that result and, therefore, judge it as “unfair” when trade has produced an undesirable result, even when no causal relationship has been established between the policy and the result. To a large extent, this result-oriented approach comes from a tendency to see a direct link between current account or trade imbalances and inadequate market access. However, it has been theoretically established that no direct relationship exists between macro trade imbalances and micro issues in trade policies and measures.

Danger of “Managed Trade”

Finally, it is important to point out that a result-oriented approach can easily evolve into “managed trade”. There are cases in which countries dissatisfied with the results of trade adopt policies that instruct their trading partners to achieve specific results in terms of market share or import value for certain foreign products (numerical targets). Such arguments have been developed into a “balance of benefits” theory, a term that was noted in the chairman’s summary attached to the 1986 Punta Del Este Declaration that launched the Uruguay Round of multilateral trade negotiations.

Frequently, the measures taken by trading partners are labeled as not only

“unfair”, but also “anti-competitive”. Thus, what they ultimately seek is “equivalency of results” rather than “equal opportunities”. This approach has the danger of hindering many excellent functions of genuine competition, the engine of a market economy. It represents an abandonment of the market economy and an abrogation of the basic principles of the WTO Agreements and the WTO’s efforts to develop the world economy according to market disciplines.

3) Economic Perspectives that Supplement “Rule-Based Criteria”

The basic position of this report favors “rule-based criteria”, which implies that legal analysis necessarily becomes dominant. As a supplement to this approach, we have, since the first edition of the report, included a brief analysis on the “economic implications” of the rules and measures discussed. There are three basic reasons for doing this.

The first reason is that trade policies and measures that depart from international trade rules and dispute settlement mechanisms that have been agreed upon in negotiations not only are infractions of the rules, but also generally have negative economic implications. They reduce the predictability and transparency of international trade and distort the international flow of goods and services, thereby exerting a substantially detrimental influence on the economic welfare of member countries. Keeping these economic effects in sight should assist the better understanding of the importance of international trading rules and dispute-settlement mechanisms.

Second, international trading rules and dispute settlement mechanisms serve as institutional frameworks for the economic activities of national governments, producers, and consumers and have a significant effect on the economic welfare that is achieved. In other words, it should be possible to basically regard trade measures and policies which do not depart from dispute settlement mechanisms or existing international trading rules as having been adopted based on said rules and mechanisms. Understanding the economic implications of the rules and mechanisms is of fundamental importance to understanding the meaning and significance of the current system.

Third, international trade rules and dispute-settlement mechanisms are not set in stone. They are merely institutional frameworks that can be changed at any time if there is an international consensus to do so. Where there are no international disciplines, our position is that international rules should be established. In searching for new international disciplines, we must have an accurate understanding of the implications that possible rules and mechanisms will have on countries’ economic welfare, and we must make a social choice regarding the systems that we prefer.

3. The 2007 Report

As previously mentioned, this report is divided into three parts. Part I discusses Japan's major trade partners' policies and measures that are problematic under the WTO Agreements and other international rules. Part II contains an overview of the WTO Agreements and other rules and discusses major cases involving these rules which form the basis of Japan's views.

In the 2007 report, special emphasis has been placed on providing a newly introduced section, Part III, which provides analysis and explanations concerning the provisions and rules of FTAs/EPAs, etc., sector by sector.

In general terms, in order to seek to improve another country's policy based on international rules, it is necessary for the industrial world, the general public including experts, and governments to work effectively together. Moreover, from this point of view, we provided information to assure broader understanding of the WTO Agreements and international trade rules such as EPAs/FTAs.

In Part I, we have described a three-step framework wherever possible: i) Outline of the measure, ii) Problems under international rules, and iii) Recent developments. These descriptions indicate how a country's measures could be problems under the WTO Agreements, and will lead to a better understanding the WTO Agreements for readers. Moreover, we have tried to describe the reactions of the Japanese Government and hope that our initial policy information feedback will lead to a better understanding of trade policies in general and help promote public-private cooperation. In this year's report, we estimated China's policies generally in light of the five years that have passed since China's WTO accession. Before preparing the 2007 report, the Secretariat announced a list of topics for inclusion in the report and invited public comments on these and any other topics.

In Part II, we describe issues of considerable interest such as the supervision of discipline regarding movement of natural persons, to enhance the public's understanding. Moreover, we have revised the text to make the report more easily understandable to those who are unfamiliar with the WTO Agreements, etc.

The newly-added Part III explains, in a systematic manner, economic partnership agreements and investment treaties. Part III explains the provisions and rules of not only the agreements that involve Japan but also those of some agreements concluded between other countries as necessary for reader's help to understand these new international rules. In addition, it describes specifics of major cases of international mediation under investment treaties, with a view to helping Japanese companies make their investment and management decisions from a broader perspective.

Criteria for Selecting Trading Partners

We have made it a rule to cover in the report a dozen or so economies important to

Japan, based on the amount of bilateral trade with each (total exports and imports).

In the 2007 report, we covered the economies of the United States, China, ASEAN¹, the EU², Republic of Korea, Chinese Taipei, Hong Kong and Australia, Canada, Mexico, India and Russia.

Figure 1: Amount of Trade with Japan

(total value of exports and imports in 2006, in 10 billions of yen)

United States	2,487
China	2,456
ASEAN	1,816
European Union	1,784
Republic of Korea	902
Chinese Taipei	749
Australia	468
[Germany]	452
Hong Kong	441
<Thailand>	422
< Indonesia>	364
< Malaysia >	333
[United Kingdom]	255
Canada	226
< Philippines >	196
[France]	193
(Russian Federation)	159
[Italy]	156
<Vietnam>	109
[Belgium]	104
India	99
World Total	14,241

Source: Ministry of Finance “2006 Customs Statistics
(export final report, import preliminary report)”

* (): Non-WTO member []: EU member < >: ASEAN member

¹ Unlike the EU, ASEAN has not joined the WTO as an independent customs territory. However, the ASEAN countries are covered in a single chapter because they share common problems.

² Although the common foreign policy of the EU is carried out as a characteristic of the EC (European Community), we decided to unify the notation in the EU for convenience in this report.

Policies and Measures Discussed

In Part I, the trade and investment policies and measures of the covered economies are discussed. Business practices and such that have nothing to do with the policies and measures taken by a particular government are not discussed here. However, Part I is not intended as an exhaustive study of these policies and measures; rather, examinations are conducted focusing on those that are considered to be important to Japan's economic and trade activities and only those are listed that may be problematic in terms of conformability with the WTO Agreements and other international rules.

There also are some trade and investment policies and measures that do not expressly violate the WTO Agreements or other international rules, but that contravene the spirit of the WTO and should be liberated or controlled under new rules. These areas generally include high tariffs, non-concession, service and government procurement, etc.

Matters Investigated and Pointed out Regarding Each Country's Policies and Measures

In Part I, matters raised and examined regarding each country's policies and measures are, as far as possible, described in three parts: (1) outline of the measure, (2) problems with international rules, and (3) recent developments. As stated in the preface, such a structure clarifies how each country's policies and measures may be problematic with respect the WTO Agreements, or, in other words, how the WTO Agreements control each country's policies and measures. The structure also helps readers to deepen their understanding of the WTO Agreements. As stated above, we have tried to describe Japan's positions more concretely than ever in the "recent developments" part.

Other Matters

Unless otherwise stated, this report indicates the state of affairs as of the end of February 2007.

The report is available on the METI website.

<http://www.meti.go.jp/english/report/index.html>