

## **U.S.—JAPAN TRADE TENSION**

### **PART 2**

# **THE STICKY PROBLEM OF NONTARIFF BARRIERS**

#### **INTRODUCTION**

In the face of a soaring U.S. trade deficit with Japan, which totalled \$37 billion last year and could grow to more than \$40 billion this year, demands have been mounting for easier U.S. access to Japanese markets. Since Japan's average tariff rate of 3 percent is already less than that of either the U.S. or the European Economic Community, attention has focused on Japanese nontariff barriers (NTBs). NTBs include import quotas, the "Buy National Products" law adopted by the Japanese government for domestic procurement, and various import regulations.

American exporters complain with justification that overly rigid standards, antiquated testing methods, and repetitious certification requirements make the Japanese market extremely difficult to penetrate. Some U.S. companies argue that these NTBs specifically discriminate against American products. American businessmen claim that, if these discriminatory regulations were abolished, the U.S. could increase its exports to Japan substantially, and the trade imbalance could be significantly reduced.

Japan, as other nations, introduced quality control, inspection, and certification procedures to provide dependable and safe products to its citizens and to ensure a healthy environment. These measures thus should not be viewed solely--if at all--as attempts to erect nontariff barriers. Similarly, the traditional Japanese government role in consumer affairs has spawned measures that, in effect, are NTBs.

Immediately after World War II, Japanese citizens were plagued by unsafe products. The international reputation of products labeled "Made in Japan" was very low. To protect domestic consumers, burnish the reputation of Japanese goods in the world market, and earn needed U.S. dollars through supplying the U.S. military during the Korean and Vietnam wars, the Japanese government adopted regulations to force Japanese companies to raise their standards.

These regulations probably did much to create the high quality for which Japanese goods today are universally respected. But the regulations also imposed enormous burdens on the Japanese economy in terms of the higher cost of goods, fewer consumer choices, a less competitive environment, and in some cases, corruption. These problems affected not only Japanese corporations but also foreign businesses seeking to export products to Japan.

For example, Japanese consumers prefer goods stamped with a Japanese Industrial Standard (JIS) mark issued by certain Japanese government agencies. U.S. companies, who want JIS marks, until recently were required to bring Japanese inspectors to the U.S. factory at the companies' expense. This put U.S. products at a disadvantage because of the extra expense and complex paperwork involved.

U.S. exporters have been pushing vigorously for the abolition of these practices that effectively raise barriers to foreign-made goods. Through such market-opening programs as the recent Action Program for Imports, Tokyo has begun responding to these pressures by ending many of its restrictions on JIS mark approval, telecommunications equipment, pharmaceuticals, medical supplies and equipment, cosmetics, and agricultural chemicals. Currently, the Diet (Japanese Parliament) is considering legislation to make these administrative reforms legally binding.

These reforms should allow American businessmen to expand their market share in Japan. But this is just a beginning; more reforms are warranted. Moreover, the faithful execution of these reforms by working level government officials is vital.

Washington now should press Tokyo to modify its regulation of consumer safety, product quality, and environmental protection, particularly in the areas of high-technology products, electrical goods, cosmetics, and food additives. The U.S. also should seek major changes in the attitudes of regulatory officials, who should begin serving the Japanese consumer rather than controlling private business. Tokyo should deemphasize regulation and intervention and give more responsibility to the private sector, including Japanese and American firms. This would do much to remove the obstacles to U.S. goods imposed by Japanese certification, standards requirements, and other nontariff barriers.

The major beneficiaries of such changes are likely to be small and medium-sized U.S. companies that have no Japanese subsidiaries or license agreements with Japanese corporations. Larger American corporations such as IBM, Texas Instruments, SmithKline Beckman, Pfizer, and TRW comply with Japanese regulations and sell more than \$40 billion worth of products annually to Japan. Thus while eliminating these NTBs would be welcome and is long overdue, this alone will not erase the U.S.-Japan trade imbalance. For this, the key factor remains the relative strength of the U.S. and Japanese domestic markets. As such, Tokyo must take bolder measures to encourage consumer-led economic growth.

#### DOMESTIC FACTORS AFFECTING JAPANESE REGULATION

Tokyo's approach to product standards and other regulations has been heavily influenced by Japan's post-World War II commercial experience and Japanese attitudes toward the role of government in product safety. The Japanese economy after the war was chaotic. The marketplace was flooded with unsafe, defective, and counterfeit products made in Japan and neighboring countries. Because Japanese citizens could not afford to bring damage suits before the courts, the public and the media demanded that the government protect consumers from low quality products. In response, Tokyo assumed active responsibility for controlling and supervising product quality and safety. This was accomplished in part by regulatory laws.

Japanese today still expect their government to assume substantial responsibility for consumer accidents caused by inferior products. For example, when the Boeing 747 crashed in August near Tokyo, high government officials and the president of Japan Air Lines had to resign their positions to indicate their responsibility. This tradition of assuming responsibility has made Japanese officials cautious in approving foreign products for sale in Japan.

A secondary objective of the regulations was to overcome the reputation that "Made In Japan" was synonymous with junk and shoddy copies. To regain international credibility and to earn foreign exchange, the Japanese government refused to allow domestic companies to export products unless they passed strict testing and certification requirements.

During the Korean and Vietnam wars, U.S. military procurement officers in Japan insisted on products that met strict specifications. To ensure compliance, the U.S. military introduced methods such as "Statistical Quality Control" (SQC). Japanese companies then invited such prominent U.S. specialists as Dr. W. Edward Deming, an industrial engineer who had helped develop high quality standards for the U.S. defense industry, to set up the SQC system. For the past two decades, one of the most prestigious awards

in Japan has been the "Deming Prize," given annually to the company with the most successful quality control program.

These strict government requirements and the procedures they inspired helped transform Japanese products from junk to quality. They were introduced solely to satisfy the needs of both domestic and foreign markets. They were not designed to discriminate against foreign goods.

Despite their enormous benefits, the regulations had harmful side effects. Some businessmen resorted to bribery to avoid regulations or to hasten government approvals. And this combination of strict regulation and corruption spawned monopolistic practices that increased prices and led to fewer choices for the Japanese consumers. For example, due to years of tight regulation of its international aviation industry, Japanese fares for international travel are much higher than those in more competitive markets such as the U.S.

One problem was that the regulations were often vaguely written. Their interpretation was left to low-echelon officials, all of which led to a very close liaison between key government officials and business representatives so that the private sector could stay abreast of complex application procedures and testing methods. This put new, and especially foreign, companies at a disadvantage because they lacked government contacts or did not recognize the importance of such a relationship.

#### REFORMING STANDARDS, INSPECTION, AND CERTIFICATION SYSTEMS

In a positive response to the international pressure generated by Japan's trading surplus, Tokyo has begun revising many of these outdated regulations. Examples:

##### Japanese Industrial Standard (JIS) Mark

At one time, U.S. companies wishing to obtain the JIS mark for their products had to bring Japanese teams to the U.S. to inspect their factories and to test sample products. Obtaining a JIS mark was completely voluntary, but Japanese consumers prefer JIS products for guaranteed quality and goods lacking the JIS endorsement face inherent marketing difficulties. Because of the expense of flying officials from Japan to the U.S., many American companies did not seek the JIS mark. The result: their goods were perceived as of low quality and hence were at a disadvantage in the Japanese marketplace. Obtaining the JIS seal of approval became much easier for U.S. firms when this requirement was abolished this year. The new regulations allow JIS approval to be granted on the basis of inspections and tests conducted by U.S. testing firms whose procedures meet Japanese criteria.

## Telecommunications Equipment

In the past, Japan required American telecommunications manufacturers to satisfy complex technical standards. What made matters worse, Japan did not accept testing results from the U.S. companies. In recent years, Japan has begun easing these requirements. Standards for Japanese communications equipment now are identical to requirements for U.S. products. American manufacturers can submit their own testing results and can negotiate with Japanese telephone companies such as Nippon Telephone Telegraph Corporation on proposed standards.

In a related field, Tokyo earlier this year made it easier for the U.S. to export to Japan more than 200 electrical appliances, such as radios, television, projectors, and electric wire. Previously, certification of the appliances' safety was obtained only through rigid Japanese government inspections. Under the new rules, certification will be granted based on data supplied by American companies. This is known as self-certification, a practice long in use in the U.S.

## Pharmaceuticals

In the past, the Japanese Ministry of Health and Welfare (MHW) required that preclinical studies for pharmaceuticals, such as research into a drug's biological action or its possible toxicity for humans, be conducted in Japan if this drug were to be sold in Japan. Such foreign test data as existed were rejected. This year, however, MHW began accepting foreign preclinical test data. MHW also has eliminated duplicative testing of drugs coproduced by Japanese and foreign firms.

In the past, if the Japanese import license for a drug was transferred from one importer to another, MHW required the new importer to re-register the drug as if it were a new product. This meant an entire new round of testing even though the content of the drug was unchanged. MHW has modified this requirement to the extent that, if the drug's manufacturer and plant remain the same, import licenses can be transferred directly.

## Medical Supplies and Equipment

In previous years, MHW did not recognize foreign clinical and nonclinical testing of medical supplies and equipment. This year MHW decided to accept U.S. test results.

As with pharmaceuticals, MHW has eliminated the difficult procedure involved in transferring import licenses for medical equipment from one importer to another. Foreign medical equipment companies can now change their Japanese importers or begin their own production in Japan with minimal delay.

In the past, MHW stipulated that only Japanese testing agencies could conduct tests on in vitro diagnostic reagents--those chemicals used in laboratory tests to diagnose disease. As of this year, foreign clinical test results are accepted on most reagents.

Under Japan's recently announced Action Program, standard medical instruments, such as centrifugal subsiders, microtomes, and constant temperature instruments are exempt from government approval requirements.

### Cosmetics

Most nontariff barriers on cosmetics have been removed in recent years. But before 1982, the MHW did not even publish the list of government-approved cosmetic ingredients. Now the Ministry lists more than 2,400 approved ingredients. Imports containing these ingredients are approved automatically for sale in Japan. The list is being developed in cooperation with American companies. All U.S. test data on cosmetics are now accepted by MHW.

Japan's product registration procedures for cosmetic products in the past were complicated and involved needless delays. Most of these procedures now have been completely eliminated or greatly simplified. For example, minor formula or pigment changes in cosmetics are now permitted without re-registration with the government. Previously re-registration was required whenever U.S. cosmetic firms changed formulas or pigments even slightly.

In the past, only Japanese companies or foreign companies established in Japan could hold product registration. Thus American cosmetic companies that had no subsidiaries in Japan could not register their products in their own name and were required to ask Japanese firms to be their agents or to establish their subsidiaries. Today, foreign firms may register products in their own names.

In the past, MHW did not explain the criteria for product safety. Thus cosmetic companies, particularly foreign firms, were left in the dark as to which cosmetic ingredients were acceptable to the MHW. Within three years the MHW will publish standards for cosmetic ingredients and abolish licensing for those cosmetics that comply.

### Agricultural Chemicals

The Ministry of Agriculture, Forestry, and Fisheries (MAFF) in the past required that all toxicology studies or other safety tests of agricultural chemical products be conducted in Japanese government laboratories. Since there were few public toxicology laboratories in Japan, this meant expensive duplication and marketing delays for U.S. agricultural chemical companies.

This year, MAFF decided not to require the duplication of testing and to accept the U.S. companies' data and the international Good Laboratory Practices standards for toxicology testing. This means U.S. chemical firms will be able to compete equally with Japanese firms.

All of these recent changes were, in large part, a result of the extraordinary pressure exerted by the U.S. government in response to its growing trade deficit with Japan. Changing the standards and requirements for telecommunications equipment, for example, was the direct result of a threat by the U.S. Congress to pass retaliatory legislation against the import of Japanese telecommunications equipment.

#### REMAINING PROBLEMS

Tokyo's recent measures easing standards-related trade restrictions on electronics, cosmetics, telecommunications equipment, and other products apply to some \$7 billion in U.S. exports to Japan this year. Clearly these reforms are significant and will allow American businessmen to expand their share of the market in Japan.

More reforms are warranted, and the faithful execution of these measures by working level government officials is vital. Washington should press Tokyo to modify further its regulations, particularly in the areas of high-technology products, electrical goods, cosmetics, medical equipment, and food additives. Specifically, the Japanese government should:

- 1) process much faster U.S. companies' patent applications in computers and high-tech products;
- 2) invite U.S. participation in the development of industrial standards and regulations governing computers and other high-tech products;
- 3) publish safety, allergenic, and dermatological standards for test data in cosmetics;
- 4) simplify product approval systems in medical equipment when U.S. manufacturers make minor modifications that do not affect performance or safety;
- 5) approve more food additives when these are internationally accepted as being safe.

Perhaps more important than the reforms themselves are the needed changes in the attitude of bureaucrats. It is common for low-echelon

officials who inspect products and production facilities to hold up a major trade transaction because of a minor technicality.

These bureaucratic attitudes are products of an era when Japanese companies were irresponsible and could not invest in high quality products. Japanese corporations today have set up their own stringent quality control systems. They are keenly aware that a reputation for poor quality will undermine the success of their products. Many sectors of the Japanese economy, therefore, do not require strict government supervision as in the past.

At the same time that the ministries are reeducating their bureaucrats, Tokyo should reduce the number of agencies and employees involved in regulation. More international standards and self-certification systems need to be adopted to streamline the process. In short, deregulation of trade will be the ultimate solution to the real opening of the Japanese market.

It should not be expected, however, that nontariff barriers reform and deregulation alone will increase dramatically U.S. exports to Japan. Other factors, such as increased consumer demand in Japan, lower value of the U.S. dollar, and effective marketing campaigns by American exporters would contribute far more to U.S. export growth.

Mainly small to medium-sized U.S. companies or newcomers to the Japanese market will feel the positive effect of the recent certification and testing reforms. Thus, the impact on the overall U.S.-Japan trade balance will be relatively minor.

## CONCLUSION

Japan is the world's second largest economy. But regulations governing safety standards, certification, and inspections have not kept pace with the country's economic development. Most of these regulations were in response to domestic demands for product safety, reliability, and quality. Yet the regulations have become obstacles to fair trade because they have not been changed fast enough to match the rapid internationalization of the Japanese economy.

Only recently--and largely in response to U.S. pressure--has the Japanese government moved toward needed reform. Washington should continue to press Tokyo for relaxation of its regulatory practices of such products as high technology, medical equipment, cosmetics, and food additives. And further, deregulation in all areas of trade procedures should be sought and efforts made to ensure that these reforms are faithfully executed by a sometimes reluctant bureaucracy.

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