PHASE I: JAPAN'S DISTRIBUTION SYSTEM AND OPTIONS FOR IMPROVING U.S. ACCESS

Report to the House Committee on Ways and Means on Investigation No. 332-283 Under Section 332(g) of the Tariff Act of 1930

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PREFACE

On October 23, 1989, the United States International Trade Commission (USITC) received a letter from the House Committee on Ways and Means (presented as appendix A) requesting that the Commission conduct an investigation, in two phases, under section 332(g) of the Tariff Act of 1930 with respect to Japan's distribution system and options for improving U.S. access to that system. In response to the request from the House Ways and Means Committee, the Commission instituted investigation No. 332-283 on November 13, 1989. The first phase of the report was to be submitted on June 22, 1990 and Phase II of the report by October 23, 1990.

The Committee requested that the first phase of the study provide an overview of Japan's distribution system, including a discussion of its structural features; official policies and practices affecting it; and business practices. In addition, the study was to "analyze the composition of Japanese imports from the United States and other countries (e.g., capital goods, consumer goods), with a view to determining the sorts of changes in Japan's distribution system that are most likely to benefit U.S. exporters."

The second phase of the study would seek experts' views on options for improving U.S. access to the Japanese distribution system, including information on the experiences of U.S. and foreign businesses with the distribution system.

A public hearing in connection with this investigation was held on January 26, 1990 and testimony was received from interested parties (witness list is presented as appendix B).

Notice of this investigation was given by posting copies of the notice at the Office of the Secretary, U.S. International Trade Commission, Washington, D.C., and by publishing the notice in the *Federal Register* 54 F.R. 48324, November 22, 1989)(appendix B).

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EXECUTIVE SUMMARY

General Conclusions

- *Certain aspects of Japan's distribution system appear to impede access to existing distribution channels by new entrants, including foreign firms.*

The separate and, in some cases, combined effect of some features of Japan's distribution system appears to impede access to existing distribution channels and to limit the number of "noncaptive" channels available to new entrants. These features include legal restrictions on retailing, wholesaling and investment and business practices which are used by manufacturers to exert vertical control over distribution channels and to reduce horizontal competition. Thus, in order to gain access to Japan's market, new entrants may be forced to rely upon more expensive alternatives, such as establishing an independent distribution network, or marketing their products in channels less likely to maximize their products' sales potential in Japan.

- *Establishing independent distribution channels appears to be difficult and expensive, in part as a result of government regulation.*

The costs associated with setting up an independent distribution system—land, rent, warehousing, transportation, and other operating expenses—all appear to be high in Japan, partly as a result of government tax and land use policies and regulations affecting entry and fees. Moreover, legal and other restrictions on entry into retailing and warehousing and on foreign investment may make it more difficult for new firms to set up their own distribution channels.

- *Social customs and attitudes may strongly affect the behavior of manufacturers, wholesalers, retailers and consumers in Japan's distribution system.*

An emphasis on long-term, mutually beneficial relations, loyalty and obligations, nonadversarial conflict resolution, and personal contact in both corporate and consumer behavior may elevate the importance of nonprice factors such as service and quality in purchasing decisions and result in less willingness by purchasers to switch suppliers or retailers. These characteristics may also increase the likelihood that certain business practices will occur within Japan's distribution channels.

- *Factors outside of the distribution system may affect the ability of U.S. firms to distribute their products.*

For some U.S. products, problems associated with "image", product design, knowledge of the market, or choice of marketing strategy may affect access to Japan's distribution channels more than any impediments within them.

Characteristics of Japan's Distribution System

- *Japan's "distribution system" actually consists of a variety of channels for moving goods through the economy.*

Japan's distribution system is composed of diversely structured channels, differing in length and operation among product sectors, that contribute to the movement of goods from the manufacturer or point of entry into Japan to the final consumer. Raw materials, bulk commodities and some capital goods tend to be handled primarily by the nine major trading companies. The distribution channels for consumer goods are generally longer than for capital goods, with goods often passing through several layers of intermediate distributors before reaching the ultimate consumer. Many foreign suppliers have successfully penetrated the Japanese market through trading companies, joint ventures, licensing, franchising arrangements or direct marketing.

There are advantages and disadvantages to foreign firms associated with each of these approaches.

- *The structures and functions associated with Japan's distribution system have been shaped by geographic, economic and social factors, including:*

  — a business and social climate that emphasizes long-term relations, personal ties, loyalty and obligation;

  — consumer preferences that emphasize non-price factors such as quality, personalized service, prompt delivery and fresh or unique products and, in some cases, preference for domestic over foreign goods;

  — high population concentration in a small geographic area (one-half the U.S. population on an area equivalent to 4 percent of the U.S. land area);

  — a relatively less litigious society with more flexible contractual relationships, and;

  — public policies and social attitudes traditionally favoring producer over consumer interests and collective over individual welfare.

- *There are several notable differences in the structure of Japan's distribution system compared to those of the United States or other developed countries.*

These differences include: 1) relatively fewer low-cost, volume discount shops; 2) a large number of retailers and a preponderance of smaller shops despite the emergence of large retailers; 3) less centralization of wholesale functions and a generally weaker position of wholesalers vis-a-vis manufacturers; and 4) greater control by manufacturers over distribution channels. Trading companies and "keiretsu" play distinct roles in the distribution of products in Japan. Nevertheless, the Japanese distribution system is not wholly unique or necessarily inefficient. The large numbers of retailers and wholesalers, frequent deliveries to retailers, and other features of the distribution system may result in superior service to Japanese consumers that they value enough to be willing to pay for.

- *Distribution of many goods in Japan is affected by a high incidence of vertical integration of manufacturers into downstream distribution channels and by other interlocking relationships between suppliers and purchasers.*

Japan's nine general trading companies control over 75 percent of Japan's imports. Such companies have recently diversified into the distribution of higher-value added products in Japan, and continue to play a major role in the distribution of raw materials and basic manufactures. While the trading companies may be known for the extensive marketing services they can provide, some foreign suppliers have expressed serious concerns about the extent to which trading companies "overpromise" their marketing efforts on behalf of foreign goods. Foreign businessmen often allege that the ties of general trading companies to other Japanese firms, including potential Japanese competitors with which they are affiliated, result in less than enthusiastic sales efforts.

Keiretsu are large groups of Japanese companies linked together through various formal and informal institutions and practices. Some are characterized by hierarchically ordered systems of subsidiaries, suppliers, subcontractors, and distributors associated with a particular manufacturer. In industries characterized by distribution keiretsu, manufacturers appear to be able to exert substantial control over distribution channels, either through direct ownership or through a variety of business practices. These industries include autos, consumer electronics, optics, cosmetics, pharmaceuticals, newspapers, and processed foods. The interdependent relationships of firms within the "inter-market" keiretsu may affect the distribution of capital and intermediate goods in more subtle but equally important ways.

- *Vertical business practices by Japanese producers appear to solidify manufacturer control over distribution channels and may make it harder for new firms to enter the Japanese market.*

Many industries in Japan are characterized by a high level of vertical integration by manufacturers into the distribution channels and a high level of industry concentration. Some observers, including the Government of Japan, have suggested that business practices such as exclusive dealings, resale price maintenance, returns policies, and discretionary rebates, particularly when occurring in combination within these channels, may "create problems for competition" and impede new entrants. Such practices may provide some benefits in terms of ensuring a continuous supply of accurate product information and providing a high level of customer service.

- *Trade associations and cartels provide a forum for coordinated action by producers.*

Trade associations are important in influencing the development and implementation of industrial and economic policy in Japan. They also serve as forums for the exchange of industry information and the setting of product standards. These associations have been alleged to be involved in activities such as price-setting, market allocation, or other collusive behavior. The Japan Fair Trade Commission (JFTC), in a number of instances has uncovered evidence of such charges, finding trade association participants in violation of the Antimonopoly Law. Concern about such abuses prompted the JFTC to issue guidelines in an effort to prevent anticompetitive activity.

Cartels are legal in Japan under certain circumstances and, even where they have not been legally sanctioned, they have been informally tolerated by the government. They appear to be most commonly used to support small- and medium-sized businesses and to rationalize declining industries. Such cartels are permitted to engage in a host of concerted actions, including production and investment coordination.

Public Policies Affecting Distribution

- *Enforcement of Japan's Antimonopoly Law is weak.*

The most important law affecting competitive conditions in Japan, and therefore the distribution of goods, is the Antimonopoly Law. Although the law is based largely on U.S. statutes, and is actually stricter in certain respects, enforcement of its provisions has generally been considered weak. As a result, there appears to have been little formal restraint on business activities that operate to the disadvantage of consumers and potential entrants, particularly foreign firms.

The JFTC has become more active in investigating and prosecuting violations of the Antimonopoly Law since the Law's strengthening in 1977. However, the JFTC is still widely perceived as "lacking teeth." Financial and other penalties for violators are considered inconsequential, and the right of private action is sharply circumscribed. Recently, the Government of Japan has committed itself to taking a more active stance against business practices that impede foreign entry. The ultimate impact of such promises on actual market behavior remains to be seen.

- *The Large Scale Retail Store Law and similar local laws have limited the expansion of large retailers, the major vendors for imported consumer products.*

The Law effectively gives local shopkeepers "veto power" over the opening of larger, potentially more efficient, stores such as supermarkets, department stores, and franchise chains. Such retailers already carry significantly more imports than the small "mom and pop" stores the Law was designed to protect. Moreover, larger stores appear to be in a better position to increase imports in the future, given their relative independence from Japanese manufacturers and their greater purchasing power, financial strength, and experience with international transactions.

- *The Government of Japan has promised reform of the Law and its administration, but U.S. suppliers may not be the main beneficiary of such change.*

The powerful political influence of small shopkeepers and continued efforts by local jurisdictions to impose more restrictive rules on retail outlets are likely to oppose anything more than moderate overhaul of the Law. Even so, it seems clear that if more large stores are established, it will open the door for expansion of U.S.-affiliated retailers in Japan and for increases in Japan's imports. However, Southeast Asian suppliers and the EC—which are currently Japan's most significant sources of imported apparel, footwear, and other consumer products—may stand to gain more in actual terms than the United States from such liberalization. Some U.S. consumer goods have grown substantially in recent years, and processed foods and leisure equipment have been identified as good candidates for expanded U.S. sales.

- *Other laws and formal practices may hinder foreign access to Japan's distribution system.*

Liquor.—Larger stores such as supermarkets that are major outlets for foreign alcoholic beverages have faced difficulties obtaining liquor licenses. U.S. firms are competitive in Japan's market for wine, beer, and distilled spirits, and argue that such barriers have become more important with the implementation by Japan of tax and tariff changes favorable to U.S. sales.

Investment.—Foreign-controlled investment is generally allowed automatically. However, there are certain sectors of Japan's economy in which foreigners are prohibited from making investments and it is often difficult for foreign firms to buy into or otherwise influence management of existing Japanese firms. For example, problems centering on cross-shareholding among friendly companies make it all but impossible for U.S. companies to buy into Japanese firms. The difficulty of carrying out such investment presumably limits the viability of entering Japan's market through the purchase of an already established marketing, sales, and service network.

Agriculture.—State-trading of certain agricultural products (wheat, wheat flour, and barley), the pork import system, and activities of the Livestock Industry Promotion Council pose distribution-related impediments to further U.S. exports to Japan. Restrictive policies with regard to food additives have also been cited by U.S. business as a hindrance to U.S. exports.

Customs, entry procedures, and warehousing.—Some of Japan's customs and entry-related procedures may increase costs to foreign exporters in the form of delayed deliveries, lost merchandise and unnecessarily high compliance costs. Moreover, Japan's airports and seaports have not kept pace with the increase in imports, and warehouse facilities (especially cold storage warehouses) are inadequate. Entry into and competition within the warehousing industry is regulated, limiting capacity and stifling rate competition.

- *A number of forces, from within and outside of Japan, seem to be pushing Japan's distribution system in the direction of greater openness.*

A number of recent economic and social trends point towards increased openness in Japan's distribution system. Among the economic factors are the yen's sharp appreciation since 1985, which raised the price competitiveness of foreign goods and heightened pressures on existing Japanese suppliers to source from abroad; increased overseas manufacturing and direct imports; strong domestic growth and increased consumer spending; and liberalization of financial markets. Other factors that might improve the prospects for change in the distribution system are some increases in consumer consciousness and receptivity to imports (partly attributed to growing numbers of Japanese travelling overseas) and a greater awareness by the government and interest groups of the impact of certain land use, tax, and distribution policies and practices on Japanese consumers and the economy. The shift to domestic demand-led growth has reportedly increased the interest of some Japanese firms, such as general trading companies, in importing. Recent commitments by the Government of Japan under the

Structural Impediments Initiative may also signal political support for making Japan's distribution system more accessible to newcomers.

- *Nevertheless, change may come more slowly and be more incremental than has occurred in other countries.*

The changes that are occurring in Japan appear to more "evolutionary" than the revolutionary change that has typified the development of the retail sector in the United States and Europe. Even those changes that are supported by the Government of Japan, such as speedier opening of large stores under the Large Scale Retail Store Law, may be difficult to achieve given the resistance of politically powerful shopkeepers and local interests and the de facto social welfare role currently played by the distribution system in Japan. In addition, some of the factors that have the potential for introducing more competition into Japan's retail sector, such as discount chains and NIEs stores, have sometimes proved to be a short-lived phenomena or have been "co-opted" by the existing Japanese manufacturers.

- *Some features of Japan's distribution system or economy do appear promising for change in the near-term.*

Among the areas that appear to be the most susceptible to change in the near-term are improving entry, customs and testing procedures, expansion of the infrastructure (especially warehousing and roads), improving the consistency and transparency of standards and testing procedures, and lifting restrictions on sales promotions. These areas are generally less rooted in social customs than business practices and may be more amenable to policy changes. Distribution-related barriers to U.S. agricultural products may also be negotiable, but the actual impact of such changes on U.S. exports is uncertain.

- *Those features of Japan's economy and society that are likely to have the greatest impact on distribution of U.S. exports may also be the slowest to change.*

Stiffer enforcement of the Antimonopoly Law and reform of land-use and tax policies could have a positive impact on U.S. or foreign access to the Japanese distribution system over the long-term. Such changes might "shake up" the system, creating fissures in the long-standing business relationships that have made it difficult for newcomers to enter Japanese distribution channels. However, given the current weak standing of the JFTC in Japan's political system and limited enforcement of antitrust policies, it is likely that reforms in these areas will occur slowly and will be vigorously opposed by important political and business interests in Japan.

Long-term relationships between suppliers and purchasers based on a social tradition that emphasizes loyalty, obligation and personal ties help create a business climate conducive to manufacturer control over distribution channels. The lack of a true consumer movement, the absence of a strong political will for more fundamental overhaul, and the nonlitigous nature of Japanese society are other factors that will slow the pace of reform.

- *Based on recent trade patterns, other countries or Japanese newcomers may be equally or more likely to benefit from any changes that occur in the near term.*

Japan's imports of manufactures, paced by sales of consumer goods have increased markedly in recent years. Personal consumption has fueled Japanese economic growth. Partly as a result, EC and Southeast Asian suppliers, who are Japan's leading suppliers of consumer goods including autos, apparel, and household appliances, have garnered the largest share of the increase in Japan's manufactures imports. Moreover, Southeast Asian and EC suppliers rapidly gained ground against U.S. suppliers in the sale of capital goods to Japan, traditionally a source of U.S. strength. Nevertheless, U.S. exports of manufactured goods improved in 1989, growing faster than Japan's imports of such goods from the EC and Asian NIEs. Shipments of machinery, automotive vehicles and parts, and consumer goods such as sporting equipment have all registered strong gains. A variety of factors will influence whether this pattern holds in the future, including the composition of Japanese domestic demand, the relative competitiveness of U.S. and other foreign suppliers, and whether there are any shifts in Japanese corporate behavior that will improve the sales prospects for American firms.

Introduction and Summary

The distribution system of any market economy is important because it is one of the primary means by which prices are set through the interaction of supply and demand among manufacturers and purchasers at all levels. Various factors involved in the distribution of products may affect the accessibility of a market to foreign suppliers. Products that do not "make it" through the distribution system will never reach store shelves or the hands of end-users. Difficulties experienced by foreign suppliers in penetrating the Japanese distribution system have been the subject of recent attention by government and business alike. This study examines many aspects of Japan's distribution system that have been the topic of bilateral discussions or have been raised as concerns by U.S. exporters.

Purpose of the Report

The central focus of this report is to provide an overview of Japan's distribution system including a discussion of its structural features; official policies and practices affecting it; and business practices. The study will also analyze the composition of Japan's imports from the United States and other countries. Many features of Japan's distribution system are described, individually or in some combination, either because they affect foreign access or simply to provide relevant contextual information. The report attempts to depict how the individual participants in Japan's distribution system (manufacturers, wholesalers, retailers and consumers) behave, how groups of these participants (in the form of the industrial groupings, trading companies, trade associations, and retail chains) interact, and how official policies affect the distribution of goods.

The report also considers the effects of such features or practices on the ability of newcomers, particularly U.S. companies, to access Japan's distribution system. The report should be read with an eye for how each of the features discussed interacts with other elements of Japan's distribution system; how the various features are affected by the legal, business and social environment in which they operate; the extent to which any individual feature is affected by the various other practices described; and finally, what the entire distribution system looks like.

While it is important to explain what the report does attempt to do, it is just as important to keep in mind what it does not. First, although some comparisons of features or practices found in Japan's distribution system with those in other developed countries are made, the report is not intended to represent a comparative study of the relative openness of distribution systems. Comparisons made in the text, for example, with regard to the numbers of wholesalers or retailers in the system, are not intended to imply "good or bad," but rather to place information in a relative context. Second, information on the impact of individual practices on particular products is provided where available or practicable. However, the report is not a study of distribution channels for specific products.[1] Finally, although some information about the experiences of foreign companies is presented, the report does not represent an in-depth record of U.S or foreign experience with the distribution system. Phase II of this report, scheduled for completion by October 23, 1990, will include more detailed information on foreign companies' experiences with Japan's distribution system.

Organization of the Report

"Distribution" is traditionally defined as all the economic activities associated with bringing goods from the port of entry or manufacturer to the final consumer. In this report, the discussion of Japan's distribution system will be broadened to include public sector policies affecting the distribution of goods, such as the Large Scale Retail Store Law, the Antimonopoly Law, and restrictions on investment and on sales promotions. In addition, features of the economy that indirectly affect the distribution of products—such as customs procedures and distribution-related infrastructure (e.g., trucking and warehousing) will be considered. The impact of business practices and of consumer and corporate behavior on the distribution of products will also be discussed.

The discussion of Japan's distribution system is divided into two main parts. The section on "structural features," describes those organizations, laws, and other aspects of the economy that form the core of Japan's distribution system. Structural features of the distribution system include such participants in the system as manufacturers, wholesalers, retailers, and consumers, as well as other features whose nature and/or role may differ from their counterparts in other countries. These include industrial groupings (keiretsu), general trading companies, trade associations and cartels. The second section, on "functional features," examines business practices, attitudes, and other factors influencing the behavior of such actors in the distribution system. "Vertical practices" take place between firms at different stages of the distribution chain, and include exclusive dealing,

[1] For further information regarding the distribution of different types of products in Japan, see: *Industrial Groupings in Japan 1986/87*, Dodwell Marketing Consultants (Tokyo: November 1987), 411 pps.; *Retail Distribution in Japan*, Dodwell Marketing Consultants (Tokyo: October 1985), 450 pps.; or *Distribution Systems in Japan*, Business Intercommunications, Inc. (Tokyo, 1985), 464 pps.

resale price maintenance, rebates, and returns policies. "Horizontal practices" occur within the same level of the distribution chain, i.e., among several producers or wholesalers, and are usually associated with cartels and trade associations. Such practices include price fixing and market allocation. Other features, such as the legal environment, "buy national" attitudes, and social customs, are also discussed in various sections of the report because they may have a significant effect on the behavior of participants in Japan's distribution system.

Summary of Major Themes

Close-up View of the "System"

There is not a monolithic entity that can be defined as the "Japanese distribution system." Instead, as in all developed market economies, there are a diversity of channels and means for moving goods from manufacturer or point of entry into Japan to the industrial user or consumer. Many of the features which currently characterize Japan's distribution system, such as the numerous small stores, and the linkages between and within various layers of the distribution chain, are the product of historical, economic, and cultural factors. Some elements of Japan's distribution system, such as returned goods policies, are also present in other economies such as the United States and western Europe. However, the frequency with which these practices occur in Japan and their effects on price competition and on the ability of foreign suppliers to enter existing distribution channels may be accentuated because of weak enforcement of antitrust laws and certain characteristics of Japanese consumer behavior and business relations.

A snapshot of the Japanese distribution system reveals the following: groups or chains of companies with linkages upstream and downstream throughout the manufacturing, wholesale and retail sectors. The length of the chains ranges from just a few companies to huge networks. The cohesiveness of the linkages differs according to the form they take. For example, legal ownership can be clearly distinguished from informal ties reinforced by subcontracting on other institutionalized business practices. These chains or groups may in turn be associated with Japan's general or small trading companies, who together account for more than three-fourths of Japan's total imports.

Although some independent wholesalers, some parallel importers and some direct sales exist, most distribution activities in some way are affected by the linkages among Japanese companies. Nearly 90 percent of all business transactions in Japan takes place among parties involved in a long-standing relationship of some sort, according to a recent Japan Fair Trade Commission (JFTC) study. As a result of these relationships, U.S. manufacturers frequently face situations where the major potential customers are closely allied with or even owned by the Japanese competitor. The linkages themselves may take the form of "unfair business practices" such as exclusive dealing or unauthorized retail price maintenance, but much more often are ill-defined or fall into a grey area outside of legal guidelines. The ties between firms may also be ". . . far too complex, indefinable, unmeasurable, or just plain mushy to be set down in documents, contracts or formulae."[2] As such, they are often beyond the capacity of outsiders to detect or penetrate.

Superimposed on the distribution channels are governmental restrictions on retail sales, especially those that limit the opening of department stores and supermarkets (which carry a larger share of imports than other stores), imports of agricultural products, and the use of sales promotions. All of these policies limit the ability of U.S. exporters to enter Japan's market. Beyond these legal restrictions are administrative features such as delays associated with entry or customs procedures and inconsistent testing procedures that also hinder access to the Japanese market.

The end result of these close, sometimes overlapping relations and practices in Japan's distribution chains is that it may be unusually difficult and expensive for foreigners, including U.S. exporters, to break into the system by locating suitable channels or by setting up their own. Indeed, a recent study by the Industrial Bank of Japan (IBJ) states that, "The possibilities to use those distribution channels meant for domestic products for selling imported products are generally few, because manufacturers' control over distribution through their groupings is still strong."[3]

Profile of the Wholesale and Retail Sector

A profile of the wholesale and retail sectors follows. The purpose of this section is to provide a snapshot the distribution system as it exists today as well as comparative information on the composition of these sectors in Japan and in other industrialized countries. The large number of retail stores and wholesalers, as well as the relatively high proportion of wholesale to retail transactions in Japan has been the focus of

[2] Thomas B. Lifson, "What Do Japanese Corporate Customers Want? A Guide For American Firms Selling in Japan," in *U.S.-Japan Relations: New Attitudes for a New Era*, (Boston: The Program on U.S.-Japan Relations Center for International Affairs, Harvard University, 1984), p. 170.

[3] "Changing Japanese Distribution System," *Industrial Bank of Japan Review*, Industrial Bank of Japan (IBJ), Feb. 20, 1990, p. 7.

attention with regard to the question of whether or not the Japanese distribution system is overly complex or inefficient. This section of the report will discuss some of the factors contributing to the large numbers of retailers and distributors including the lack of storage space in Japanese homes, the density of Japan's population, lesser reliance on automobiles for shopping, consumer preferences for fresh food and prompt delivery, and legal restrictions in the retail sector. The fragmented nature of Japan's distribution system is an important factor that must be taken into account when examining the behavior of participants in the distribution channels.

Manufacturers, Wholesalers and Retailers

Next, the report describes the role that manufacturers, wholesalers, retailers, and consumers play in the distribution of goods in Japan. In this section, as in many others, the intention is not necessarily to draw specific comparisons between the role of these participants in Japan and other countries. Instead, it is to explain how they affect the distribution of goods, both foreign and domestic, as well as any major characteristics of their behavior that might result in different effects on imports than on other goods.

Manufacturers set up their own distribution channels following the introduction of mass-production after World War II when it became apparent that wholesalers were suffering financially and not in a position to effectively distribute their products. Through equity holdings, loaning of personnel, and reliance on a number of business practices, manufacturers are able to influence distribution of their own brands. Wholesalers in Japan are not only a major conduit for information, financing and actual movement of goods between retailers and manufacturers, but they are also an important link at the upstream end of the chain in manufacturers' control over distribution channels, and at the downstream end in fostering the personal contacts with the other wholesalers and with retailers. In the retail sector, the dichotomy in purchasing patterns of the more than 1.6 million small stores and the large chains stores is discussed. The relatively few numbers of mass discounters in Japan first mentioned in this section becomes more important throughout the report. Changing trends in the retail and wholesale sectors, partly a reflection of the increasing use of computerized information systems and changing consumer spending patterns, are also discussed here.

Japanese Consumers

The importance of nonprice factors in Japanese consumer behavior, including the heavy emphasis on quality, service, and personal relations affects every facet of distribution in Japan. This includes the types of products, including imports, that are distributed; the timing of deliveries; product design and packaging; and the number of retailers and wholesalers in the distribution system. The changing lifestyles and spending habits of Japanese consumers are discussed as they relate to the potential for increased imports, such as a growing awareness of price differentials between goods sold in Japan and in other countries. Constraints on increased consumer spending on imports from the United States, in particular, include current consumer preferences for luxury products from Europe and lower priced goods from South East Asia, and "image" problems associated with U.S. products.

The "Channels"

In discussing the structural features of the distribution system, the report will first explain the various types of distribution channels available to any new entrant. The two relatively less expensive approaches for foreign companies are the use of trading companies or joint ventures with Japanese firms. Although each of these approaches may provide an entree to the traditional distribution channels and short-term gains in market share, drawbacks are often associated with such strategies. The ties of trading companies to domestic manufacturers have led to claims that they are less than enthusiastic promoters of imported goods and may actually refuse to handle products that compete with those of the Japanese producer. Establishing independent distribution channels may be an alternative, but it is also the most costly strategy. As will be described in detail, high land prices and transportation fees add to the costs of setting up an independent distribution network in Japan. In addition, legal restrictions on entry in the retail, wholesale, service, and transportation sectors may inhibit the ability of new companies to set up their own distribution networks. High levels of cross-shareholding among companies and formal restrictions on foreign investment may also make it difficult for outsiders to establish distribution channels by purchasing an existing Japanese network.

Keiretsu, Trading Companies, Trade Associations

The next section of the report analyzes the overlapping types of ties between firms in Japan in terms of the extent to which they facilitate or control imports and distribution of products. The discussion of industrial groupings known as keiretsu examines the debt, equity and personnel linkages that contribute to the cohesiveness of the different types of keiretsu organizations and notes the emphasis on stability and long-term relationships among member companies.

Distribution of autos is discussed as an example of a sector characterized by keiretsu relationships.

With regard to trading companies, it is noted that in FY 1987, the nine largest trading companies handled more than three-fourths of Japan's imports and an amount that could be increasing. One interpretation of the figures is that trading companies are helping to find and market foreign goods suitable for Japan's market, thereby facilitating foreign access. However, it has also been reported that the trading companies' control over imports, coupled with their ties to domestic manufacturers, may limit the sales levels that new entrants can hope to achieve and make it difficult for smaller, and perhaps more independent trading companies to compete.

The lack of participation of foreign companies in trade associations is mentioned because of the more significant role that these groups play compared to other western countries in consulting with the Government on decisions affecting industrial policy and regulation of particular industries. Trade associations are also reported to be forums for the conduct of other business practices that may stifle competition in Japan's market. The legal status and anticompetitive activities of cartels are noted to the extent they may affect the introduction of goods in Japan.

Public Policies and Other Features Affecting Distribution

Distribution-related public policies, including the Large Scale Retail Store Law, are then described. The administration of this law and the resulting constraints placed on the opening of large stores are discussed, as well as the potential effects on imports of modifying or abolishing the law. This law and other local laws appear to play a role in the difficulties faced by foreign firms when seeking to enter Japan's market for consumer goods. Moreover, the report suggests that the effects of the high degree of control exerted by Japanese manufacturers and trading companies over distribution in Japan on competition and on the ability of foreign suppliers to enter Japan's distribution channels may be accentuated by weak enforcement of the Antimonopoly Law. Restrictions on liquor and warehouse licensing, state-trading of certain agricultural products, delays associated with customs and entry procedures, and high transportation costs are also discussed.

In evaluating the effects of the Large Scale Retail Law's relaxation, it is noted that there are also a number of restrictions imposed by local authorities that are even stricter than the national law. The easing of both types of laws could lead to the development of more large stores in Japan and perhaps even an expansion of Japan's imports. However, there are several factors that could limit the prospects for an increase in imports from the United States as a result of such changes. These include the fact that the small stores that the law is designed to protect are a powerful political force in Japan, that the primary source of imports of consumer goods for large stores is not the United States, that land costs make opening large stores extremely expensive, and that consumer preferences which may not necessarily favor U.S. imports appear to play an important role in the purchasing decisions of large stores.

Business Practices

Following the discussion of structural features is the second major portion of the report, which describes functional features. The section focuses on business practices which frequently occur within distribution channels, particularly within distribution keiretsu. The major practices discussed include exclusive dealings, resale price maintenance, returns policies, and rebates. These practices, often occurring in combination and with other social customs, may lead to a high degree of manufacturer control over distribution channels and create the potential for discrimination against new entrants.

Composition of Japan's Trade

Recent trends in the composition of Japan's trade are then analyzed. The section shows that during 1984–1988, the primary beneficiaries of the increase in imports to Japan were the Asian NIEs (newly industrialized economies) and the European Community. It appears that the greatest likelihood for an increase in U.S. exports could be in the area of manufactured goods that accounted for 70 percent of U.S. exports to the world and 58 percent of U.S. exports to Japan in 1989. Improvements in adopting appropriate marketing strategies and understanding Japanese business relations by foreign companies also appear to be one factor that could lead to increased imports of both consumer and capital goods.

The Effects of the "system" on Imports

The final section of the report discusses the effects of Japan's distribution system on new entrants and especially foreign companies from the perspective of whether any of the various features, singularly or in some combination, impede new entrants. This includes features and practices that may be either efficient or inefficient. The report concludes that the effects of certain features and practices may be to solidify manufacturers' control over distribution channels and/or impede access to existing distribution channels by new entrants, both domestic and foreign.[4]

With relatively few "noncaptive" channels available, new entrants, both foreign and domestic, may be forced into more costly or less effective alternative distribution channels, such as setting up an independent distribution system.

Certain other characteristics of Japanese corporate and consumer behavior may increase the importance of nonprice considerations in purchasing decisions and make it difficult for newcomers to break into existing purchaser-supplier relationships. Most important, however, "attaching importance to stable and long-term business relationships reduces the uncertainty of the future, minimizing costs and risks. . ."[5] of doing business for firms already operating in the distribution channels. Thus, foreign companies may face particular difficulties entering the distribution system.

Even in cases where a foreign company with a suitable product has invested a large amount of resources, satisfied all legal requirements, developed a good marketing strategy and arranged for physical distribution of the product, there is still no guarantee that the product will be bought by a Japanese purchaser or consumer. For consumer goods, the foreign company must locate appropriate retail outlets for the goods, which would most likely be large retail stores (of which there are fewer than in other countries) since the smaller "mom-and-pop" stores carry few imports. The importer must negotiate for shelf space, which usually requires that a Japanese retailer switch from a long-term domestic supplier and perhaps forfeit other "perks" associated with carrying the domestic product (rebates, generous returns policies, financing, temporary loan of personnel from the manufacturer, or inventory space from the wholesaler). Once the product is displayed, consumer biases against foreign products, preferences for quality and service, or some sense of obligation to a particular local store might further diminish the chances of the imported product actually being bought. For capital goods, additional or different problems, including agreements among groups of purchasers or "buy Japan" biases, might also dilute the full sales potential of a foreign company that has "successfully" set up its own distribution network.

[4] Exclusionary business practices and vertical control of retailers by Japanese manufacturers have been cited by the National Association of Manufacturers as the major impediment facing U.S. manufacturers trying to export to Japan. Testimony of R.K. Morris, Director, International Trade Policy, National Association of Manufacturers before the Senate Committee on Finance, Nov. 6, 1989.

[5] "Participation of Foreign Companies in the Japanese Distribution System," Ministry of International Trade and Industry, (MITI), Nov. 1989, p. 12.

On the secondary issue of efficiency, there are divided views among economists as to whether Japan's distribution system is efficient or inefficient. Some argue that the system is an efficient adaptation to Japan's geographic, cultural, and historical conditions. Others claim that the large numbers of wholesalers and retailers in Japan add to the final costs of products as reflected by some studies showing higher distribution margins and higher retail prices in Japan compared to other countries. Resolution of this issue is beyond the scope of this study. The main focus of this report is on the effect of the features and practices on importers wanting to enter Japan's market, rather than on the overall efficiency with which the system serves the needs of Japanese consumers.

Some consideration is given to those U.S. sectors most affected by particular features or practices in Japan's distribution system. It is very difficult, however, to assess the potential for increased exports from the United States created by particular changes in certain aspects of Japan's distribution system. Recent studies indicate that some features of Japan's distribution system may have a differential effect on capital goods relative to consumer goods, a traditional source of U.S. export strength. The channels for capital goods are less complex than those for consumer goods. However, these channels may be more affected by the interwoven relationships of industrial groupings that dominate this sector. Any potential increase in U.S. exports of capital goods would probably be contingent on a weakening of interfirm relations or stricter enforcement of Japan's antitrust laws.

Background

Relative Importance of Distribution to Other Trade Issues

In examining Japan's distribution system, it is important to place its effects on potential importers in the context of the macroeconomic variables and other factors that affect bilateral trade. Since the early 1980's, numerous studies have attempted to estimate the role of Japan's trade barriers, relative to other factors such as macroeconomic policies, in the overall level and composition of Japan's imports. Though sizeable differences in magnitude are evident, essentially all identify macroeconomic factors as the most significant variable in explaining the massive and stubborn imbalance characterizing U.S.-Japan trade today. The chronic U.S. savings shortfall and generally high spending levels in the 1980's were the mirror image of Japan's high savings and tight fiscal policies. Trade barriers, though less important, also appear to play a role. A few academics have concluded that trade barriers in

Japan do not appear to be much worse in Japan than in other countries.[6] However, several others have blamed trade barriers for depressing the overall level of Japan's imports, as well as for skewing the composition of them. Two general schools of thought on the nature of and the appropriate approach to the "Japan problem" have emerged, one more market-oriented and the other revisionist.

The more market-oriented group seems to agree that rectifying the current U.S. imbalance between savings and consumption—by, for example, reducing the U.S. budget deficit—may be the single most important step that could be taken to reduce the U.S. trade deficit with Japan. However, a of number these analysts also believe that Japan can and should do more to open its markets to foreign goods. Formal policies—such as tariffs, quotas, and discriminatory public purchasing policies—remain important obstacles to U.S. exports in certain product areas such as agricultural commodities, processed wood products, and satellites. More recently, however, exclusionary business practices and excessive domestic regulation in Japan, whether or not overtly discriminatory, have been identified as potentially significant factors affecting foreign suppliers. Various aspects of the distribution system have been identified as prime candidates for reform. Many of these distribution-related issues are being addressed by U.S. negotiators in the Structural Impediments Initiative, which appears to be based on the idea that rectifying market imperfections and competition-limiting practices will ultimately result in more imports by Japan.

The so-called "revisionists," on the other hand, question whether such an approach is either realistic or sufficient, since, in their view, Japan's market does not operate like other developed market economies do.[7] They call Japan "peculiar" or different, pointing to the composition and conduct of Japan's trade, the way its society operates and what it values, how power is divided and used, and how its firms compete.[8] Proponents of this view have called Japan an "outlier," citing, among other things, statistics showing a relatively low propensity to import, a relatively low degree of penetration by foreign manufactures, a relatively small amount of intra-industry trade, and a relatively high concentration of Japan's exports in a few product categories in comparison to countries at a similar level of development.[9] A number of analysts add to these statistical comparisons observations about the role of government and business in the economy, pointing to close linkages among Japanese firms and between government officials and particular interest groups and to a relative lack of independent action by consumers and workers. Indeed, some have claimed that there exists a "national consensus" in Japan that manufactured goods should be imported only when they are not produced at home and that domestic production of high value-added products should be substituted as soon as possible. The fundamental conclusion reached by "revisionists" is that Japan does not behave in ways typical of "market economies." Even so, some of these analysts believe that government industrial polices and informal practices by Japanese businesses, including some associated with the Japanese distribution system, are at the root of the "problem" of U.S. access to the Japanese market.

High retail prices in Japan in part, have, been the catalyst for the current interest in distribution-related issues. According to a 1988 survey by Japan's Economic Planning Agency (EPA), prices of 306 goods and services were between 26 and 48 percent higher in Japan than in New York. These EPA results have been borne out by studies conducted by a host of Japanese and U.S. groups over the last few years. Several possible reasons for the higher prices were cited by the EPA study, including quotas on agricultural products, price discrimination (charging lower prices in foreign markets than in the Japanese market), and higher distribution and marketing costs.

In addition, the track record and experiences of U.S. firms attempting to operate in Japan has also drawn the attention of policymakers to impediments associated with the distribution system. While there are indeed some well-documented cases of U.S. firms that have been successful in Japan, these appear to be a minority.[10] Approximately 200 U.S. Fortune 500 companies have attempted to enter the market, but failed.[11] There are volumes of anecdotal evidence about U.S. companies that have "done

[6] Edward E. Lerner, *Sources of International Comparative Advantage*, (Cambridge, Massachusetts: MIT Press, 1984); Gary R. Saxonhouse, "What's Wrong with the Japanese Trade Structure?" *Pacific Economic Papers*, July 1986.

[7] For a discussion of this debate see, Susan MacKnight, "The U.S. Trade Deficit with Japan: Something Must be Done," *JEI Report*, No. 17A, Apr. 28, 1989.

[8] See, for example, Karel Van Wolferen, *The Enigma of Japanese Power People and Politics in a Stateless Nation*, (London: MacMillan, 1989) and Clyde V. Prestowitz, *Trading Places: How We Allowed Japan to Take the Lead*, (New York: Basic Books, 1988).

[9] An analyses of Japan's trade patterns are presented in Edward J. Lincoln, *Japan's Unequal Trade*, and Robert Z. Lawrence, "Does Japan Import Too Little? Closed Minds or Markets?" *Brookings Papers on Economic Activity*, No. 2, 1987.

[10] According to one consulting firm, "Yet, with all of these readily available annals of accumulated knowledge by self-proclaimed experts on Japan, the record of western companies is dismal. Some estimate the failure rate of western businesses in Japan is as high as 50 percent." "Winning Operating Strategies in Japan," A.T. Kearney Management Consultants, 1989, p. 3.

[11] USITC staff interview with representative of A.T. Kearney, Tokyo, Japan, Feb., 1990.

all the right things" to distribute their products in Japan—developed products of equal or superior quality to Japanese products that are suitable for Japanese consumers, developed a long-term marketing strategy by obtaining information on consumer trends, developed effective advertising, after sales service plan, and sales promotion campaigns and shown a long-term commitment to the market. For some reason, despite a major commitment of time and resources, even well-known companies with large market shares in other countries have been unable to either enter Japan's distribution channels or to distribute their products at competitive prices. The Government of Japan itself has indicated that there may be a need to make changes in policies or processes that have an impact on the way goods are transferred from producers to purchasers or consumers.[12] Nevertheless, based on previous U.S. negotiating experience and recent trade patterns, there is no guarantee that U.S. exporters to Japan would be the major beneficiaries of currently proposed changes in laws, practices or policies affecting distribution.

As will be described in detail later in this report, while the United States has shared fairly equally in the absolute increase in Japanese imports during 1985-89, it has lost ground to the EC and the Newly Industrializing Economies (NIEs) as a supplier of manufactured goods and in the sale of certain products, notably capital goods. Moreover, Japan's imports of consumer goods, for which Southeast Asia and the EC are leading suppliers, have risen proportionately more than its imports of capital goods. On the other hand, U.S. shipments of consumer nondurables have registered above-average gains, and the generally lackluster U.S. exports performance in shipments of manufactured goods seems to have reversed in 1989.

Corporate Behavior and the Business Climate in Japan

The behavior of Japanese companies is particularly important as it is likely to affect the expectations and operations of new firms, both domestic and foreign that attempt to enter Japan's distribution channels. This section of the report discusses certain notable factors, aside from short-term profit considerations, that influence Japanese corporate attitudes and behavior. The characteristics of Japanese corporate behavior that are discussed below are important in helping to explain: (1) why domestic firms operating in Japan's distribution channels behave as described later in the study, and (2) why certain business practices associated with manufacturer control over distribution channels might be beneficial from the standpoint of Japanese manufacturers, wholesalers and retailers. It does not suggest that profit and loss considerations are not a major determinant of corporate behavior, but rather that those considerations may be heavily influenced by characteristics that are associated with Japanese culture and social customs. Specifically, in Japan, social traditions that emphasize group loyalty, interdependence, and non-adversarial decision-making may result in market behavior by firms that is significantly different than might be expected in a society such as the United States where individualism and "survival of the fittest" are emphasized.

These differences in perspective lead Japanese companies to view relations and competition with other firms somewhat differently than American firms. For example, the concerns of a single firm might be compromised at times for the welfare of a group or chain of companies. Firms might be less willing or interested in switching to lower priced suppliers if doing so would have a detrimental effect on the chain or group of companies as a whole. Firms in Japan may exhibit such behavioral characteristics to different degrees, depending, for example, upon whether they are involved in one of the subcontracting networks or distribution keiretsu described later in this report.[13]

Long-Term Relations

In Japan, the emphasis on long-term relations is a major factor in all facets of conducting business and cannot be underestimated in terms of its influence on corporate behavior. According to Thomas Lifson:

> Japanese firms prefer to do business with other firms on the mutual expectation that they will continue to interact into the indefinite future. . . There is sometimes virtually a moral content to this preference: firms which avoid permanent relationships are almost regarded as promiscuous, and not to be fully trusted or relied upon. The Japanese business community is highly supportive of the norm of permanent ties.[14]

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[12] See, for example, "The Distribution System in Japan," Ministry of International Trade and Industry, September 1989, and "Summary of MITI's Vision for the Distribution System in the 1990s", (Provisional Translation), MITI; and "Japan-U.S. Structural Impediments Initiative: Interim Report by the Japanese Delegation", Apr. 5, 1990.

[13] Much of the discussion in this section is based on information by Thomas B. Lifson, "What Do Japanese Corporate Customers Want? A Guide For American Firms Selling in Japan," in ch. 10 of U.S.-Japan Relations: New Attitudes for a New Era, (The Program on U.S.-Japan Relations Center for International Affairs, Harvard University, 1984).

[14] Lifson, p. 164. Although Lifson refers primarily to the Japanese market for intermediate goods, the characteristics of corporate behavior noted could be cited as the norm rather than the exception for most Japanese companies. See, for example, Lincoln, pp. 88-89 and Clyde V. Prestowitz, *Trading Places*, (Tokyo: Charles E. Tuttle, Co., 1988), pp. 151-184.

Lifson notes that this does not mean that Japanese firms never have short-term relations with other firms, "but that such transactions usually account for only a portion of the firm's dealings, and are not characteristic of the most important linkages. They are seen as a peripheral or supplementary source of supply. Over-dependence on unstable relationships is simply seen as not prudent."[15] Continuing, Lifson notes:

> In contrast, the pure American model assumes that unless governed by long-term contract, every transaction stands on its own as a discrete entity. At its conclusion, each party is free to go elsewhere for its needs. Any other arrangement or expectation would infringe on the ability of a firm to maximize its welfare.[16]

Thus, many of the transactions that occur in Japan's distribution system may seem to contradict U.S. perceptions of how corporations ought to behave under similar circumstances. For example, when lower prices are offered for the same products or services, a U.S. purchaser might be expected to switch suppliers for the short-term gain. In Japan, however, this type of behavior is much less likely to occur in the corporate realm and applies at the consumer level as well.[17] The benefits of such long-term relations, perhaps while not readily apparent to some U.S. firms attempting to enter the market, are quite rational from the Japanese corporate perspective. According to Japan's Ministry of International Trade and Industry (MITI), "This practice of placing high value on long-term stable relationships is economically rational in that it helps to reduce future uncertainty, disperse costs, and diminish the risk burden."[18]

In the United States, firms may enter transactions or business relations with the expectation that a specific product or service will be provided (usually spelled out in a written contract). Reimbursement for the services rendered is expected promptly. The decision to enter into the transaction may be based primarily on the firm's own short-term economic interests, rather than any long-term view of other benefits not directly related to the transaction. By contrast:

> When firms do business with each other in Japan, it is understood that more than just goods, services, and the money to pay for them circulate between the two parties. Exchange of inside information, personal ties, and a variety of unmeasurable factors such as trust are expected to develop between the two organizations. . . both sides are hopeful of developing new technology, production, sales, or other potential through the relationship . . . there may be the germ of a new product, technology, or the valuable factor which is being created unbeknownst to the present actors on both sides. Yet this may in the long run prove to be the most valuable aspect of the relationship.[19]

Thus, for a Japanese firm, an individual transaction often includes more than the printed words in the contract. It is just one element of a complex, long-term relationship between companies that may have many facets.

Loyalty and Obligation

Another primary consideration of corporate behavior in Japan that is associated with traditional Japanese social customs is the emphasis on loyalty and obligation in relations:

> [T]he willingness of firms (and individuals) to recognize and fulfill their obligations is one of the foremost criteria used by others in deciding on whether or not to begin an association with them. . . . This is one important factor underlying Japanese companies' choosiness in deciding with whom to do business and their desire to have relatively frequent and extensive contact...[20]

Obligation, in this sense refers not only to those that have already been incurred, but also to future circumstances. A high level of obligation and reciprocity characterize interfirm relations in Japan and contribute to the priority companies place on achieving customer satisfaction:

> The underlying desire of firms to be attached to their business associates by webs of mutual obligations helps account for the oft-noted tendency of Japanese firms to emphasize high levels of service to customers. Not just responsiveness to, but anticipation of customer needs is one way to build up a store of obligation which may prove highly useful at some point in the future.[21]

A long-term view of business relations again influences how different types of obligations, including financial obligations, are treated. According to a representative of a major U.S. consulting firm in Japan, "there is a tremendous float in the system." He refers to the fact that payments in Japan are frequently stretched from 90–120 days, manufacturers and wholesalers allow for a "float" in payments and goods are sold to retailers long before they are required to pay for them.[22]

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[15] Lifson, p. 165.
[16] Ibid.
[17] See section on consumer behavior.
[18] "The Distribution System in Japan", MITI, Nov. 1989, p. 18.
[19] Lifson, p. 165.
[20] Ibid., p. 168.
[21] Ibid.
[22] Interview with representative of A.T. Kearney, Tokyo, Feb. 2, 1990.

Impact of Loyalty and Obligation on Decision to Switch Suppliers

The important role that loyalty and obligation play in business relations becomes especially apparent during economic downturns or when an opportunity to switch to lower cost or higher quality suppliers arise. In a recent press article, Clyde V. Prestowitz commented on the differences in U.S. and Japanese corporate views regarding changing suppliers:

> We [Americans] think that business should be done on the basis of the best offer. . . If a new supplier comes along with a better price, and if we *don't* switch, we may be sued for discriminatory practices. . . But in Japan, if you dump a supplier of 20 years, just because of a small price break, it would be considered unfair and disloyal.[23]

Japanese firms with longstanding ties to other companies will allow them time to adapt to changes in the market:

> It follows naturally from the permanence, complexity, closeness, and mutual obligation characteristics that a firm would wish to give a supplier an opportunity to match the terms current in the marketplace, even if the adjustments necessary to enable the firm to respond to the market might require some time or effort, rather than abruptly replacing the vendor with a new source of supply. . . Rather than simply passively waiting for the vendor to respond, it is common for firms to render active assistance in helping their suppliers adapt to new developments. This makes sense not only because both firms (and the entire product system) benefit from the adjustment, but also because such assistance represents further obligation-creating investment.[24]

The rationale for maintaining business relations with traditional suppliers rather than entailing the risk of switching to a new supplier can be explained as follows:

> Existing close relationships with suppliers are seen as valuable and efficient mechanisms. A certain investment would be necessary to help existing suppliers match the new products or prices. At a minimum, there would be a time lag before receiving the benefits. At a maximum, the purchaser might be required to expend time, money, or other resources to help its suppliers adjust. But this expenditure is seen as less than the investment which would be necessary for an equally effective and efficient relationship to develop with a new American supplier, perceived as unfamiliar with the Japanese business environment and perhaps unwilling to do things 'the Japanese way.'[25]

For foreign firms or newcomers, this could mean that entering into business relationships with Japanese firms or selling in Japan could require a long-term commitment and persistence:

> When new suppliers make sales calls, they are normally accepted or rejected depending on whether or not the customer is satisfied with the relationship with the existing seller. Even if rejected, continued monthly calls over a period of a few years can result in a small beginning to business transactions. Such a long path to development of sales is sometimes unavoidable in Japan.[26]

Even after a substantial investment of time, money and energy the pay-offs for the foreign or new firm may not be guaranteed.

Personal Contact

Personal relationships are a very important aspect of conducting business in Japan. Interfirm ties are dependent on relations between individuals within each company. Japanese firms usually hire young staff members who will work for the company until they are in their fifties. They are expected to develop strong personal relations with counterparts in other firms of about the same age and background with the hope that the relations will be strengthened over the years. The employee himself has an interest in building up a relationship with the other firm because it will increase his chances for promotion. The company will have an incentive to have the employee work on maintaining the relationship for a long period since the costs of establishing the contact in the first place are high in terms of time and training.[27]

In sum, the close networks of interfirm relations that have developed in Japan may not be as irrational or inefficient as it might appear on the surface. Although the costs of developing the close relationships in the first place may be high, once they are established, the costs of additional transactions may be relatively low. In the words of the Japan Chamber of Commerce and Industry:

> It requires a great deal of time and effort to establish this kind of mutual trust and in that sense, the costs of entering the market are liable to be high. Once a relationship has been established, however, a number of advantages become apparent. The cost of individual transactions falls because they can be simplified—such as making orders by telephone—due to the mutual trust established. From a long-term point of view,

[23] H.D.S. Greenway, "The teen-age mutant ninja trade talks," *Boston Globe*, Apr. 20, 1990, p. 13.
[24] Lifson, pp. 168-169.

[25] Ibid., p. 170.
[26] *Industrial Goods Distribution in Japan*, p. 29.
[27] Lifson, pp. 170-171.

this is significant because it reduces overall costs.[28]

The Legal Environment for Business in Japan

In contrast to the United States, where lawyers and the law are involved in the conduct of all aspects of business, the role of the law and lawyers in Japan is very different. Historically, there were no lawyers in the American sense in Japan until the Meiji Era began in 1868. Moreover, there was no specialized training in law or legal procedures.[29] The system strongly discouraged litigation to pursue individual rights, including business rights, as disruptive to the all important goal of social harmony. Remnants of this pervasive disinclination to resort to the legal system to resolve disputes linger to the current day, evident in the tendency of traditional Japanese contracts to contain broad descriptions of the parties' rights and obligations, combined with an agreement to negotiate any problems which may arise.[30] The emphasis is on developing an atmosphere of trust in order to foster a continuing business relationship.[31]

The development of the modern Japanese legal system began with the importation of Western legal precepts, largely based on the civil law system of Germany, into Japan in the second half of the 19th century. After World War II, the legal system of the United States exerted a strong influence on Japan, through the efforts of the occupation authorities in rewriting both the Japanese Constitution and the Japanese corporate, civil rights, securities regulation, income tax, labor, and antitrust laws. Thus, the modern Japanese legal system is a hybrid of traditional precepts, European civil law, and American statutory and common law principles.

One striking difference between the Japanese legal system and that of the United States is the relatively of low number of lawyers in Japan. In the mid-1980s, there was approximately one lawyer for every 515 people in the United States, while in Japan there was one lawyer for every 9,622 persons.[32] One reason for the relatively low level of lawyers in Japan is that there is only one law school, the Legal Training and Research Institute in Tokyo. In order to be admitted to practice law in Japan, one must graduate from that school.[33] Approximately 500 students graduate from the Institute's two-year training program each year. Of these, 70 to 80 become judges immediately, and continue as judges throughout their careers, 40 to 50 are employed by the government as procurators, and the remainder enter the private practice of law.

It is, however, misleading to simply compare the numbers of practicing attorneys in Japan and the United States. There are numerous persons who, while not practicing attorneys, perform tasks associated in the U.S. with lawyers. Among these are judicial scriveners, who draft court documents, transfer title to land, and give advice in these matters; administrative scriveners, who draft legal documents submitted to government offices; patent and trademark agents (benrishi); and tax representatives (zeirishi). In addition, the major Japanese universities all have law departments, where students can specialize in the study of law as undergraduates. Persons who graduate with a "major" in law cannot be admitted to practice in Japan, but often work in corporate or governmental legal departments, giving advice and drafting documents. Practicing lawyers are generally only consulted when litigation is intended. Thus, business, including contract negotiations, is usually carried out by the Japanese without the involvement of lawyers, although employees with a specialization in law are commonly involved. Again, this is typical of the general Japanese disinclination to resort to formal legal processes, or to involve practicing lawyers, not only in the conduct of business, but in general.

Structural Features of Japan's Distribution System

This section describes the structural features of Japan's distribution system including such participants in the system as manufacturers, wholesalers, retailers, and consumers. It also discusses other features of the economy whose nature and/or role may differ from their counterparts in other countries such as keiretsu, trade associations and cartels.

[28] "Distribution System and Market Access in Japan," The Japan Chamber of Commerce and Industry, June 1989, p. 15.

[29] Obviously, there were persons who became experienced in the ways of courts and counseled litigants even before formal training of lawyers. Hahn, *Japanese Business Law and the Legal System* 24, note 4 (1984).

[30] Michael K. Young, "The Function and Operation of Japanese Law: A Comparative Perspective" in Kusuda-Smick, ed., *United States/Japan Commercial Law and Trade*, 605 *et seq.* (1990). Young argues that Japanese behavior regarding legal process is highly rational and determined by cost/benefit considerations, and that Americans, if situated precisely the same as the Japanese, would act similarly. Ibid., 606.

[31] It should be noted that many Japanese companies, particularly the larger ones, have "learned" from their experiences with foreign business, and have adapted to the more specific contractual definition of parties' rights and duties common in the United States. Moreover, the Japanese show less disinclination in pressing those rights and obligations in the context of international contracts. Nonetheless, the traditional emphasis on harmony and developing a continuing business relationship remains important both in conducting business with a Japanese company, and particularly in operating in the Japanese economy.

[32] Hahn, *Japanese Business Law and the Legal System* 12 (1984).

[33] Because the Institute accepts only Japanese citizens as students since 1955, no foreigner can be admitted to the Japanese bar directly. Recent efforts have resulted in some loosening of the restrictions on practice by foreign lawyers in Japan.

Profile of the Wholesale and Retail Sectors

One commonly noted characteristic of the Japanese distribution system is that there are large number of retailers and wholesalers compared to other countries. Although Japan has only one-half the population as the United states, it has about 5 percent more retail stores. In 1988, there were 1.62 million retail stores and 436,502 wholesalers in Japan. There were 132 retail stores and 36 wholesalers per 10,000 people. By comparison, in 1982 there were 1.5 million retail stores in the United States and 36,000 wholesalers. In other words, in 1982, there were 65 retail stores and 16 wholesalers per 10,000 people in the United States (see table 1).

Within the retail sector, there are a large number of "mom and pop" stores in Japan compared to other industrialized countries. These shops make up what is often referred to as the "traditional" portion of the retail sector. Approximately 93 percent of all retail stores in Japan had fewer than 10 employees in 1982 (see Table 2), compared with 80.5 percent in the United States.[34] Fifty-four percent, or 874,330, of all retail stores in Japan had only one or two employees in 1988. This compares to 40 percent in the United States and 67 percent in France in 1982. Small retailers are particularly common in the food sector. In 1982, there were 725,000 retail food shops in Japan with approximately 3 employees each. There were also 20,000 supermarkets that year with an average of 26 employees.

Coexisting with the small shops is the "modern" segment of the retail sector. This segment consists of department stores, superstores (supermarkets), and convenience stores. Daiei, Seiyu, Nichii, JUSCO, Ito-Yokado, and Marui are some of the biggest chain stores. Only 2,000 shops in Japan, mostly department store or supermarket chains, employ 100 or more people. In the United States, by comparison, multiunit operators accounted for 50 percent of retail sales and more than one-half this volume was from stores of over 100 employees.[35]

In addition to the large number of retailers in Japan, there are a large number of wholesalers as well. In 1988, there were 436,502 wholesalers in Japan. Many of these wholesalers are small. Approximately 75 percent of wholesale establishments, or 327,095 wholesalers, had fewer than 10 employees (see table 3) in 1988.[36] Only 2.5 percent had 50 or more employees. However, there were 2,956 wholesale establishments with 100 or more employees, accounting for about two-fifths of total wholesale turnover in 1988. This includes the annual sales of such large trading companies as Mitsui & Co., Ltd. and Mitsubishi, Corp. Few Japanese wholesale companies besides these trading companies have sales of $1 million or more. In the United States, on the other hand, one-half of wholesalers have sales levels this high.[37] There were 94,000 wholesalers in the food sector in 1982. Again, smaller firms dominate the food sector. Forty-eight percent of those firms were small, with fewer than 5 employees and handled about 5 percent of total wholesale food sales. The other 42 percent of food wholesaling is handled by the 0.7 percent of total food wholesalers with 100 or more employees.

[34] The average number of employees per retail store in Japan was 4.2 in 1988 compared to 7.5 in the United States in 1982.

[35] "Japan's Distribution System: The Next Major Trade Confrontation?", *Japan Economic Institute*, Mar. 17, 1989, p. 4.

[36] Hideo Takahashi, "Structural Changes in Japan's Distribution System," *Japan Economic Institute Report*, Nov. 10, 1989, p. 3.

[37] "Japan's Distribution System: The Next Major Trade Confrontation?", p. 4.

Table 1
Comparison of retail and wholesale businesses in different countries

	United Japan (1988)	*United States (1982)*	*West Kingdom (1984)*	*France (1982)*	*Germany (1985)*
Number of retail stores (thousands)	1,620	1,509	242	472	407
Number of wholesale stores (thousands)	437	376	105	78	119
Number of retail stores per 10,000 people	132	65	43	87	67
Number of wholesale stores per 10,000 people	36	16	19	14	19
Number of retail stores per wholesale store	3.7	4.0	2.3	6.1	3.4
Annual sales of retail stores per employee (million yen)	17	25	13	17	16
Annual sales of wholesale stores per employee (million yen)	103	94	41	35	61

Source: "The Distribution System in Japan," Ministry of International Trade and Industry, May 1989.

Table 2
International comparison of size of retail stores

Number of Employees	*Japan (1988)*	*United States (1982)*	*France (1982)*	*West Germany (1985)*
		(percent)		
1-2	54.0	40.0	66.7	14.7
3-9	39.3	40.5	30.1	62.8
10-19	4.3	10.4	1.9	14.7
20-49	1.9	6.5	1.0	5.7
50-99	0.3	1.9	0.2	1.2
100 and Over	0.1	0.7	0.2	0.9

Source: Adapted from Economic Planning Agency, Seventh Report of Study Group on Distribution, March 1989.

Most products in Japan pass through more than one wholesaler on their way from the manufacturer to the retailer. By comparison, in the United States, most manufactured goods move through one layer of wholesalers that sort, assemble, grade, and store the goods for resale. In 1982, 86 percent of all goods purchased by retailers in Japan came from wholesalers, 11 percent came from manufacturers and less than one-half of one percent were imported from abroad.[38] One indicator of the number of layers or tiers in the distribution system is the ratio of the value of wholesale to retail sales. A higher ratio indicates that a product passes through more tiers in the distribution chain. The ratio of wholesale to retail sales in Japan was 3.9:1 in 1988 compared to 1.7:1 for the United States or 1.4–1.5:1 for Great Britain, France, and West Germany.[39]

The composition of Japan's retail distribution system has changed slightly during the past few years. There has been a drop in the number of shops with one or two employees, from 60 percent of all retail stores in 1982 to 54 percent, or 874,330 in 1988. During the same period there has also been a 30 percent increase in the number of retail shops with 10 to 19 employees. The number of these stores increased from 54,000 in 1982 to 70,382 in 1988.[40] The number of department stores with 50 or more employees increased from 368 in 1987 to 371 in 1988. However, their share of total retail sales increased by only 1 percent during the period 1980–1988.

[38] Erich Batzer and Helmut Laumer, *Marketing Strategies and Distribution Channels for Foreign Companies in Japan*, (Westview Press, 1989), p. 64.

[39] There are divided views on whether the number of layers represents efficiencies or inefficiencies in the distribution system. See discussion entitled "The Effects of Japan's Distribution System on Exports."

[40] Takahashi, "Structural Changes in Japan's Distribution System", pp. 3–4.

Table 3
Size structure of Japan's distribution sector

Number of Employees	*1982 Outlets Numbers*	*Share*	*1985 Outlets Number*	*Share*	*1988 Outlets Number*	*Share*
			Retail Industry			
1-2	1,036,000	60.2%	940.000	57.7%	847,330	54.0%
3-4	413,000	24.0	408,000	25.0	422,025	26.1
5-9	188,000	10.9	190,000	11.7	213,999	13.2
10-19	54,000	3.1	58,000	3.6	70,382	4.3
20-29	15,000	0.9	15,000	0.9	19,183	1.2
30-49	9,500	0.6	10,000	0.6	12,249	0.8
50-99	4,500	0.3	4,800	0.3	5,361	0.3
100+	1,900	0.1	2,000	0.1	2,070	0.1
Total	1,721,465	100.0	1,628,644	100.0	1,619,599	100.0

Number of Employees	*1982 Establishment Number*	*Share*	*1985 Establishment Number*	*Share*	*1988 Establishment Number*	*Share*
			Wholesale Industry			
1-2	100,000	23.3%	93,000	22.5%	95,340	21.8%
3-4	108,000	25.2	105,000	25.4	110,109	25.2
5-9	120,000	28.0	115,000	27.8	121,646	27.9
10-19	61,000	14.2	59,000	14.3	64,689	14.8
20-29	18,000	4.2	18,000	4.4	20,078	4.6
30-49	13,000	3.0	12,000	2.9	13,898	3.2
59-99	7,000	1.6	6,900	1.7	7,786	1.8
100+	2,800	0.7	2,700	0.7	2,956	0.7
Total	428,858	100.0	413,016	100.0	436.502	100.0

Note: Because of rounding, figures may not add totals shown.

Source: Ministry of International Trade and Industry, as cited in Japan Economic Institute report, No.43A, November 10, 1989.

Factors Contributing to the Number of Wholesalers And Retailers

The large number of wholesalers and retailers in Japan can be attributed to a combination of geographic factors, consumer behavior, social factors and legal restrictions in retailing.[41] These include a shortage of habitable land coupled with high real estate costs, the lack of storage space in homes, the importance of certain nonprice factors in Japanese consumer behavior (service, quality, and personal relations), and the lack of an adequate social security system.

Japan's population is one-half (122 million) that of the United States (245 million), and occupies only 4 percent of the land area of the United States. The population per habitable land area is 16.9 persons per square kilometer compared with 0.8 per square kilometer in the United States. The Kanto Plain which includes Tokyo is one of the most densely populated regions of the world with nearly 12 million people, some living on reclaimed land. Approximately one out of every four Japanese, or 27.5 million people live within a 30 mile radius of the Imperial Palace located in central Tokyo.[42]

Most Japanese live in cities with congested traffic conditions that encourage Japanese consumers to travel by foot to stores near their homes. Most Japanese consumers have small residences with little space for large appliances to store large quantities of products such as frozen food.[43] [44] For example, the average kitchen in Japan holds 9 cubic feet of refrigeration, compared to 19–20 cubic feet in an average American kitchen or 12 cubic feet in a European kitchen.[45] The typical Japanese diet includes large quantities of fresh, perishable foods that require frequent shopping.[46] Therefore, proximity to the nearest retailer is more important to Japanese than the typical American consumer, for example. One market analyst concluded:

> A survey of housewives in Tokyo, New York, London, Paris and Bonn. . . in 1981 found that Japanese women go shopping for food far more often than the other nationalities. They are very partial to fresh foods, preferring fresh fish and fresh vegetables to the canned or deep-frozen variety. This helps explain the existence of the large number of small specialist shops selling vegetables, fruit, fish and meat in every small settlement throughout the country. Of the total of over 1.6 million retail shops in Japan, almost half are food shops. The great importance of fresh foods obviously has considerable effects on the distribution system.[47]

The importance of fresh food to Japanese consumers helps explain the large number of wholesalers as well. According to one market survey, ". . . Japan maintains such a highly developed social system for the collection, pricing and delivery of perishables—a system without parallel in any other country."[48] Each morning in Tokyo, wholesale companies sell commodities from farmers and fishermen's associations that are auctioned off to retailers and brokers at central wholesale markets. There are also hundreds of smaller wholesale markets around the country.[49] The large numbers of wholesalers support small-and medium-sized food retailers.[50]

According to 1984 study, 58 percent of all Japanese consumers lived within a 10-minute walk of a food shop and 84 percent lived within a 20-minute walk of one.[51] Frequent shopping serves an important social function in Japan as well:

> The Japanese consumer likes to be able to choose from among an almost unlimited number of types of shops offering wide-ranging, personal service in the immediate vicinity of his or her home. This is regarded in Japan as an essential part of the quality of life and the Japanese are prepared to pay for it through higher prices. Personal contact while shopping in the neighborhood has an important social function for the Japanese housewife. And this also applies to the department stores, which in Japan have always been much more

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[41] C. Tate Ratcliffe, "Approaches to Distribution in Japan," in *The Japanese Economy in International Perspective*, 1975, p. 103.

[42] "Tokyo Aims to Reshape Itself as 'World Class City'," *The New York Times*, Feb. 8, 1987.

[43] "The Distribution System in Japan—Toward a More Open, Consumer-Oriented Distribution System", MITI, Tokyo, Japan, Nov. 1989.

[44] "Large purchases for stock are therefore rarely found in the Japanese system." Batzer and Laumer, p. 48.

[45] Statement of Andrew J. Takas, Vice President of Government Relations, Whirlpool Corporation, at the USITC, June 7, 1990.

[46] One observer reports, "Japanese consumers display a strong preference for perishable food. For example, they prefer fresh fish and vegetables to processed foods; they like to cook 'raw materials' at home rather than buy ready-to-eat items. . . This demand for perishables explains the existence of so many small stores for vegetables, fruits, fish and meat in every community across the country. In this respect Japan is similar to France and Italy, where there is relatively heavy consumption of fresh fish and vegetables." Yoshihiro Tajima, "Japan's Distribution System: An International

[46]—*Continued*
Comparison," *Journal of Japanese Trade and Industry*, 1984, p. 17.

[47] Batzer and Laumer, pp. 49–50.

[48] Tajima, p. 17.

[49] Ibid.

[50] Consumption of processed foods in Japan is gradually increasing as a result of more women entering the workforce and the "westernization of the Japanese diet, particularly among young people. . .". Tajima, p. 17.

[51] "Food Processing Industry in Japan," Japan External Trade Organization, Aug. 12, 1984, pp. 14–15.

than mere shopping places. For decades they were a center of social life and for many Japanese that is still so today.[52]

Small stores also serve as an important source of employment for retired persons given the lack of an adequate social security system in Japan. Japan's "lifelong" employment system at most large corporations means that employees usually retire at age 58 or earlier, although there has been movement towards a later retirement age. The pensions between this age and 65 (when eligibility for state pensions begins) are often inadequate. The pensions usually consist of lump-sum payments rather than annuities. Therefore, upon retirement many employees of large companies use their severance payments and take advantage of personal contacts to become self-employed shopowners or distributors. Companies sometimes assist retirees in becoming established within their own distribution channels. Employees of small and medium-sized industrial firms who are discharged during economic downturns frequently also enter the wholesale, retail or restaurant businesses, which require relatively little capital and are comparatively easy to manage:

> Small wholesale and retail businesses have acted as an employment buffer in Japan, helping to keep unemployment low. In the 1970s, when Japan faced a real recession in the wake of the first oil shock and manufacturing employment fell, the number of very small outlets increased.[53]

In addition, small shopkeepers frequently work at part-time jobs and other members of the family substitute in running the shop. The owners live on the premises and pay no rent. This allows the small shops to operate on relatively low margins.[54]

High land prices and legal restrictions on opening large retail operations are a disincentive to own and operate large stores. The Large Scale Retail Store Law and local regulations restrict and delay the opening of large stores in Japan.[55]

Some analysts claim that small retailers have been able to resist competitive pressures and the influx of large stores because they have built up a large amount of goodwill in the neighborhoods where they have operated for generations. The owners usually live in the store building which they own and manage with their families. Therefore, they may be less inclined to change business locations because they attach long-term emotional value as well as monetary value to their land unlike larger commercial operations that might view the land from the point of view of strictly its market value.[56] [57]

At the other end of the spectrum, Japanese chain stores are much smaller than those in the United States. Daiei, Japan's largest chain store, had annual sales totaling $5.1 billion in 1983 compared to Sears' sales of $35.9 billion in that year. According to one study, ". . . Japanese stores do not possess anything like the size or economies of scale that U.S. retailers do."[58]

Efficiencies or Inefficiencies of the Distribution System

Some of the current debate over access to Japan's distribution system has centered on whether the Japan's distribution system is efficient or inefficient. There are divided views among economists on this question.[59] Some economists argue that the Japanese distribution system is an efficient adaptation to its geographic, cultural and historical conditions. According to this view, high land prices and the small size of Japanese homes raise storage costs for households and create a need for holders of inventories outside the home (i.e., conveniently-located retailers).[60] At the same time, the geographic size of the country allows for lower costs of restocking many stores compared to the United States.[61]

Much of the discussion about the efficiency or inefficiency of the Japanese distribution system has centered on whether the numerous layers in the distribution channels contribute to higher

[52] Batzer and Laumer, p. 49.
[53] Lincoln, p. 125.
[54] Batzer and Laumer, p. 54.
[55] See section regarding restrictions on retail distribution.

[56] "Retailing in the Japanese Consumer Market", Japan External Trade Organization, 1985, p. 23.
[57] The small stores have joined together to form the Japan Federation of Specialty Store Associations with 30,000 members and total sales of $1 billion.
[58] Thomas K. McCraw, *America Versus Japan*, (Boston: Harvard Business School, 1986), p. 103.
[59] "Inefficiency can only be defined in relative terms, since there is no standard definition of whether a system is efficient or not. This is particularly true when making international comparisons. What may be acceptable in one society may be utterly inconceivable in another. Furthermore, simple price comparisons cannot begin to explore the complex interrelationship between price service, product, brand image, etc. that make up the 'product' the consumer is ultimately buying." William J. Best and Takuro F. Ueno, "Measuring the Inefficiencies of the Japanese Distribution System," A.T. Kearney International, Inc., 1989, p. 2.
[60] One analyst observes: ". . . the complex distribution system represents a rational response to domestic economic realities. An extensive network of neighborhood stores, for example, is not just a convenience for Japan's primarily urban population; it is more like a necessity. The traffic congestion and limited parking facilities in major metropolitan areas, the limited amount of storage space in most homes, the Japanese penchant for fresh fish and the premium placed on personalized service all encourage consumers to patronize nearby shops." "Japan's Distribution System: The Next Major Trade Confrontation," Mar. 17, 1989, p. 5.
[61] David Flath, "The Economic Rationality of the Japanese Distribution System," Dept. of Economics and Business, North Carolina State University, Mar. 1989.

retail prices. Numerous price surveys have been done, including some by the Japanese government, that show that the retail prices of comparable goods in Japan are higher than in most Western industrialized countries.[62] However, a comparative study of the U.S. and Japan's distribution system notes:

> Even though overall prices for many consumer items in Japan remain noticeably higher than those in the U.S., it may well be that Japanese and American consumers are still not buying *exactly* the same thing. Thus, it may be slightly inaccurate to assert simply that American distribution is more "efficient" than Japanese when different things are being bought. Japanese consumers may be paying, quite willingly, for superior information and service; or they may be purchasing time, through the device of buying at the nearest store rather than at the least expensive one.[63]

The price comparisons have led some analysts to conclude that retail prices are higher in Japan because of the multiple markups that occur at each stage of the distribution chain, especially at the wholesale level. According to this view, if the multiple wholesalers and other intermediaries could be reduced or eliminated, prices would fall to world levels, consumers would benefit and it would be easier for foreign companies to enter the market because they would be able to deal directly with Japanese retailers.[64]

Another view holds that the distribution system is not inefficient and that the large numbers of retailers and wholesalers or the length of the distribution route do not add to the total cost of the product.[65] [66] According to this perspective, annual sales per retail and wholesale employee are similar to those in Europe or the United States. Inventory turnover is also shorter for both retailers and wholesalers, indicating they are efficient.[67] According to one estimate, value-added in wholesale and retail trade for Japan and the United States is comparable, at 26 and 24 percent respectively.[68] Lawrence concludes that if the distribution margins are the same in the two countries, but final prices of products are higher in Japan, the high prices are being paid to producers rather than distributors. He observes:

> Indeed the different behavior of exports and domestic prices points to the capacity of *producers* for price discrimination. Apparently, they are able to maintain prices at levels which are higher in Japan than elsewhere. This confirms in aggregate, the anecdotal evidence, discovered by many Japanese tourists, of what James Fallows has called the 47th Street Photo phenomenon: Japanese goods cost less in other countries than they do in Japan.[69]

Nevertheless, it appears that the multiple numbers of distributors in Japan and other features may at times add bona fide costs associated with the provision of superior service to retailers and consumers. In addition, the importance of nonprice factors in supplier-purchaser relations, such as personal relations, high demands for quality, and prompt delivery, may represent rational behavior from the perspective of the participants. Nevertheless, resolution of the question of whether Japan's distribution system is actually efficient is not possible in the abstract.

[62] In 1985, prices in Japan were 25 percent higher in Japan than in the United States and 42 percent higher than in the European Community, according to the purchasing power parity estimates used by the OECD for deflating measures of inventories. Robert Z. Lawrence, Brookings Institution, Statement before the Joint Economic Committee, Oct. 11, 1989, p. 14.

[63] McCraw, p. 104.

[64] Best and Ueno, p. 3.

[65] "Distribution System and Market Access in Japan," Japan Chamber of Commerce and Industry, June 1989, p. 2.

[66] When it first entered the Japanese market, Seven-Eleven, a U.S. convenience store chain reportedly decided to add an additional layer of secondary vendors to their distribution chain in order to reduce costs. Company representatives pointed out that in the United States, manufacturers deliver to one vendor who then delivers to all retail stores. The wholesalers can achieve high economies of scale and can sell small lots with a wide variety of goods. When Seven-Eleven first entered the Japanese market they had a different vendor for each product, or 80 vendors. They decided to ask the

[66]—*Continued*
manufactures to deliver to a single wholesaler who would deliver to all stores in the same prefecture. In the United States, according to Seven-Eleven "it wouldn't make sense" to have an additional wholesaler, but in Japan where there are inadequate and crowded roads and transportation costs are high, it does. The distance between Seven-Eleven's secondary wholesaler to its stores is only 20 kilometers, compared to 40 kilometers between the nearest primary wholesaler and its stores. By shifting the responsibility for numerous daily deliveries in congested traffic to the secondary wholesalers nearest to the retailer, Seven-Eleven was able to reduce its delivery costs.

[67] "Distribution System and Market Access in Japan," Japan Chamber of Commerce and Industry, June 1989, p. 12.

[68] The analysis was based on distribution margins using input-output tables in Japan and the United States. Payments by the retail and wholesale sector for indirect inputs in both countries were about one-third of total output. Payments to the real estate sector were about the same. Lawrence statement before the Joint Economic Committee, Oct. 11, 1989, p. 15.

[69] "The comparative data on profit rates in manufacturing, as calculated by the OECD, lend further support to the notion that Japanese manufacturers have considerable market power . . . rates of return in Japanese manufacturing have typically been twice as high as those in the United States and other industrial countries. Similarly the share of profits in value-added in Japanese manufacturing (44.0) percent in 1983 was much higher than in the United States (25 percent)." Ibid, p. 16.

Manufacturers, Wholesalers and Retailers

Manufacturers

Historical Role in Distribution

Many features and practices of Japan's current distribution system have pre-war or even feudal origins. These include the multiple numbers of distributors, close relations between producers and distributors, and hierarchical business relations. Historically, there has been a movement away from inter-related regional systems of distribution towards the establishment of fewer national distribution systems. Although the emphasis on regional distribution is declining, it continues to be a very important factor affecting distribution costs and patterns in Japan.[70] Control over distribution channels has generally shifted away from the wholesalers and to the manufacturers since World War II.

The multiple layers of the distribution system originated during the feudal period when, because of their geographical isolation, each province of Japan had its own distribution system. As a result of the different characteristics of each region, manufacturers depended on intermediaries who were more familiar with and better equipped to serve customers on each of the four main islands of Japan. If manufacturers had chosen to rely on direct sales, rather than middlemen to market their products, it would have been necessary for them to develop a huge number of contacts because of the differences in the geographic regions and the need to make numerous deliveries. By using intermediaries or other wholesalers, manufacturers were able to market their products at lower costs. This system of multiple layers was efficient as long as the cost was lower to manufacturers than that of maintaining their own intermediaries nationwide.[71]

Thus, Japan's distribution system during the pre-war period was largely characterized by smaller manufacturers dependent on the wholesalers for financing, storage and distribution services.[72] Some manufacturers were able to reorganize the traditional marketing channels and establish their own distribution channels. However, wholesalers largely dominated distribution channels through their ability to influence the production decisions of small manufacturers and the purchasing decisions of retailers:

> . . . in most consumer industries large wholesalers and trading firms occupied a pivotal position in the marketing system prior to World War II. Indeed, as the captain of the channel, they exercised almost uncontested leadership. A typical pattern was for large wholesalers to dictate to small manufacturers under their control what and how much to produce; at the same time they enjoyed considerable influence over the actions of retail outlets.[73]

After World War II, with the emergence of mass-produced goods, manufacturers began to gain control over distribution channels at the expense of wholesalers who were ill-equipped to handle large volumes of mass produced goods. After the war, wholesalers were undercapitalized, suffering financial losses, too small to carry large inventories, and very fragmented. Manufacturers, on the other hand, were attempting to develop consumer loyalty for their brands and needed effective distribution channels.[74] Unable to rely on the wholesalers as much, they became more involved in the distribution of consumer goods:

> As the environment of distribution changed, large-scale manufacturing firms began to reorganize their own sales organizations from the mid-1950s onwards. . . Changes in the distribution system were notable in the consumer industries, because the marketing-oriented manufacturing firms were increasing. . . Thus, the traditional distribution system dominated by the wholesalers over many years changed fundamentally. The producers took the place of the wholesalers who had dominated distribution channels, and the result was the emergence of a manufacturer-dominated distribution system with vertical integration.[75]

Manufacturers began setting up their own wholesaling operations and retail stores or dealerships, particularly in sectors such as household appliances, sewing machines, consumer electronics, automobiles, and motorcycles. Such arrangements benefited the manufacturers controlling the marketing channels because they could be guaranteed serious efforts by distributors to sell their products.[76]

The amount of control that was exercised by manufacturers over their distribution chains varied. In some cases, manufacturers fully owned their wholesalers and retailers.[77] Such ties allowed the head company to place directors in

[70] John A. Dawson, "Japanese Distribution: Effectual yes, but is it efficient?", *The Japanese Market: A Guide to Distribution*, 1989, p. 11.

[71] Michael R. Czinkota and Jon Woronoff, *Japan's Market: The Distribution System*, (1986) Praeger Special Studies, p. 76.

[72] Czinkota and Woronoff, p. 76.

[73] "Marketing Behavior of Large Manufacturers," p. 109.

[74] Ibid., pp. 109-112.

[75] Kazutoshi Maeda, "The Evolution of Retailing Industries in Japan," p. 267.

[76] Czinkota and Woronoff, pp. 47-49.

[77] Richard E. Caves and Masu Uekusa, "Industrial Organization," in *Asia's New Giant*, (Washington, D.C.: The Brookings Institution, 1976), pp. 476-77.

the sales outlets (or on committees that were charged with responsibility for making marketing decisions). In addition, manufacturers further reinforced their influence by lending personnel to retailers. This practice ensured enthusiastic sales of their products and imposed further loyalty on the part of the store owner who usually needed the extra sales help.

In cases where the manufacturer did not own the wholesaler, other dependent relationships were often formed. Manufacturers provided credit and rebates to wholesalers and retailers to assist them with cash flows and to further instill loyalty. Subcontracting networks were set up in which subsidiaries and contracting corporations built components for the manufacturer. The larger firm concentrated on final assembly and high value-added processes while the smaller subcontractors performed specialized and labor-intensive tasks. Companies engaging in these types of relations or practices included such major manufacturers as Matsushita, Nissan, Toyota, and Suntory. In some industries manufacturers became skilled marketers because department stores rented out space to them. Products sold in this manner included cosmetics, fashion goods, household appliances and furniture.

Often manufacturers, recognizing that their area of expertise was production and not distribution, made exclusive contracts with wholesalers. Small retailers, for their part, relied on the wholesalers to provide inventory and distribution services. Thus, close relationships developed among these layers of the distribution chain.

Retailing also served an important social function in that it helped maintain employment levels and income. Japanese employees who received a lump sum payment upon retirement (as opposed to an ongoing pension as in the United States) often entered the retail business as a means of ensuring a continuing source of income. Because these "new" retailers were relatively inexperienced, they frequently relied on wholesalers for information and services.

Current Role in Distribution

The advantages to the manufacturer of controlling distribution of their products include developing brand loyalty, providing good after-sales service, and improving acquisition of marketing information. Consumers may benefit from being able to purchase on the basis of a reputable brand name and in obtaining good after-sales service. There may, however, be certain negative effects of manufacturers' involvement in the distribution of their products:

> On the other hand however, one cannot overlook the demerits like the decrease of free activities by distributors, emergence of unhealthy customs, locked-up clients and the increase in distribution costs.[78]

In general, manufacturers' behavior is based on long-term, profit maximization considerations which emphasize stable, mutually beneficial relations with purchasers:

> Japanese marketers tend to set short-run share goals rather than profit goals with the expectation of achieving profitability in the long run. Setting a share goal implies that marketers desire to obtain a share which may lead their products to become and remain socially visible and socially acceptable.[79]

A February 1990 study by the Industrial Bank of Japan elaborated further on the reasons for manufacturers behavior:

> The formation of distribution channels through the grouping of distribution market players affiliated with manufacturers and traditional business practices can be interpreted as commercial behavior with extremely economical rationale for the achievement of goals, that is the expansion of [sales of] the manufacturers products.[80]

In order to maintain loyalty and stability in relations with intermediaries and retailers, manufacturers rely on a variety of business practices such as resale price maintenance, returns policies, rebates, and other practices which are discussed in detail later in the report. For example:

> In the field of consumer goods, such as apparel, cosmetic products, and bathroom products, the adoption of various rebate systems, product return systems under which manufacturers accept the return of their unsold products from retailers, dispatched sales clerk systems, etc. have strengthened the manufacturers' control over the distribution community.[81]

According to a 1988 study of retail distribution in Japan by Dodwell Marketing Consultants that surveyed distribution channels for nearly 20 products: "Manufacturers exercise powerful control over consumer prices. Manufacturers can dictate the prices at which wholesalers and retailers sell merchandise to the next tier of distributors. Hence, manufacturers can prevent consumer prices from decreasing."[82]

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[78] *Distribution Systems in Japan*, pp. 17 and 18.

[79] Misuo Wada, "Selling in Japan: Consumer Behavior and Distribution as Barriers to Imports," in Thomas A. Pugel, ed., *Fragile Interdependence*, (Lexington, Mass.: Lexington Books, 1986), p. 9.

[80] "Changing Japanese Distribution System," IBJ, p. 5.

[81] Ibid., IBJ, p. 5.

[82] *Retail Distribution in Japan*, p. 66.

Traditional Japanese social customs which emphasize long-term, personal relations may reinforce tendencies for manufacturers and purchasers to support each other during economic downturns:

> Many traditional business practices are seen in the Japanese distribution structure. In the area of cement and plastic resins, manufacturers pay supplementary money in the form of sales price reductions, when their end-users, namely the raw concrete companies and plastic processors respectively, incur operating deficits. . . the user companies' habit of heavy dependence on manufacturers has been deeply rooted in this market, thus a de facto grouping of users under the manufacturers' initiative tends to be formed. The same type of business customs are also adopted in the craft liner and gasoline markets, by introducing retroactive price reductions in times of market depressions and price adjustments after the sales.[83]

The ability of manufacturers to exert control over distribution channels vis-a-vis the wholesalers and retailers varies according to the relative strength of the manufacturer, wholesaler or retailer and the type of product. The IBJ study notes that "many of Japanese distribution routes for the products of given manufacturers have an exclusive tendency vis-a-vis other manufacturers' products, because these routes are often grouped for a single manufacturers' products alone." The study goes on to note:

> In the area of intermediate goods, such as components and raw materials, control of the distribution channels by manufacturers through joint sales companies is powerful. In the field of consumer goods, control of distribution channels by manufacturers through affiliated sales companies—affiliated retailers routes is often found, and traditional business practices are diverse. Various business customs serve as an adhesive bond to the control of the distribution community to the manufacturers.[84]

As noted earlier, sometimes the relations between Japanese manufacturers and other participants in the distribution channels are even closer. The manufacturers may hold equity positions, or provide directors and other management personnel for companies that act as wholesalers:

> When such capital or personnel ties exist between the manufacturer and its sales company or dealers, there is a strong likelihood that the arrangement may transcend the trading practices described above and there may be even longer-term and more stable relations than usual between the manufacturer and its distribution people, and it is easier in such cases for the manufacturer to interfere in the distribution of its products than it is when such capital or personnel ties are non-existent.[85]

According to one view, manufacturers' control over distribution channels may be increasing in the producer goods and intermediate goods areas, while it may be loosening in the consumer goods area.[86]

Wholesalers

Although some changes occurred during the postwar period, there are many similarities between the historical role of wholesalers in Japan and their role today. Like their counterparts in the United States, Japanese wholesalers serve as information links between manufacturers and retailers. However, Japan's wholesalers usually do not have as much influence in distribution channels as wholesalers in other industrialized countries:

> . . . while there has been some turn to larger scale and cooperative arrangements in the wholesale sector, there has not been as much centralization as in the United States and Europe, and wholesalers have not developed into an effective countervailing force vis-a-vis the manufacturers. Quite unlike the situation in Japan, it is not uncommon for mass-merchandising retailers in the United States to perform some of the functions of wholesalers to deal directly with manufacturers, and the large-scale cooperative purchasing organizations in many European countries have likewise developed the clout needed to counter the manufacturers' economic might. The distribution revolution has not developed that way in Japan.[87]

Japan's wholesalers carry substantially greater risks associated with financing and inventory functions than their U.S. or European counterparts because they frequently serve financially weak retailers and small manufacturers. Wholesalers typically provide marketing information, financing, returned goods services, inventory functions, and sales personnel to stores. Although not required by contract retailers usually buy goods on commission and the

[83] "Changing Japanese Distribution System," IBJ, p. 5.

[84] "Ibid., IBJ, pp. 4-5.

[85] Toshima Tsuruta, et al., "An International Comparison of Distribution and Trade Practices and Competition Policies," International Study Group on Distribution Structures and Trade Practices (April 1986), p. 8.

[86] "Changing Japanese Distribution System," IBJ, p. 1.

[87] Tsuruta, et al, p. 3.

wholesalers do not receive payment until the goods have been sold. Unsold goods are returned to the wholesaler, who thus accepts the risk of selling them. These returned goods can then frequently be returned to the manufacturer.

As a reflection of producer, retailer and consumer demands, service is reportedly the highest priority for wholesalers. According to a recent study, "The ability to deliver rapidly and reliably is a more important competition factor in Japanese commerce than a slightly lower price."[88] Wholesalers handle frequent, small-lot deliveries for the mom-and-pop stores which have limited storage space. In some cases wholesalers may provide deliveries two to three times a day. One analyst reports:

> Wholesalers will deliver the smallest quantities to retailers on demand, so that the latter's storage space requirements can be kept to a minimum. They give their purchasers who have little capital credit for up to five months (the sole criterion for credit worthiness is the length of time the business relationship has been in existence) and will take back unsold goods without complaint. In addition, they advise the retailers on such matters as how to display and advertise their goods, they give courses on book-keeping and grant additional discounts to retailers who undertake to work exclusively with one wholesaler. The smaller shopkeepers thus have no reason to terminate this tried and tested division of labor, even if it does entail heavy dependence.[89]

Wholesalers in Japan often assume a greater financing risk than their counterparts in other countries by granting retailers unusually long periods of credit.[90] Wholesalers also provide substantial sales support for both retailers and manufacturers, especially with regard to sales promotions, by paying sales personnel to work in the retail stores. The rationale is that the wholesaler (and sometimes the manufacturer) often better able to explain the products to the customers than the retailer's employees.[91] The pivotal role performed by wholesalers in Japan in fulfilling inventory functions for small Japanese retailers, compared to those in other industrialized countries, allows small shops to carry a greater selection of goods to serve their customers. This is likely to enable such stores to remain viable competitors in the retail sector, despite their small size. As one expert explains:

> Wholesalers allow de facto consignment sales by accepting return of unsold goods and by vastly extending the range of manufactured goods a small retailer can offer. Even in highly concentrated industries, heavy participation by wholesalers can be extremely effective if the product carries a low unit price or is in high demand as a daily necessity (such as cosmetics, film, synthetic detergents, processed foods, etc.) so that retailers are able to carry a fairly diverse stock. In other words, in the United States the retailers must have economies-of-scale since they have to master the art of selling a rich assortment of products. In Japan, small retailers can survive because most of the assortment function is done by the wholesalers."[92]

Many small and medium-sized wholesalers do not have the resources to carry out all of these support functions without the backing of the manufacturers:

> Wholesalers in turn look to particular manufacturers for support, completing the web of dependency that ties the bottom of the distribution chain to the very top and simultaneously puts manufacturers in a position to control the brands stocked by neighborhood retailers and the prices charged. To some analysts, this relationship is what makes it hard for foreign suppliers and domestic newcomers alike to break into the Japanese market.[93]

The wholesaler is paid a commission by the manufacturer for collecting payments from the retailers. To cover their risks associated with providing financing and to compensate for other services they provide, wholesalers add a mark up to the price of goods handled. As each wholesaler adds his margin or markup for handling the product, the price of the product rises. Margins are affected by the size and frequency of shipments, current sales, the buyer-seller relationship and the product. [94] [95] [96]

As in other facets of business transactions in Japan, the reasons for the number of wholesalers in a particular distribution channel "in most cases—have to do purely with the length and closeness of the personal relationships."[97] According to one source:

[88] Batzer and Laumer, p. 64.
[89] Ibid., p. 52.
[90] Ibid., p. 64.
[91] Ibid., p. 64.

[92] *The Scoreboard of Global Competition*, U.S. and European Companies in Japan, p. 92.
[93] "Japan's Distribution System: The Next Major Trade Confrontation," p. 7.
[94] Michael Birt, "Industrial Market Research Can Help Decipher Japan's Distribution System," *The Journal of the ACCJ*, June 1989, pp. 69-71.
[95] Another facet of the margin structure is rebates or sales bonuses that manufacturers offer to wholesalers. Rebates are given one or twice a year and can total up to two percent of total sales if sales goals are met. This is another means by which wholesalers and manufacturers are tied together.
[96] Robert Lawrence suggests that, in aggregate, margins added in the distribution sector to the final goods price are comparable in the United States and Japan. He argues that manufacturers are responsible for the higher consumer price level evident in Japan. See Lawrence, Statement before the Joint Economic Committee, Oct. 11, 1989.
[97] Ibid., p. 67.

[f]rom a purely rational point of view the services of some individual wholesalers could often be dispensed with altogether. But in the network of relationships that make up the Japanese distribution system there is an unwritten code of conduct which requires every recognized wholesaler within the hierarchy to be allowed to participate in the distribution business.[98]

Not all wholesalers are involved in the physical distribution of goods. Some wholesalers are supplied by regional or national distributors who serve as purchasing centers and negotiate directly with the manufacturers. For example, a large wholesaler may sell goods to another smaller wholesaler, but the goods are then delivered by the manufacturer directly to the smaller wholesaler rather than the first wholesaler. This pattern is likely to occur where the smaller wholesaler has long-term relationships with the retailer, but does not have as close a relationship with the manufacturer as does the larger wholesaler. In other cases, even smaller wholesalers may be supplied directly from the manufacturer, but only on the condition that another larger wholesaler, a few layers up, guarantees payment. Under those circumstances, (1) the smallest wholesaler is nearer to the retailers than the other wholesalers and is in a better position to supply them; (2) the smallest wholesaler is linked through personal relations to another wholesaler who has long-term relations with the manufacturer; and (3) the manufacturer reduces his risks of not being paid while being assured of a nationwide distribution channel. The intermediary wholesalers do not incur large expenses since they are not responsible for the physical distribution of the goods, but they receive a portion of the sales revenue for granting credit.

There are differences in how closely tied the wholesalers are to either the producers at one end of the chain, or the retailers, at the other end. For example, in the case of consumer products, the producer may prefer to eliminate as many middlemen as possible in order to be closer to the retailer. This results in increased economies of scale in storage, transport, and sales promotion. The factor that determines how successful he is in rationalizing the chain is how closely his product line matches that of the retailer. If he has a narrower range of products, he will have more difficulty in setting up an exclusive dealer arrangement with retailers. This is a situation where a wholesaler can step in and provide the retailer with a range of goods from other manufacturers as well.

[98] Lawrence, Statement before the Joint Economic Committee, p. 64.
[99] "Japan's Distribution System: The Next Major Trade Confrontation," p. 6.

In other cases where a producer makes a full line of specialized products and there are stores carrying that line of products, the producer can link up with the retailer directly without the need of wholesale services. The producer can instead set up an independent sales company that carries out the functions of a wholesaler.[100] Matsushita is an example of a producer that organized a chain of sales companies to promote a brand image for a chain of retailers.

In most cases, the higher the concentration at the production and retail ends of the distribution channel, the fewer number of layers required for distribution. For example, a large producer of processed foods would require only one primary wholesaler in order to reach a large retailer. However, this same producer would need two levels of wholesalers, both primary and secondary, in order to reach a small retailer.[101]

The total number of wholesalers in Japan increased from 413,016 in 1985 to 436,502 in 1988. In 1985, sales for the wholesale sector totaled 432,506 billion yen, compared to 101,716 billion yen for the retail sector. However the figure for wholesalers included internal sales, that is sales which take place between wholesalers. Transactions between central and regional wholesalers have grown and the level of sales handled by secondary or intermediate wholesalers has also increased. In 1985, about 40 percent of wholesale sales were related to consumer goods and 60 percent to raw materials, semi-manufactures, and capital goods.[102] The proportion of consumer goods passing through the wholesalers to retailers fell from 54 percent in 1972 to 47 percent in 1982. The average wholesale margin also fell during this period.

The strength and numbers of wholesalers in the marketing chain varies according to the industry and the product. In the case of some consumer products, agricultural produce, fish, food and beverages, there are more secondary wholesalers in the distribution channels. However, for clothing, products usually often pass directly from the primary wholesaler to the retailer. Secondary wholesalers also play a prominent role in the distribution of raw materials and capital goods such as ores and metals, building materials and machinery.[103]

There are two divergent trends occurring in the wholesale sector. On the one hand, the position of the wholesaler in Japan has been weakened somewhat in recent years. There is a trend among retailers and manufacturers to

[100] Many such sales companies were formed from wholesalers that used to assist producers who did not produce a full product line. These wholesalers merged into single sales companies to achieve economies of scale in distribution.
[101] Ratcliffe, p. 107.
[102] Batzer and Laumer, p. 70.
[103] Ibid., p. 66.

eliminate wholesalers from the distribution chain, especially for high-volume goods. More Japanese manufacturers are trying to establish direct marketing channels without the use, or with only limited use of wholesalers. In some cases, the use of point-of-sales systems (POS) has made it possible for retailers and manufacturers to accumulate information that reduces their need for wholesalers.[104] [105] One niche of the traditional wholesale market has eroded in recent years, with the emergence of cash-and carry wholesalers. These are wholesalers who buy from small manufacturers on the basis of product and price competitiveness. They generally do not provide financing and delivery, permit return of unsold merchandise; do not handle name brands; and the transactions do not depend on close, personal relations, as is typical of traditional wholesalers.[106]

In response to manufacturer and retailer efforts to circumvent them, wholesalers are themselves becoming more vertically integrated. Wholesalers are acquiring small manufacturers, frequently associated with subcontracted work, especially in the clothing industry. At the other end of the distribution chain, wholesalers are also acquiring retail businesses. Large wholesalers are merging with other downstream partners. To improve their information services, about 90 percent of the large wholesalers have computers whereas about 30 percent of the smaller wholesalers had computers in 1985.

At the same time, rapid diversification of consumer demand has increased the need for small quantities to be delivered to retailers at frequent intervals. Retailers, who are carrying greater numbers of new products, are trying to limit the size of their inventories through detailed purchasing schedules for use by each part of the company. Wholesalers are becoming more specialized in order to be in the best position to meet these increasing needs for small deliveries. Manufacturers are utilizing wholesalers more to implement their "just-in-time" systems for purchases of raw materials, components, etc. in order to reduce inventories.

[104] See discussion of POS under the section on the retail sector.

[105] By mid-1988 over 20,000 stores in Japan had point-of-sale (POS) technology which enables them to collect information on product sales. The technology involves reading a product bar code identifier which is used by over 33,000 manufacturing companies. POS is used more for inventory and marketing in Japan than in the United States. Customer cards are also being used to collect data on individual consumers. POS was introduced in Japan by Seven Eleven. There are two views of the possible effects that POS may have on the distribution system. On the one hand, POS creates closer ties between the retailer and manufacturer because the manufacturer immediately gets information on how products are selling at the retail level. By transferring information on consumer preferences directly to the manufacturer, retailers are able to bypass wholesalers and gain more leverage with regard to inventories and the purchased price for products. On the other hand, some observers claim that by eliminating more wholesalers, having more direct access to retailers and receiving extensive information on sales, manufacturers will be in a position to exert even more control over distribution. USITC staff interview with the ACCJ, Tokyo, Japan, Feb. 1, 1990 and "The Japanese Market: A Guide to Distribution," *The Anglo-Japanese Economic Institute*, 1989, p. 5.

[106] Ibid., p. 74.

Retailers

Japan's retail sector did not follow the same pattern of development that occurred in other industrialized countries.[107] In the United States, there has been a historical trend toward the development of mass-merchandising retailers, including large-volume discount stores. In Europe, numerous cooperative purchasing organizations involving retailers or wholesalers and retailers have developed as a counter force to manufacturers. In Japan, the historical development of the distribution structure has followed a different pattern, whereby, despite an increase in the numbers of large retailers, ". . . the distribution revolution did not drive the smaller retailers out of business. Far from it. Rather, there has been a steady increase in the number of retail outlets since 1955, and the smaller retailers continue to hold a dominant position in the Japanese distribution structure."[108] In Europe and the United States, retailers bypassed the wholesalers and purchased directly from the manufacturers.

One of the factors contributing to the difference in the retail sector in Japan was the influence of railways and other means of mass transit on distribution. Department stores were originally set up at the end of major railway lines and were run by railroad companies. Today, many of the large department stores are still located near major subway and train stations.[109] In the United States, by contrast, the structure of the retail sector was heavily influenced by automobile usage and a highly-developed highway system. Mass-merchandising stores such as shopping centers and discount stores were built along major highways in the suburbs of cities in the United States. Although Japan built expressways following World War II, these roads serve mainly as "national overland transport arteries, and they do not provide the close-mesh webs of roads for everyday driving that the equivalent highway systems in the United States and Europe do, with the result that there are physical constraints on the development of mass-merchandising suburban retail outlets in Japan."[110]

[107] A recent study of the Japanese distribution system states, "The developments on the Japanese retail scene can be better described as evolution than revolution." Batzer and Laumer, p. 58.

[108] Toshima Tsuruta, et al, "An International Comparison of Distribution Structures and Trade Practices and Competition Polices," International Study Group on Distribution Structures and Trade Practices (April 1986), p. 3.

[109] "Japan: An International Comparison, 1989", Keizai Koho Center, p. 29.

[110] Tsuruta, et al, p. 4.

Other factors, such as limited usable land space and land prices have affected the make-up of the retail structure. As one analyst observes:

> In retailing, severe limits on available land make it impractical for the Japanese to emulate American-style shopping centers, with their huge malls and prodigal parking lots. Over the last thirty years, urban land prices in Japan have skyrocketed.[111]

Some changes have occurred in the structure of Japan's retail sector including the growth of convenience stores, mail order businesses, and discount consumer electronics outlets. However, these developments are the exception, not the rule.[112]

In Japan there has been only limited development of a system of voluntary chains controlled by wholesalers and purchasing cooperatives.[113] This may be attributed, in part, to the strong sense of independence exhibited by the small shopowners who are not willing to give up control of product ranges, shop fittings or external appearance of their stores to such cooperative groups.[114]

The Japanese retail sector is organized according to the type of store and the product carried. The main types of retailers are department stores (ordinary and credit), specialty stores (ordinary and high-class), general merchandise stores, superstores (e.g., supermarkets, discount stores)[115], convenience stores, variety stores, off-price stores, "Do-It-Yourself stores, mom-and-pop stores, drug-stores, public markets, roadside stands, and non-store sales.[116] Retailers within each of these groups may specialize in certain types of products such as food, clothing, and household goods.

The number of department stores in Japan has grown at a very slow pace.[117] During 1980–1988, the number of department stores increased from 325 to 371. (table 4) Six of these stores were opened during 1987–1988.[118]

[111] McCraw, p. 104.
[112] Ibid., p. 103.
[113] In Japan, there are three types of chain stores: (1) voluntary chains which are organizations of independent retail stores and expand by affiliating existing stores; (2) regular chains which have a corporate structure of unified capital and expand by setting up new stores; and (3) franchise chain stores. Voluntary chains, in principle, purchase merchandise from the headquarters of the chain while regular chains are supplied merchandise under the headquarters' direction. "What's What in Japan's Distribution System," (Tokyo: The Japan Times, 1989), p. 35.
[114] Batzer and Laumer, 1989, p. 61.
[115] Superstores are frequently referred to as "supermarkets" in Japan although they do not specialize in food as do supermarkets in the United States. "Retailing in the Japanese Consumer Market", Japan External Trade Organization, 1985, p. 16.
[116] *What's What in Japan's Distribution System*, (Tokyo, The Japan Times, Ltd., 1989), p. 35.
[117] In this case department stores refers to those with 50 or more employees.
[118] "Japan's Distribution System: The Next Major Trade Confrontation?" p. 9.

Initially, department stores carried medium-to-high-priced goods, but as incomes have risen, department stores began to carry more luxury items. During 1980–88, almost 50 percent of department store sales were clothing. Food and beverages, furniture, appliances and other housewares respectively accounted for 21.2, 4.8, 1.4 and 4.4 percent of total sales.[119] Sometimes specialty goods are sold in department stores by tenants who pay rent or a commission on their sales. The largest department stores in Japan are Seibu, Mitsukoshi, Takashimaya, Daimaru, Marui, Matsuzakaya, Isetan, Hankyu, Tokyo, and Sogo.[120]

Large retailers such as department and superstores carry more imports than small stores, which carry virtually no imports. However, the percentage of total imports carried by large stores is still relatively low, ranging from 10 to 20 percent.[121] The United States is not the main source of imports. For example, in 1989, the major sources of imports for the largest chain store in Japan, by rank, were Korea, Taiwan, the United States, the People's Republic of China and Italy.[122] Surveys have shown that in general that large retailers are receptive to imports. However according to one source, "it cannot be overlooked that imported goods in general are still put on sale at high prices and do not have a 'price breaking function' as they do in the Federal Republic [of Germany]. This naturally prejudices their sales prospects."[123]

General merchandise stores, comparable to Sears and Roebuck in the United States (except that they also sell food in Japan), and superstores (supermarkets which carry many non-food items) handle a wide variety of products which were originally offered at discount prices. More and more these types of stores tend to offer luxury items. Superstores tend to carry more food products than general merchandise stores. The top ten superstore or supermarket chains in Japan are Daiei, Ito-Yokado, Seiyu, Jusco, Nichii, Uny, Nagasakiya, Uneed, Izumiya, and Kotobukiya.[124] Superstore chains may be comprised of a number of these different types of stores. For example, Daiei, the largest retail conglomerate, controls a major supermarket chain, a chain of specialty stores, a chain of discount stores, a chain of convenience stores and a department store.[125]

There are not as many self-service stores (those without floor sales clerks) in Japan as in the U.S. or western Europe. In 1982, there were 22,200 wholly self-service stores, accounting for 15.5 percent of retail stores.[126] Of the total

[119] Ibid, p. 9.
[120] "Japan: An International Comparison, 1989", Keizai Koho Center, p. 29.
[121] Batzer and Laumer, p. 58.
[122] USITC interview with chain store, Tokyo, Japan, Feb. 6, 1989.
[123] Batzer and Laumer, pp. 48-49.
[124] Ibid., p. 14.
[125] Wada, p. 109.
[126] Ibid., p. 61.

Table 4
Large retail stores in Japan, 1980 and 1985-88[1]

					Distribution of Sales (percent)				
Year	*Yearend number of stores*	*Yearend sales floor space (1,000 sq. meters)*	*Yearend employment (1,000)*	*Value of sales[2] (billion yen)*	*Food and Clothing*	*Other beverages*	*Furniture*	*Appliances*	*Housewares*
				Department stores					
1980	325	5,409	168	6,501	49.0	20.5	5.7	1.4	5.0
1985	360	6,201	170	7,982	49.3	21.5	5.1	1.5	4.7
1986	365	6,310	170	8,416	49.5	21.6	4.8	1.4	4.6
1987	368	6,414	171	8,879	49.7	21.5	4.7	1.5	4.5
1988	371	6,563	176	9,552	49.5	21.2	4.8	1.4	4.4
				Other large self-service stores					
1980	1,613	7,183	194	5,684	34.0	42.5	2.7	4.1	6.0
1985	1,931	8,963	220	7,299	31.4	43.7	2.3	4.5	5.8
1986	1,966	9,275	228	7,560	31.4	43.3	2.3	4.5	6.0
1987	1,975	9,514	232	7,875	31.4	42.5	2.3	5.0	6.0
1988	1,975	9,695	236	8,332	31.5	41.9	2.3	5.3	5.9

[1] Stores with 50 or more employees.

[2] The following average annual exchange rates can be used to convert the yen sales figures: 1980, Y226.74; 1985, Y238.54; 1986, Y168.52; 1987, Y144.64; and 1988, Y128.15.

Source: Ministry of International Trade and Industry.

number of self-service stores in Japan, only 1,975 stores had 50 or more employees in 1988.[127] One type of self-service store is the convenience store that is open 24 hours per day, situated in accessible locations, offers a limited range of products and caters primarily to working singles and couples. The primary products carried by convenience stores include food items and necessities packaged for immediate use and "fast food." Most convenience stores have less than 300 square meters of floor space.[128] More than one-half of the convenience stores are operated on a franchise basis by the large superstore chains such as Daiei (Lawson, Sunchain). Seven Eleven Japan Co., which is 51.4 percent owned by Ito-Yokado, introduced the American concept of convenience stores to Japan in 1974 with nineteen franchise stores. The company has 3,653 stores with net sales of $5.4 billion in FY 1989.[129] Prepared rice and hot filled buns accounted for 18 percent of FY 1989 total sales.[130] Other convenience store chains have followed including My Shop, Lawson, Sunshop Yamazaki, Sun Chain, and Family Mart.

Specialty stores focus on carrying a certain type of product, such as sporting goods, or products that can't be found in other stores. The owners or employees are often able to provide specialized advice or expertise to consumers concerning the products they carry.

There are very few discount stores in Japan. Those that exist carry a variety of products that are purchased in bulk from the wholesaler or directly from the manufacturer. They generally carry a limited range of products, hire part-time staff, have limited advertising expenses and control capital investments in order to cut costs. There may be limits on the appeal of this type of store to Japanese consumers, because of the "bare bones" appearance and staffing.[131] As with other large-scale stores, potential developers of discount stores generally run into stiff local opposition from small shopowners and other existing retailers that have limited their numbers.[132] [133]

Two types of discount stores that were at first viewed as a signal of optimism by the press and some U.S. policymakers, have now been assessed as a one-time occurrence or "fad". One concept was "box stores" that provided only minimum service and primitive displays in return for substantial discounts. These stores "flopped here, even though they opened during a recession."[134] Another chain of stores known as "NIES Shop" which opened in January 1988 seems to have faded in popularity as well. These stores focused on carrying primarily electronic products from Southeast Asia and offering them at lower prices than the local brands. After an initial favorable response by consumers, the stores have failed to attract return customers, reportedly because of inadequate stock and poor merchandise display.[135]

Another example of discount retailers is the electric and electronic appliance stores that have opened in the Akihabara section of Tokyo. In that location, retailers can buy quantities of goods from primary wholesalers. These outlets which first emerged during the 1970s, do not provide traditional services that are expected of Japanese retailers such as delivery, wrapping, insurance, installment payments plans and displays of products. Prices at these outlets are generally said to be 10 to 20 percent below normal, but the actual selling prices are subject to bargaining between the consumer and the retailer. Such stores are said to for 20 percent of the $20 billion "white and brown" goods market in Japan. Among these stores are Best Denki, Daiichi Katei Denki, Ishimaru, Yamagiwa, Nisshin and Laox. According to one source, "While the visitor may gain the impression that discount districts like Akihabara account for the bulk of electrical appliance sales, collectively the small neighborhood stores account for more. Here, clearly, the consumer is indicating the importance of service and a readiness to pay for it."[136]

Initially, Matsushita, Toshiba and Hitachi, who together control 75,000 franchised mom-and-pop outlets opposed the opening of such stores. The development of such stores does not appear to have led to a sizeable increase in imports. In commenting on the Akihabara district, Ed Lincoln has said:

> Because this retailing district led a moderate increase in retail price competition in the 1970s, it would logically be on the frontier of accepting imports at the present time. Import penetration in these stores, however, is mostly limited to OEM products; virtually no foreign brand names are visible.[137]

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[127] "Japan's Distribution System: The Next Major Trade Confrontation," p. 9.

[128] *What's What in Japan's Distribution System*, p. 46.

[129] Seven-Eleven Annual Report for 1989, p. 3.

[130] According to Seven-Eleven representatives, the concept of fast-food in Japan is different from the United States. Japanese consumers prefer food such as rice and fish paste which is freshly prepared, packaged and taken home to eat. USITC staff interview, February 6, 1990. "Eating while you're walking down the street is bad manners. Snack foods are sold at street stands and it is polite to stand at the snack stand while eating."

[131] See section on consumer behavior for further information.

[132] *What's What in Japan's Distribution System*, p. 44.

[133] One discount store in Kobe, Japan was opposed by store owners up to 12 miles away, even though the store was being built on reclaimed land—those areas of Japan with the least amount of vested local interests. USITC staff interview February 8, 1990.

[134] George Fields, *The Japanese Market Culture*, (Tokyo: The Japan Times, 1989), p. 202.

[135] Interviews with U.S. Embassy officials, Tokyo, Japan, Feb. 1990.

[136] Fields, p. 202.

[137] Lincoln, pp. 132-133.

There are two major consumer cooperative organizations in Japan, Seikyo (Japanese Consumers' Cooperative Union) and Nokyo (Agricultural Cooperative). Seikyo is an umbrella organization for consumer cooperatives in Japan that develops products for its members. Each of the 670 Seikyo branches is an independent organization. Some branches operate stores while others deliver products to consumers who are, in principle, members. Cooperatives provide comparatively low-priced health foods and products with no chemical additives. The coops are able to offer lower prices by buying in bulk through the central organization. However, there are legal restrictions that prevent coops from selling outside of their region and which prevent them from marketing their products through other retail stores.[138] Nokyo, the agricultural cooperative organization, consists of independent local, prefectural and national groups that sell primarily farm produce, daily necessities, sundry goods, and electrical appliances. Farmers and general consumers can both avail themselves of Nokyo products and services.[139]

Consumer Behavior

Traditional Characteristics

Consumer behavior is an important factor influencing the distribution of goods in any society. As one well-known expert on Japan's distribution system has suggested: "The shape of a nation's distribution system is determined by the lifestyles of its consumers. Japan is no exception." [140]

There are two seemingly contradictory characteristics of Japanese consumer behavior. First, traditional consumer preferences include a priority for quality, fast-delivery, status and personalized service; a tendency towards groupism, obligation and cooperation in social and business relations; and high loyalty to products made in Japan. A second, there is an overlapping trend toward modernity involving more emphasis on individualism and choice. Japanese consumer behavior has a direct influence on the demand for products and the distribution process.

Japanese consumers have a "split personality" with regard to product prices. For standardized products, Japanese consumers reportedly seek the lowest price. For products that consumers find particularly attractive, they place more emphasis on service or quality and are willing to pay a significant premium.[141]

[138] USITC staff interview with consumer cooperative, Kobe, Japan, Feb. 8, 1990.

[139] *What's What in Japan's Distribution System*, p. 49.

[140] Japan's Distribution System: An International Comparison," *Journal of Japanese Trade and Industry*, May/June 1984.

[141] "Distribution System and Market Access in Japan," Japan Chamber of Commerce and Industry, June 1989, p. 23.

Nonprice factors also play an important role in consumer preferences and behavior. Japanese consumers are noted for placing high demands on retailers to offer high quality products, delivery and personalized service.[142] [143] [144] Japanese consumers also demand a wide selection of merchandise on-hand, after-sales service, detailed product information and a pleasant shopping environment, according to surveys done for the Government of Japan. The emphasis on service is reflected at the retail and wholesale level[145]:

> Wholesalers and retailers in Japan are service-oriented to a degree that would nowadays be unimaginable elsewhere. . . Like nowhere else, service to the customer is the ultimate yardstick for the Japanese retailer. Comprehensive personal advice, short delivery times for consumer durables, the guarantee of efficient maintenance and repair service, rapid procurement of spare parts, etc. —it is taken for granted that even the smallest retail shop will provide such services.[146]

Retailers are apparently responsive to such consumer demands.[147] A study by Japan's Small and Medium Enterprise Agency indicated that

[142] Birt, p. 65.

[143] The following passage illustrates the types of services that are frequently offered in Japan:

> Supermarket check-out counters have two or three people ringing up and bagging groceries. Some stores deliver, with each bag arriving neatly stapled closed. Dry ice is inserted alongside the frozen foods to assure that they don't spoil on the way.
>
> There are no limits to what is home-delivered—video movies, dry cleaning, health foods, rented tailcoats—this last one requires two visits from the sales staff, first for a fitting, second for delivery of the altered and freshly pressed garment. Office deliveries are common, too, especially of lunch . . . Self-service gasoline has yet to make its appearance here in any significant way. Attendants . . . They often empty ashtrays and stop traffic to let the motorist back on the road.
>
> Department stores seem to have twice, if not three times the floor staff of American ones. Many stores wrap everything they sell. Upscale customers don't have to come in at all—the goods are taken to their homes for display and selection. Those who don't conform, stand out. And there is pressure on them to change their ways.
>
> John Burgess, "Japan Still Bows to Customers' Whim", *Washington Post*, March 6, 1987, p. A1, A31.

[144] "Distribution System and Market Access in Japan, Japan Chamber of Commerce and Industry, June 1989, p. 23.

[145] See sections on retail and wholesale sectors for further information.

[146] Batzer and Laumer, p. 50.

[147] For example, one of the four largest retail chain stores reported that they have a "lifestyle advisor system" whereby once a month housewives, their largest consumer group, are invited to the store to provide customer preference advice. Interview with large retail chain store, Tokyo, Feb. 7, 1990.

retailers focus first on cultivating personal contacts with customers; second, on selection of a range of goods; and third, on low selling prices.[148]

Japanese consumers generally prefer items that are perceived to be of high quality or status. This especially applies to consumer products such as autos, apparel, food, appliances and luxury items. Japanese consumers generally associate high price with high quality.[149] Consumers are also reportedly very concerned about the appearance of a product.[150]

> Consumers in Japan are very particular about the perfect appearance of any consumer product. Any spot on a package even if it is on the label, will disqualify the product entailing return of goods and possible elimination from the list of suppliers. This adds to the cost of the product which the distributor has to account for in his pricing.[151]

Product packaging and labeling is also apparently very important. According to a firm that specializes in direct imports of food products from the United States: "Japanese consumers prefer lithograph labels. In one case, a U.S. pasta company was unsuccessful in selling its product because the ink from the package rubbed off onto consumers' hands and consumers complained that the shapes of the contents were uneven."[152] One importer of U.S. products reported in general: [The] U.S. type of pull tab that folds into the can is unacceptable in Japan. Japanese consumers believe you should pull off the tab and throw it away because it's unsanitary."

The status image of a product, its packaging and its price is especially important with regard to customary gift-giving which occurs throughout the year and especially in the year-end gift giving season (o-seibo). Gift-giving in Japan is important because it represents more than just an exchange of presents—it strengthens the relationship between the participants and serves as a means of communication. Gifts are generally given to parents, bosses, business clients and teachers. There has been a growing trend toward unusual and expensive gifts in Japan:

> The price of a gift is usually considered much more important than the kind of gift. A year ago a prestigious Y5,000 ($36) bottle of whiskey made by Japanese distillers was a typical gift. However, once the price was decreased 25 percent in response to cuts in Japan's liquor taxes, gift sales of this whiskey slipped, and demand shifted to a more "prestigious" whiskey, which was newly priced at Y5,000.[153]

The market for gift giving is estimated at approximately 12.7 trillion yen ($90.7 billion), which is higher than total department store sales. It is expected to rise to 20 trillion yen ($142.9 billion) annually within the next five years.[154] The importance of gift-giving relative to overall retail sources is further described:

> . . .if there is a trend away from o-seibo, the department stores will be in disastrous straits. Gift giving is very much a barometer on how well department stores will fare financially for the year. According to a survey by the Sumitomo Bank, for the year-end gift giving season of 1985. . .the average, married salaried worker is committed to non-routine expenses amounting to 2 percent or so of his income, over the New Year period. In turn 22 percent of this expenditure is used on o-seibo gift giving, excluding gifts given to family members. . . institutional gift giving is where the real action is. . . There is no major market in the world in which gift giving has such an impact—both on the distribution system and the consumer. While the 'Japanese are unique' claim is tiresome and certainly overdone, this is one aspect in which Japan presents a distinct characteristic to global marketers. . .the emphasis on execution, which shows in the enormous emphasis placed on the packaging of gifts in Japan. This is why department stores dominated all categories, with their prestige imparted via their wrapping papers.[155]

At least some Japanese consumers reportedly also demonstrate a high preference for products made in Japan.[156] However, they may decide to purchase imports, if there is a very large price differential between the import and the local brand or if the imported item is considered to be of particularly high quality or status. One study of consumer preferences for electronic products showed that consumers would expect a 30

[148] Cited in Batzer and Laumer, p. 50.

[149] According to one source: "The sole agent system in Japan is the only way for a product of a company to be distributed in Japan, but this means high prices. But Japanese consumers like high-priced items." Interview with the LDP, Jan. 30, 1990.

[150] Statement by the European Business Community in a meeting with the FTC Advisory Committee, Jan. 30, 1990, p. 9.

[151] For example, one researcher specializing in Japanese agriculture issues noted that when grapefruit is shipped to Japan, about one-third is thrown away immediately because of product imperfections (defects in the skin or shape). Japanese consumers expect shiny, perfectly round grapefruit, so each grapefruit is polished individually and repacked. At the retail level, the grapefruit is polished and repackaged or rewrapped. By the time the grapefruit is sold at the retail level, about 50 percent of the product has been thrown away. Interview with professor, Faculty of Agriculture, Kyoto University, Kyoto, Feb. 9, 1990.

[152] Interview with Ryoshoku, Tokyo, Japan, Feb. 7, 1990.

[153] "Japan's Price Structure," *Japan Economic Institute*, Jan. 26, 1990, p. 8.

[154] "Japan's Price Structure," p. 9.

[155] Fields, p. 107.

[156] John A. Dawson, "Japanese Retailing: Movement to the Post-Traditional Stage", *Journal of Japanese Trade and Industry*, No. 2, 1989, p. 54.

percent price differential before they would purchase imported products instead of the local brand. Japanese consumers reportedly have no preference for country of origin with regard to imports, but again look for products that they associate with high quality or status.[157] [158] [159] Perceptions of lack of reliability associated with some imports has resulted in a negative attitude toward some imports.[160] For example, in the case of apparel, Japanese consumers prefer products from France or Italy compared to U.S. clothing. Japanese imports by the largest chain stores range from 10-12 percent. According to interviews with both U.S. and Japanese companies, the one reason for the low level of imports in the stores and particularly from the United States is consumer preference.[161]

Social obligations and responsibilities may also play a role in consumer purchasing decisions. For example, if there is a convenience store and a small "mom-and-pop" store located next to each other, a neighborhood resident may patronize the smaller shop, even if the prices are higher, because of personal relationship or sense of obligation to the shopowner. This sense of obligation may be due to the fact that the "mom-and-pop" stores are generally owned by retired persons with no other income.[162]

Changing Demographics and Spending Patterns

While traditional behavior still appears to have a predominant influence over consumer behavior, other factors have contributed to a growing tendency toward modernity. These factors include greater affluence and higher disposable income of young people; increased leisure time and spending on leisure activities; an increase in actual and perceived mobility; an aging society; increasing contrast between urban and rural lifestyles; and a desire for more individualism in consumer spending.[163]

The majority of today's Japanese population did not experience the poor living conditions of the immediate post-war era.[164] Today about 80 percent of the Japanese population considers itself to be middle class. Despite the relative perception of wealth for most of the population, there is an increasing gap between the "haves," those who are the owners of real estate and/or who have made windfall profits from the stock market during the 1980s, and the "have nots." During January through September 1987, real income grew by 0.6 percent for 80 percent of consumers while consumer spending for this group actually declined by 0.6 percent. The current boom in consumer spending is being carried out by the top one-fifth of consumers with the highest incomes. Real income of this wealthy group of consumers grew by 3.6 percent between January and September 1987 and their spending increased 4.6 percent over the previous year. The new rich (nyu ritchi), or those with property assets valued at more than 100 million yen as of January 1987 accounted for 6 percent of all households in Japan.

A large portion of this increased spending is being carried out by the so-called new rich belonging to the generation born in the 1960's and 1970's. This age group tends to have more discretionary income because they frequently do not have mortgage payments or education expenses. Large companies and Government ministries often provide subsidized housing for younger employees, tax-free "downpayment" savings accounts and low interest housing loans. Another group pouring spending money into consumer goods are the "OLs", or office ladies (young, single women who work) who avoid-housing expenses by living with their parents and spend a large portion of their salary on clothing, trips and entertainment.[165] [166] [167]

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[157] Regarding Japanese consumers' willingness to try foreign imports: "Probably the Japanese consumer is more approachable and in many respects displays an eagerness to acquire prestigious or at least well-thought of foreign consumer products." "Passport to Japan: Businessman's Guide, 1988/89", Business Intercommunications, Inc., 1988, p. 143.

[158] Seven-Eleven was advised "not to sell cheap products" in Japan despite the fact that it previously believed that one of the keys to its success in the U.S. market was to be price competitive. Interview with Seven-Eleven, Tokyo, Japan, Feb. 6, 1990.

[159] A 1988 survey by MIPRO showed that almost 75 percent of respondents showed no preference for either imported or domestic goods if there were similar items and the quality and price were reasonable. However, only 1.3 percent said they prefer imported goods.

[160] Fields, p. 202-3.

[161] Interviews with large retail chain stores on Feb. 7, 1990 and Feb. 2, 1990; interview with professor, Faculty of Agriculture, Kyoto University, Feb. 9, 1990; and interview with 7-11, February 6, 1990.

[162] USITC staff interviews with Japanese business and trade associations, February 1990.

[163] "The Japanese Market: A Guide To Distribution", p. 14.

[164] Interview with a retailers association in Japan, Feb. 5, 1990.

[165] "The Rise and Rise of the Japanese Yuppie," *Business Week*, Feb. 15, 1987, p. 56

[166] The consumption patterns of the younger generation of Japanese may have implications for U.S. products: "In the age of seeking only to possess something, the U.S. was the clear model . . . spending now is to achieve a uniqueness, to have a 'slice of life' that is different from others." Ibid.

[167] One symptom of the change in lifestyle and a move away from the traditional aversion to debt is the increase in credit card use. During the 1980's the number of credit cards in circulation increased by 10 percent. By the end of 1987, there were 110 million credit cards in circulation in Japan. Credit-card spending now accounts for a third of credit sales in Japan. However, this amounts to only one-seventh of total credit spending, including bank loans, compared to the United States where credit card sales account for one-quarter of all credit spending. "Japan Goes for Credit and Chips", *The Economist*, Apr. 30, 1988, p. 73.

Consumer spending patterns have also been influenced by the rising costs of owning homes. The average price of a 960 square feet home within an hour's commute of Tokyo costs about $315,000, while houses in Tokyo run about $632,000, and small apartments or condos cost about $378,000.[168] With 30- to 40-year payouts required to purchase modest inner city apartments, many young Japanese realize they will never have enough to be able to buy a home. There are even some reports of 100-year mortgages for financing home purchases to be paid off by the buyer's grandchildren.[169] With banks lending up to only four times the annual income (which is about $50,000 for typical wage-earners), owning a home is an unreachable goal for many Japanese. In the entire country, about 60 percent of all Japanese own their own homes, while in the Tokyo area, the figure is only 40 percent. Many Japanese consumers who are unable to afford homes are spending their money on automobiles, travel and other luxury items.[170]

In addition to the landed versus nonlanded gap, there is an increasing contrast between city lifestyles and small town or rural lifestyles. Young residents of the metropolitan areas are generally more affluent and exhibit more conspicuous consumption and leisure lifestyles. They show greater receptivity towards international products than their counterparts outside of the cities.

Other trends also signal a move toward modernity. Consumer spending has shifted in recent years from traditional purchases to leisure activities such as sports, travel and eating out. Although average working hours are still 20 percent longer than in Europe and the United States, certain segments of the population have substantial leisure time. Actual and perceived personal mobility has risen as car ownership has increased, foreign travel has grown, and internationalization of the media has occurred. In 1988, over 10 million Japanese tourists traveled overseas. Two-thirds of foreign travelers between 15 and 24 years of age were females, the leading group of Japanese consumers for apparel and other consumer goods.

Consumer Consciousness and Organization

Japanese consumers have traditionally linked their own welfare with that of the large, export-driven corporations. Because of this association, in the past they were reportedly willing to accept high prices and limited selection for the sake of the success of Japan's international companies. However, those factors mentioned previously are apparently leading to demands for more lower priced products in the domestic market. Increasing consumer consciousness could lead to greater receptivity towards more reasonably priced imports, such as more Japanese tourists traveling abroad. But in general consumers lack good information on pricing differentials between Japan and other countries.[171] Japanese tourists are aware of price differentials, but there has been no mass campaign to inform other consumers.

Japanese consumers are not organized as a political and social force on a level comparable to that in the United States.[172] There are several reasons for this. First, there have been no overall consumer awareness programs in the media. Second, although Japanese consumers might be interested in lower prices, the wholesale and retail sectors employed a total of 10.2 million workers in 1985.[173] There may be some realization that reform of the distribution system in a short time period could lead to dislocations in the economy, including a loss of employment. According to one source:

> Quite a few market change predictions in the past have not materialized because they assume consumer sovereignty . . . with the advent of the supermarket, it was thought that the number of small retail outlets would be reduced since they cannot possibly compete in price. But in stepped the government to pass laws to inhibit the growth of supermarkets and to prolong the agony of high prices. I am not aware of vociferous protests by consumer groups on this score, at the time. With admirable humanistic instincts, their sympathies were with the little guy who will be driven out by the more efficient big baddies.[174]

Thirdly, no political party or interest group has attempted to harness the potential influence of consumer interests. Fourth, consumers traditionally have been concerned with protecting people from health hazards, avoiding disruption from import competition to jobs, and personal relationships. According to one observer of Japanese consumers:

> In early 1986, I sat on a panel that included a housewife as a representative of a consumer group. . . I naturally assumed that our consumer representative would be all for imports that would reduce the price pressure on her constituency. The audience was first

[168] Elaine Kurtenbach, "Japanese are facing up to Land Inflation and Soaring Costs for Real Estate," *Washington Post*, Apr. 21, 1990, p. E11.

[169] Ibid., p. E11.

[170] Ibid., p. E11.

[171] USITC staff interview with officials of the Economic Planning Agency, Tokyo, Japan, Jan. 31, 1990.

[172] It might be noted that the term "consumer rights" is absent from the "Basic Acts for the Protection of the Consumer" which was issued in Japan in 1968. Fields, p. 136.

[173] "Japan's Distribution System: The Next Major Trade Confrontation," Fields, Mar. 17, 1989, pp. 5 and 6.

[174] Fields, p. 132.

lectured on the high standards set by the Japanese consumer on product, quality, not always met by imports. True enough. Then too, she said, Japan has the world's highest safety standards for such things as toys, appliances and food. 'We certainly cannot jeopardize the safety of our kids.' My mouth gaped when she declared that trade liberalization implied the lowering of safety standards and she would prefer higher prices to that.[175]

Having discussed the behavior of consumers, manufacturers and wholesalers, the next section of the report focuses on the different types of distribution channels in which these participants operate.

Types of Distribution Channels

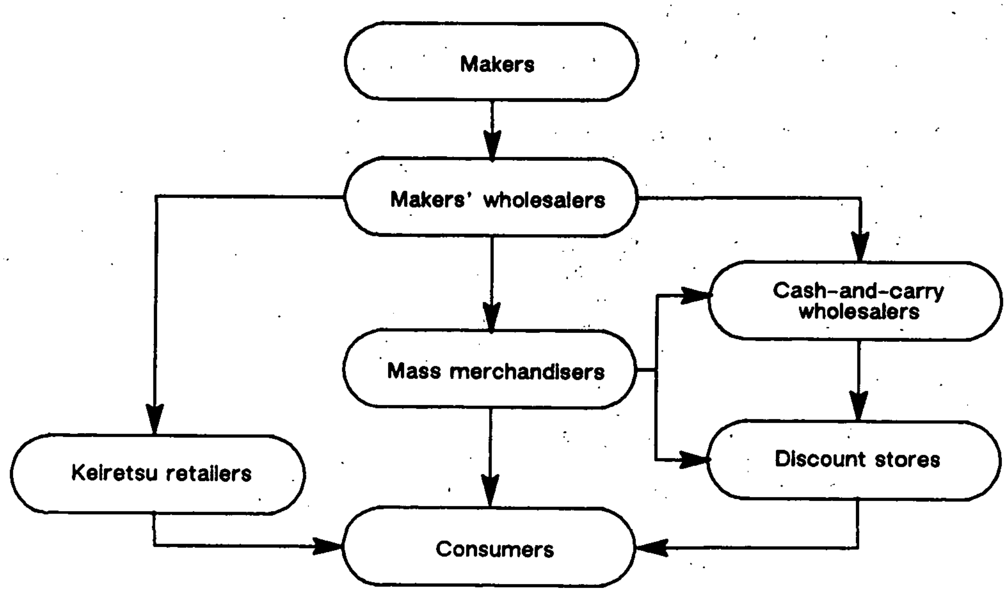
As noted earlier, there is not a single, uniform "distribution system" in Japan for moving products through the economy to the consumer. Rather, in Japan, as in most countries, there are a number of channels for different products and sectors that are differentiated by historical, social and cultural conditions, levels of competition and other factors (see figures 1 and 2).[176] There are also different distribution channels for identical products.[177]

Distribution channels in Japan are no more complex or simple than in other countries. There are some simple distribution channels and some complex ones.[178] For new entrants, both domestic and foreign, the primary issue is access to the channels, whether they are simple or complex. There are several factors that determine the length of the distribution channels. Among them are the type of product, the size of the market for the product, consumer or purchaser behavior, and the degree of manufacturer control over the distribution channel for the product.

There are several traditional means of marketing imported consumer products in Japan. These include the use of either generalized trading companies or specialized trading houses, signing licensing arrangements with Japanese companies, establishing joint ventures, and setting up a wholly-owned distribution channel. The advantages of each of these approaches depend on the type of product, the marketing strategy, goals, and the amount of financing available to the foreign company. Each of these options is discussed in the sections below.

[175] Fields, p. 133.
[176] Birt, p. 65.
[177] Batzer and Laumer, p. 64.
[178] Dawson, p. 10.

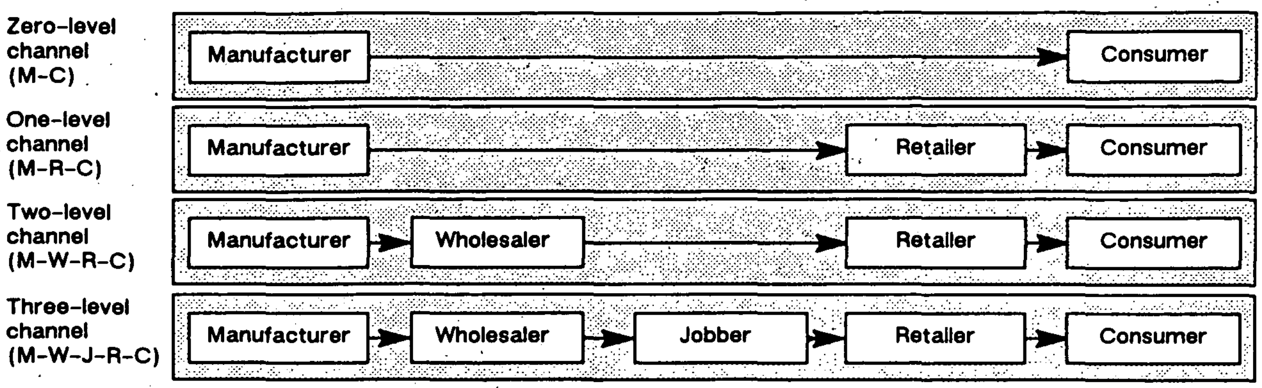
Figure 1
Captive and alternative distribution channels



Distribution routes of household electric appliances

Source: Japan Economic Journal, August 19, 1989.

Figure 2
Examples of different-level channels



Source: *Marketing Management: Analysis, Planning, and Control*, Fifth edition, (1984) Prentice-Hall, Englewood Cliffs, NJ, p. 542.

Distribution channels tend to be different for capital and consumer goods.[179] [180] Raw materials, bulk commodities and some capital goods are primarily imported by the nine major trading companies and distributed directly or indirectly through wholesalers. Products handled by trading companies include coal, metals, oil, gas, chemical products, wheat, and food products. Many non-commodity industrial goods are handled via commission agents in the exporting country or sales representatives in Japan. Capital goods generally pass through trading companies to smaller, specialized companies that handle items such as machine tools, metalworking equipment, and woodworking equipment.

For consumer goods, where the market is more fragmented, there are a number of different distribution options for the same products. In the processed foods industry, for example, approximately 64 percent of the total product passes through a three step chain (manufacturer-primary wholesaler[181]-secondary wholesaler) before reaching the retailer. About 27 percent of the total product moves through two levels (manufacturer-wholesaler) and only 5 to 8 percent moves directly from manufacturer to retailer.[182] In the United States, by contrast, approximately 17 percent of processed foods moves directly from the manufacturer to the retailer.[183]

[179] *Distribution Systems in Japan*, Business Intercommunications, Inc., (Tokyo), 464 pp.

[180] See, for example, *Industrial Goods Distribution in Japan*, Dodwell Marketing Consultants, (Tokyo, Japan), Nov. 1987, 411 pp.

[181] A wholesaler is classified as primary if it has an "open account" with a manufacturer.

[182] Birt, p. 65.

[183] William J. Best and Takuro F. Ueno, "Measuring the Inefficiencies of the Japanese Distribution System," A.T. Kearney International, Inc., 1989, p. 4.

Trading Companies

While trading companies can be found in other countries, nowhere else have they grown to the extent and scale that they have in Japan. Japan has nearly 10,000 firms classified as trading companies which are engaged in both distribution of products in Japan and foreign trade.[184] The seventeen largest of these are known as general trading companies, or sogo shosha (or, simply "shosha").[185] The nine largest trading companies can be distinguished from the thousands of other Japanese trading houses known as primary wholesalers by their global presence, wide range of goods and services offered, and sheer size. All of the six leading general trading companies rank

[184] "Trading company" is a narrower term than the Japanese word shosha, which encompasses trading companies, intermediaries, wholesalers and distributors which promote business between suppliers and buyers. The vast majority of the 10,000 shosha specialize in a particular product or range of products and are known as sermon shosha. This category, in turn, consists of both independent firms and those which are captives of a particular maker or buyer. Additionally, there are roughly another 90,000 medium or small-sized companies ("mini" shosha) which are secondary or tertiary distributors closely linked to manufacturers or larger shosha. *Industrial Goods Distribution in Japan*, 1987, pp. 19-20.

[185] The figure of seventeen firms reflects membership in the Sogo Shosha Committee of The Japan Foreign Trade Council, Inc. More commonly, the term is restricted to the nine (or six) largest of these. The firms are: Mitsui & Co., Ltd., Mitsubishi Corporation, C. Itoh & Co., Ltd., Sumitomo Corporation, Marubeni Corporation, Nissho Iwai Co., Ltd., Toyo Menka Kaisha Ltd., Kanematsu-Gosho, Ltd., and Nichimen Corporation. For a general description and analysis, see M.Y. Yoshino and Thomas Lifson, *The Invisible Link: Japan's Sogo Shosha and the Organization of Trade*, (Cambridge: Westview Press, 1986); Kojima and Ozawa, *Japan's General Trading Companies: Merchants of Economic Development*, (Paris: OECD, 1984); and Alexander K. Young, *The Sogo Shosha: Japan's Multinational Trading Companies*, (Westview Press, 1979).

among the ten largest non-U.S. firms in the world. Total external and domestic activities for the nine amounted to about yen 103 trillion for the fiscal year ending March 1990, equivalent to more than one-quarter of Japan's GNP.[186]

Many of the "agents", "distributors", and "wholesalers" referred to in this study are either general trading companies or affiliates of general trading companies. However, because of their ample funds, reputations and comprehensive business capabilities, multinational trading companies have far greater power than ordinary wholesalers. The general trading companies have even been characterized by observers of the Japanese economy as, "the most powerful single concentrated force in Japanese business."[187]

The basic functions of the general trading companies can be reduced to serving as intermediaries in trade[188] and working to develop trade flows by increasing the supply of products. In carrying out their trade functions the trading companies have developed distinctive competencies in finance, risk absorption, resource development, business organization, investment and the collection of information. The increasingly sophisticated extended functions which the trading companies perform outside the areas of marketing and physical distribution widen and strengthen their business ties and, thus, the control they maintain over product flows.

The trading companies were originally fostered by the Government of Japan following the Meiji Restoration, and were again protected and supported (with, for example, favorable allocations of scarce foreign exchange and generous import quotas) after World War II. A commercial right to intermediate in trade ("shoken") was actually created for the trading companies in order to ensure their position.[189] In addition, the trading companies benefited from a guaranteed level of business and other support from their respective intermarket corporate groups.

[186] "Domestic demand leads trading firms to profits," *The Japan Economic Journal*, Sept. 30, 1989, p. 3. Japan Fair Trade Commission (JFTC) "Survey on the Present State of Business Activities of the Sogo Shosha," Anti-Monopoly Law Colloquium 97-4, Apr. 19, 1983, p. 84.

[187] Ballon and Tomita, *The Financial Behavior of Japanese Corporations*, (Tokyo, Kodansha International, 1988), p. 63.

[188] The trading companies transact trade both on a dealer's basis—taking title of the goods for resale—and on a representative basis in which the trading company assumes the risk of irrecoverable debts, but not of market fluctuations and unsold goods. In both cases a second distinction may be made between direct delivery of products (goods shipped directly from maker to client, while invoicing and payment is handled by the trading company) and delivery via the trading company.

[189] Kojima and Ozawa, p. 54.

The trading companies were free to invest in extensive distribution systems. Their infrastructure includes huge complexes, or *kombinatos*, for the unloading, warehousing and distribution of imported products such as food, chemicals and steel products.[190] New entrants wishing to establish an independent distribution channel in Japan may often be at an insurmountable disadvantage against the heavy "sunken" investment which the trading companies were able to make under favored conditions.

The trading companies have traditionally derived the majority of their income from their international activities. Each general trading company has a worldwide network of offices with some 150–200 branches or affiliates for gathering and handling trade, financial, technical and general economic data. The general trading companies handle an array of products and high technology items. The global networks of the top six firms alone handle 4 percent of the world's trade and they have been involved in numerous multi-billion dollar development projects overseas.

Traditionally, the general trading companies imported raw materials for Japanese manufacturers, channeled the flow of producer intermediates, and exported the manufacturers' finished products (see table 5). However, the general trading companies also have a large and expanding presence in Japan's domestic distribution system. The trading companies' domestic dealings represent from 10–20 percent of the total wholesaling volume in Japan, and the top six accounted for 12 percent of gross domestic product in 1986. For the first half of fiscal 1988, domestic sales accounted for 47 percent of total trade volume for the top nine companies. This represents a large jump from average historical levels of about 40 percent and may climb higher in tandem with domestic demand-led growth in Japan.

Table 5
Sales of the 9 major general trading companies by commodity, Japanese Fiscal Year 1988

Commodity	*Sales (billion yen)*	*Percent of Total Sales*	*Percent over Previous Year*
Energy	14,717	15.0	-8.9
Metals	27,983	28.5	17.3
Machinery	23,835	24.2	9.3
Chemicals	6,803	6.9	4.0
Food Stuffs	10,432	10.5	12.7
Textiles	8,077	8.2	6.4
Others	6,571	6.7	8.7
Total	98,328	100.0	7.8

Note: Figures may not add to totals shown due to rounding.

Source: The Japan Foreign Trade Council Inc., 1989

[190] Kojima and Ozawa, p. 111.

The role of Japan's general traders has evolved with the maturation of the Japanese economy (as evidenced by the shift to the low-growth economy, movement away from heavy industrial sectors, financial liberalization), de-emphasizing their original role as brokers for the manufacturing, mining, and agriculture sectors. Periodic economic shocks such as the energy crisis, collapse of commodity prices, and rapid appreciation of the yen have affected this transition, forcing the trading companies to modify their traditional business in order to survive.[191] With some degree of success, the trading companies have added higher value-added products to their trade mix, diversified into new areas of goods and services, and become more involved in third-country transactions.[192]

Not only do the trading companies play a role in physical distribution and financing but they participate heavily in the development of the domestic market.[193] In the consumer goods area, the extent to which the trading companies have reached down to secondary wholesaling and retailing varies by industry and product. In the majority of industries the trading companies operate within the existing distribution channels, while in others they have introduced new, alternative routes of their own.[194] The trading companies have also adopted a strategy mid-way between these two patterns: rationalizing fragmented wholesalers and retailers by combining them into larger entities.

[191] Perhaps the trading companies' diversity is the key to their survival. They repeatedly disprove analysts who have predicted their decline into irrelevance at various "turning points." See Hitoshi Misono, "The Decline of the General Trading Companies: A Restatement," Ekonomisuto, Mar. 12, 1974.

[192] In spite of their diversification efforts, trading companies remain relatively less profitable than firms in other sectors. Their operating profit to sales ratio during fiscal years 1975-81 was 1.5 percent, as against wholesalers and retailers, 3.7 percent and 6.3 percent compared to manufacturing firms. However, the trading companies' profits have been more stable. Senjuro Takahashi, "Is the Distribution System a Trade Barrier?" *Economic Views From Japan*, Keizai Koho Center, Tokyo 1986 p. 32. Partly counteracting the vigorous efforts of the trading companies to handle more high margin manufacturers is the opposing trend of Japanese manufacturers to export and invest overseas. Automobiles, consumer electronics, and semiconductors are examples of highly lucrative product areas for the Japanese economy from which the trading companies are all but shut out. For an overview of recent diversification strategies see Jon Choy, "Japan's Sogo Shosha : Back to the Future?" reprinted from the *Japan Economic Institute Report*, in: *The Journal of the ACCJ*, Feb., 1989.

[193] Ballon and Tomita, Kodansha International, Tokyo, 1988, p. 64.

[194] In instances in which the traditional middlemen do not offer sufficient economies of scale the trading companies may "operate their own distribution centers for added efficiency." The Japan Foreign Trade Council, Inc., "The Sogo Shosha: What they are and how they can work for you," p. 2.

Japan's trading companies have had a substantial influence on the ability of foreign companies to penetrate Japanese consumer markets at the retail level. Foreign firms have benefited from the trading companies' consumer market activities most clearly in the restaurant and fast-food areas, where a number of American firms have linked with trading firms to establish franchises in Japan. Supermarkets, however, have not enjoyed similar success. As one expert reports: "As early as in 1963 Sumitomo Trading Company planned to establish a supermarket chain in Japan jointly with Safeway of the United States. In the face of stiff opposition from independent local retailers, the venture did not materialize."[195]

The general trading companies are estimated to have ties to over 100,000 Japanese companies, but their dominant status in domestic distribution is best understood with reference to two distinct subsets of related companies. While trading firms differ little from Japanese companies, in general, in their preference for transacting business through long-term cooperative relationships, ties are especially strong with (1) firms from the shosha's fellow inter-market industrial groups and, (2) with their own network of affiliates.[196]

Beginning in the late 1960s, large manufacturers increasingly assumed their own marketing functions as large retail chains emerged. In order to keep pace with these changes, as well as to tap a booming domestic market, the leading general trading companies took a fresh look at the product lines they carried and intensified their commitment to establish close ties with the mass consumer market. The initial actions taken by the trading firms included developing, leasing, and managing supermarkets and shopping centers. They next moved into formal cooperative arrangements with major manufacturers and large supermarket chains. According to one scholar's account of these past arrangements: "[they] went considerably beyond what is considered a normal commercial relationship," such as one in which a major trading company extended yen 20 billion in credit in return for a commitment from Japan's second largest supermarket chain to purchase 20 percent of its total merchandise from the that trading company.[197]

The trading companies have also constructed major merchandising and distribution centers, and have promoted "voluntary chains" through their network of controlled wholesalers. The trading companies have been active in

[195] Yoshino, pp. 213, and pp. 212-216.

[196] For further information on trading companies ties to other companies, see section entitled "Unique features of Japan's distribution system".

[197] Yoshino, pp. 213-214.

establishing vertically integrated sources of supply, particularly in the areas of apparel and fresh foods.[198] In contrast, creating captive markets via collaborative arrangements with the independent-minded mass merchandisers has been less common to date. Consumer markets remain relatively new and challenging territory for the trading companies, and it is difficult to predict what their ultimate impact will be upon mass merchandising in Japan. Recently, demographic and purchasing power trends have led several shosha to target recreation and leisure services as promising growth areas.

Role in Import Distribution

As important as domestic distribution has been to the trading companies, relative to the overall Japanese economy, their role is even greater in the area of foreign trade. The trading companies' historical mission was to overcome the economic obstacles presented to Japanese firms by distinct, culturally different markets.[199] The general trading companies have been able to draw upon (and adapt) their extensive domestic network—manufacturers, warehousers, distributors, and retailers—for import business. Without their expertise in import and export, the trading companies would not be able to play the integrative role which they do on behalf of both their upstream affiliates and independent customers.

Impact on Aggregate Trade Flows

For FY 1987, 77 percent of Japan's total imports was accounted for by the nine general trading companies and was valued at 17,222 billion yen. They also handled 45 percent of Japan's total exports, or a total of 14,927 billion yen. The nine largest trading firms imported 3,071 billion yen worth of goods from the United States into Japan in FY 1988, up 10.2 percent from FY 1987. In 1981, the same trading firms (chiefly through their U.S. subsidiaries) accounted for almost 10 percent of U.S. global exports and ran a surplus, from the perspective of the U.S. trade account of $6.2 billion.

While there is some evidence that the general trading companies may by importing more from the United States than exporting, their impact may be less benign in terms of broad access to the Japanese market. Given the recent increased attention regarding corporate control over bilateral trade,[200] the major issue with regard to trading companies is whether they facilitate imports to Japan or are the first in a series of impediments to penetrating Japanese distribution systems.

As indicated above, during the late 1980s, the nine top general trading companies were handling about three-quarters of Japan's imports and about one-half of its exports. Two European researchers have noted: "Such a concentration of foreign trade in the hands of a few firms is unparalleled in the rest of the world, apart from the foreign trade agencies of the state trading nations."[201] Not only is the trading companies' share of Japan's total imports large, but it has also been growing appreciably in recent years. This trend is particularly notable in light of certain other developments which might suggest a declining role for the general traders. First, the evolution of Japan's economy away from energy-intensive and heavy industries has undercut the demand for the type of raw materials and bulk intermediates that for years have been the trading companies' mainstays. Furthermore, commodity and oil prices have been soft in recent years. The emergence of some diversified distribution channels into Japan, including "development imports" (OEM production for Japanese manufacturers, wholesalers, or retailers), direct or parallel imports, and individual imports offer exporters to Japan alternatives to traditional reliance upon the trading companies. If these channels begin to account for a measurable volume of imports, one would expect to see some reduction in the trading companies' share of total imports.

The trading companies' import record can be explained, in part, by their aggressive pursuit of new business to support what may have been lost through the restructuring of the economy. It is likely, also, that the trading companies have benefitted from the recent surge of investment in plants in Asia by the Japanese manufacturers. Unlike the majority of their North American investments, Asian factories appear to be potentially significant sources of exports destined back to Japan.[202]

[198] These activities include overseas tie ups, exemplified by recent investment and business tie ups in beef and pork production in the United States. "Mitsubishi to raise porkers in U.S. tie-up," *The Japan Economic Journal*, Sept. 30, 1989, p. 3.

[199] The historical importance of the trading companies on the export side has been extensively detailed, one analyst says, for example: "Without the trading companies many small Japanese firms could not hope to exploit foreign markets. The trading companies have effectively become the overseas procurement, sales and financing departments for thousands of Japanese companies." Stephen Bronte, *Japanese Finance*, (New York: IPC Business Publications, 1982), p. 113.

[200] See, for example, Robert Z. Lawrence, "How Open is Japan," Paper prepared for the National Bureau of Economic Research-sponsored conference on "The U.S. and Japan: Trade and Investment," held Oct. 19-20, 1989 in Cambridge, Massachusetts. (Forthcoming).

[201] In the Federal Republic of Germany, by way of comparison, the institutional import and export agencies handle only about one sixth of exports and a quarter of imports. Batzer and Laumer, pp. 74-75. Another economist has documented that, "Japanese trade is distinctive because foreign exports to Japan have generally been shipped by the foreign affiliates of Japanese firms", Lawrence, op. cit., p. 1.

[202] Lincoln, p. 121.

The trading companies, at least until recently, have had nearly as tight a grip on imports to Japan from the United States as they have had on Japan's total imports. The share of U.S. exports to Japan handled by the American subsidiaries of the six largest general trading companies is about 60 percent.[203] Some observers have suggested that control by Japanese firms over U.S. bilateral trade flows has impeded U.S. suppliers from reaping the full benefits of Japan's current import boom, and from establishing the type of long-term relationships which are crucial to sustained business with Japanese corporations.

According to some analysts, it is likely that trading companies will continue to be a major vehicle for U.S. exports to Japan. However, it is nearly impossible to evaluate their performance characteristics across the range of industries and activities in which they engage. Further while the general trading companies often appear to have comprehensive capabilities, they clearly emphasize some types of business over others. Therefore it is difficult to assess categorically whether, on balance, they are a help or hindrance to foreign companies seeking to penetrate the Japanese market. The experience of U.S. exporters working through general trading companies is likely to vary widely, depending on the company's size, type of product, marketing strategies, and a host of variables within the Japanese and world markets. U.S. exporters have noted certain strengths and weaknesses of the trading companies: in some product areas they excel, in others they have not yet participated, and in still others they may constitute "blind allies" if not barriers. The advantages and disadvantages of using trading companies are discussed below.

Advantages of Using Trading Companies

Trade data shows that the trading companies are able to bring a range of products from their U.S. clients to market in Japan. The scale of the trading companies and the quality of their resources have been widely reported. In the case of raw materials and other commodities in particular, it appears that the trading companies manage exports to Japan at considerable savings of expense, time, and effort for foreign firms. For example:

> To keep a flow of one million tons of soybeans moving steadily to Japanese edible oil producers [one] trading company: watches weather and market conditions, contracts for purchases with proper timing and in sufficient amounts to realize savings for buyers, arranges ship charters and insurance, assures compliance with agricultural regulations, and provides on-shore transportation to the users' factories.[204]

Perhaps the most often cited advantage of using a trading company is their capacity to assume responsibility for the entire process of importing and distributing goods in Japan, from advertising to customer services. For example:

> For a European exporter of nuclear plant safety systems one major shosha entered into an exclusive marketing contract to: assist where needed with import licenses, permits, tests, selecting technicians for installation work, and monitoring the nuclear power industry. . .[205]

The notable efficiency of trading company intermediation results in part from their close group relationships and ability to "internalize" a large share of their transactions. One of the largest U.S. multinationals relies on a trading company to import its commodity chemicals because it reduces its overhead while limiting exposure to the Japanese market during downturns, helping the manufacturer to shift to secondary markets. A major U.S. paper supplier goes through a general trader at the request of its newspaper clients who depend on the trading companies to provide delivery and financing. Such instances in which the request for trading company intermediation comes from the buyer, are not uncommon. In these cases it is not unusual to find the foreign exporter going through a single trading company to supply a single customer even absent of any exclusive dealing arrangements.

The general trading companies have been an entry vehicle for a number of firms, both small and large, from a wide range of industries.[206] The Japan External Trade Organization (JETRO), a government-owned corporation, points out that using trading companies is one way for a foreign exporter to Japan to reduce the required investment in the early stages of market entry.[207] Lately the trading companies have spun-off a large number of subsidiary trading firms in order to better penetrate consumer goods markets or to meet the challenge of more technically competent senmon (specialized) trading companies, which focus on a product area, such as machine tools or woodworking equipment. Using such an affiliated trading firm can provide the foreign client with the strengths of the general firm, and the expertise of the specialized firms.

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[203] Peter Truell, "Why Reactions Differ to Japan and Germany," *The Wall Street Journal*, Feb. 26, 1990, Sumio Kido, "Trade 'Crisis' Spurs Import Drive," *Japan Economic Journal*, July 29, 1989.

[204] *Selling in Japan*, (Tokyo: Japan External Trade Organzation [JETRO], 1985) p. 138.

[205] Batzer and Laumer, p. 84.

[206] Czinkota and Woronoff, p. 58.

[207] *Selling in Japan*, p. 147.

In larger ventures, tie-ups with group trading companies can have the advantage of providing access to banking, insurance and other companies in the group on more favorable terms. Several recent studies and articles written in Japan have called upon foreign companies to exploit the "in" of the trading companies and other major Japanese corporations as a means to "develop relationships" and "break into vertical and horizontal groups in Japan."[208] Finally, in some product fields, a trading company may represent the best option to domestic channels locked up by the established actors. Consumer electronics, optical goods, and processed foods, where manufactures have "channelized" distribution, are possible examples. For instance, one trading company has imported General Electric's air conditioners and refrigerators.

Unfortunately, however, these types of goods have not played well to the traditional strengths of the general traders, as will be discussed next.

Disadvantages of Using Trading Companies

As described above, the general trading companies operate in a web of business connections, which has been described as a general market access problem.[209] While long-term relationships and ties of reciprocal indebtedness pervade the Japanese business environment, they are especially prevalent for the trading companies, for whom access to the business world and inside market information is critical. The sales potential embodied in these corporate ties, however, is mitigated by the tendency of these same ties to limit the trading companies' freedom of action. These giant firms often find themselves constrained in what products they can import, under what terms they will be sold, and how much market share they can seek for those imports. Extensive anecdotal evidence given by foreign firms which have been frustrated in their efforts to export to Japan through the general trading companies lends credence to a view of the trading companies as "sentries at the gate" of the Japanese distribution system.[210]

Of the potentially constraining inter-firm relationships maintained by the trading companies, the two most obvious ties are those to subsidiaries and to fellow members of an inter-market keiretsu. The potential problem for foreign exporters to Japan posed by the group affiliations of the trading companies is considered to be important enough to be pointed out in a Japanese government publication:

> The group membership of the trading company being considered should be investigated, and before the deal is actually concluded it should be made clear as to whether dealing with a particular trading company will imply working exclusively with other members of the group . . .close tie-ups with one group might foreclose opportunities to deal with firms in other groups.[211]

While subsidiary and keiretsu ties of the major trading companies are common public knowledge—often as a result of trademarks or company advertising—certain other relationships are less transparent to market newcomers. The regional sales director for the Pacific region of a major American computer manufacturer has confirmed this aspect of business relationships in Japan: "The most difficult part of Japan's distribution system is understanding the interconnections. You often have other companies influencing the firm you're dealing with, and it takes a lot of time to figure out who's really making the decisions."[212]

This problem results, in part, because the trading companies' import decisions are likely to be influenced by a myriad of suppliers, customers and other business partners which are usually not group members. The general trading companies' ties to the major Japanese manufacturing firms are the most significant in this regard. In explaining why Japanese firms, in general, often fail to pass along the savings of lower priced imports to the Japanese buyer, one scholar has written that, "Japanese firms are as interested in protecting their relationships with domestic suppliers as they are in passing along cost savings to others."[213]

While relationships with other Japanese firms are clearly important, the leverage of even a major client over a general trading firm is not without limit. As several economists have argued for the Japanese economy as a whole, all but the tightest of trading company ties must yield, at some point, to price differentials caused by exchange rate changes or other factors of relative competitiveness.

It appears that relationships with domestic manufacturers may not only influence the price of foreign imports channeled through trading companies, but also the volume in which they are sold, and in some cases, the initial decision of

[208] Okimoto, p. 115 and Industrial Bank of Japan, pp. 8, 10, 16.
[209] Lincoln, p. 89.
[210] For business accounts of the pitfalls of using trading companies, see: Written statement of the ACCJ to the USITC, Dec. 11, 1989, pp. 4-5, and the ACCJ submission to MITI, Oct. 1988. See, also, statement submitted to the USITC on behalf of the National Forge Company, Feb. 1, 1990, pp. 7-8.

[211] *Selling in Japan*, p. 148.
[212] *The Japan Economic Journal*, July 15, 1989.
[213] Michael Gerlach, "Keiretsu organization in the Japanese Economy: Analysis and Trade Implications," in Chalmers Johnson, Laura D'Andrea Tyson and John Zysman, eds., *Politics and Productivity: How Japan's Development Strategy Works* (Ballinger, 1989), pp. 141-76.

whether to import a particular product at all.[214] Some of the factors influencing the trading companies' decisions of which products to handle have been summarized as follows:

> . . . while the sogo shosha are in the business of trading, they are not equally interested in dealing with every possible partner. They would tend not to cooperate with foreign companies that produce competitive goods. They prefer handling bulk commodities to processed ones since this is done locally by their clients. They would even tend not to take on finished products that compete directly with manufactures whose exports they carry.[215]

A chief criterion of the trading companies in selecting products to import to Japan appears to be whether or not the products will compete directly with domestic products with which that firm is already involved.[216] [217] [218] This is one of the main concerns voiced by U.S. businessmen with experience in marketing in Japan. Given the unique dynamics of Japanese industrial organization (the fact that each of the major group companies compete head-to head with one another in almost all of the major industries) it is likely that a trading company may opt not to take on a particular import even when it is not currently handling a comparable domestic good. The trading company may have other relations with the domestic firms that carry the product in question, or as a general rule it may be leery of upsetting "orderly" market conditions for the domestic Japanese producers.

U.S. businesses which rely on Japanese trading companies have reported a common pattern in cases in which they suspect that conflicting domestic ties or interests of the trading firm are limiting their exports.[219] Typically, entry of the foreign products is smooth and initial sales growth brisk. At some early stage, however, the market share for the product stalls.

It has been reported that trading companies follow an unacknowledged, but economy-wide standard known as the "10 and 20" rule whereby a foreign supplier's share of the Japanese market cannot exceed 10 percent of the market, absent a 20 percent or greater price advantage over his domestic competitors. Reportedly, informal limits on import penetration are often the case in commodity products, where the goods are interchangeable and the trading companies tend to balance their sales efforts. While it is not uncommon for the trading company to require that they be given sole importer status, it is less common that they agree to act as an exclusive dealer on behalf of a foreign manufacturer.[220]

Certain disadvantages for U.S. exporters who opt to use a general trading company stem precisely from their "general" nature. The fact that the trading companies already handle such a great number of established products may inevitably restrict their efforts on behalf of yet another manufacturer's products.[221] One survey notes two other conspicuous limitations:

> First of all, general trading firms do not handle any item for which the unit volume of transaction is small. Some say that they do not even consider a business unit below 20 million yen. . . Secondly, excepting mass market merchandise, they are weak on items for which a carefully planned sales policy is required due to their lack of channels to the end-line retailers.[222]

The latter point holds true especially for sophisticated manufacturers requiring after-sales service, for which, "trading companies have never been an effective route", even in purely domestic business.[223] Some exporters of industrial goods which require technical personnel to work with the consumer have overcome this shortcoming by opening liaison offices in Japan or placing representatives with the trading companies.[224]

Another option for the exporter has been to turn to the smaller, specialized trading companies. Specialized trading companies, however, do not appear to be without significant shortcomings of their own. The IBJ study notes that these firms have "rather weak" technical and marketing capabilities, particularly in the areas of steel materials and integrated circuits, where they account for 65 percent of imported semi-conductors, but act as a "bottleneck" for further sales growth.[225] It is also noted that the

[214] Submission of the Alliance for Wood Products Exports Regarding the Japanese Wood Products Industry Distribution System, before the USITC, Jan. 30, 1990, p. 5.

[215] Czinkota and Woronoff, p. 36.

[216] Lawrence, "How Open Is Japan", p. 23.

[217] USITC interview with U.S. businessman, Washington, D.C., Dec. 1989.

[218] USITC interview with U.S. businessman in Tokyo, Japan, Jan. 1990. The promotional literature of the trading companies' association asserts that the members are "supply/demand oriented," and not "user or manufacturer oriented." However, representatives of two trading companies confirmed that the impact on domestic inter-firm relations is an important business consideration in taking on imports.

[219] USITC field interview with U.S. businessman, Tokyo, Feb. 1990.

[220] It appears that often refusal to act as an exclusive dealer stems from the insistence by the Japanese manufacturer being supplied that "their" trading company handle two or more sources. ACCJ, Apr. 28, 1989, p. 5; Batzer and Laumer, pp. 75, 83; and JETRO, *Industrial Marketing in Japan*, 1978, p. 10.

[221] Batzer and Laumer, p. 83.

[222] *Distribution Systems in Japan*, p. 35. Czinkota and Woronoff, pp. 57 58.

[223] Lincoln, p. 88

[224] Batzer and Laumer, p. 83.

[225] "Changing Japanese Distribution System," IBJ, p. 8.

specialized firm is even more likely than a general one to be handling competing products to the would-be import, since, by their nature, they must carry everything in a specific line, and because they are more likely to own their own production subsidiaries or to be dominated by local manufacturers.[226]

The complaint is often heard within the American business community in Japan that the general trading companies regularly over-promise the extent to which they are capable or prepared to provide national market coverage of certain distribution support services.[227] This criticism stands, allegedly, even in instances in which the U.S. exporters recognize in advance such inherent limitations of the trading companies as have been mentioned above. Given their superior market position and—in at least some areas—the lack of readily available alternative import distribution channels, the trading companies are able to extract exclusive import agent arrangements without performance stipulations.[228] This serves to exacerbate the problem of over-promising and makes it more difficult for an exporter to dissolve its relationship with the trading companies.

Finally, it has been noted that in exporting to Japan through a trading company the manufacturer has "virtually no influence over selling prices, marketing and sales promotion."[229] This is particularly the case in the many instances where the trading companies are acting as sole import agents. While a manufacturer may face this loss of control whenever it turns to an outside distributor, the market position and comprehensive business approach of the trading companies may lessen the influence of the exporter to a greater degree. Some claim that even in the case of commodity exports to Japan, which are not usually controlled by sole agent arrangements, the relatively few trading companies which specialize in particular commodities are able to decide their own margins and set prices accordingly.[230]

Prospects for Import Expansion

Although they have not imported a large number of manufactured goods in the past, the general trading companies have been accelerating the volume and value of imports they bring into Japan, with particular emphasis on manufactured goods, including consumer products. They may be motivated by a desire to capitalize on expanding domestic demand by bringing in imports from Japanese affiliates to replace business they have lost in other fields.

Recently MITI has been prodding Japan's major manufacturers and the trading companies to adopt import expansion targets for parts and manufactured goods.[231] [232] More recently, MITI requested that the major trading companies establish U.S. export-supporting centers at a number of their U.S. offices.[233] While noting that the general trading companies have been traditionally weak in importing manufactured goods in quantity from the United States, Lincoln notes that, "because these firms also play a facilitating role, they could do much to open doors for foreign manufacturers."[234]

It remains to be seen whether the general trading companies will emerge as leaders of the trend toward greater import penetration, or lag behind a group of large manufacturers, such as Matsushita and Canon, which are said to be aggressively promoting manufactured imports. The ability of the general trading companies to swiftly switch to handling new types of imports has been hampered by traditional administrative divisions within the firms and has required a restructuring of management. But perhaps even a greater challenge to trading companies will be accommodating increased levels and new types of imports given their obligations to domestic interests.

The general trading companies appear to have a preference for transacting business through long-term cooperative relationships, especially with: (1) fellow inter-market industrial group members, and (2) with their own network of affiliates. These relationships are important as they affect the general trading companies' role in distribution.

Ties to Industrial Groups

Each of the six largest trading companies acts as the core trading company and, often, as the coordinator-secretariat of joint projects for the respective inter-market corporate groups to

[226] Czinkota and Woronoff, p. 58.
[227] Interview with U.S. businessman, Tokyo, Feb. 2, 1990.
[228] Statement of the ACCJ submitted to the USITC, Dec. 11, 1989, p. 4. See, also, ACCJ submission to MITI, Oct. 1988.
[229] Batzer and Laumer, p.83
[230] European Business Community (EBC), Meeting with JFTC Advisory Committee, Jan. 30, 1990, p. 5.

[231] Batzer and Laumer, p.75.
[232] Trading companies were declared eligible (along with retailers and wholesalers, generally) to benefit from tax incentives for imports under the Government of Japan's most recent import promotion plan. Ministry of International Trade and Industry, "Import Expansion Measures," Jan. 1990.
[233] *The Japan Economic Journal*, May 20, 1989.
[234] Lincoln, p. 88. One of the 6 major shosha, for example, has set up a unit to rent offices to newly landed foreign businesses. A similar venture into a school providing Japanese language training and counseling in business customs, however, proved unsuccessful and folded soon after its founding. According to an executive of that same company, "Foreign companies feel it's difficult to get into business in Japan, but we can assist them, introduce them to the Japanese market, identify potential customers here and distribute their merchandise." *U.S. News & World Report*, Aug. 24, 1987, p. 43, and USITC field interview, Tokyo, Feb. 1990.

which they belong.[235] These inter-market groups are discussed separately below. (See figure 3)

Along with the city banks, the general trading firms form the nuclei of the six inter-market groups and their officers are the leading members of their respective presidential councils. The trading company-group relationship is different from the pre-war era when the major trading companies functioned as nearly exclusive sales and purchasing arms for their respective zaibatsu. The post-war maturation of the group industrial firms into major multinationals has further diminished the once-critical importance of the general trading companies to the manufacturers' operations.[236] However, today's trading e within groups and also deal with manufacturers from competing industrial groups. The recent drive of the trading companies to diversify into new lines of business (in communications, for example) has reportedly led them into consortia with manufacturers from rival groups which, occasionally, include two or more competing trading companies.

The trading companies' leadership status within the groups is shared with the groups' key financial institutions (typically, a commercial bank, trust bank, and an insurance company). In its most recent periodic survey of the big-6 groups the Japan Fair Trade Commission (JFTC) found that the "stockholding rate and the director dispatchment rate of general trading firms to their member corporations are rather smaller than the corresponding rates of banks, and they are continuing to decline."[237] Although arguably overshadowed by the city banks and government bureaucrats, the influence of the general trading companies over corporate Japan should not be dismissed. As of July 1987, of the roughly 1,900 firms listed on the Japanese stock exchanges, about 450 had directors (and 80 had representative directors) who previously were managers in one of the 9 trading companies.[238]

As the JFTC reports, the general trading companies maintain business relations with virtually all the companies in their respective groups[239] and can draw on their intimate capital, financial and business ties with fellow inter-market group members. Group banks continue to be a key source of external funds for the trading companies.[240] Moreover, as a result of their role as recipient and provider of substantial amounts of finance, the general trading companies are able to contribute substantial integrative power to the keiretsu, both vertically and horizontally.[241] A widely acknowledged bias continues to exist for own-group transactions and cooperative ventures, although there is continued dispute regarding its frequency and extent.[242] Sales of inputs to fellow group members and purchases of outputs from them by the sogo shosha, while by no means a dominant share, is substantial. Of the total domestic business of the three former zaibatsu general trading companies for FY 1981, the above figures were, respectively, 21 percent and 9 percent.[243] Intra-group sales of particular products, furthermore, such as those classified by the JFTC as "machinery, instruments and other" are considerably higher than the average for all products. It is difficult to determine how much, if any, of the negative impact from discriminatory group procurement practices falls upon U.S. exporters.[244] However, a consideration of the competitiveness of U.S. capital goods and intermediates in other national markets—and the absence of formal trade barriers in Japan against many of these goods—suggests that some of the failure of U.S. exporters of these goods to succeed in Japan may be attributable to discrimination against non-group suppliers.

Ties to Affiliate Networks

The second type of company groupings with which the general trading companies are intimately involved is their own constellation of subsidiaries and affiliated firms. In 1983, the top six general trading companies held stock in some

[235] Some trading companies serve more than one group and their involvement with their respective fellow members differs from one group to another. *Industrial Groupings in Japan 1986/87*, p. 12.

[236] Japan's steel industry, for example, is no longer dependent as it once was on logistical support and information from the general trading companies to coordinate the production process from mine to market. Makers of consumer durables prefer to market directly. Nor, more generally, are the trading companies any longer in a position to wield decisive financial leverage over customers and suppliers in today's relatively liberalized capital markets.

[237] JFTC/Japan Views, "The Actual Conditions of the Six Major Corporate Groups," No. 7, Aug. 1989, p. 4. An earlier survey by the JFTC in the same series reportedly estimated the level of intra-group shareholding by the general trading companies at less than one-half the level of the group main banks. Young, p. 42.

[238] *Industrial Groupings in Japan 1988/89*, p. 10.

[239] JFTC, Apr. 19, 1983, p. 118.

[240] *Distribution Systems in Japan*, p. 34.

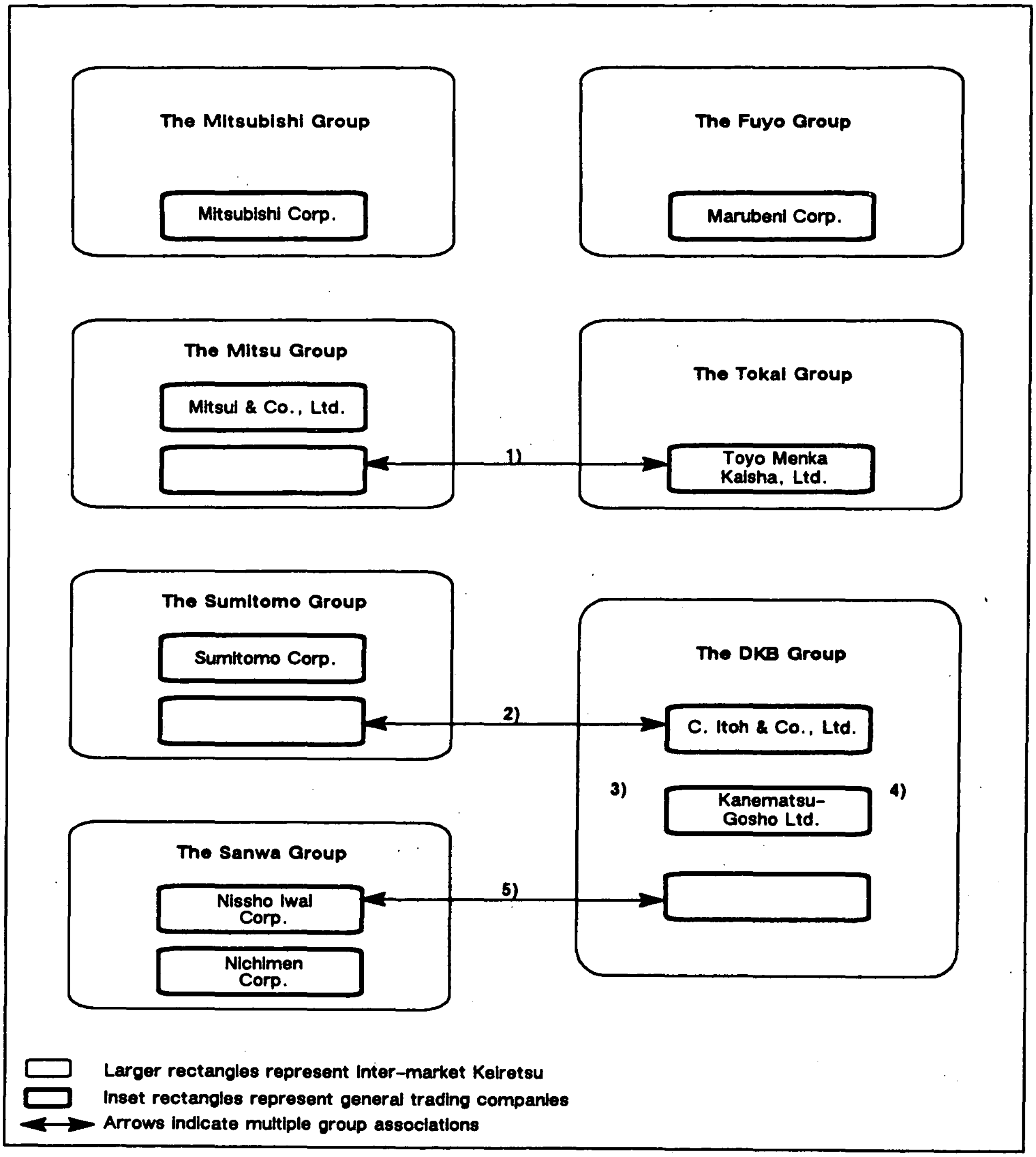
[241] Ballon and Tomita, p. 66.

[242] For example, see: Michael Gerlach, in *Politics and Productivity* and Daniel Okimoto, "Outsider Trading: Coping With Japanese Industrial Organization," in Kenneth B. Pyle, *The Trade Crisis: How Will Japan Respond?*, (Seattle: Society for Japanese Studies, 1987), pp. 96 and 90-91. For a cultural and sociological analysis: Ronald Dore, *Taking Japan Seriously*. For a view of intra-group sales and purchases as a largely unimportant phenomenon: Higashi and Lauter, *The Internationalization of the Japanese Economy*, 1987, pp. 40-41. Kazuo Nukazawa, *Keiretsu: Myths and Realities*, (Tokyo: Keidanren, 1985).

[243] The figures for the three, younger bank-centered groups, and those in which international transactions are included are somewhat lower. JFTC, Apr. 19, 1983, p. 121.

[244] Bergsten and Cline, pp. 66-67.

Figure 3
Participation of general trading companies across inter-market keiretsu



Source: *Industrial Groupings in Japan*, Dodwell Marketing Consultants, 1988.

5,800 companies and held 10 percent or more of the stock in 3,900 of these firms. The trading companies owned 20 to 50 percent of 710 firms ("kanren-gaisha") and held 50 percent or more of the stock in 504 firms ("ko-gaisha" or subsidiary). According to an earlier study, about two-thirds of subsidiaries of trading companies were located in Japan, while one-third were located abroad. Approximately one-half of the firms engaged in commerce (sales companies, distribution centers, transportation companies etc.), while about one-third represented a broad range of manufacturing industries.

The various scenarios through which affiliates are set up or drawn into the "family" of the trading company—and the resulting hierarchical pattern beneath the trading company—resemble those of the vertical "kigyo keiretsu" outlined above. Again, stockholding, loans, and seconded personnel are the chief cohesive mechanisms. So, too, do the motivations of both parent and related firm for creating the affiliation. Surveys by the JFTC conclude that the trading companies are able to exert significant influence over their affiliates' fiscal and managerial policies through their capital and personnel ties.[245]

In the case of less than wholly-owned affiliates, (mainly small and medium-sized enterprises) the general trading companies have acquired stock primarily to strengthen their business dealings with those firms. For FY 1982 over three-quarters of those firms whose stock was 10 percent or more held by a trading company transacted business through that trading company, frequently via sole agency contracts, or less frequently, exclusive purchase contracts. The share of total domestic sales and purchases of the big-6 general trading companies accounted for by this second grouping of "insider" firms amounted to about 8 percent and 13 percent, respectively.[246]

The tightly controlled worldwide network of affiliates gives the giant parent firms needed flexibility and, it is surmised, some leeway to minimize their tax bills through the allocation of prices and profits.[247] Many of the wholly-owned subsidiaries are the product of strategies by the trading companies to streamline management or enter new, (often high-technology) fields. Perhaps more importantly, trading firms have acquired stock or other interests in firms in order to form their own keiretsu, thereby extending proprietary distribution channels downstream into secondary wholesaling and retailing. Changes in the distribution sector, such as the competitive challenge posed to wholesalers and other intermediaries by both retailers and manufacturers, accelerated the need for the general trading companies to reposition themselves. The strategic choice facing the trading companies today is whether to move closer to manufacturers upstream or become more involved in distribution services downstream.[248]

The financing function performed by the big trading companies already mentioned is especially relevant in trading company dealings with smaller firms, including non-affiliates. The reciprocal nature of the obligations is best understood in the context of the stratification between large and small-to-medium sized firms within Japanese industrial structure. Analysts have described the implications of loans by the trading companies as follows:

> While this makes these [recipient] companies somewhat dependent on the trading company, it also works in the other direction in that the trading company must help them prosper if it is to earn a proper return on its money, or, in bad times, avoid defaults. This is another reason why traders are partial to their own network.[249]

Concern over the degree of economic concentration represented by the general trading companies (as well as certain other huge corporations) led to the passage in 1977 of an amendment to Sec. 9 of the Antimonopoly Law which limited the aggregate holdings of stock in other Japanese companies by large non-financial companies to the larger of its net assets or capital.[250]

Sole Import Agents

Another channel available to foreign suppliers seeking to enter Japan's distribution system is through sole import agents. In recent years, both general and specialized trading companies have

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[245] Of the firms which are 10 percent or greater held by the general trading companies about 80 percent received seconded executives, approximately one-third received loans or loan guarantees, and about one-fifth had business tie-ups captured in written contracts of one year or more. JFTC, Apr. 19, 1983, pp. 109-115.

[246] JFTC, Apr. 19, 1983, p. 111.

[247] Young, p. 49.

[248] Field interview with an executive of a Japanese general trading company. Some trading firms, at least in some sectors, have avoided the choice by expanding in both directions: "Now a trading house is not just a mediator on a distribution line," says an industry expert. "It also acts as a manufacturer, distributor and retailer at the same time." *The Japan Economic Journal*, Sept. 30, 1989, p. 3.

[249] Czinkota and Woronoff, pp. 35-36

[250] Iyori and Uesugi, pp. 29-30. Studies by the JFTC subsequent to passage of the amendment have confirmed that trading companies were forced to slow their rate of acquisitions (and in some cases, actually divest) in the 1978-1980 period, but have since resumed their previous rates of investment which were legally accommodated by their intervening asset growth. Perhaps more significantly, some (including the JFTC) have suggested that the general trading companies have responded to the quantitative ceiling imposed by the amendment by consolidating their holdings to deepen existing relationships, rather than continuing to diffuse their influence.

operated as sole agents for a number of European and American manufacturers. A sole import agent agreement between a foreign supplier and a Japanese partner grants exclusive rights to the Japanese firm to import and market a particular product or products. The Japanese partner is typically also responsible for a variety of other duties such as minor repairs or modifications to the product, selecting the appropriate distribution channels, coordinating advertising and aftersales service. There may be some disadvantages to this approach, however. Since many sole import agents are also general trading companies that already handle a number of similar products from domestic manufacturers, they may be less inclined to sell competing products on behalf of foreign manufacturers.[251] In addition, the larger the sole import agent, the more likely that it will be able to control downstream channels, exert pressures on retailers and to obstruct parallel imports.[252]

Sole import agents may contribute to increasing competition in Japan to the extent that they facilitate entry of foreign products into the market by pursuing coherent, vigorous sales efforts. They may also reduce the risks or costs associated with distributing products in Japan. There are examples of successful use of sole import agents by foreign firms. Using Mitsukoshi Ltd. as their sole distributor, Tiffany and Co. increased sales in Japan by 38 percent in 1988. A West German firm, Bartec Barlian Technik GmbH, provides leak-monitoring systems for nuclear power plants through an agreement with Mitsui & Co., which provides assistance in acquiring import permits, testing and finding partners for installation work.[253]

However, if import agents also have exclusive sales licenses, thereby agreeing not to import the same product from others, the effects on the ability of competing firms to enter the market may be negative.[254] In addition, manufacturers often have virtually no control over marketing, selling price, or sales promotions under such conditions. According to some reports, sole agents are able to control marketing channels and consumer prices for imported goods to a large extent.

Comparative price surveys done for the Government of Japan have shown that well-known, prestigious brand-name consumer goods such as watches, china, jeans, and liquor which are marketed by sole import agents may be marked-up by 30-50 percent over the c.i.f. price while the markups on unbranded articles have been shown to be in the range of 10-25 percent.[255] The government of Japan, the American Chamber of Commerce in Japan and others have attributed much of the price differential between consumer products in Japan and other industrialized countries to sole import agents. These higher prices are reportedly sometimes part of a deliberate marketing strategy:

> Where imported manufactured goods are sold in Japan at much higher prices than comparable Japanese products, this is due in a majority of cases to the pricing policies of the Japanese sole importers. Their pricing of prestige consumer goods in particular is often aimed at low sales but high profits. In many cases this occurs with the full agreement of the foreign suppliers and with the specific objective of enhancing the prestige value of the goods through the higher price and expensive advertising.[256]

The European Business Community (EBC) has stated, "The sole import distribution system has played a vital role in the development of European branded consumer goods in the Japanese market."[257] The EBC points to the services provided by sole import agents such as sales promotion, protection of name-brand image and provision of a sales force. The EBC claims that the differences in the price of consumer products handled by sole import agents in Japan compared to overseas can be attributed to the "costs of business operation (staff costs, premises, interest rates, trade margins, etc.)" that are incurred by the sole distributor, plus his return on investment. In addition, the EBC says, "We do not believe that imported products are highly priced because exclusive distributors are making excessive profits." Any unsustainable price differences between the imported goods and those overseas will be corrected by market mechanisms, according to the EBC.[258]

In 1978, the JFTC found that practices by sole import agents such as refusing to carry competing articles in the product range, tying of selling prices, prevention of parallel importing[259] and limiting the number of sales outlets were widespread. However, since the finding, there

[251] Batzer and Laumer, pp. 83-84.
[252] Ibid., pp. 75-79.
[253] Ibid., pp. 83-84.
[254] Tsuruta, pp. 15-16.

[255] See discussion of price survey by the Japan Institute for Social and Economic Affairs as cited in Bazar and Laumer, pp. 88-89.
[256] Batzer and Laumer, p. 90.
[257] Statement of the European Business Community (EBC) in a meeting with JFTC Advisory Committee, Jan. 30, 1990, p. 2.
[258] Statement of the European Business Community (EBC) in a meeting with JFTC Advisory Committee, p. 2.
[259] Parallel imports are products which are imported directly from countries of origin or sales shops in third countries without going through sole agents of imported products. Development imports are those where distributors themselves issue specification documents and import overseas manufactured products. Personal imports are those in which individuals directly import products via catalogs and others.

has been an increase in the number of parallel importers selling the same products at lower prices than those of the sole agents.

Parallel importing has been lawful in Japan since 1972. There are both benefits and problems associated with parallel importing. On the one hand, it opens more marketing channels and reduces the danger of unfair exploitation of the sole import agent's monopoly. On the other hand, the contractual partner must bear the risks associated with marketing and advertising instead of relying on a local firm.[260]

Joint Ventures

Joint ventures are a common route used by foreign firms when attempting to distribute products in Japan. One of the benefits of a joint venture with an appropriate partner is that it can relieve some of the difficulties associated with the Japanese language, bureaucracy, and business customs for the foreign company. Joint ventures may also provide crucial connections to potential customers, banks and business partners. Some of the first joint ventures in Japan were with large multinational companies, such as those entered into by Union Carbide and Xerox. In recent years, smaller firms have increasingly used joint ventures to enter Japan's market, for example, in the commercial and consumer services fields. Some problems associated with joint ventures reportedly include the tendency of the Japanese partner to seek managerial control of the venture and the inability to retain local Japanese staff.

Several types of joint ventures have typically been utilized by foreign companies to distribute their products in Japan. Sometimes a joint venture may be set up as an alternative to using a trading company or other importer and to make direct contact with a local wholesaler. This allows the foreign company to stay better informed about marketing conditions, hire its own sales force and provide direct input into advertising. Foreign pharmaceutical companies such as Bayer and Smith Kline have pursued this approach. In another less common type of joint venture, the foreign company decides to manufacture its products locally in order to provide a more control over the development and marketing of its products. Examples of joint ventures that were set up in order to manufacture and distribute products locally include Caterpillar-Mitsubishi and DuPont-Toray.

One popular type of joint venture is the franchise. In Japan, a foreign company does not generally recruit its franchisees directly, but instead links up with a Japanese company that builds up the franchising network, either by itself or through a joint venture with the foreign firm. Japan is the second largest market for U.S. franchisors, with the majority in food-related categories such as restaurants (Denny's), donuts (Mister Donut), cookies (Mrs. Field's), ice cream shops (Steve's), and convenience stores (Seven-Eleven).

The popularity of "business format franchising," which includes trade name licensing, transfer of know-how, and an entire business format for the sale of a service or product is expected to continue as the tastes of Japanese consumers diversify and small- and medium-size retailers search for new opportunities to remain in business.[261] Seven-Eleven Japan, in a joint venture with Ito-Yokado, operates a chain of over 3,600 convenience stores throughout Japan, the majority of which are franchises. Kentucky Fried Chicken's joint venture with Mitsubishi and McDonald's arrangement with Fujita are also examples of franchising arrangements.

In recent years, a number of U.S. companies have decided to dissolve their joint venture relationships in order to gain more control over their distribution channels. In most of these cases, "divergent objectives of joint venture partners, particularly about financial commitments"[262] were a major factor leading to the dissolution of the joint ventures. Once a foreign firm has used the Japanese partner to enter the market and to establish distribution channels, the joint venture is often capable of supporting itself. At that time the buy-out option becomes more attractive to the foreign firm.[263]

Licensing Arrangements

Foreign companies sometimes enter into licensing arrangements to market their products in Japan. Under these arrangements, the Japanese partner produces and markets the foreign brand product in exchange for a royalty. The advantages for the foreign company are that the Japanese manufacturer is in a better position to provide both feedback from consumers and after-sales service. Although such an arrangement may absolve the foreign firm from having to engage in a costly or time-consuming effort of creating a marketing program in Japan, licensing arrangements may create certain problems. The foreign firm may unintentionally create a Japanese competitor in the particular product area or related areas or be forced to surrender valuable proprietary technology.[264]

Direct Marketing

Direct marketing is increasingly being used by foreign companies as an alternative to traditional

[260] Batzer and Laumer, pp. 75–79.

[261] U.S. Department of Commerce, International Trade Administration. "Marketing in Japan." *Overseas Business Report*, April 1987, pp 15–16.

[262] "Winning Operating Strategies in Japan," p. 12.

[263] Ibid.

[264] Batzer and Laumer, pp. 86–87.

distribution channels. Direct marketing, including such nonstore sales as mail order businesses and door-to-door-sales, are increasing in Japan. Amway, Tupperware, and Franklin Mint are examples of companies that have marketed their products in Japan through these routes.

Direct marketing currently amounts to only about one percent of retail sales in Japan, compared to about 17 percent in the United States. Although direct marketing has been in existence in Japan for many years, it has only recently gained in popularity. This growth, more than 10 percent a year, can be attributed, in part, to changing lifestyles, particularly the increase in the number of working women who have limited time to shop.[265]

With 1988 sales of more than $500 million, Amway was the seventh fastest growing company in Japan in 1988,[266] according to a MITI study. Amway sells household items, toiletries, and cookware using about 500,000 home-based Japanese distributors selling though personal contact with customers. Consumer preference for personalized service may be one reason for Amway's success. Amway set up its own distribution system using independent distributors with fax machines, computers, telephones and, in remote areas, using the postal service. Orders for goods are forwarded by computer to Amway's automated warehouses in Tokyo, Fukuoka, and Kobe. Products are distributed from one of Amway's three distribution centers within 72 hours of receiving an order. In 1987 Amway (Japan) Ltd. pretax income was $167 million (25 billion yen).[267]

There are some difficulties associated with direct marketing in Japan. The high costs associated with warehousing make it expensive to build up inventories in Japan. It is also difficult for foreign direct marketing companies to compete with companies that have production facilities in Japan with regard to after-sales service, returns policies, and prompt delivery of goods.

Direct Mail

During April 1987 through March 1988, the mail order business in Japan reached $8.9 billion in sales.[268] In September 1989, the Ministry of Posts and Telecommunications introduced a new catalog rate which is 30-percent lower than the parcel post book rate previously used to mail catalogs. Since September of 1989, 8.4 million pieces of mail were handled at the new catalog rate.[269]

Some foreign companies such as The Sharper Image Corp. and Sears, Roebuck & Co. are attempting to circumvent Japan's numerous distributors through the use of direct mail. However, foreign companies account for less than 1 percent of Japan's direct-mail market. Some of the problems associated with this distribution route are high fees on bulk mail and high costs associated with establishing local inventories. The high costs of opening and maintaining checking accounts in Japan limits the method of payments by Japanese consumers. Companies also have difficulties obtaining lists of customers because they are considered to contain proprietary information and are not rented or sold as often as in the United States.[270] [271]

Setting Up Independent Distribution Channels

In many overseas markets, the most desirable option for foreign companies that want to maximize control over distribution of their products is to set up an independent distribution system. This is also the most expensive, time-consuming and difficult means of distributing products in Japan. A few companies have opened their own manufacturing facilities and distribution channels in Japan without linking up with a Japanese partner. IBM is an example of one firm that has been successful in this regard. However, many companies are not in a position to raise the funds needed to set up independent distribution channels in Japan.

A variety of factors may make it difficult for new entrants, particularly foreigners, to establish independent distribution networks in Japan. The problems are reflected in the comments by Ray Ahearn of the Congressional Research Service:[272]

> One way to break through this system and to sell in Japan's producer goods markets is to establish a manufacturing facility in Japan. Some U.S. companies that have done this have become part of the Japanese system and have become very profitable. In

[265] A 1986 survey in the Tokyo area showed that 70 percent of all working women interviewed have purchased through direct marketing.

[266] Ronald E. Yates, "Patience Pays Off for U.S. Firm's Business in Japan," *The Washington Post*, Jan. 28, 1990.

[267] "Amway Leads the Way", *Business Tokyo*, Nov. 1989, p. 27.

[268] "Japan's Distribution System: The Next Major Trade Confrontation," p. 8.

[269] Interview with the Ministry of Posts and Telecommunications, Feb. 1, 1990.

[270] "Can This Catalog Company Crack the Japanese Marketing Maze?", *Business Week*, Mar. 19, 1990.

[271] Nippon Telegraph and Telephone is considering introducing toll free telephone service by mid-June 1990. Such actions could facilitate direct mail orders. "Japan-U.S. Structural Impediments Initiative: Interim Report by the Japanese Delegation," Apr. 5, 1990.

[272] Written testimony of Raymond J. Ahearn, Specialist in Trade Relations, Congressional Research Service, before the Joint Economic Committee, Oct. 11, 1989, p. 9.

general, this requires a substantial commitment of time, effort, and money. And there are few short cuts, such as buying into the Japanese production system through mergers and acquisitions, due to the heavy cross-ownership of shares among Japanese companies.

Indeed, as noted later in this report, friendly cross-shareholding among firms makes it nearly impossible to purchase outright an existing sales and service network. Firms considering setting up their own distribution channels by seeking tie-ups or affiliations with existing distributors may find that willing wholesalers and retailers are hard to come by. Exclusive dealing arrangements are likely to close-off some channels immediately, and firms linked by keiretsu, trading companies, and subcontracting networks are likely to have ties to other experienced candidates. Moreover, the emphasis on maintenance of long-term relationships may make technically unaffiliated firms less willing to take on an untested supplier or account, particularly to the extent that doing so would jeopardize long-standing ties, the availability of easy credit, and the payment of expected rebates.

The complications and costs multiply for firms seeking to establish a distribution system from the ground up. Hiring personnel is particularly difficult for foreign firms. The tradition in Japan of lifelong employment in some industries, the lower propensity of Japanese employees to switch employers than in countries such as the United States, and the importance to employees of perks (such as subsidized housing and arrangements for a proper post-retirement) may make recruitment difficult, since such benefits often imply an existing presence in the Japanese market. In addition, the recent decisions by the corporate headquarters of some American firms to abandon fairly successful operations in Japan because of hostile takeover fears may make potential employees think twice about joining the ranks of a foreign firm.

Once established, it may be difficult to compete effectively with other distributors, particularly large firms such as trading companies who are likely to enjoy economies of scale in distribution-related operations, better access to information, and greater leverage in bargaining over variable fees for transportation and services common in Japan. Distributors tied to existing Japanese suppliers may already occupy most of the prime locations for serving customers in Japan. Large Japanese trade companies and industrial firms reportedly have also been active in the acquisition of prime commercial property during the recent rise in speculative land purchases, including office space in major cities and the port facilities needed to unload and maintain adequate stocks of merchandise in Japan.

The enforcement of legal restrictions may also thwart newcomer's plans. Not only are national and local regulations likely to result in delays and higher costs for building new retail and warehouse facilities, their administration may force new entrants to establish fewer outlets and reduce the size of planned stores, perhaps so much so that it is no longer economically rational to open them. Obtaining a license to sell liquor or import certain agricultural commodities could also be an uphill battle. Setting up a service facility may in fact be impossible as a result of conflicting government regulations, as the case of automobiles described later illustrates.

Breaking the hold of current relationships between such purchasers and dominant Japanese suppliers is likely to require not only lower prices, but comparable incentives too. This may be a difficult proposition, given the lack of transparency with which practices such as rebates and returns are currently carried out. Some Japanese customers may be of the view that foreign suppliers are of dubious reliability, given what they see as the vagaries of trans-oceanic transportation and the sometimes fleeting interest of foreign firms in the Japanese market. They may ultimately agree to purchase commercially viable quantities, but only after a long series of small trial shipments or upon the storage of significant quantities of the good in Japan. Both of these preconditions add to unit costs, diminish the price competitiveness of the foreign product, and make a fledgling venture more vulnerable to failure. The uncertainties associated with entry and customs clearance procedures further heighten the risks and may raise costs. Moreover, to the extent that they lead to delivery delays and higher rates of spoilage, the problems associated with import clearance may undermine the ability of new distributors to establish a reputation for quality and reliability.

The fact that many of these costs would be unrecoverable in the event of failure raises the stakes for suppliers using such a strategy for entering the Japanese market. Customer demands for prompt before and after service and the need to compete with established Japanese brands may necessitate heavy expenditures for sales promotions and advertising, as well as for the training and recruitment of service personnel. This may be particularly the case for foreign products because some Japanese customers may already have preconceived views about the quality or services associated with such goods. Moreover, social traditions that place heavy emphasis on personal contact, long-term commitment, and demonstrated reliability may require new entrants to spend substantial amounts of time, effort, and money to establish goodwill with potential purchasers. The risk of failure may in fact be heightened given the need to establish numerous retail outlets in order to achieve the sales required to break even.[273] Finally, the lack of vigorous antitrust enforcement in Japan means the government is unlikely to curb the ability of existing suppliers to coerce the new entrant's potential customers.

In a recent submission to the Japan Fair Trade Commission, the European Community summarized the concerns of foreign suppliers thinking about setting up an independent distribution network:[274]

> No product can start to sell here without a considerable investment, the return of which is uncertain. Our Japanese competitors have had many years in a protected market where they could spend huge sums on advertising and promotion in total freedom to build huge markets and to acquire large market shares.

Whether or not all of these factors simply "up the ante" for new participants or pose barriers to new entrants cannot be determined in the abstract. Some firms may find the market more amenable to entry and be willing and able to expend the time, energy, and money required over a period of years to establish a viable independent distribution network. Others may decide that the risks are too high, despite the potential for healthy profits over the long-term if such a venture succeeds. The relatively few known cases of foreign firms entering Japan's market via the establishment of a completely independent distribution network suggest that when all is said and done, such a strategy often does not make rational sense from a business perspective.

There are a number of costs involved with setting up a distribution system in Japan that all new entrants, both domestic and foreign must face. Many of these costs are related to simply operating a business in Japan, such as incorporation costs, renting or buying land, and leasing or buying office equipment. Costs of leasing warehouse space, transportation equipment or specialized machinery vary with the type of business. According to Michael Czinkota and Jon Woronoff:

> Not every firm will be able to afford a long-term commitment of managerial time and financial resources necessary to compete successfully in Japan. For example, even though a firm may know that success for its products mandates the maintenance of a warehouse, the stationing of a service technician, and the establishment of a local presence in Japan, this is not always feasible given limited resources. The decision often boils down to whether there will be enough product sales or sufficient profits to justify the expenditures. Currently, in analyzing cost versus profit potential, many firms decide to forego opportunities.[275]

Land Costs

The greatest cost associated with setting up a distribution channel for both foreign or domestic companies is land. Although land costs may not be a barrier to entry in the classic sense of economic theory, they account for a significant portion of the costs of doing business in Japan. The total book value of Japanese land has reportedly doubled over the past three years, to $14 trillion. This level is nearly twice the book value of all U.S. land, an area 25 times larger than Japan.[276] Thus, the same amount of land in Japan costs, on the average, 62.5 times more than in the United States.[277] Average costs of residential land values in Tokyo rose from $231 dollars per square foot in 1985 to $694 dollars per square foot in 1989.[278] According to the *Wall Street Journal,* "Cramped two-bedroom apartments in the city sell for $1 million or more."[279] The cost of commercial land rose from $1,735 dollars per square foot to $5,792 per square foot over the same period. The world's most expensive commercial property is located in the Ginza business district of Tokyo and is valued between $23,700 and $40,000 per square foot.[280] [281] Land for a medium-sized 500 square meter shop (5,400 square feet) would cost $216 million, on the highest valued property.

The average rental price for office space in Tokyo is $191 per square foot compared to $156 per square foot in London or $64 per square foot in New York. Moreover, little space is available

[273] As noted previously, Japanese consumers tend to shop locally, forcing suppliers to sell their products in a relatively dense network of retail outlets in order to be well-represented in the market and achieve sufficient sales levels. The absence of an outlet in a given neighborhood may well mean that no sales are made to residents of that neighborhood. Similarly, the market share of particular firms is apparently directly related to the number of sales outlets they have managed to open. See Czinkota and Woronoff, pp. 52-54.

[274] Statement of the EBC in a meeting with a JFTC Advisory Committee, Jan. 30, 1990, p. 10.

[275] Czinkota and Woronoff, p. 125.

[276] According to a recent press report: "Land inflation has given Japan 60 percent of the value of all real estate worldwide, though it comprises 0.3 percent of the world's land mass." Elaine Kurtenbach, p. E11.

[277] Fields, pp. 188-189.

[278] Nomura Research Institute estimated that Japan's average residential land costs in 1985 were $493 a square meter compared with about $21 for the United States and $33 for Great Britain. "Japanese Land Use, Business Practices Hurt Some U.S. Firms," *Journal of Commerce*, Dec. 20, 1989, p. 7.

[279] Marcus W. Brauchli and Masayoshi Kanabayashi, "Land Prices in Japan are Getting So Steep The Nation is Jittery," *The Wall Street Journal*, Mar. 23, 1990, p. 11.

[280] Kurtenbach, p. E11.

[281] Keith M. Rockwell, "How Real Estate Pumps Up Japanese Stocks," *Business Week*, Feb. 12, 1990, pp. 78-79.

for purchase or rent. Vacancy rates in Tokyo are about 0.2 percent.[282] During 1989, in Japan's second largest city of Osaka, the price of residential land rose almost 60 percent while commercial land prices increased by almost 44 percent.[283] [284]

Japan's tax laws favor agricultural use of land over other uses.[285] Loopholes in the tax laws exempt 85 percent of the undeveloped plots of land in Tokyo from high residential taxes. Owners who claim to be farmers pay less than 0.0001 percent of the assessed value of their land in taxes. This compares to 70 to 80 times that rate for residential land. City farmers can declare their intent to farm for 10 years and pay the low tax rate while the value of land appreciates.[286] Inheritance taxes are as high as 80 percent of inherited assets,[287] however, there is no tax on inherited farm land as long as it continues to be farmed.[288] [289]

If a company, whether foreign or domestic, has enough capital it is quite possible to purchase land. However, according to recent press reports, most real estate purchases can be attributed to speculative purchases by brokers or by those who already own large amounts of land. Real estate investments are reportedly one of the best tax write-offs for landowners or those with high-incomes.[290] This may discourage high rates of real estate turnover:

> At the same time, profits from land sales are taxed at 50 percent unless the money is used to purchase new property within one year's time. So there is little incentive for Japanese property owners to sell, and those that do must quickly buy again to avoid high taxes, a factor that often sends real estate prices spiraling.[291]

[282] Kurtenbach, p. E11.
[283] Ibid.
[284] Following recent declines in the Tokyo Stock Market, there have been some concerns that real estate prices might also fall. However, according to the *Wall Street Journal*, "Although Tokyo property prices have slipped a bit recently, they are more than double 1986 prices, with the city's most expensive land selling for a world-topping $200,000 a square meter." The Bank of Japan has raised interest rates and is worried about further land speculation. Brauchli and Kanabayashi, p. 11.
[285] Although the scarcity of land available for all uses is the major contributor to the high cost of land in Japan, such tax laws also contribute to higher costs.
[286] About 85 percent of the population that lives on farms earn their income from nonfarm jobs. Fewer than 10 percent of the people actually engage in agriculture. "The Party Gets Stronger While the Government Gets Weaker," *Business Week*, July 13, 1987.
[287] Kurtenbach, p. E11.
[288] Rockwell, p. 7.
[289] The government is considering tax reforms that would affect the differences in the tax treatment of farmland, but there may be heavy opposition from farmers and other vested interests to any changes that would affect their current low tax rates. Kurtenbach, p. E11.
[290] Kurtenbach, p. E11.
[291] Rockwell, p. 7.

Land ownership also plays in Japanese companies' ability to raise capital. In explanation of the importance of landowning to capital borrowing by companies:

> One major reason for the land-price problem lies in the fact that Japanese firms have a different concept of land ownership than their Western counterparts. In Japan, the turnover of land is minimal. And there is no need for owners to make much use of their property because, in due course, the land value will go up and they can use it as collateral to obtain substantial funds from banks. In the U.S. and Europe, corporations tend to buy the land for use in other business purposes. If they don't, they can easily become takeover targets for corporate raiders, who will advocate better use of land and other assets.[292]

The same source goes on to note: ". . . instead of making productive use of the land they buy, Japanese firms merely use it to obtain funds to invest overseas. Those funds, in turn, can be used as collateral for further borrowing."[293] Firms who already own land have been able to raise funds more easily in recent years than those without real estate investments. It has been alleged that up to one-half of Japan's stock market growth in recent years may be attributed to the value of Japan's real estate.[294]

According to a recent press report, "A steep real-estate downturn also would squeeze many Japanese corporations. The highly valued landholdings on their books have given them a competitive edge by enabling them to raise capital relatively cheaply. This advantage would shrink if land prices plunged."[295]

Japanese banks have recently been blamed by the government for the contributing to the land price inflation by giving out "easy" loans to landholders. The total amount of real estate loans outstanding for major Japanese banks is $300 billion.[296] Commenting on the speculative nature of the real estate market, one report noted, "Banks accept the unrealized value of property as collateral and provide financing the same way a casino shucks out poker chips."[297]

Rental of retail space in Japan can be expensive. The initial deposit required at time of renting will be the most expensive element of this process. An average rent for retail space in four fashionable Tokyo retail locations is $192 to $250 (per 1-tsubo or 3.9 square yards) with deposits averaging from $1,666 to $2,000 per tsubo. For

[292] "Japan's Land Prices: A blessing becoming a curse," *Japan Economic Journal*, Jan. 20, 1990, p. 3.
[293] Ibid.
[294] Kurtenbach, p. E11.
[295] Brauchli and Kanabayashi, p. 11.
[296] Brauchli and Kanabayashi, p. 11.
[297] Kurtenbach, p. E11.

a 5 tsubo (20 square yards) shop in Harajuku, for example rent would cost about $1,000 a month with a deposit of $10,000.[298] [299]

Due to high costs of renting office space in Japan, many smaller foreign businesses operate out of rented apartment spaces. By operating a business out of a primary residence, a company can deduct part of rent costs as a business expense. Western-style apartments in Tokyo cost from about $3,000 to $9,500 per month compared to $820 per month for a smaller, 650-square foot Japanese-style apartment.[300] Residential rents in the major urban markets have not kept pace with the skyrocketing land costs (presumably because landlords have been holding land for tax advantages and capital gains rather than rental revenues, at least until recently).

The high cost of land in Japan adds to the expenses of U.S. firms and all others doing business there. The additional expenses are greater for firms engaging in land-intensive distribution activities such as warehousing, wholesaling, and retailing. There is no indication that this burden is greater for U.S. firms than for others. However, the high cost of land raises the costs of doing business and, consequently, tends to deter the entry of new firms, including U.S. firms, into the Japanese market. In addition, if land can be used more efficiently by firms doing a larger volume or more diversified business, then the high cost places smaller or less diversified firms at a disadvantage and tends to deter entry.

The ownership of land by some incumbent firms in Japan does not give them an advantage over landless firms, apart from the fact that they have attained some amount of wealth from the appreciation of their land in recent years.[301] Regardless of ownership, the effective cost of land for business purposes is about the same for all firms using comparable land. Firms that use their own land incur an implicit cost of income foregone from not renting to others. Since the market for rental land is highly competitive, this foregone income should roughly equal the rent that other firms pay to use comparable land.

Other Costs

In addition to land costs there are other expenses associated with setting up an independent distribution network. Rental of office equipment is 100 percent tax deductible in Japan as a business expense. Rental of a telex can cost over $173 per month, but installation charges may be in the $1,147 to $1,467 range. A fax system may cost anywhere from $233 to $1,333 with installation charges of $167 to $500. A basic business telephone system with capacity of up to 8 units would cost over $4,000 for installation, bond and purchase of the phones.[302]

Incorporating in Japan can be done in one of two ways, either as a *yugen-gaisha,* a limited liability corporation, or a *kabushiki kaisha,* a standard shareholder-owned corporation. The former is used mainly for smaller companies and the latter for large corporations. In practice, however, many smaller companies incorporate as *kabushiki kaisha,* owing to the prestige, status, relative ease of attracting good employees, and indication of corporate stability associated with that form of incorporation.[303] Firms capitalized at yen 10 million or below ($67,000) receive the most favorable tax treatment in Japan.[304] As a result, entrepreneurs in Japan frequently establish new companies instead of increasing the capital of their existing firm, in order to raise additional capital.[305]

For the majority of foreign firms operating in Japan [those capitalized at less than $53,000 (yen 8 million)] tax rates are 30 percent for ordinary income of $53,000 or less and 42 percent for income over $53,000. When dividends are paid, these tax rates drop to 24 percent and 32 percent, respectively.[306] Municipal and prefectural inhabitant's tax rates are also required of individuals and corporations.[307]

Despite the high costs of establishing an independent distribution network in Japan, some foreign companies have been successful in this regard. One example of a company that was successful in establishing its own distribution

[298] Helene Thian, *Setting Up and Operating a Business in Japan: A Handbook for the Foreign Businessman* (Tokyo: Charles E. Tuttle Co., Inc.,1990), pp. 97-99.

[299] Dollar figures in this section are converted from yen using an exchange rate of $1-150.00 yen.

[300] The fees include at least four months' rent up front part of which is refundable, but about two month's of which is "key money", or a fee paid for the privilege of becoming a tenant. Kurtenbach, p. E11.

[301] The unrealized land value could be used for collateral on a loan or liquidated, but this is a separate issue from the cost of land use.

[302] Thian, pp. 166-168.

[303] Ibid., pp. 34-39.

[304] For instance, entertainment deductions are determined by capitalization. Firms capitalized at yen 10 million or below may deduct yen 4 million in entertainment expenses, while firms capitalized above yen 10 million may only deduct yen 3 million. Thian, pp. 37-38.

[305] Initial costs of incorporating a *kabushiki kaisha* include (1) Articles of Incorporation ($267 stamp tax); (2) notary public fee for Articles of Incorporation ($273 $280); (3) attorney's fees ($1,333); (4) registration fee ($1,000); (5) miscellaneous expenses ($173) for a total of about $3,053. Registration of a trademark, without opposition by a third party or rejection by the Patent Office costs about $940.

[306] Thian, p. 65.

[307] Municipal inhabitant's taxes for corporations are determined using a standard per capita rate or a standard income-based rate, usually 12.3 percent. An enterprise tax for corporations is 6 percent for income of $23,300 or less (yen 3.5 million), 9 percent for income of $23,300 to $46,700 (yen 3.5 to 7 million), and 12 percent for income over $46,700 (yen 7 milliion).

network was Coca-Cola. The company began selling soft drinks in 1946 to the Allied occupation forces and expanded to Japan's civilian market in 1960. Coca-Cola developed a route sales network in Japan, which bypassed wholesalers and distributed to shops that sell their product. However, the company has become a successful market leader.[308]

Since its entry into the market in 1978, Clinique, a division of Estee Lauder, has been successful in increasing its presence in about 90 up-scale Japanese department stores and 19 smaller shops run by department stores. Clinique and other cosmetics makers pay department stores product margins, for setting up sales counters, for beauty advisers, and for distributing samples and catalogs. However, they do not pay for the use of the floor space.

Companies such as Johnson & Johnson and Nestle have set up wholly owned subsidiaries. Other companies such as Kodak and Proctor & Gamble have purchased wholesalers that had previously handled their products.

Unique Features of Japan's Distribution System

Keiretsu

Corporate groups, known broadly as "keiretsu" are a unique and central feature of the Japanese economy.[309] The overlapping of different "types" of keiretsu, interaction with nominally independent firms, and the mutability of keiretsu membership over time have led to particular confusion about the role of keiretsu in Japan's distribution system. In addition to the confusion associated with attempting to classify keiretsu, there is some debate among Japanese observers as to the overall impact of keiretsu and their activities on Japan's economy.

According to some experts on Japan's distribution system and accounts by foreign businessmen, the formation of keiretsu often result in the "channelization" of distribution in some sectors of the economy. They may also result in the closure of these channels to foreign companies or new entrants to the market. For distribution of consumer goods, the primary concern for new entrants is exclusive control of existing sales routes by Japanese manufacturers. For the distribution of intermediate and capital goods, the problem raised most often by exporters to Japan is that of discriminatory procurement policies, and particularly, non-arm's-length nature of many transactions. Third, the keiretsu that are prevalent in both consumer and producer sectors may make it difficult for new entrants to gain a foothold in the Japanese market. Various business practices associated with keiretsu in these sectors contribute to manufacturer control over distribution channels.

Structure

Keiretsu can be distinguished by the types of business activities they engage in. Those made up of firms from a broad range of commercial and industrial fields are known as "inter-market keiretsu", and those made up of firms representing successive stages of the production and sale of a single industry or closely connected industries are called "intra-market keiretsu". The inter-market keiretsu are occasionally referred to as "horizontal" groups because of the nearly co-equal nature of member relationships and they most closely approach a conglomerate-style of organization.[310] The organization of the intra-market keiretsu is characteristically hierarchical. The product-market relation between parent and subsidiary can be anything—vertical, horizontal, conglomerate—and there is little aggregate information on the relative importance of the various types.

Much of the confusion present in discussions of keiretsu and attempts to define their importance stems from the frequency with which the firms from the various styles of keiretsu overlap or interact with one another. (See figure 4) For example, one of the top 9 trading firms, Nissho Iwai, is affiliated simultaneously with two of the "big-6" groups. And several of the largest

[308] Coca Cola's experience in generating higher profits in Japan compared to its U.S. operations may be typical of other companies: "However, to the companies who have made the long-term commitment to Japan, the rewards are considerable. Profits reported by major western companies in Japan are generally at or above worldwide operating margins. A.T. Kearney recently conducted a study of western manufacturing firms with operations in Japan for more than 10 years. Fifty percent of the companies had Japan operating margins above their company's worldwide level; some were as much as 225 percent of their worldwide average." "Winning Operating Strategies in Japan," p. 3.

[309] Efforts to measure the percentage of all Japanese firms that are within a keiretsu have generated confusion due to conflicting definitions of the keiretsu, both outside, and even within Japan. The Japanese term "keiretsu" comes from "kei" meaning "lineage, faction, group" and "retsu" meaning "arranged in order." For a general description of keiretsu see, Caves and Uekusa, *Industrial Organization in Japan*, The Brookings Institution, Washington, 1976; *Industrial Groupings in Japan*, pp. pp. 3-16; Hiroshi Okumura, "Interfirm Relations in an Enterprise Group: The Case of Mitsubishi," *The Anatomy of Japanese Business*, NY, 1984, pp. 173-75; Douglas Ostrom, "Keiretsu and other Large Corporate Groups In Japan, *Japan Economic Institute Report*, Jan. 12, 1990; Czinkota and Woronoff, pp. 22-23, 34-37.

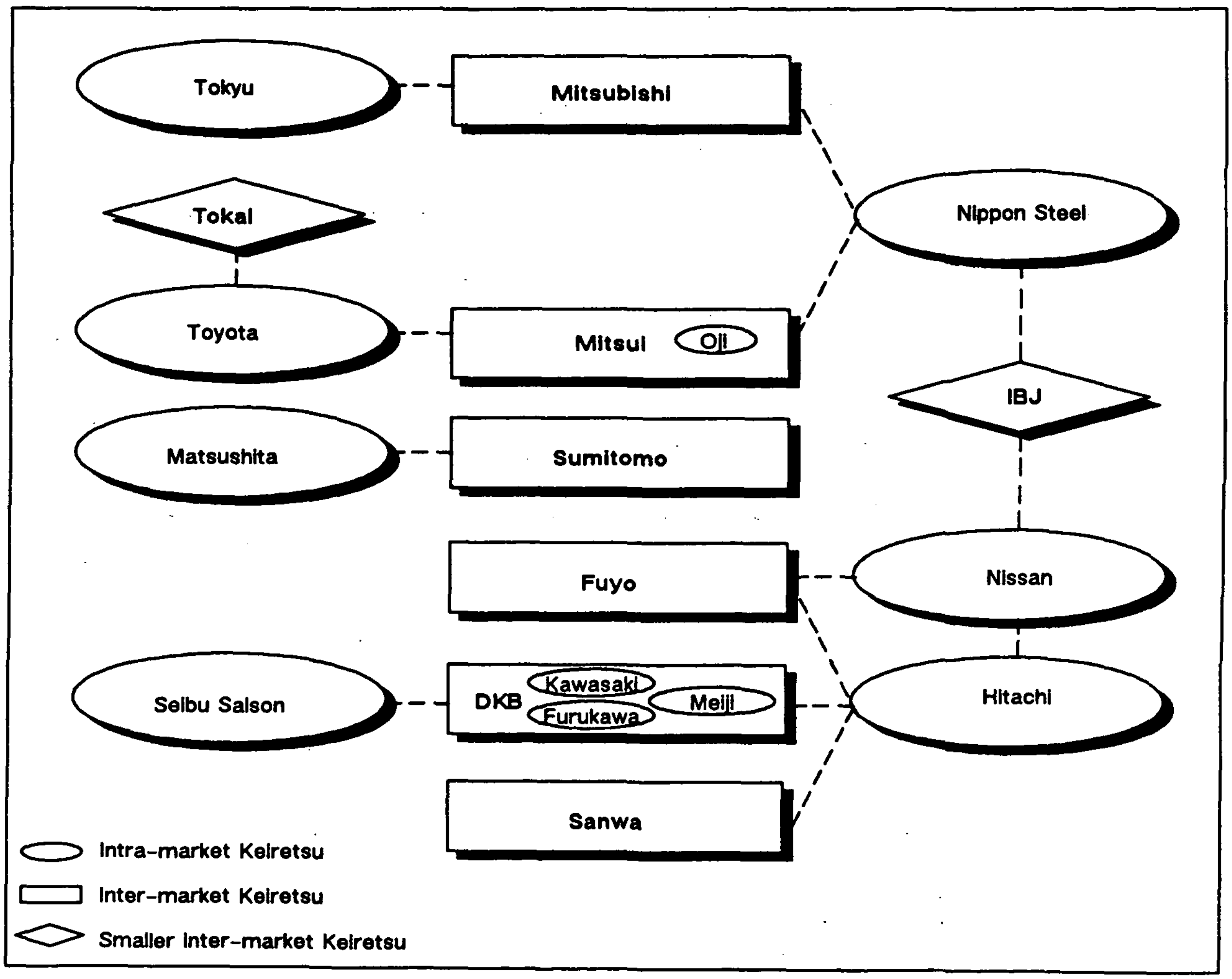
[310] It must be noted, however, that inter-market keiretsu member firms remain independent companies, making the links much weaker than those of American or European conglomerates. Regarding their "horizontal" nature, it should also be noted that it has been dealings and relationships among, rather than within, the 6 major inter-market keiretsu that have most often been an object of scrutiny in Japan from an antitrust perspective.

enterprise groups such as Toshiba or Nissan or Toyota have some degree of affiliation with one of the "big-6" inter-market keiretsu at the same time that they constitute a discreet grouping of their own. Similarly, one of the best known of the distribution keiretsu—the 35,000 outlets overseen by the giant, diversified Matsushita Electric Industrial—coexists with an upstream kigyo (enterprise) keiretsu.[311] Moreover, linkages among keiretsu member firms strengthen or attenuate over the years, and departures and additions of individual companies are not unheard of.

A range of formal and informal institutions and practices link firms together in one of the various forms of keiretsu. The most important mechanisms for defining and maintaining keiretsu membership are: (1) networks of debt capital, (2) stable shareholding and cross shareholding, (3) shared directorships and seconded senior managers, (4) executives' councils (in the case of the large inter-market keiretsu), and (5) common traditions and shared corporate assets (e.g. company logos).

[311] Ostrom, pp. 4-5.

Figure 4
Relationships among different keiretsu types



Source: *Industrial Groupings in Japan*, Dodwell Marketing Consultants, 1988.

Inter-market Keiretsu

The popular notion of keiretsu today centers upon a half-dozen groups made up of Japan's corporate giants, most of whom have pedigrees reaching back to the Meiji era of the late 19th century.[312] Commonly dubbed the "big-6" industrial groups *(roku-dai kigyo* or *kigyo shudan)*, these keiretsu bring together the major "city" banks, large manufacturing concerns,[313] general trading companies (*sogo shosha*), and trust banks and insurance companies. The discussion below will briefly consider their more important mechanisms for cohesion, which include certain informal practices and traditional characteristics.

In large part, the "big-6" are reconfigurations of the member firms of the pre-war oligopolistic family concerns known as zaibatsu.[314] However, today's groups not only lack their predecessors' close family control, exercised through holding companies, but their members appear to engage in more independent action and less internalized trade.[315] Because these groups are each organized around a large bank, and because the firms are linked more by finances than products, they are also often known as financial keiretsu (*kinyu keiretsu*). (see figure 5). The giant, diversified general trading companies, of which one is typically associated with each of the six groups, have also taken on some of the coordinating and "flagship" roles performed in the pre-war years by the zaibatsu holding companies. However, the trading companies also play prominent roles in both international trade and the domestic distribution of goods in their own right, and are, because of their importance, treated separately above.

The simplest measure of membership in the six inter-market groups, participation in largely social or symbolic executives' councils, gives a total of some 193 firms.[316] These blue chip firms are of considerable size, together accounting for about 15 percent of the total assets of the Japanese economy, 17 percent of total sales, 5 percent of all employees, 56 of the top 100 manufacturing firms, and the top 5 from the commercial bank, trust bank, and insurance company fields. Moreover, relatively loose financial disclosure requirements (as well as accounting practices regarding valuation and the consolidation of affiliates) probably cause their overall influence within the Japanese economy to be understated. Moreover, their share of total assets nationally increased slightly between 1970–1981. It is frequently stated that the relative importance of the "big-6" within the Japanese economy and, more particularly, their internal cohesiveness, has been in decline since the mid-1970s.[317]

The six inter-market keiretsu can be further subdivided. First, there are three groups which are descendants of three of the major zaibatsu of the prewar era (the Mitsubishi, Mitsui, and Sumitomo houses). (see figure 6). The other three inter-market groups formed around major commercial banks (Fuyo, Sanwa Bank, Dai-Ichi Kangyo Bank). The major qualitative difference between the two types is a somewhat lesser degree of affinity or cohesiveness among firms of the latter type, apparent in a lower incidence of intra-group transactions and shareholding.

Sharing the inter-market orientation of the big-6 groups, a number of additional firms are linked to a particular bank as a principal source of credit, and for some degree of managerial support. The development of the Fuji, Sanwa and Dai-Ichi Kangyo banks' groups has been paralleled on a lesser scale by the emergence of keiretsu constellations centered on the Tokai Bank, the Industrial Bank of Japan and the remaining major commercial ("city") and long-term banks. This phenomenon is called the "main bank system."[318] Main banks fulfill the function of guarantor and lender of last resort for affiliated firms, typically providing 20 to 30 percent of a company's total loans, as well as a number of "seconded" (retired or dual-service) executives. In turn, the banks are to a degree dependent on their keiretsu "clients" for a steady stream of business.

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[312] This subset of keiretsu has been the principal concern of the JFTC, as reflected in their series of periodic surveys of keiretsu financial and business dealings.

[313] Typically, with all major industries represented in each group, but with no more than one firm from that particular industry. This is known in Japan as the "one-set system," (wan-setto-shugi).

[314] Technically and historically, however, these groups were not referred to as "keiretsu."

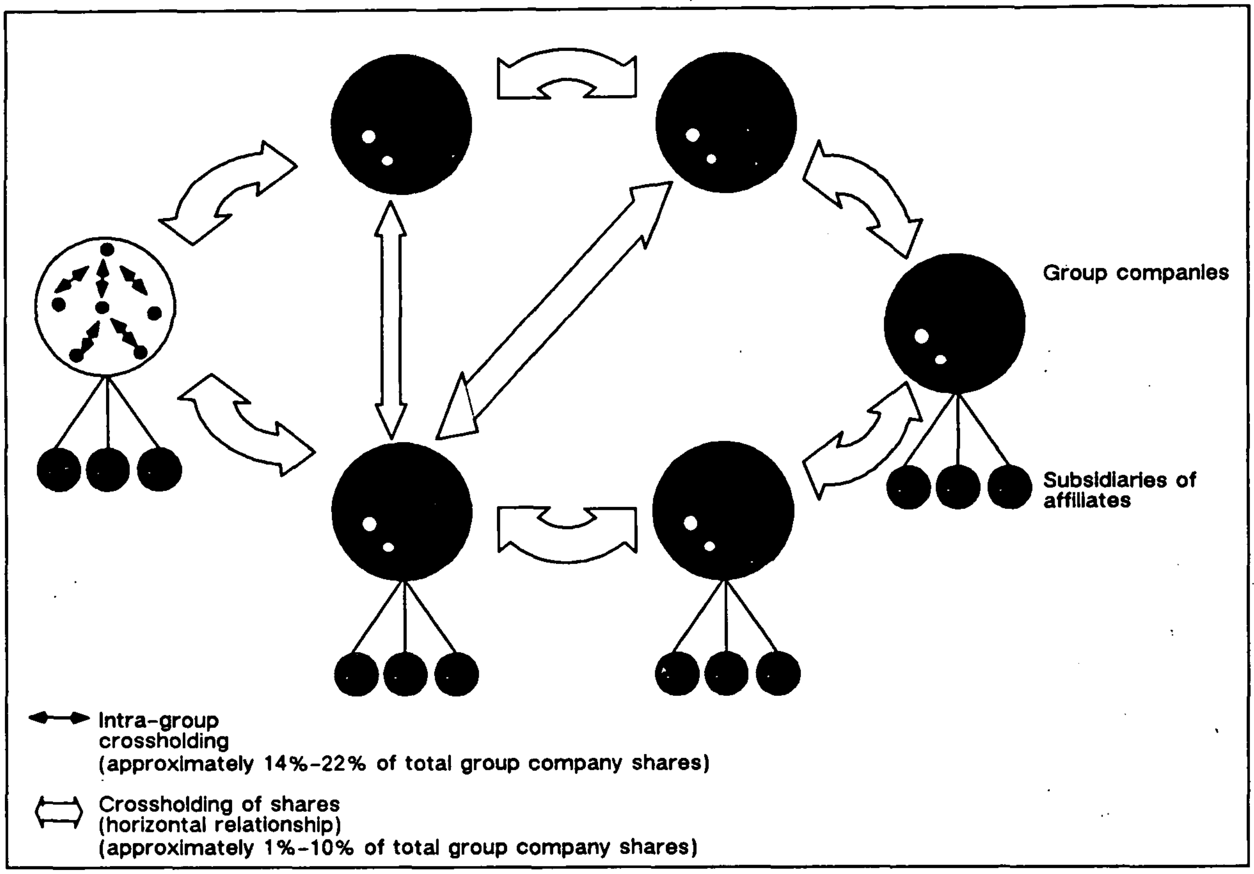
[315] The economic reforms imposed by the U.S. occupation in the late 1940s included dissolution of the zaibatsu, a partial purge of leading managers, deconcentration measures directed at certain other large enterprises (including the trading companies), and an explicit ban on all holding companies. The original Antimonopoly Law which served as the cornerstone for most of these and other economic reforms is described in, Eleanor Hadley, *Antitrust In Japan*, 1971, pp. 121–24, 370–71; and Iyori and Uesugi, *Antimonopoly Laws of Japan*, 1983, pp. 11–16.

[316] However, if subsidiary and affiliated firms (or further, their subsidiaries) are included the number would rise to over of 1,000 firms.

[317] See, for example: Higashi and Lauter, *The Internationalization of the Japanese Economy*, 1987, pp. 40–41. According to some analysts, one reason for the relative decline of the inter-market keiretsu is that, while their activities span the range of economic endeavor, their center of gravity remains in the heavy, energy-intensive industrial sectors. In contrast, the most dynamic growth has largely been witnessed in younger companies independent of the "big-6" circle. Caves and Uekusa, *Asia's New Giant*, (Washington, D.C: The Brookings Institution, 1976), p. 499, Table 7-5.

[318] Ibid.

Figure 5
Structure of the inter-market keiretsu (the big 6, or "financial" groups)

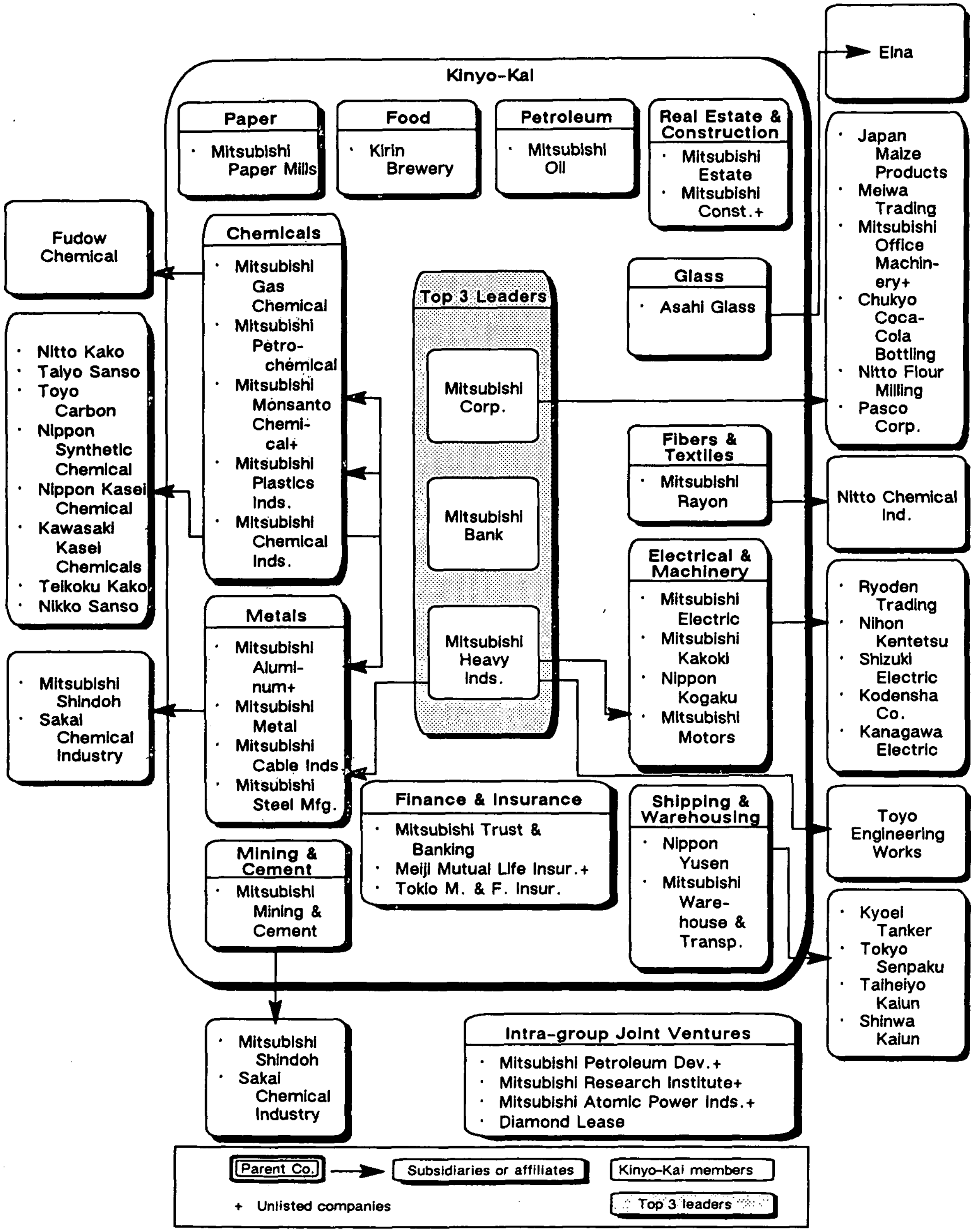


Horizontal connections over a wide spectrum of industries

Types	Groups	
Groups of Zaibatsu Origin	Mitsubishi Mitsui Sumitomo	The six major groups
New groups centering around leading city banks and general trading houses	Fuyo DKB Sanwa	The six major groups
New groups centering around leading city banks and general trading houses	Tokai IBJ	The two medium-sized industrial groups

Source: *Industrial Groupings in Japan*, Dodwell Marketing Consultants, 1988/89.

Figure 6
Example of an inter-market keiretsu: The Mitsubishi Group



Source: *Industrial Groupings in Japan*, Revised Edition 1988/89, Dodwell Marketing Consultants, Tokyo, October 1988.

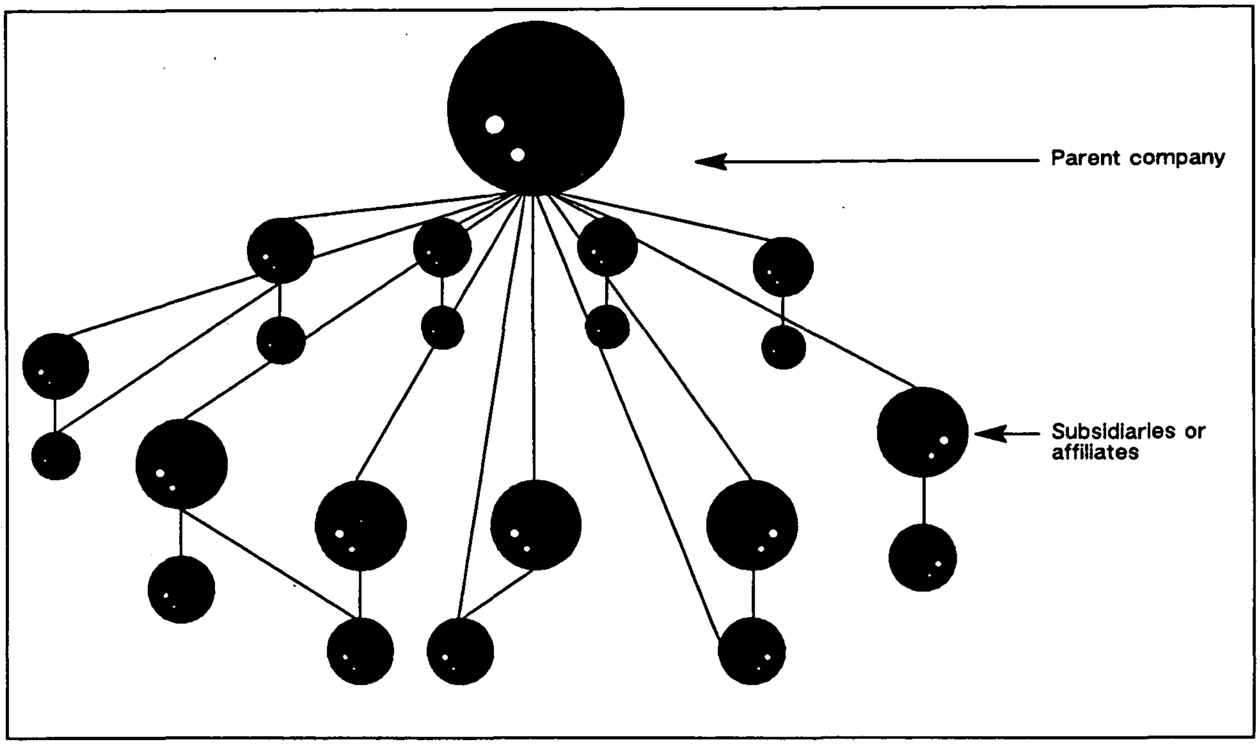
Intra-market Keiretsu

The second major type of keiretsu is the hierarchical organization of the "enterprise" or "industrial" (*kigyo keiretsu*) groups. Each of these is composed of one (or more) large independent company(ies), its subsidiaries and affiliates, and its subsidiaries' affiliates—typically comprising a grouping of anywhere from one-half to three dozen firms. (see figure 7). These keiretsu are focused in a single or limited number of related industries. The Toyota and Nissan groups in the automotive industry, the Nippon Steel Group in the iron and steel industry, and the Hitachi and Matsushita Groups in the electrical machinery and electronics industries are representative of the several dozen vertical groups of particular significance to Japan's economy. The prominence of intra-market keiretsu which are centered on such famous manufacturers gave rise to the name "industrial keiretsu," although it is possible for intra-market keiretsu to form around non-manufacturers—such a retailer (Daiei, Inc.), or a railroad company (Tokyu Corp.).[319]

Membership in a particular *kigyo keiretsu* may result either from an independent supplier being drawn into a close or nearly exclusive relationship

[319] Ostrom, p. 3.

Figure 7
Structure ot the Intra-market keiretsu ("kigyo," "industrial," or "enterprise" groups)



Types	Groups
Groups established around large industrial concerns	Nippon Steel Hitachi, Nissan Toyota, Matsushita, etc.

Source: *Industrial Groupings in Japan*, Dodwell Marketing Consultants, 1989.

with the central firm(s), or from having an internal function spunoff, creating a nominally/legally independent affiliate.[320] Shareholding within the kigyo keiretsu is, accordingly, at a markedly higher level than is the case for the "big-6" keiretsu, and more often takes the form of one-directional holding by the lead firm(s) than reciprocal cross-shareholdings. In addition, shareholding by nonfinancial companies in Japan is not subject to the 5 percent legal limit for banks—or even the 10 percent ceiling for insurance companies.[321] For this reason these groups are sometimes also referred to as "capital keiretsu" (*shihon keiretsu*) in order to draw attention to their equity ties, which tend to be markedly stronger than those of firms affiliated through an inter-market keiretsu. The other hallmark of the kigyo keiretsu is a vertical division of labor, paralleled by a hierarchy among the affiliated firms.

At times it is difficult to differentiate discreet intra-market keiretsu groups from the more general phenomenon of subcontracting. Subcontracting is far more prevalent in Japan than in most other industrialized nations. More than three-quarters of firms employing more than 100 persons use subcontractors.[322] Further, it is estimated that auto manufacturers in the U.S. typically account for well over one-half of the total value of their finished product, while in Japan the figure may be as low as 30%, the rest being accounted for by subcontractors and other out-of-house producers.[323] Like the inter-market keiretsu, a principal purpose for intra-market keiretsu and subcontracting networks is to conduct the maximum possible volume of business in stable, long-term relationships.[324] When debt, equity and personnel links are added to the subcontracting relationship—as they frequently are—the resulting networks are largely equivalent to the vertical keiretsu.

Distribution Keiretsu

The intra-market vertical keiretsu include a more specialized grouping known as distribution keiretsu, or *ryutsu keiretsu*. While these keiretsu share the sectoral and vertical orientation of the enterprise groups, the direction of integration is downstream, into the distribution, marketing, and sales of finished products. These keiretsu may incorporate both wholesale and retail layers, and be involved in a variety of physical, title, payment, information, and promotion activities relating to distribution. Perhaps the most notable divergence of the distribution keiretsu from the other types is the means of cohesion: equity ties and other finance, while often present in distribution keiretsu,[325] are frequently less important than the use of business practices detailed elsewhere in the report, such as rebate and returns policies.

Distribution keiretsu have tended to cluster in a relatively few industries such as automobiles, consumer electronics, optics, cosmetics, pharmaceuticals, newspapers and processed foods.[326] (see figure 8). While examples exist of distribution keiretsu being formed by wholesalers and even large retailers, it has been the efforts of manufacturers to forge alternative, captive channels of their own that has given rise to the phenomenon known as *ryutsu keiretsuka*, translated as "distribution channelization," or "the formation of "integrated marketing networks."[327] Manufacturers began to develop distribution keiretsu on a widespread basis during the latter half of the 1950s, and the trend has accelerated from the 1960s until the present. As noted elsewhere in the report, certain durable

[320] The most characteristic form of affiliation for the kigyo keiretsu is either upstream or downstream within the manufacturing process. However, other forms of affiliation have lent themselves to strategies intended to expand market share (quasi-horizontal affiliation), to diversify the core firm's business, and to advance overseas. Okumura, pp. 173–75; Caves and Uekusa, *Asia's New Giant*, p. 501.

[321] Ostrom, p. 3.

[322] Caves and Uekusa, *Asia's New Giant*, p. 512.

[323] Rodney Clark, *The Japanese Company*, p. 68; Tetsuo Minato, "A Comparison of Japanese and American Interfirm Production Systems," in Hayashi, Ed., The U.S.-Japan Economic Relationship: Can It be Improved? NY University Press, N.Y., 1989; Cole and Yakushiji, *The American and Japanese Automobile Industries in Transition*, Ann Arbor, 1984, ch. 9.

[324] Analysts further suggest that there are a range of other likely motivations for keiretsu-formation, (some of which are best achieved through long-term relationships) including: the utilization of the wage and capital cost differentials between large and small enterprises in the Japanese economy, the ability to use internal pricing to rationalize price structures prevailing in imperfectly competitive ambient markets, the minimization of transaction costs, risk shifting, and the stabilization of profits over time and across keiretsu members. See, for

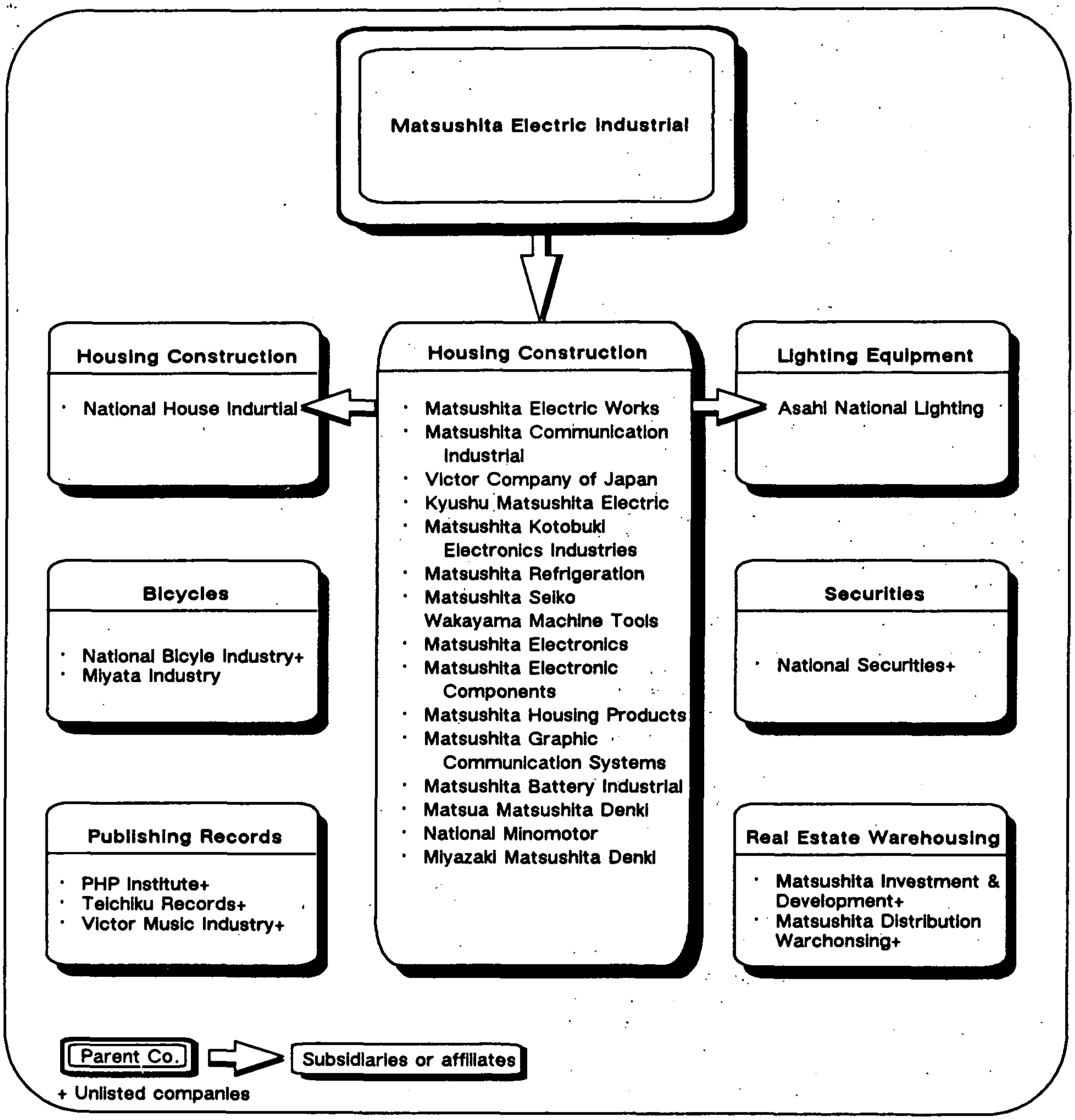
[324]—*Continued*
example: Iwao Nakatani, "The Economic Role of Financial Corporate Grouping," in, M. Aoki, Ed., *The Economic Analysis of the Japanese Firm*, North Holland, 1984, pp. 227–47; Tom Roehl, "Japanese Industrial Groupings: A Strategic Response to Rapid Industrial Growth," University of Washington, Seattle, Aug. 1988. Another common explanation for both keiretsu and subcontracting networks that has been developed is that they reflect a cultural predilection for emphasizing the human dimension of business dealings.

[325] An expert study group appointed by the JFTC recommended that competition policies pay special attention to the possible problems arising from manufacturers' capital holdings in firms in the distribution sector and their secondment of managers to such firms. JFTC, pp. 24–25.

[326] Perhaps one reason that distribution keiretsu have remained limited to a relatively small number of sectors is resistance from already established independent wholesalers and retailers. For a report on the current struggle being waged in the consumer electronics area, see: Yuko Inoue, "Manufacturers at War with Discount Retailers," *The Japan Economic Journal*, Aug. 19, 1989.

[327] Yoshino, pp. 109–128.

Figure 8
Example of an intra-market keiretsu: The Matsushita Group



Source: *Industrial Groupings in Japan*, Revised Edition 1988/89, Dodwell Marketing Consultants, Tokyo, October 1988.

goods were new to the market in the immediate post-war era, such as automobiles and consumer electronic products. Their development reflected the strides made by Japanese heavy industry, often by adapting imported foreign technology. At the time of their introduction, however, the distribution sector lacked the capital, facilities and expertise needed to mass market these new products.

To remedy this deficiency, manufacturers intervened to provide dealers with the necessary capital and technical assistance. In the process they established a distribution system tailored to high volume sales under their direct control. Further impetus to the formation of distribution keiretsu was provided by the progressive narrowing of nondurable goods subject to authorized resale price maintenance.[328] Producers of these products, reportedly, began to develop and strengthen distribution keiretsu arrangements as a means to maintain resale price maintenance on a *de facto* basis. Another interpretation offered for the origins of manufacturer-led distribution keiretsu is that they arose because of fierce competition among manufacturers.[329]

Distribution keiretsu may enable manufacturers to reduce distribution costs by simplifying marketing channels, allowing bulk shipments, rationalize inventory controls; promoting customer service, by emphasizing specialized knowledge and experience, improving post-sales service and quality control; and ensure effective communication by keiretsu dealers about changing customer tastes. There is considerable doubt, however, about whether any of the resultant cost savings have generally been passed to the Japanese consumer. According to Ishida Hideto:

> Reductions in marketing costs, for example, are seldom passed on to customers. This is because the aim of keiretsu integration in distribution is to stabilize prices at the distribution stage by promoting product differentiation. Interbrand competition among distributors is eliminated by distribution keiretsu and the manufacturer's business and pricing policies are more easily realized even without binding instructions . . .[330]

Moreover, many observers claim that the distribution keiretsu engage in restrictive marketing arrangements and act as a perpetuator of a host of allegedly unfair business practices and customs that may discriminate against outsiders.[331] These practices include resale price maintenance, exclusive dealing arrangements, single-outlet-single- account systems (*itten itchoai*) systems andvarious discriminatory rebate schemes. As a result, the growth of distribution keiretsu is considered to be a central issue for antitrust policy in Japan today, that also has potentially significant implications for market access of U.S. goods.[332]

"Cooperative arrangements" by distribution keiretsu, barriers to entry into the distribution system which has led to "the growth of oligopoly in the distribution system," unfair business practices and exemptions under the antimonopoly law have been singled out by the JFTC as areas of antitrust concern. The activities of distribution keiretsu involve:

> . . . systematic or interrelated efforts by manufacturers (and wholesalers to force retail dealers to organize in order to promote cooperation as well as to force them to carry out producer-determined policies at the retail level."[333]

In sum, it is clear that the keiretsu and various corporate groupings have singular significance for the distribution of goods and services in Japan, both domestic and imported. The significance of the keiretsu issue was reflected by its inclusion as a topic for discussion under the Structural Impediments Initiative.[334] Many of the economic and cultural explanations for their existence have complex and long-standing foundations. It is equally apparent, that, because of the diversity of keiretsu structures and economic activities, it is necessary to differentiate among the various types in evaluating the impact they have upon distribution systems.

The type of keiretsu with the most obvious relative importance to distribution channels are the ryutsu keiretsu. In those product lines for which a particular manufacturer is able to control or heavily influence successive stages of distribution, it is clear that the channels are far from open toward imports and potential entrants to the market.[335] Although the activities of manufactures within distribution keiretsu may represent a significant impediment to certain channels of the distribution system, this type of keiretsu appears to be limited to those industries noted above.

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[328] The 1953 amendments to the Antimonopoly Law continued exemptions for manufacturer-imposed resale price maintenance for trademarked goods and copyrighted works.

[329] "Changing Japanese Distribution System," IBJ, p. 7.

[330] Ishida Hideto, "Anticompetitive Practices in the Distribution of Goods and Services in Japan: The Problem of Distribution Keiretsu", *Journal of Japanese Studies*, v. 2, 1983, pp. 324-25.

[331] The IBJ report notes two cases in which the distribution keiretsu may cause antitrust problems: "The first case is where one grouping denies the presence of other groupings, or denies access to diverse distribution channels other than its own. The second version is that such grouping entails illegal exclusivity." IBJ, p. 7.

[332] Ishida, pp. 319-321; IBJ, p. 7.

[333] Ibid., p. 322.

[334] Among the commitments made by the Government of Japan at the urging of U.S. Government representatives in the SII interim report was the following:

> The Fair Trade Commission (FTC) will strengthen its monitoring of transactions among keiretsu firms, including but not limited to, those which have cross shareholding relationships, to determine whether these transactions are being conducted in a way that impedes fair competition.

"Japan-U.S. Structural Impediments Initiative: Interim Report by the Japanese Delegation", p. 26.

[335] For a further discussion of the effects of distribution keiretsu on distribution channels, see section of the report on vertical business practices.

The "financial" or "enterprise" keiretsu, on the other hand, may represent a different order or obstacle to foreign exporters of capital and intermediate goods. For these types of interfirm relationships, the problems that outsiders encounter appear to be much more subtle than the foreclosing of an entire "proprietary" distribution channel. However, the characteristics of complex interdependence and the priority given to long-term stability by keiretsu members, involves more fundamental aspects of how business is conducted in Japan and may therefore be more intractable.

Japan's Automobile Distribution System

The Japanese automobile industry is one of the most frequently cited examples of a strong distribution keiretsu, and one in which exclusive dealing has often been viewed as pervasive.[336] [337] According to a summary of a 1977 JFTC study: "All of the one to two thousand automobile dealers in Japan belong[ed] to a specific manufacturer-keiretsu."[338] Many representatives of U.S. automakers have argued that their success in the Japanese auto market is being hindered by their lack of access to the extensive dealerships of Toyota, Nissan, and Honda. The outlets for these Japanese companies account for approximately 73 percent of the auto sales in Japan,[339] yet very few of these retailers sell other foreign or domestic brands of cars in the same outlets as the Japanese brands,[340] and then, according to U.S. automakers,[341] only with prior approval from Japanese manufacturers. Given the high land prices in Japan, it is argued that investment in a sufficient number of new dealerships to adequately represent U.S. automakers in the Japanese market would be extremely costly for either Japanese dealers or U.S. automakers. According to a February 1990 study by the Industrial Bank of Japan, "The new establishment of one's own dealership network has reached its limit, due to the difficulties in the after-sale service system and soaring land prices."[342] Thus, access to the dealerships of Toyota, Nissan, and Honda has been deemed to be critical to the success of U.S. auto companies in the Japanese market.[343]

Japanese industry representatives, however, consistently claim that dealers are free to sell any brand of car they want, and the decision on which brands to carry is most likely based on dealer estimates of expected return on the investment necessary to sell an additional brand through their dealership.[344] [345] Further- more, many Japanese industry officials state that Toyota, Honda, and Nissan have diverse product lines, and that there is little incentive to add imported models to those lines.[346]

In 1978 and 1979, the JFTC studied various sectors of the Japanese economy thought to be closed and characterized by outdated business practices. In the study of the automobile distribution system, the JFTC concluded that the auto industry had become almost completely "keiretsu-ized". Automakers were found to have extensive control over dealerships, and were able to get dealers to agree to business practices, such as exclusive dealing arrangements.[347] The study found that dealer ties to the manufacturers were

[336] Czinkota and Woronoff, p. 48; ICGS, p. 8; Sachio Sugimoto, "Import restrictions in Japan's distribution system", *Dynamics of Japanese-U.S. trade relations*, p. 130; "The inside story of domestic car wars: revolting dealers", *Nikkei Business*, Dec. 5, 1988, (English translation); "Taste for the exotic fuels Japan's imported car trade", *Financial Times*, Sept. 26, 1989, p. 10; Ishida, p. 326, Batzer and Laumer, p. 179.

[337] The perspective of U.S. auto producers is most forcefully argued in "Automobile sales in Japan—the American makers' perspective", presentation to the Trade Expansion Committee, American Chamber of Commerce in Japan, Tokyo, Japan, June 5, 1989.

[338] Ishida, p. 326.

[339] "Vehicle sales top 7 million units for the first time ever in 1989", *Japan Automotive Insight*, Jan. 1990, p. 3.

[340] The most notable exception within Japan's three largest automakers is Nissan dealers which have carried the Japan-produced VW Santana. Sometime during the Japanese fiscal year beginning April 1, 1990, Nissan dealers will begin carrying the VW Passat, which is manufactured in West Germany. USITC staff interview with representatives of Nissan Motor Co., Tokyo, Japan, Feb. 8, 1990, and telephone interview with Nissan Motor Co. representative, Washington, D.C., Mar. 8, 1990.

[341] ACCJ presentation, June 5, 1989.

[342] "Changing Japanese Distribution System," IBJ, p. 9.

[343] ACCJ presentation, June 5, 1989; USITC staff interview with Chrysler representative, Dec. 1989 and Mar. 5, 1989.

[344] While it is often stated that Japanese auto companies have exclusive dealing clauses in their contracts with dealers, representatives from Toyota and Honda stated that they have never had such clauses in their dealer contracts. Nissan removed such clauses from its contracts in 1980.

[345] Japanese auto industry representatives have stated that Japanese manufacturers do not prevent dealers from carrying imported automobiles. Although U.S. industry representatives have contacted dealers of Japan's three largest automakers in an effort to have them sell U.S. autos, representatives from Toyota, Honda, and Nissan do not know of such contacts.

[346] While these companies have diverse product lines, the products available to dealers is limited by the fact that Japanese automakers sell their products through designated sales channels, making dealer access to various models dependent upon what sales channel the dealer represents. A dealer would have to represent all the marketing channels to have access to all models.

[347] Like many rapidly growing industries in Japan, the auto industry experienced extensive manufacturer involvement in the distribution system after World War II. Japanese manufacturers modeled their relations with dealers after the U.S. system. For example, Toyota borrowed heavily from the system used by General Motors, while Nissan largely modeled its system after Ford. Koicki Shimokawa, "Marketing history in the automobile industry: the United States and Japan," in Akio Okochi and Koichi Smiokawa (eds.), *Development of mass marketing: the automobile and retailing industries*, (Tokyo: University of Tokyo Press, 1981). USITC staff interviews with Nissan representatives

strengthened by having a high level of equity ownership in dealers and having manufacturers' managers working in dealerships. Relative to other retail businesses, dealerships were found to have low profitability and to be highly reliant on manufacturers for rebates to retain profit margins. The JFTC reportedly remains concerned about the relatively low profitability of auto dealerships, and the resulting potential for exploitation by manufacturers. Manufacturers' control over the dealerships was found to be so strong that a dealer's survival was essentially in the hands of the manufacturers.[348]

In an attempt to curtail these practices, the JFTC issued administrative guidance in 1980, after which a number of business practices in the auto industry were revised, including the existence of exclusive dealing provisions in contracts.[349] Despite some reforms, it is widely argued that Japanese automakers maintain exclusive dealing, even though exclusionary provisions are no longer written into manufacturer-dealer contracts.[350]

Japanese automakers are not alone in being identified as applying pressure on dealerships to sell only their product. Although antitrust rulings between 1941 and 1949 forced U.S. automakers to drop exclusive dealing clauses from their franchises, "it is likely that they continue to discourage dual franchises across companies. One indication of this is that, of the 24,000 dealers selling U.S. makes in 1980, fewer than 3 percent handled the makes of two or more U.S. companies".[351] Some analysts have also noted that exclusive dealing occurs in West Germany and France.

Auto import sales in Japan

The limited presence of U.S. automakers in Japan must be considered in the context of historical developments in the Japanese industry. Prior to World War II, GM, Ford and Chrysler were dominant forces in the Japanese auto industry, with all three companies manufacturing automobiles in Japan. Ford and GM controlled approximately 90 percent of the Japanese market in 1934.[352] In an effort to develop a domestically owned Japanese auto industry, the Motor Vehicle Manufacturing Business Act was passed in 1936, which restricted manufacturing in Japan by foreign firms. Additionally, import duties on motor vehicles were raised from 50 percent to 70 percent, and duties were raised on parts as well. By 1939, all manufacturing operations in Japan ceased, and in 1941, the Government of Japan seized all assets of U.S. auto companies. After World War II, auto imports into Japan were again restricted in an effort to allow the domestic industry to develop. In 1965, restrictions on imported vehicles were lifted.[353] However, according to U.S. industry, a variety of non-tariff barriers continue to substantially restrict imports.[354] Imports from the United States increased beginning in the late 1960s, peaking in 1979 (at nearly 22,000 units)[355] before falling dramatically during the energy crisis. U.S auto imports into Japan declined to 1,816 units in 1985, before again increasing.[356]

The auto market in Japan has grown consistently since 1985, with particularly strong growth occurring since 1987. Import sales have increased dramatically in percentage terms, but given the low base level, imported cars still

[347]—*Continued*
(Tokyo, Japan, Feb. 8, 1990) indicated that some Japanese automakers felt vulnerable to large U.S. auto companies before World War II, and during the 1950s, and placed exclusive clauses in contracts to strengthen their position in the Japanese market.

[348] Summarized in Ishida, pp. 326–27.

[349] Ibid., pp. 326–27. While the content of the current JFTC study group conclusions of distribution-related business practices has not yet been made public, it is anticipated that new guidelines may further address dealer contracts. USITC staff interview with representatives of Honda, Tokyo, Japan, Feb. 8, 1990.

[350] Batzer and Laumer, p. 179; Czinkota and Woronoff, p. 49; ACCJ paper, USITC staff interviews with representative of General Motors, Tokyo, Japan, Feb. 7, 1990, and representative of Chrysler, Washington, D.C., Jan. 19, 1989 and Mar. 5, 1990. The apparent feeling among Toyota and Nissan dealers that those manufacturers would not tolerate sales of imports along with their products is noted by Miho Yoshikawa, "Carmakers spice up showrooms with imports", *The Japan Economic Journal*, Oct. 14, 1989. Although no mention is made of exclusive dealing specifically, a recent study by the Industrial Bank of Japan (February 1990) concludes that the distribution system for imported autos is largely closed.

[351] Walter Adams, *The structure of American industry*, (Macmillan Publishing Co., 1982), p. 165. Approximately half of all U.S. auto dealerships are exclusive, according to a letter from representative of NADA to representative of JAMA (letter provided by representative of Toyota Motor Sales, U.S.A.). According to data gathered during a USITC staff telephone interview with representative of Ford Motor Co., Jan. 22, 1990, approximately 8 percent of the dealerships of GM, Ford, and Chrysler sell Japanese-brand autos in the same facilities with those U.S. brands.

[352] C.S. Chang, *The Japanese auto industry and the U.S. market*, Praeger: New York, 1981, pp. 22–24. ACCJ presentation, p. 2.

[353] Chang, p. 93.

[354] ACCJ presentation, June 5, 1989, p. 3. Key among the restrictions have been the certification of imported autos and a commodity tax on vehicles with engine displacements of over 2 liters. While substantial improvements have been made, U.S. automakers note that certification procedures and taxes still impede imports of autos.

[355] ACCJ presentation, June 5, 1989, p. 3.

[356] USITC staff interview with General Motors, Tokyo, Japan, Feb. 7, 1990.

account for a relatively minor (4.1 percent in 1989) share of the market. Imports from West Germany (120,293 autos in 1989) far exceed those from any other country, and account for 2.7 percent of the market (See table 6). The second largest number of imports in 1989 were from the United States, and totaled 19,084, representing a 31.5 percent increase over 1988. U.S. imports account for 0.4 percent of the market. The low overall level of auto imports into Japan has been argued to be evidence of the closed nature of the auto distribution system.[357]

Table 6
Automobile exports to Japan, 1985-89

Country	1985	1986	1987	1988	1989
	(Number of autos)				
West Germany	40,157	53,916	74,289	91,648	120,293
United States	1,816	2,345	4,006	14,511	19,084
United Kingdom	2,513	4,033	6,771	9,789	14,519
France	1,009	1,729	3,933	6,153	10,487
Sweden	2,033	3,151	4,699	6,737	9,753
Italy	2,492	3,046	3,032	4,216	4,564
Other countries	152	137	220	529	1,724
Total	50,172	68,357	96,950	133,583	180,424

Source: Data provided by Japan Automobile Manufacturers Association.

As shown in table 7, General Motors is the largest U.S. exporter to Japan, followed by Ford, Honda USA and Chrysler. All three U.S. auto companies have pursued different strategies to compete in Japan's market. GM sells its cars primarily through Yanase & Co. and Suzuki dealers, and to a lesser extent, through Isuzu dealers.[358] Yanase has a long history of specializing in the sale of imported autos, and has several hundred dealers and associated dealers that sell GM autos. Approximately 70 Suzuki dealers sell GM autos.[359] A GM official stated that this sales network is quite strong, and represents the network that GM will utilize in its long-term sales effort in Japan, given the existing structure of the distribution system for autos.[360]

[357] USITC staff interview with Chrysler, Washington, D.C., Mar. 5, 1990.
[358] Autos are commonly also imported by parallel importers. GM officials in Japan voiced strong opposition to parallel importers. GM officials believe that although parallel importers may increase the price competition for GM cars, they import and market autos in ways that are inconsistent with GM's policies and practices. GM officials believe approximately one-third of GM cars enter Japan through parallel importers.
[359] There are also approximately 15 Isuzu dealers that sell GM products.
[360] USITC staff interview with representative of General Motors, Tokyo, Japan, Feb. 7, 1990.

Table 7
U.S. Automobile Exports to Japan, by brand, 1989

Brand	Units
General Motors:	
Chevrolet	3,323
Pontiac	2,238
Cadillac	1,068
Buick	588
Oldsmobile	14
Total	7,231
Ford:	
Ford Probe[1]	3,283
Other models	2,683
Total	5,966
Chrysler:	
Chrysler	922
AMC	48
Dodge	2
Total	972
Honda:	
Honda U.S.A.	4,697
Other	217
Total	4,914
Total	19,083

[1] Ford Probe is produced jointly with Mazda.

Source: Data provided by Japan Automobile Manufactures Association.

Consequently, free access to the dealerships of Toyota, Nissan, and Honda is not GM's goal, and the company does not necessarily even want its products sold in those dealerships, given the firm's existing distribution strategy. Nevertheless, GM believes that exclusive dealing practices exist, and that full access to the Japanese dealer network would be best for the U.S. auto industry in general.[361]

Ford Motor Co. markets its products through Autorama, Inc., a joint-venture sales channel with Mazda Motor Corp.,[362] in which Ford has 34 percent equity. Autorama sells both imported Ford autos as well as Ford-badged autos produced by Mazda in Japan. Autorama has approximately 290 outlets which sold 5,603 Ford imports in 1989. Ford estimates that the number of Autorama outlets will grow to 500 by 1992. A Ford representative in Japan stated that the company is still assessing the long-term potential of Autorama as a dealership network for Ford autos, and does not discount the possibility of setting up its own distribution network in Japan.[363]

In 1988, Chrysler International Corporation and J. Osawa & Co., Ltd established a joint

[361] Ibid.
[362] In 1979, Ford acquired a 25 percent equity interest in Mazda Motor Corp. USITC staff interviews with representatives from Mazda Motor Corp., Feb. 8, 1990, and Ford Motor Co., Feb. 13, 1990, Tokyo, Japan, indicate that representatives from both firms consider Autorama to be an enterprise operated and managed primarily by Mazda, and one in which Ford exerts relatively little influence.
[363] USITC staff interview with representative of Ford Motor Co., Tokyo, Japan, Feb. 13, 1990.

venture to sell Chrysler and Jeep vehicles in Japan. The enterprise was created with 85 percent investment from J. Osawa & Co., and 15 percent from Chrysler International Corp. The company has approximately 47 outlets in Japan, and is the sole importer and distributor of Chrysler and Jeep vehicles.[384] Honda is currently considering carrying Chrysler trucks in Honda dealerships in Japan.

Relations between Japan's auto manufacturers and dealers

Widespread equity holding in dealers has been stated to be an important means by which Japanese auto companies ensure dealer loyalty. Equity ownership by Toyota, Nissan, and Honda in their dealerships is common, though not an overwhelming characteristic. As shown below, none of the three automakers has complete ownership of more than 37.9 percent of its dealers. Any level of equity ownership is infrequent among Toyota dealers (13.7 percent of all Toyota dealers), while it is higher among Honda and Nissan dealers (46.7 percent and 58.2 percent, respectively).[365] Among the dealers of the three brands in general, equity participation is not present at any level for well over half the dealerships.[366] Toyota and Nissan representatives indicated that equity ownership tends to occur most often in Tokyo and Osaka where land prices are particularly costly for dealers, suggesting that equity ownership is greater in these important market centers.[367]

Manufacturers' Equity in Auto Dealers

Company	*Level of equity by manufacturer*			
		(percent)		
	100	99–50	49–1	0
Toyota	3.8	1.6	8.3	86.3
Nissan	37.9	8.8	11.5	41.8
Honda	27.3	7.6	11.8	53.3

Source: USITC staff interviews with representatives of Japan Automobile Dealers Association.

U.S. automakers rarely have equity in dealers in the United States.[368]

Given the close ties between dealers and producers within distribution keiretsu, equity independence clearly does not necessarily mean that dealers are entirely independent, financially or otherwise, from manufacturers. As is typical of distribution keiretsu in general, auto dealers are believed to be so dependent upon manufacturers for discretionary financial incentives and loans that they will not jeopardize these financial ties by carrying an imported brand. The reputed low profitability of Japanese dealers makes such financial ties particularly important.[369] [370] [371]

Toyota provides sales incentives to its dealers based on sales volume, sales of cars near the end of the model year, and dealer market share within the area of primary responsibility. It is possible that incentives based on market share could create an incentive to carry only Toyota autos since sales of other brands might reduce a dealer's market share (based on Toyota sales), but such a result is not guaranteed. All of Toyota's incentives combined equal about two percent of the sales value of their cars.[372] Manufacturers also provide loans to dealers, but Japanese industry representatives note that dealers more commonly acquire loans from local banks. The overall importance of manufacturer loans to dealers is not clear.[373]

Japanese auto manufacturers sometimes provide their own personnel to dealerships, but the practice is largely related to the level of equity ownership in the dealer. For example, neither Honda or Nissan have such personnel in their dealerships that are independent. Toyota normally dispatches its employees (management and marketing experts) to dealerships in Japan

[384] ACCJ presentation, June 5, 1989.

[365] Toyota has little equity in its dealers largely because after World War II it recruited existing dealers, especially from Nissan by promising to treat the dealers as equals. Nissan never fully overcame a depleted dealer network, and was forced to fund dealerships directly. Michael Cusermano, *The Japanese Automobile Industry*, (Cambridge: Howard University Press, 1985), pp. 124–25.

[366] This is apparently true for the auto industry in general, where 55 percent of the dealerships have no manufacturer equity participation. Letter from representative of JAMA to representative of NADA, Jan. 29, 1990, provided by representative of Toyota Motor Sales, U.S.A.

[367] USITC staff interviews with representatives from the Japan Automobile Dealers Association (Tokyo, Japan, Feb. 7, 1990) indicate that the average cost of setting up a dealership on the edge of Tokyo is several million yen.

[368] USITC staff interview with representative of National Automobile Dealers Association, Mar. 28, 1990.

[369] Batzer and Laumer, p. 179.

[370] Representatives of Toyota, Nissan, and Honda state that these incentives are based strictly on sales targets and market share, and are entirely independent of the dealers decision to carry another brand. Similarly, while all three auto companies provide loans to their dealers, provision of that credit is said to be unrelated to whether or not a dealer carries another brand.

[371] In the past, the JFTC has been concerned with manufacturer incentives. USITC staff interview with representatives of the Japan Automotive Dealers Association, Tokyo, Japan, February 7, 1990.

[372] USITC staff interviews with representatives of Toyota, Toyota City, Japan, Feb. 9, 1990. Toyota representatives acknowledged that, in theory, incentives based on market share might discourage dualing with other brands, but that this is not the effect, mainly because the incentives are relatively small.

[373] Nissan representatives stated that Nissan dealers rarely acquire funds from Nissan. Honda representatives stated that Honda dealers generally get loans from banks. Toyota representatives estimate that in one-half of all instances in which Toyota dealers require capital they acquire those funds from Toyota, while all other times acquiring funds from banks or their own resources.

only if Toyota has 50 percent or more equity participation in the dealership.[374] [375] Thus, like equity ownership, the presence of manufacturers' personnel in dealerships is common, but not predominant.

Manufacturers provide their dealers with a wide range of services and assistance that are similar to those provided by U.S. manufacturers to their dealers. Such services and assistance commonly include educational and training programs (both technical and business related), consultation and advice, advertising support, and credit (or subsidizing of dealer credit) to customers.

Japanese auto manufacturers play a critical role in the decision-making process regarding importation of some autos. For example, the presence of VW Passats in Nissan dealerships is a result of Nissan Motor Company's decision to sell the autos in those dealerships. The decision was made in consultation with dealers who wanted to sell the Passat. Similarly, Honda Motor Co. is making the decision as to whether or not to carry Chrysler trucks through Honda dealers. Officials from the Japan Automobile Importers Association stated that dealers generally prefer the Japanese manufacturers to be heavily involved in the decision to sell imports. Dealers feel more secure when the Japanese manufacturer negotiates the agreement to carry imports, believing that the agreement will be less biased toward the import manufacturer. If the dealers are more certain of the stability of the contract, they will be more willing to invest in the infrastructure required to sell and service the import brand.[376]

Both U.S. and Japanese industry officials believe that there are a variety of marketing reasons that help explain the low sales of U.S. autos in Japan, including the larger size and perceived lower quality of U.S. models compared to Japanese automobiles. Representatives of both GM and Ford note that market demand for U.S. autos is low and that Japanese consumers still have a negative image of the quality, fuel efficiency, and size of U.S. autos.[377] Less frequently noted reasons for limited sales of U.S. cars include failure to produce right-hand drive autos (which are common in Japan), a lack of commitment by U.S. companies to invest the resources necessary to establish an infrastructure to support the product, and the relatively low resale value of U.S. autos in Japan.

Some industry analysts believe that the absence of imported autos from dealerships for Toyotas, Nissans, and Hondas is, at least partly, a result of a business climate that is based on loyalty to one manufacturer. Indeed, a representative of Ford in Japan felt that the lack of imported autos in Japanese dealerships is more a result of dealer loyalty to manufacturers than pressure to be exclusive dealers. Such loyalty to manufacturers cannot be dismissed as insignificant. Other industry analysts believe that while dealer loyalty may be strong, dealers perceive that manufacturers would simply not tolerate a decision to carry another brand of car.

Trade Associations

Japanese firms are highly organized into nationwide, regional, industry specific, trade, and product-line associations. There are approximately 24,000 industrial and commercial associations registered with the Government of Japan. Participation in these associations by Japanese companies is very high, while participation by foreign companies is very low.

Trade associations often play an important role in the development and implementation of industrial and economic policy in Japan. As a result, the lack of foreign participation in Japanese trade associations can be a significant detriment to foreign companies seeking to operate in the Japanese market both by limiting their access to information, and by limiting their influence on policy development.

The chief functions of trade associations in Japan are collecting and exchanging data on a sector or particular product, collaborating on standards setting and research into new materials or products, and representing their industries' interests to the Government of Japan and the media. Trade associations also perform an important semi-official function in providing a focal point for coordination and cooperation with the government in the formulation of policies toward particular industries. Thus, the role of trade associations in the conveying of information and objectives to Government officials is critical in the development of industrial policies which determine the environment in which business operates. While administrative guidance has been described as the means by which the Japanese Government encourages businesses to take actions the Government deems necessary or useful, one commentator suggests that "[a] more accurate description would stress the extent to

[374] Toyota management and marketing experts are dispatched to other dealerships only when they are experiencing operational difficulties, and only at the dealer's request. Once the difficulties are corrected, Toyota withdraws its personnel.

[375] USITC staff interview with representative of Toyota Motor Sales, U.S.A., Inc., Washington, D.C., Mar. 13, 1990.

[376] This view is supported in Cusumano, p. 123, where it is noted that before World War II, many Japanese dealers of GM and Ford cars were unhappy with the way GM and Ford treated them. Toyota was able to recruit many GM and Ford dealers in Japan for this reason.

[377] USITC staff interviews with representative of General Motors, Tokyo, Japan, Feb. 7, 1990; and Ford, Tokyo, Japan, Feb. 13, 1990.

which Government policies reflected the needs and demands of those being 'guided'".[378] Moreover, association executives are usually former industry executives and/or former ministerial officials, who previously engaged in the regulation of the industry in question.[379] This relationship has been identified as encouraging cooperative behavior between industry, trade associations, and the Government. Lack of participation in trade associations may limit foreign business' opportunities to participate in shaping the environment in which they must operate.

Historically, trade associations exercised strong control over Japan's post-war economy. The Trade Association Act of 1948 was passed in order to bring trade associations under governmental supervision. Following the peace treaty in 1952, the provisions of the Trade Association Act were softened, and it was repealed in 1953. Trade associations then became subject to the provisions of Japan's Antimonopoly Law.

Section 2(2) of the Antimonopoly Law defines which associations fall within the purview of the law. Associations subject to the law must comply with certain reporting and/or filing requirements. In addition, trade association activities which substantially restrict competition, limit entry into the market, or cause members to engage in unfair business practices, are prohibited under section 8(1) of the Antimonopoly Law. Violations of the provisions of Section 8 of the Antimonopoly Law may be punished by the issuance of cease and desist orders to trade associations and their members, or by a fine or surcharge imposed on the members.

Exemptions for certain trade association activities from under the Antimonopoly Law were provided in the 1953 revisions. Trade associations of small and medium-sized business were allowed to conduct certain concerted activities, while general associations were permitted to create, under the auspices of the Japan Fair Trade Commission, rationalization or depression cartels to combat adverse conditions in their industries. In addition, export associations formed under the Export and Import Trading Act and export marine industry associations authorized by the Act concerning Export Marine Industry Promotion are exempt from the Antimonopoly Law. In 1979, the JFTC issued a Guide on Trade Association Activities, consisting of an outline of the regulatory system applicable to trade associations, a discussion of the activities of trade associations that may give rise to liability under the Antimonopoly Law, and an outline of the exemptions from application of the Law. In addition, the JFTC has established a preliminary consultation system for trade associations, similar to the Business Review Letter system of the Antitrust Division of the U.S. Department of Justice. Unlike administrative guidance in other contexts, the JFTC's negative clearance system involves written opinions, which are subsequently published, but have no binding force.

It is generally believed that trade associations in Japan may restrain competition by providing a forum for members to coordinate and/or restrict the activities of members and by reducing the business opportunities of nonmembers. Collectivist behavior by trade associations has also led to the formation of clandestine cartels and facilitated other exclusionary business practices, such as enforcing exclusive dealing and boycott-type actions. Association-based cartels have frequently been charged by the JFTC with conspiring to fix prices, adjust production, and allocate market share. In fact, nearly one half of the over 700 cases decided by the JFTC between 1947 and 1979 involved Antimonpoly Law violations by trade associations and their members. They are also thought to create barriers to the entrance of foreign competitors into the Japanese markets through standard-setting and other aspects of their activities.[380] A provision of the new tax law allows the formation of "consumption tax cartels" through which companies will be permitted to consult on how to incorporate the new three percent consumption tax into their pricing during a three year transition period. Numerous industry and commercial trade associations have registered under this provision, arousing fears that the consumption tax cartels may be used as a cover for wide-spread price fixing.

Participation in Japanese industry associations by U.S. and other foreign companies located in Japan is at a low level. Of the more than 40 U.S. firms registered with the American Chamber of Commerce in Japan, only 4 are members of the Japan Chemical Association, and 2 of these are represented by their Japanese joint-venture partner. Similarly, the 34 member Japan Petrochemical Association and the Soda Ash Industry Association, which has been investigated several times for Antimonopoly Law violations,

[378] Haley, "Administrative Guidance versus Formal Regulation: Resolving the Paradox of Industrial Policy," in Saxonhouse and Yamamura, eds., *Law and Trade Issues of the Japanese Economy* 108 (1986).

[379] The practice of "amakudari," literally, the "descent from heaven," whereby ministry officials nearing retirement age (55) are assisted and placed by their ministry in industry, and trade associations, is ubiquitous in Japan. Prestowitz, pp. 113, 117.

[380] A recent example of a concerted exclusionary practice which may have been facilitated by the existence of an industry association involved an American manufacturer who was temporarily unable to place advertisements for its products with either of the industry's two trade journals due to pressure directed at the journals by the Japanese industry.

do not include American participation. Possible reasons for the low level of participation by foreign firms, despite the seeming advantages of association membership for firms attempting to do business in Japan, are: (1) the requirement that firms be incorporated in Japan, (2) membership dues, and the fact that association activities are conducted in Japanese.[381] Resistance by Japanese member firms does not appear to be a major factor, although some associations approve membership on a recommendation basis. Perhaps more troublesome from the perspective of American business executives who might contemplate membership is concern over possible difficulties as a result of the extra-territorial application of U.S. antitrust law to U.S. business activities overseas. Such concerns appear based on the belief that trade associations are involved in price-setting, market allocation, or other collusive behavior.

Cartels

Any discussion of cartels in the Japanese economy must recognize the basic principle that, in certain circumstances, cartels are legal in Japan. Historically, Japanese industry was highly concentrated and cartelized. While the original Antimonopoly Law, enacted at the instigation of American occupying authorities following World War II, clearly prohibited collusive behavior through cartels, the goal of achieving rapid economic growth as viewed by the industrial ministries quickly came into conflict with the anticartel policies of the Antimonopoly Law. Among other things, the 1953 revisions to the Antimonopoly Law, enacted largely at MITI's instigation, permitted formation of cartels to aid firms in a "recession," and to enable them to "rationalize" their productive capacity. "Recession" was broadly defined, and "rationalization" cartels could be authorized if the firms in an industry wanted to make investments to increase their productivity and to catch up with Western levels. Requests to form cartels could be initiated by a group of firms or a trade association, and the authorization power was largely in MITI's hands.

MITI's cartelization authority gave legitimacy to a number of cartels that had been formed earlier pursuant to administrative guidance. The trend of the number of authorized recession and rationalization cartels increased through the 1950s, to a peak in 1966 when 16 "recession" cartels and 14 "rationalization" cartels were in effect.[382] In addition to the authorized "recession" and "rationalization" cartels, numerous legal cartels were authorized by industry-specific laws enacted during the 1950s and 1960s to "promote," "stabilize," or "adjust the demand and supply" in the industries selected. The industries involved included shipbuilding, cement, iron, steel, chemicals, machinery, electronics, and textiles. The principal goals of such authorized cartels were to increase investment, rationalize production through the achievement of economies of scale, and increase economic growth. Consequently, the number of legal cartels in Japan rose steadily from 162 in 1955 to a peak of 1,079 in 1966, declining thereafter to 509 in 1982.[383] By 1988, there were some 310 cartels legally exempt from Japan's Antimonopoly Law, including 2 depression cartels, 1 import cartel, 53 export cartels, 185 small-and medium-sized firm related cartels, 53 cartels authorized under the environment sanitation act (i.e., barbers), and 16 cartels authorized under other laws.[384] As of November 1989, there were 265 cartels exempted by the JFTC.[385]

In addition, extralegal collusive activities were also being practiced pursuant to ministerial administrative guidance, involving price fixing, output reduction, and other concerted activities relating to investment, market share, adoption of technologies, and purchasing (including importation) of raw materials. At the same time, prosecution of illegal cartel activities by the JFTC dropped sharply. For example, surcharges assessed against Antimonopoly Law violators have dropped dramatically in recent years. Taking note of the fact that surcharges assessed in 1981 were higher than they were in any of the following years, the sum total of surcharges assessed from 1977 to 1987 was about 9.8 billion yen, or about $65.3 million at an exchange rate of 150 yen to the $1.00. The exchange rate was significantly weaker than that for much of the period, thus the fines actually translate into an even lower dollar amount.[386] The reason for the decline, according to the JFTC, is growing awareness of the penalties that were introduced in 1977. JEI, however, states:

> Others believe that the FTC basically caved in to political pressure and eased up on price-fixers and other violators of the Antimonopoly Law. . . The sanctions themselves are a drop in the bucket in terms of overall economic activity in Japan. The total amount levied over 10 years is far less than the annual profit of a single large Japanese company. . ."[387]

[381] The entrance fee for the Japan Chemical Association is $1,500, and dues vary between $1,500 and $15,000 annually. U.S. Department of State Telegram, Apr. 12, 1989, no. 06504. Although membership dues may not be high relative to business assets or profits, it may not be worthwhile for foreign firms to pay to join an association whose affairs are conducted in Japanese.

[382] Hahn, *Japanese Business Law and the Legal System* 136 & Table 7.2 (1984).

[383] Ibid.

[384] As reported by Douglas Ostrom, "Japan's Competition Policies," *Japan Economic Institute Report*, No. 20A, May 19, 1989, p. 11, based on data from the JFTC.

[385] "Fair Trade Commission: Will Japan's Corporate Watchdog Finally Learn to Bark?," *Japan Economic Journal*, Apr. 14, 1990, p. 5.

[386] Ostrom, p. 9.

[387] Ibid., 9–10.

As is evident from this description, the tendency toward concerted and collusive behavior is strong in Japan, and was officially supported for a long period. This is quite in keeping with the history of Japanese industrial growth, and a general cultural bias toward group behavior. Consequently, it was not until the recession of the mid 1970s, following the oil crisis of 1973, and the deceleration of growth in the Japanese economy, that it became apparent that policies of promoting cartelization to foster economic growth might be counterproductive. Following the 1977 revisions to the Antimonopoly Law, the JFTC became more active in investigating and prosecuting violations of the Law involving cartel activity. Horizontal collusive activities by cartels have received more attention than have vertical activities, although recently this priority seems to have shifted. The successful criminal prosecution of oil supply companies for price fixing following the 1973 oil crisis is indicative of further strengthening the JFTC's bargaining position in informal "administrative guidance" over cartel activity. Nevertheless, cartels are still permitted under the Antimonopoly Law, and the 1978 Designated Recession Industries Stabilization Act and other special laws continue to provide for the formation of legal cartels pursuant to MITI or JFTC approval.[388]

Notwithstanding the developments in the 1970s and 1980s, the anticompetitive impact of cartels and other concerted actions by Japanese firms and industry associations remains a major concern of foreign firms seeking to penetrate the Japanese market.

Distribution-Related Public Policies

Antimonopoly Law

The Law Relating to Prohibition of Private Monopoly and Methods for Preserving Fair Trade of 1947, commonly called the Antimonopoly Law, was originally passed under pressure from U.S. occupation authorities after the Second World War seeking to ensure that a revival of the concentrated economic power of the prewar "zaibatsu" would not take place. Based in large part on provisions of U.S. antitrust statutes such as the Sherman, Clayton, and Federal Trade Commission Acts, Japan's Antimonopoly Law incorporated much of then-current American thinking about the proper role of antitrust law in a nation's economy. However, in many of its original provisions, the Antimonopoly Law was more restrictive than U.S. law. For example, original Article 8 imposed a per se standard against monopolies, while U.S. law only operated against attempts to monopolize or abuse monopoly power under a "rule of reason."[389]

In the context of a Japanese historical and business environment based on cooperation and consensus and tolerant of horizontal collusive behavior, the Antimonopoly Law was something of an anomaly. Moreover, the tension between industrial policy, designed to foster industrial production and economic growth, as established by the various government ministries, including MITI, and an antitrust policy designed to foster competition in the interest of consumers, continues to this day. The generally lax enforcement of the antimonopoly laws in Japan, compared to that of most Western industrialized countries has resulted in little official restraint on business activities that operate to the disadvantage of potential entrants, particularly foreign ones.

Since its enactment, Japan's Antimonopoly Law has undergone several revisions.[390] The first major amendment to the law, in 1949, removed the ban on intercorporate stock ownership, eased the restrictions on mergers and acquisitions, and relaxed the restrictions on interlocking directorates. In addition, the approval authority of the Japan Fair Trade Commission (JFTC) over mergers was changed to a prior notification requirement. In 1953, additional substantial revisions to the Antimonopoly Law weakened the original thrust of the law. In addition to further easing of the provisions on intercorporate stock ownership and interlocking directorates, the amendments legalized certain types of cartels ("depression" and "rationalization" cartels), legalized resale price maintenance contracts in connection with certain consumer goods in daily use, as well as for copyrighted and trademarked goods, and abolished the Trade Association Act, incorporating its provisions concerning illegal cartel activities in the Antimonopoly Law.

During the 1950s and 1960s, numerous special laws were enacted exempting certain activities in specific industries from the provisions of the Antimonopoly Law.[391] In addition to legal

[388] One recent example involves the rush to form "consumption tax cartels" under the provision of the new tax law which allows companies to consult on how to incorporate the new three percent consumption tax in their pricing during a three year transition period.

[389] Sherman Act, Section 2, 15 U.S.C. § 2, *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945); *Standard Oil Co. of New Jersey v. United States*, 221 U.S. 1 (1911).

[390] Ariga, Japan, ¶¶ 2.01-2.07, in *Competition Laws of the Pacific Rim Countries*, 1989.

[391] Numerous "special industry" cartels were formed pursuant to these exemption laws. The power to allow such cartels was granted to specific government ministries, including the power to coerce companies into joining the cartels. Several thousand such cartels were authorized and formed during the 1960s and 1970s. Hahn, *Japanese Business Law and the Legal System* 138-39 (1984). The number has declined significantly since then. However, the decline in the number of approved cartels does not necessarily mean that the importance of cartels has diminished. One leading

cartels authorized by special exemptions or as depression or rationalization cartels, numerous industries, particularly basic industries comprised of large companies, undertook production curtailments in the 1950s, pursuant to administrative guidance issued primarily by MITI.[392] The JFTC frequently criticized such production curtailments as being in violation of the Antimonopoly Law. However, no prosecutions or punishments were ever instituted, largely because of the lack of evidence of collusion by the companies. During the 1960s, MITI policy encouraged mergers in an effort to build up enterprises large enough to compete with the leading enterprises in the United States and Europe, despite the JFTC's efforts to control mergers in fear of excessive concentration and resulting oligopoly power.[393]

However, the resulting publicity, and a growing appreciation of the importance of competition policies, resulted in a new revision of the law in 1977 which strengthened its provisions.[394] Amendments included imposition of surcharges on undue profits arising out of illegal price-fixing arrangements, increased fines, and reporting requirements in cases of parallel price increases by leading enterprises in concentrated industries. In addition, the JFTC was authorized to order corporate dissolution or divestiture if concentration in an industry is accompanied by barriers to entry, lack of downward price movements, and unusually high profits.

> Article 1 of the Antimonopoly Law sets forth its overall objectives: This Law, by prohibiting private monopolization, unreasonable restraints of trade and unfair methods of competition, by preventing excessive concentration of power over enterprises and by excluding undue restriction of production, sale, price, technology, etc. through combinations and agreements, etc. and all other unreasonable restraints of business activities, aims to promote free and fair competition, to stimulate the initiative of entrepreneurs, to encourage business activities of enterprises, to heighten the levels of employment and national income and, thereby, to promote the democratic and wholesome development of the national economy as well as to assure the interest of the general consumer.[395]

Article 3 of the Antimonopoly Law prohibits unreasonable restraints of trade and private monopolization. Article 2(6) prohibits unreasonable restraints of trade by cartels through price fixing, limiting production, or limiting access to technology, facilities, supplies, or the output market. Article 2(9) provides that corporations with an unduly disproportionate bargaining power in a given product market could be dismembered. Article 2(9) further prohibits specific unfair methods of competition such as refusals to deal, undue price discrimination, charging unduly low prices with the intent to drive out competition, coercing, exclusive dealing, resale price maintenance, and establishment of sole agency contracts. Many of these practices are not deemed per se violations of the Antimonopoly Law, but are judged by the reasonability of the behavior in the particular circumstances. The Antimonopoly Law also proscribes cartels among entrepreneurs (Article 3), trade association (Article 8(1)), and, in principle, price and output cartels (Article 8-3).[396] Article 10, paragraph 1 prohibits acquisitions of shares resulting in substantial restraints of trade, and Articles 15 and 16 prohibit mergers and purchases having the same effect.

Articles 27 et seq. of the Antimonopoly Law establish the Japan Fair Trade Commission (JFTC). The JFTC is an independent administrative and quasi-judicial body, responsible directly to the Prime Minister, although lacking cabinet rank.[397] Its members are appointed by the Prime Minister, with the consent of both houses of the Diet. The JFTC has primary jurisdiction to administer antitrust laws in Japan.[398] JFTC investigations originate in

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[391]—*Continued*
antitrust scholar in Japan has argued that the importance of cartels since 1977 has remained fairly constant, since the ratio of manufacturing industry shipments covered by legal cartel arrangements to total manufacturing shipments has remained fairly constant. *Id.* at 140, citing Matsushita, "The Antimonopoly Law of Japan," paper presented at the Federal Bar Association U.S.-Japan Trade Law Conference, June 6-7, 1979.

Moreover, even though legal cartels are authorized for only a limited time, their effects may last far longer. A U.S. embassy official commented "Cartel[s] may expire early. But they are usually based on membership in trade associations, so it is not that hard to fix prices anyhow." USITC staff interview with U.S. embassy official in Tokyo, Jan. 30, 1990.

[392] Hiroshi "Antitrust and Industrial Policy in Japan: Competition and Cooperation" in Saxonhouse and Yamamura, eds., *Law and Trade Issues of the Japanese Economy* 56 (1986).

[393] Matsushita "*The Antimonopoly Law of Japan*" 11 *Law in Japan* 58 (1978).

[394] Ariga "Japan" ¶¶ 2.01-2.07, in *Competition Laws of the Pacific Rim Countries*, 1989.

[395] Ostrom quoting Hadley, *Antitrust in Japan* 121 (1970).

[396] These latter have, since 1977, been subject to a mandatory surcharge (Article 7-2).

[397] The structure of the JFTC, as an administrative agency outside of the Cabinet, following the American model, is in part responsible for its relative lack of power in Japan. The JFTC's pursuit of competition policies has resulted in frequent clashes with ministerial pursuit of industrial policies, particularly by MITI. However, the JFTC's influence appears to be on the upswing since its successful criminal prosecution of petroleum wholesalers for price fixing. In its 1980 decision affirming the price fixing convictions, the Tokyo High Court severely criticized administrative guidance concerning production restrictions as inducing Antimonopoly Act violations. Hahn, *Japanese Business Law and the Legal System* 141

one of three ways: follow-up of private complaints, violation reports from the Procurator General, or independent initiation of investigations by the JFTC staff. Although the Antimonopoly Law provides for private antitrust actions and possible criminal penalties, as well as damages under general tort principles, these provisions have been ineffective.[399] Unlike U.S. antitrust law, the Antimonopoly Law does not provide for treble damages. Moreover, the structure of the Japanese legal system, which prohibits class action suits for damages, limits discovery, and imposes high costs for trial, discourages private actions as well.[400]

Following a determination that the Antimonopoly Law has been violated, the JFTC usually issues a recommendation finding, indicating voluntary measures to be taken to remedy the violation. If the recommendation finding is not followed, formal proceedings are instituted in which the JFTC acts as the decision-maker. Defendants may accept a consent decree, or await a formal decision. Formal decisions may be appealed to the Tokyo High Court. Of the 733 cases decided by the JFTC between 1947 and 1981, 69 were formal decisions, 108 were consent decisions, and 544 were recommendations.[401] In addition, the JFTC may issue "warnings" or "cautions" to firms or trade associations when it believes their activities may result in Antimonopoly Law violations.[402] Violations of the provisions of the Antimonopoly Law may be punished by the issuance of cease and desist orders, and criminal prosecutions (which are rare) in certain circumstances. In addition, a fine or surcharge requiring a portion of the profits from the unlawful conduct to be paid to the government may be assessed in cases involving unreasonable restraints of trade which relate to prices or affect prices by curtailing supply.[403]

In addition to investigations and decision-making, the JFTC has, pursuant to section 19 of the Antimonopoly Law prohibiting unfair business practices, issued and periodically revised a designated list of business practices considered to be "unfair." The JFTC's Notification No. 15 of 1982 replaced the 1953 list of unfair business practices, and expanded it to 16 items. The practices detailed in the notification may be classified into three broad categories, (1) practices by which monopoly power is created or maintained, (2) practices amounting to abuse of monopoly power, and (3) practices in contravention of commercial ethics. Specifically, the notification lists undue refusals to deal (including primary and secondary boycotts), price discrimination, inducing customers of a competitor by means of offering an undue advantage, exclusive dealing, vertical restrictive dealing, including resale price maintenance, interfering with the transactions of a competitor, and interfering with the internal affairs of a competitor.[404] The Antimonopoly Law does not provide for criminal penalties for violations of section 19, and thus the JFTC is limited to issuance of cease and desist orders.[405]

Since enactment of the Antimonopoly Law, there has been limited political support for active antitrust enforcement. According to one authority on Japan's legal system:

> . . . antitrust-law enforcement can hardly be described as vigorous, at least in the American sense. While the Japanese Fair Trade Commission regularly commences administrative actions against alleged violators of the antitrust laws, most of these cases end in consent decrees and their total number is relatively small compared to the number brought by government agencies in the United States. Private enforcement, moreover, is almost unheard of. . .[406]

The JFTC's actions have been more vigorous since the 1977 revision of the Antimonopoly Law, with greater emphasis on non-manufacturing sectors of the economy. One of the JFTC's

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[397]—*Continued*
(1984). Subsequently, the JFTC issued a policy statement in March 1981 stating that administrative guidance without a specific legal basis which affects vital market conditions such as price or production volume would likely induce cartel agreement and cannot be accepted from an antimonopoly standpoint. The JFTC further stated that even though such guidance was issued to each entrepreneur individually, there was always a danger of cartel agreement present. Iyori and Uesugi, *The Antimonopoly Laws of Japan* 57-58 (1983).

[398] Thus, in effect, the JFTC combines the functions of the Federal Trade Commission and the Antitrust Division of the Department of Justice in the United States.

[399] As of 1983, 5 civil suits for damages had been filed under the Antimonopoly Act. Of these, three resulted in out of court settlements, while plaintiffs lost the other two cases. Iyori and Uesugi, *The Antimonopoly Laws of Japan* 127 (1983).

[400] Hahn, *Japanese Business Law and the Legal System* 132-33 (1984).

[401] Iyori and Uesugi, *The Antimonopoly Laws of Japan* 163, 167 (1983).

[402] *Japan Economic Institute Report* No. 7B, Feb. 16, 1990 at 7. In recent years, the number of warnings and cautions has been significantly greater than the number of recommendations, suggesting that business activities are scrutinized for possible anticompetitive behavior.

[403] Iyori and Uesugi, *The Antimonopoly Laws of Japan* 54-56 (1983). Surcharges are based on the prices of and "turnovers" in the goods or services involved during the period in which the unfair practice was occurring, and range between one and four percent. Ibid. at 55.

[404] Iyori and Uesugi, *The Antimonopoly Laws of Japan* 266 (1983).

[405] Between 1953 and the issuance of Notification No. 15 in 1982, the JFTC rendered decisions in 69 cases of alleged unfair business practices. Iyori and Uesugi, *The Antimonopoly Laws of Japan* 96 (1983).

[406] Michael K. Young, "Comment," in Thomas A. Pugel, ed., *Fragile Interdependence* (Lexington, Mass.: Lexington Books, 1986), p. 77.

primary concerns in recent years has been the prevention of resale price maintenance by manufacturers through the distribution keiretsu. Previously, the JFTC's efforts had been concentrated on horizontal price-fixing and other collusive activities.[407] In September 1978, the JFTC established a group of scholars and journalists who, with the assistance of the JFTC staff, were directed to develop a theoretical framework for handling manufacturer controlled restraints on competition in the distribution sector. The group issued its report on March 17, 1980.[408] The report is not an official guideline of the JFTC, although its use has been endorsed as a "textbook" for reference within the agency and as an informal guide for manufacturers.[409]

Because of the tendency of Japanese firms to accept recommendation findings or consent decrees, few cases involving distribution activities have been decided by the Japanese courts. However, from those, a few principles can be discerned. In the "First Powdered Milk" cases, the Japanese Supreme Court affirmed JFTC rulings that resale price maintenance agreements violate the Antimonopoly Law. In the "Second Powdered Milk" cases, the JFTC issued a formal decision holding that an arrangement whereby manufacturers insisted on exclusive dealing by wholesalers and made specific customer assignments to wholesalers violated the Antimonopoly Law. Other decisions and recommendation findings of the JFTC indicate that resale price maintenance arrangements in conjunction with exclusive dealing requirements and assignments of sales territories violate the Antimonopoly law. Beyond these decisions, however, there appears to have been little formal intervention of the JFTC in the distribution system, and consequently relatively little direct impact of the Antimonopoly Law on anticompetitive aspects of the distribution system.

Recently, the JFTC has been showing increased interest and activity. In addition to proposing increased fines as penalties for unfair business practices, the JFTC has instituted a new study group on unfair business practices. In the past, such study group reports have resulted in revisions of the JFTC's policies and guidelines. The most recent budget calls for increased funds for JFTC activities, suggesting a more general governmental recognition of the importance of enforcement of the Antimonopoly Law, as does the most recent commitment to enhanced enforcement of the Law.[410]

However, some analysts, including well-known Japanese experts on the distribution system, doubt that stricter enforcement of the Antimonopoly Law and a reduction in unfair business practices will actually occur, at least in the near future. For example, the *Japan Economic Journal* recently reported:

> . . . the agency's [JFTC's] low status, its lack of resources and lack of public support will inhibit stricter enforcement of the 1947 Anti-Monopoly Law. . . said Kenji Sanekata. . ."I think there will hardly be an effect (of the revision) unless the FTC really uses its stronger powers". . . Karel van Wolferen added: Trying to enforce the Anti-Monopoly Law would mean taking away the cornerstone of the Japanese edifice. The whole idea is nonsensical" . . . Masu Uekusa. . . said the FTC is too willing to make exceptions and to allow firms to form cartels.[411]

The number of violations of the Antimonopoly Law found by the JFTC declined from 30 in 1975 to only 6 in 1987. According to the Japan Economic Institute, "[i]n FY 1986 and FY 1987, no price-fixing violations by wholesalers were found despite the appreciation of the yen and the likelihood that at least some firms made extraordinary efforts to maintain prices notwithstanding lower yen-denominated costs for their imported products."[412]

Unlike the United States, private antitrust suits in Japan are rare and at best result in small settlements:

> Antitrust law in the United States functions in part as a set of rules governing transactions between enterprises. Consequently, there are many private antitrust actions. In contrast, the Antimonopoly Law in Japan is viewed as a regulatory statute to be administered by the FTC. There are few private suits.[413]

The JFTC's lack of political support by the LDP and consequent low level of funding compared to ministries and other government agencies may contribute to relatively weak enforcement of antitrust policies:

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[407] Amanda Covey, "Vertical Restraints under Japanese Law: The Antimonopoly Law Study Group Report" 14 *Law in Japan* 56 (1981).

[408] Report on the Treatment of Distribution Channelization under the Antimonopoly Law.

[409] After compiling digests of major cases, summarizing leading economic and legal theories, considering market studies of five industries, and surveying government policy toward distribution restraints in the United States and Europe, the report lists eight "typical" practices used by manufacturers to channelize distribution and outlines standards for judging the legality of the practices. Covey, "Vertical Restraints under Japanese Law: The Antimonopoly Law Study Group Report" 14 *Law in Japan* 49 (1981).

[410] U.S.-Japan Working Group on the Structural Impediments Initiative, *Interim Report and Assessment*, Apr. 15, 1990, at 21.

[411] "Fair Trade Commission: Will Japan's Corporate Watchdog Finally Learn to Bark," *Japan Economic Journal*, Apr. 14, 1990, p. 5.

[412] Ostrom, p. 9.

[413] Iyori Hiroshi, "Antitrust and Industrial Policy in Japan: Competition and Cooperation," in Gary R. Saxonhouse and Kozo Yamamura, *Law and Trade Issues of the Japanese Economy*, p. 63.

For years' Japan's Fair Trade Commission has been regarded as a toothless watchdog, cowed by big business. and the nation's bureaucracy. . . And that's unlikely to change in the near future, according to commentators, despite recommendations of the Structural Impediments Initiative (SII) interim report.[414]

In addition, the public's view of the legal environment may also play an important role. According to press reports, the JFTC chairman, Setsuo Umeazawa has stated, "Such legal action [criminal prosecution] does not fit in Japanese society, where lawsuits are discouraged."[415]

Restrictions on Sales Promotions

As originally enacted, section 2(9)(iii) of the Antimonopoly Law provided for the designation by the JFTC of unfair business practices in contravention of commercial ethics. In 1962, in order to better attain the purposes of that section, the Act Against Unjustifiable Premiums and Misleading Representations was passed. The act provides that the JFTC, by notification, may restrict or prohibit the types or amounts of premiums offered, as well as the offering of prizes by lotteries or similar schemes. In general, a maximum of 2 percent of the sales price of goods or services can be spent for premiums, and the offering of premiums exceeding 100,000 yen annually by manufactures, producers, or wholesalers of designated goods (primarily consumer goods) is generally prohibited. The JFTC has issued specific notifications restricting or prohibiting the offering of premiums in specific industries, including newspaper, chocolate, cameras, chewing gum, cosmetic soap, household electrical appliances, agricultural machinery, automobiles, and tires.[416]

In addition to JFTC actions, including notifications, hearings concerning violations, and issuance of cease and desist orders, Section 10 of the Act provides that entrepreneurs or trade associations may enter into fair competition agreements (Competition Codes) in order to prevent unjustifiable premiums and misleading representations if the JFTC approves the agreement. Such agreements specify rules or standards for premiums in a specific industry, and usually establish an intra-industry supervisory body to monitor violations, with the power to assess penalties. There are currently approximately 50 Competition Codes promulgated by some 29 industry associations, in addition to the general guidelines established by JFTC notifications. As a rule, the industry codes are more detailed, and more restrictive, than the statutory requirements.

The original purpose of the limitations on premiums and other sales promotions was to prevent fraud, ensure that competition was based on price, and to avoid "excessive competition." There have been complaints, however, that the limitations, especially under the Competition Codes promulgated by industry associations, unduly restrict marketing efforts with respect to new products, and particularly imported products. An April 1986 study conducted for MITI on Japan's distribution system noted:

> . . . it is felt that lenient enforcement of the regulations against giveaways and premiums would work to the advantage of the companies that have already achieved strong market positions and would make it more difficult for foreign firms to achieve market entry. This danger is especially evident for companies from countries where giveaways and premiums are regulated in principle, since they are not familiar with competitive market strategies utilizing such giveaways and premiums and would thus be at a disadvantage.[417]

In general, restrictions on premiums and sales promotions appear discriminate against all new entrants, whether foreign or domestic and make it more difficult to enter the market.

Restrictions on Retail Distribution

Small businesses in Japan have long had tremendous political influence. Their pressure on the ruling Liberal Democratic Party (LDP) in the 1970s led to the enactment (1973) and then strengthening (1978) of the Large Scale Retail Store Law.[418] The Law was intended to check the expansion of large retail stores, such as department stores and supermarkets, in order to facilitate the adjustment of local retailers to new competition.[419] Such large stores already carry more imports than their smaller counterparts, and appear to be in a better position to expand them in the future.

Expansion of large retailers has slowed considerably since passage of the Large Scale Retail Store Law. Moreover, no foreign-owned or managed retail store has ever opened under the Large Scale Retail Store Law. Partly because of their lack of representation in the store review process, Japanese consumers appear to face higher prices and limited choices. Foreign suppliers may also suffer to the extent that the

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[414] "Fair Trade Commission: Will Japan's Corporate Watchdog Finally Learn to Bark?, p. 5.

[415] Ibid.

[416] There has recently been a loosening of the restrictions imposed on premiums in the chocolate industry. U.S. Department of State Telegram, Tokyo, Apr. 13, 1988, no. 06650.

[417] Tsuruta, et al, p. 27.

[418] Officially, the Law Concerning the Adjustment of Retail Business Operations in Large-Scale Retail Stores, Law No. 109 of Oct. 1, 1973.

[419] Katsuro Kitamatsu, "Takeshita Poised to Blaze Trail Through Distribution Labyrinth," *The Japan Economic Journal*, July 9, 1988, p. 4.

regulations make it harder for new entrants to crack the large and growing Japanese market for consumer goods. This section will discuss the formal Japanese government restrictions on retail distribution and their potential impact on new entrants, particularly foreign ones.

Legal Requirements and Application of the Large Scale Retail Store Law

The central government's Large Scale Retail Store Law (*Daitenhou*) was enacted in 1973, primarily in response to pressure from small- and medium-sized stores for legislative protection from the expansion of superstores during the 1960's.[420] The law currently requires any proposed store with planned sales space of over 500 square meters (or 5,400 square feet) to notify MITI or the local authorities before beginning operations.

The 1973 Large Scale Retail Store Law originally applied only to the opening of stores over 1,500 square meters (in larger cities, the threshold is 3,000 square meters). The Law was amended in 1978 to expand its purview to stores between 500 and 1,500 square meters, slowing a boom in medium-sized grocery chains begun during the 1970s. Stores larger than 1,500 square meters (16,146 square feet), or 3,000 square meters in the case of large cities[421] became "class one" stores and are under the direct jurisdiction of MITI. Stores between 500 and 1,500 square meters (or 500–3,000 square meters in the case of large cities)[422] became "class two" stores and "are under local government jurisdiction."[423]

The law itself only requires retailers planning to open or expand stores beyond the established limits to "notify" the authorities in writing of their plans at least seven months before the store's projected opening (Art. 3 and 5).[424] Certain other activities—renovations and enlargements of existing stores (Art. 12) and changes in hours or monthly and annual days of operation (Art. 10)—also may require notification and adjustment under the law.[425] Upon receipt of the required notifications, MITI is to "consider the impact on retail businesses in neighboring areas" of the proposed store opening (Art. 7), in consultation with the local chamber of commerce and other community interests. After doing so, "the Minister or other authorities concerned" are empowered by the Law to issue recommendations or orders[426] to the prospective retailer regarding "the opening date, floor space, closing time, and number of mandatory holidays."[427]

Continued dissatisfaction by small retailers led MITI to issue supplementary regulations or "guidance" that significantly tightened its application of the Law. In 1979, MITI issued administrative guidance requiring prospective store operators to submit Article 3 notifications at least 13 months before the planned opening date, as opposed to the law's requirement for 7 months prior notice.[428] MITI issued administrative guidance in January 1982 that required new store owners to hold an information meeting with local retailers and consumers that might be affected by the proposed store.

A separate set of 1982 administrative guidance "established guidelines for the size of stores that could be opened in cities of varying population" and expanded the consultative role of localities in the adjustment process.[429] The guidance called upon retailers to exercise

[420] Prior to 1973, there were two other laws restricting the expansion of department stores. One was passed in 1937 and repealed in 1947. Another law was passed in 1956 and repealed by the 1973 law. For an in-depth discussion of the history and recent administration of the Large Scale Retail Store Law, see Frank K. Upham, "Legal Regulation of the Retail Industry: The Large Scale Retail Stores Law and Prospects for Reform," Harvard University Program on U.S-Japan Relations Occasional Paper No. 89-02.

[421] Takatoshi Ito, "Is the Japanese Distribution System Really Inefficient," paper presented at the National Bureau of Economic Research conference on The U.S. and Japan: Trade and Investment, Oct. 19 and 20, 1989, p. 15.

[422] Ibid., p. 15.

[423] Specifically, the prefectural governor's office was given the right to review the prospective store's application. Upham, pp. 14 and 44.

[424] "According to Article 5 of the Large Retail Store Law, the owner or operator of a proposed store with sales floor space of more than 1,500 square meters (16,146 square feet) must submit an application to the Ministry of International Trade and Industry at least five months before the planned opening; a company interested in opening a store with a selling area between

[424]—*Continued*
500 square meters (5,382 square feet) and 1,500 square meters is subject to the same requirement but the application goes to the prefectural government. If the planned store is part of a mall or similar shopping complex, the contractor must submit an application to either MITI or the prefectural government (Article 3), depending on the size of the store, before the store files its application under Article 5." This notification must be submitted at least seven months prior to the store's expected start of operations. Takahashi, p. 7. Upon receipt of said request, MITI is required to notify surrounding retailers and post a public notice stating that "retail activities in the proposed building are subject to adjustment under the Law." Article 4 prohibits retail activity in the building for seven months after MITI's public notice. Upham, p. 10.

[425] Flath, p. 3.

[426] According to Frank Upham, "An Article 7 recommendation is entirely voluntary. Its recipient has no legal duty to obey or respond, and the recommendation itself is not a legally cognizable act under Japanese administrative law. If the recipient does not agree to the terms of the recommendation, however, Article 8 of the Law gives MITI the power to order compliance if it determines that there is the likelihood of severe injury to the interests of local small and medium retailers....Other articles give MITI additional recommendation powers for particular business activities that it finds deleterious to the interests of local merchants." Upham, p. 6-7.

[427] "The Distribution System in Japan," (MITI), May 1989, p. 16.

[428] Upham, p. 15.

[429] MacKnight, p. 8.

"self-restraint" in opening stores in towns and cities already having a high concentration of large retailers. MITI also established annual limits for increases in total floor space for certain specified retail companies and created a formula to evaluate individual store applications based on the size of the proposed retail facility, the size of the community, and the number and size of stores already serving the community.[430] MITI defined a specific threshold to identify especially large firms whose applications for further expansion were to be discouraged and used administrative guidance to "slow the spread of supermarket chains."[431]

MITI's actual administration of the law has been much stricter than the letter of the law and then its administrative guidance would suggest, however. The timetables contained in the law and guidance might lead one to believe that the entire notification and adjustment process could be completed within fourteen to twenty months from the date of submitting notification. In practice, however, the process typically drags on for years, primarily as a result of MITI's unofficial practice of not even accepting formal notification under the law until the prospective retailer demonstrates that all potentially affected merchants in the surrounding area have withdrawn their objections to the project.[432] This administratively-granted influence gives mom and pop stores a vehicle for delaying a new store's opening, or thwarting it entirely.[433] The most common scenario, however, is for existing store operators to use the "pre-notification" process to exact concessions from prospective store operators, such as scaling down the store's size, restricting hours and days of operation, and obtaining agreement to lease space on favorable terms or to contribute to local shopping district improvements.[434]

Local authorities, such as the cities of Tokyo and Osaka, also restrict expansion of large retailers, usually affecting stores in the 200–500 square meter range (2,153 to 5,400 square feet). The *Nihon Keizai Shimbun* has reportedly estimated that more than 60 percent of local governments have imposed limits on the opening of "medium scale" retailers of between 200 and 500 square meters.[435] Another source estimates that "twenty of Japan's 47 prefectures have put on the books stronger regulations than MITI's, while 233 municipal governments have their own versions."[436] Tokyo city and its individual wards each have issued administrative guidance imposing limits on retailers over and above those contained in the 1973 Law. These restrictions are not just based on size: some local governments have special restrictions against retailers with large firm affiliations and against those who own any store larger than 1,500 square meters.[437] Even small stores can be subjected to local scrutiny if they are owned by nonresidents[438] or affiliated with convenience store chains.[439]

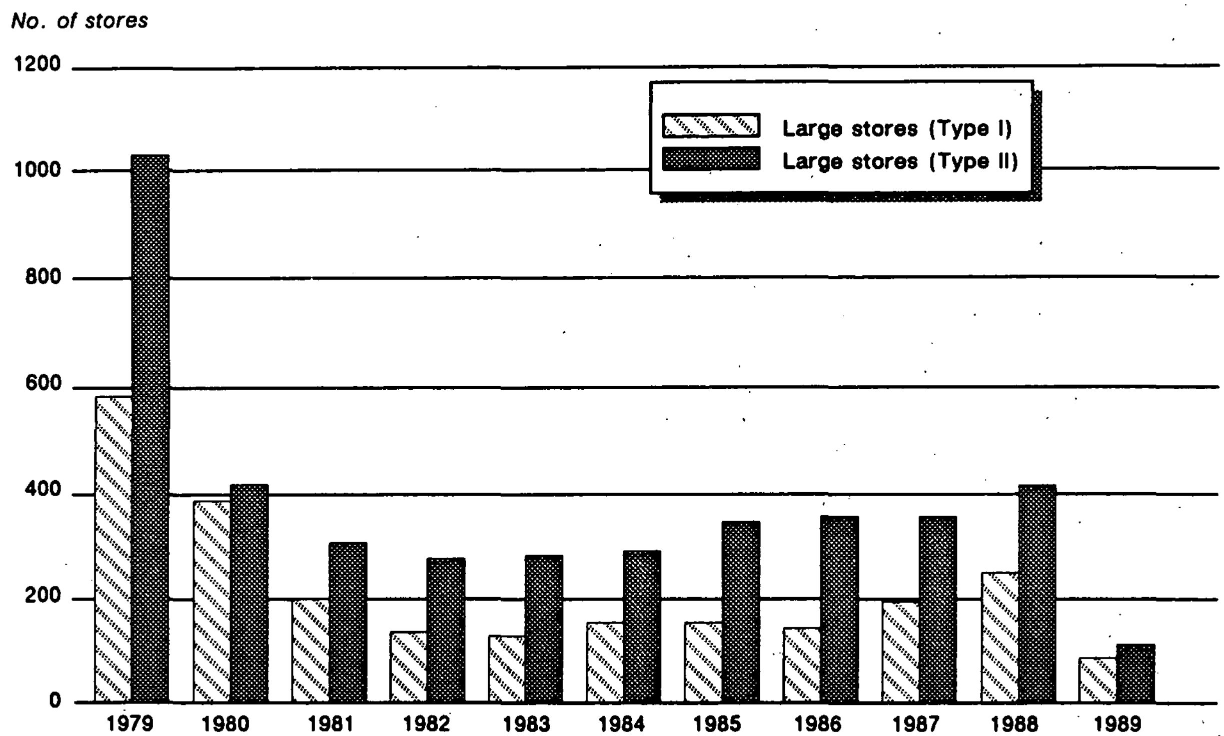
The expansion of large retail outlets in Japan has slowed markedly since 1979. In the three years following issuance of MITI's 1979 administrative guidance, the total number of large and medium store notifications dropped by 75 percent, and the number of applications for both classes has held steady at a slightly increased level ever since. One analyst observes, "MITI apparently accomplished this reduction without ever exercising its formal power" under the Law to order compliance with its recommendations.[440] There is also some evidence that the Law has had a chilling effect on expansion or renovations of existing store facilities. Moreover, no foreign-owned or managed retail store has ever opened under the Large Scale Retail Store Law.[441] Figure 9 shows the number of applications for opening large stores submitted to MITI during the 1979–89 period.

While there are some signs that larger stores in Japan—department stores, supermarkets, and "superstores" (general merchandisers)—have gained market share at the expense of small retailers, the pace has been slow. As one analyst observes, "As a result of the law and the way MITI applied it, the number of new large stores in Japan plummeted after 1982. The market

[430] Upham, p. 16.
[431] MacKnight, p. 8.
[432] Upham, pp. 18 and 26.
[433] U.S. Department of State Telegram, Feb. 17, 1989, Tokyo, No. 03064.
[434] For example, Keidanren reports that "The letter of the law requires only that large retailers notify the authorities about their plans for new stores, but the application of the law has turned out differently. Often local business operators raise objections when a large retailer submits an explanation of its expansion plans, as required under Article 3 of the law, and as a result the local authorities fail to process the notification." Keizai Koho Center, "Deregulating Distribution," *KKC Brief*, No. 48, July 1988.

[435] "Restrictions on Medium-Scale Stores Spread," *Nihon Keizai Shimbun*, Sept. 20, 1988, as cited in Upham, op. cit, p. 44.
[436] Takahashi, p. 8.
[437] Tsuruta Toshimasa, "What should the Large Store Law Be Like in An Age of Internationalization," *Ekonomistuo*, Dec. 13, 1988, p. 49, as cited in Upham, p. 19.
[438] Takahashi, p. 8.
[439] Takashi Masuko, "Small Shops Are Big Barrier to Deregulation," *The Japan Economic Journal*, July 9, 1988, p. 2.
[440] Upham, p. 27-28.
[441] Ibid., p. 37.
[442] According to a *Nikkei Ryutsu Shimbun* Survey, based on the value of annual sales, the share of large-retail stores in total retail sales in Japan was 13.2 percent in fiscal year 1966, 22.7 percent in 1975, 20.9 percent in 1983, and 22.4 percent in 1987. The share held by small- and medium-sized chain stores and general retailers stood at 86.8 percent in 1966, 77.3 percent in 1975, 79.1 percent in 1983, and 77.6 percent in 1987. As cited by William L. Brooks, "Distribution in Japan," p. 3.

Figure 9
Applications for opening large stores



Note: Type I are stores with more than 1,500 m² of floor space. Type II are stores with more than 500 m² but less than 1,500m² of floor space.

Source: MITI.

share of large retailers also has remained stagnant at about 22 percent."[442] The share of retail sales accounted for by chain stores has also remained essentially flat between 1979 and 1985, standing at just 8 percent, less than half the market share garnered by chain stores in the United States and the United Kingdom.[442]

Impact of the Law on Retail Distribution

The Large Scale Retail Store Law and similar local regulations have also been blamed for inhibiting competition, both between large and small retailers and among large retailers themselves.[444] For example, an advisory organ to the Japan Fair Trade Commission (JFTC) singled out MITI's implementation of the Large Scale Retail Store Law for criticism. In a February 1988 report, the blue-ribbon panel asserted that MITI has allowed the "prior explanation" procedure established by administrative guidance in 1982 to become essentially an approval system by local shopkeepers.[445] Case studies contained in the report show that store openings have sometimes been delayed by up to a decade, and that the resulting retail facility is often much smaller than originally planned. Moreover, the procedure rarely includes input from interests, such as consumers, likely to favor opening of new stores. In an October 1989 report, an advisory committee to the JFTC concluded that "the regulations put in place by administrative

[443] "Relaxation of the Large Stores Act Gives Large Retailers a Golden Opportunity," *Industria*, Sept. 1989, p. 38. Major chain stores have also reportedly remained in the same rank order in terms of sales almost for more than 10 years. Masuko, p. 2.

[444] The Research and Study Group on Distribution Issues concluded that, "Not only are some of the procedures, such as the pre-opening explanation, which are not required by the law, costly and time-consuming, the tendency for these procedures to drag out the time until a new store opens entails heavy costs and affects the sales price of the products in the store after it has opened. It allows already-existing large scale retail stores an avenue to avoid new competition and preserve their

[444]—*Continued*
own position." Research and Study Group on Distribution Issues, "Summary of the 7th Report by The Research and Study Group on Distribution Issues: Toward the Formation of an Open and Competitive, Consumer-Oriented Distribution Structure," (USITC translation), p. 4.

[445] JFTC Research Council on Government Regulation and Competitive Policies, "Interim Report," Feb. 8, 1988.

guidance . . . are often vague, and are difficult to predict in advance. This heightens the risk to anyone desiring to begin in the business, and in the end, it puts an excessive burden on new participants."[446] Keidanren, a federation of primarily big businesses in Japan, argues that such uncertainties and delays lead to higher costs.[447]

Critics of the Large Scale Retail Store Law charge that by inducing long delays[448] and restricting entry of potentially more efficient operators[449] into the retail segment of the distribution chain, the regulations have resulted in higher distribution-related costs.[450] Large supermarkets also appear to be the only major types of retail format from which Japanese consumers purchase primarily on the basis of price, rather than on the basis of other factors such as service or "a friendly atmosphere."[451] Moreover, variety appears to be a factor in the selection of a department store. Restricting entry of such retailers may result in higher prices[452] for many consumer products[453] and constrained choices.[454]

A few analysts have expressed skepticism of the law's impact. Some have suggested that general business conditions in Japan—such as the lackluster pace of consumer spending between 1982 and 1986 and a shift in shopping habits away from large stores in favor of smaller specialty shops and convenience stores—combined to minimize the law's restrictive impact, at least up until the recent upturn in consumer spending during 1988 and 1989.[455] One analyst observes:[456]

> [T]he sluggish rise in Japanese retail sales since 1980 would have put a damper on the expansion plans of large chains even in the absence of government regulations. Sales have yet to expand by more than 5 percent in any one year, in part due to the modest growth of consumer spending during the decade but also because a greater proportion of spending is going for services rather than goods. Department stores have done slightly better on average than the overall figure, especially last year when they registered a 6.9 percent gain and industry sales went up only 3.9 percent. Nationwide supermarket/superstore chains, in contrast, have under-performed the market—again with the exception of 1988 (a 4.6 percent increase).

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[446] JFTC Study Group, "Review of Government Regulations from the Perspective of Competitiveness Policy," Oct. 31, 1989, (USITC translation), p. 5.

[447] "Views on the Relaxation of Regulations in the Distribution Sector," Keidenren, Mar. 23, 1988. The report states, "An institution wishes to submit a notification because it has reached a decision on the feasibility of creating a store. If—irrespective of whatever conclusions may be reached by the local Council for Coordinating Commercial Activities—the whole deliberation process is prolonged indefinitely, changes in prices, the economic environment, and other factors can cause that institution's initial investment plans to be thrown into confusion," pp. 1-2.

[448] Such delays obviously result in lost time, but may also mean prospective large store operators are forced to pay significantly more for available land than they otherwise would have to, since the advance notice given to local business interests can give speculators an opportunity to drive up the final purchasing price of land.

[449] Large retail establishments enjoy greater labor productivity than smaller stores, a fact which may mean savings for suppliers with access to such distribution routes. Economists for Japan's Economic Planning Agency report that retail sales per person were about 2.5 times higher for department stores than the overall average, 1.9 times higher for large scale general merchandise superstores than average, and about 1.2 times greater for convenience stores than average. As of 1982, the average sales per person was $83,300 at stores with more than 10 employees, compared with $51,500 at stores with fewer than 10 employees. Masoyoshi Maruyama, Yoko Togawa, Kyohei Sakai, Nobuo Sakamoto, and Masaharu Arakawa, "Distribution System and Business Practices in Japan," October 1989 draft, p. 7, 39, and 44, based on data from MITI's 1988 Census of Commerce. These measures may not necessarily mean that larger stores are more efficient overall, since larger stores are likely to be more capitalized than smaller stores, implying a substitution of capital for labor.

[450] Frank Upham reports that in its "Cost of Living '88" report," Japan's Economic Planning Agency "estimated that 40 percent of the retail price of domestic goods and 59 percent of imported goods were attributable to distribution costs." He based this observation on Economic Planning Agency, Kaihougata ryuutsuu shisutemu no kouchiku no mukete [Toward the Construction of a Liberalized Retail System], Tokyo, 1988, table 2, p. 53.

[451] Non-price considerations were more important than price considerations for all of the other formats examined in the survey—department stores (for which

[451]—Continued
variety and quality were the most important considerations in deciding whether to patronize such establishments), specialty stores (quality and service), and general stores (friendly atmosphere and good service). As reported by the Ministry of International Trade and Industry, "The Distribution System in Japan: Toward a More Open, Consumer-Oriented Distribution System," Nov. 1989, p. 5.

[452] In 1987, for example, Japan's price level was estimated by MITI to be 48 percent higher than that of the United States and 55 percent higher than that of the United Kingdom. MITI stated that "this phenomenon is believed to have resulted primarily from rapid changes in the exchange rate." "The Distribution System in Japan," May 1989, pp. 12-13.

[453] As noted previously, a joint survey conducted by the U.S. Department of Commerce and Japan's Ministry of International Trade and Industry found that "in five of six product categories examined, products in Japan were more expensive. Perhaps most telling of all, 21 of 24 products imported in both countries from third-country exporters were found to be more expensive." As reported by Rockwell, p. 1A.

[454] Susan MacKnight concludes, "The bottom line is that the current distribution system limits the availability of consumer durable and nondurables from the United States and jacks up the prices of those products that do make it onto store shelves." MacKnight, p. 4.

[455] See, for example, Noriaki Takaoka, "Large Retail Store Act will be Standing Dead 10 Years from Now," as reported in *Shukan Toyo Keizai*, Sept. 30, 1989 (USITC translation.) It should be noted that consumer spending has been driving Japanese economic expansion since fiscal 1988, and is expected to continue to do so in the near-term. "Relaxation of the Large Stores Act Gives Large Retailers a Golden Opportunity," *Industria*, Sept. 1989, p. 37.

[456] MacKnight, pp. 9-10.

Finally, department stores and specialty shops, which tend to be more likely to carry imports, reportedly have little interest in significantly expanding their floor space in the future. Instead, they are increasingly turning their sights to renovation of existing facilities. The lack of affordable land and difficulties in its purchase associated with the fragmented plot ownership, Japan's current labor shortage, and the rising costs of construction will all limit the prospects for expansion of larger stores, some analysts suggest.[457]

MITI claims that the law simply provides a framework for coordination between large stores and local merchants, and says that the regulations were not meant to give local interests "veto power" over the opening of new stores. MITI officials note that provision for such coordination is not unique to Japan, pointing out that France and Belgium have similar permit schemes for new retailers.[458] A MITI official interviewed by USITC staff[459] suggested that U.S. state and local zoning regulations sometimes serve the same purpose as Japan's restrictions on larger retailers.[460]

As discussed earlier, others claim that Japan's web of small retailers is economically rational.[461] If such arguments about the rationality of Japan's existing distribution structure are correct, the law's relaxation would likely have a marginal impact on retailing in Japan, since there would be little economic incentive for consumers, retailers, or manufacturers to reevaluate existing shopping patterns, wholesale relationships, or distribution routes.[462] On the other hand, if these arguments are true, small retailers would appear to have no reason to fear relaxation or even repeal of the Large Scale Retail Store Law.

Impact of the Law on Imported Products

Large retailers, with their extensive shopping areas and sophisticated purchasing departments, are important potential vendors for imported consumer products in Japan.[463] The Economic Planning Agency issued a report in July 1988 which concluded that the Large Scale Retail Store Law, as presently administered, seems biased against imports. Moreover, the nontransparent administration of the law may have a disproportionate effect on foreign firms seeking to enter the retail sector in Japan.[464] Japan's major retailers, meanwhile, argue that, by limiting selling floor space, the law may discourage them from carrying more imports in place of domestic goods.[465]

Data on imports by large stores since 1985 seem to support the view that large stores, especially chain stores, sell more imported products than small retailers. MITI has reported that large retail store imports as a fraction of total sales reached 12 percent in fiscal 1986 and 16 percent in fiscal 1987, compared to about 4 percent in the early 1980s.[466] By contrast, the import share for small shops is reported to be "infinitesimally small and often totally non-existent." Direct imports apparently account for a growing percentage of large store imports.[467] Mirroring the long-standing practice of U.S. and other foreign retailers, larger Japanese retailers are designing and manufacturing products by licensing "private label" production overseas, at substantial savings.[468]

[457] Waichi Sekiguchi, "Big-Store Law Revision Means Small Change for Imports," *Japan Economic Journal*, Jan. 10, 1990, p. 6.

[458] Ministry of International Trade and Industry, "The Distribution System in Japan," May 1989, pp. 24 25.

[459] USITC field interview with Commercial Policy Division of MITI, Jan. 29, 1990.

[460] On the other hand, the Ala Moana Center in Honolulu, one of the largest shopping centers in the United States, is owned by Daiei, a major Japanese retailing firm headquartered in western Japan. In a February speech, Ambassador Armacost reported that, "Chairman Nakauchi of Daiei told me that when he purchased Ala Moana, the red tape was minimal. All he had to do was check that the liquor license was up to date." U.S. Department of State Telegram, Feb. 8, 1990, Tokyo, no. 02335. Yoahan, a Japanese department store group, recently opened a large department store in New Jersey.

[461] See, for example, David Flath, "The Economic Rationality of the Japanese Distribution System," (Mar. 1989) North Carolina State University, Raleigh, North Carolina.

[462] One analyst suggests, for example, that it will remain economically efficient for certain department stores and for small-scale retailers in local shopping areas to continue to rely heavily on wholesalers, notably

[462]—*Continued*
in the field of apparel distribution. To the extent that it remains economically rational for such stores to continue to rely on wholesalers to provide services such as returns of unsold goods, the prospects for increased imports by such stores, even with a liberalization of the large stores law, may be poor, they claim, since high return rates may make wholesalers leery of carrying imported goods. Itoh, pp. 14-15.

[463] For example, Keidanren reported on Oct. 25, 1988 that "The strength of the yen has prompted companies within the Japanese distribution sector, in particular department stores and mass-retail outlets, to seek out and purchase goods through direct import, to import goods manufactured overseas while specifications are provided by Japanese companies, to conduct parallel imports, and to act as agents for those individuals wishing to import....The unprecedented diversification and improving of import channels in itself have an effect of lowering prices of imported goods. It is also widening the range of choices available to consumers and is creating downward pressures on prices of similar products made in Japan." Keidanren (Japan Federation of Economic Organizations), "How the Distribution Sector is Taking Advantage of the Benefits Derived from the Strong Yen," Oct. 25, 1988, p. 1.

[464] Upham, p. 13.

[465] "Panel Studies Law Shackling Big Chain Stores," *The Japan Economic Journal*, Mar. 12, 1988, p. 4.

[466] William L. Brooks, "Japan's Distribution System in Flux," *Speaking of Japan*, p. 20.

[467] U.S. Department of State Telegram, Mar. 28, 1989, Tokyo, No. 05508.

[468] According to one analyst, direct imports are sold in stores at prices 30 percent or so below those of comparable domestic brands. William L. Brooks, "Distribution in Japan," *Nikko Nexus Management News*, Vol. 1, No. 8, Dec. 1987, p. 4.

A number of analysts believe that working through such mass-market stores or retailing directly is the best way for foreign firms to break into Japan's market for consumer goods.[469] Leading U.S. and Japanese analysts are reported to believe that large retailers "are in a good position to introduce and aggressively promote" imported products, because "they have the display space, marketing skills, service departments, and financial resources to do it effectively."[470] Larger establishments such as superstores and department stores often purchase a higher volume and greater variety of consumer goods than mom-and-pop stores. Such larger stores generally are more familiar with international transactions, are more aware of foreign products,[471] and buy in quantities that are more commercially viable for foreign suppliers. Larger chains often deal in standardized goods whose sales are quite stable and predictable,[472] enabling them to buy in greater volume and offer lower prices.[473]

Perhaps most important of all, larger retailers may be more independent of Japanese wholesalers and manufacturers than smaller retailers.[474] [475] As noted previously, manufacturer control over retail distribution may play a role in limiting opportunities for foreign firms in Japan's market for consumer goods. Larger retailers and chain stores, on the other hand, reportedly rely less on manufacturers' financing,[476] rebates, returns,[477] and expertise than smaller merchants, and may therefore be more willing and able to carry imported wares.[478] In the words of one analyst:[479]

> These chains are large enough and independent enough to be free of dominance or control by wholesalers and manufacturers. Dealing in low- and mid-price items, they are more concerned with price than traditional department stores, which compete with one another in terms of service. Because of the obstacles imposed by the traditional distribution system, any effort to increase manufactured consumer goods must involve a reform of distribution, through a rising market share for the superstore chains and other innovative, independent retailing networks.

In fact, there is already preliminary evidence that the rise in chain stores is reducing the power of Japanese manufacturers in the retail market, according to the Industrial Bank of Japan (IBJ).[480]

[469] See, for example, The Industrial Bank of Japan, *IBJ Review*, No. 9 as cited in Stefan Wagstyl, "Bank Forecasts Easier Time for Importers," *The Financial Times*, Mar. 9, 1990.

[470] As reported by MacKnight, p. 10.

[471] According to the Japan Chamber of Commerce and Industry, "Although there is a strong desire to deal in imports not only in large corporations but in small and medium-sized companies, many businesses are saying that they cannot carry imports because of insufficient information and knowledge of the products." *Distribution System and Market Access in Japan*, p. 31.

[472] Motoshige Itoh suggests that some types of large retailers, such as nationwide chain stores which specialize in particular types of apparel and large-scale superstores (supermarkets) are in a relatively better position to circumvent wholesalers, import directly, and avoid traditional practices such as the return of unsold goods. These chains often specialize in limited types of commodities, sell the same types of goods throughout the country, and are located near densely populated metropolitan areas. Because they buy in bulk and deal in relatively homogeneous products, such firms often do not need to rely on wholesalers, Itoh says, noting that "it is easier for supermarkets to cover the risk of dead stocks and to collect information about products." Itoh, pp. 16 and 17.

[473] In a USITC field interview with Japan Chain Stores Association, Feb. 7, 1990, a spokesperson explained, "It is difficult to describe the superior bargaining position of the chain stores in terms of numbers, but basically we can buy on better terms and conditions than the smaller stores."

[474] MacKnight, p. 10. In its 7th report, The Research and Study Group on Distribution Issues noted that "The Economic Planning Agency asked Mitsubishi Sogo Research to conduct a survey for them of 800 retail

[474]—*Continued*
and wholesale businesses and 500 manufacturers in order to assess their awareness of the above problem points and how these should be dealt with in the future." Among other things, the Group reported that the survey found that, "[m]any of the larger retailers have some negotiating strength with respect to the manufacturer and they are able in many cases to get their way." USITC translation, p. 6.

[475] In a field interview with a representative of The Asia Pacific Trade Center on Feb. 9, 1990, the spokesperson said that in general the strength of the manufacturer relative to the retailer depends on the size of both.

[476] Rockwell, pp. 1A-2A.

[477] Flath, p. 18. Flath notes that "one important difference between retail price maintenance (RPM) and returns policy is that RPM places the risk of unsold merchandise on the retailers while returns policy places that risk on the maker....If the maker is risk neutral, but retailers are risk averse, then the returns policy would be favored over RPM," Flath claims. He continues, "Where retailers are more averse to risk than are makers and have less or no greater ability to predict the demand they will face, the makers implement the fixed price policy by accepting unlimited returns....Large chain stores, which tend not to be so risk averse, are more often subject to RPM and enjoy limited returns privileges."(p. 24)

[478] During a field interview with USITC staff on Feb. 7, 1990, a spokesperson for Ryoshoku, a processed food wholesaler, indicated that several factors tend to make it more likely that larger firms, rather than smaller firms, would carry imports. In Japan, manufacturers are generally responsible for carrying out marketing campaigns and conducting other sales activities. For imported goods, however, it is often the wholesaler who is responsible and the burden is on them to spread the word about lower priced imports. Smaller Japanese buyers also may not be willing to take the risk of buying U.S. products out of fear that they are not clearly saleable in Japan, the spokesperson said.

[479] Lincoln, pp. 124-125.

[480] The Industrial Bank of Japan, *IBJ Review*, No. 9 as cited in Stefan Wagstyl, "Bank Forecasts Easier Time for Importers," *The Financial Times*, Mar. 9, 1990.

Relaxation of restrictions on larger retailers would not only increase competition between larger and smaller retailers, but between larger retailers themselves,[481] some analysts believe.[482] Large superstores already appear to be aggressively going around the traditional distribution system, setting up parallel channels for imports in anticipation of greater growth opportunities when administration of the Large Scale Retail Store Law is eased.[483] The result of more competition among all retailers, some analysts argue, would be lower prices and better selection for Japanese consumers, and greater opportunities for foreign suppliers seeking to crack the Japanese market.[484] To the extent that such competition forces a reevaluation of existing relationships with wholesalers and manufacturers and of arrangements for warehousing, delivery, and service, it could also stimulate greater competition throughout the entire distribution chain. Moreover, any step that leads retailers to seek greater value and product selection is likely to increase the chances that foreign products will be considered and carried by retailers in Japan.[485]

Expansion of larger retailers could thus lead to a direct increase in the sales of imported consumer goods in Japan, and might have beneficial "ripple effects" as well. There are indications that larger stores and chain stores have played an important role in promoting imported products in recent years.[486] By raising the visibility of imported products with the Japanese consuming public, liberalization of retailing could help break down entrenched attitudinal biases against foreign-made goods. For example, one analyst suggests that import fairs conducted by larger retailers "may have helped make the concept of imported goods at major retail outlets more acceptable in the context of a manufacturing and wholesale distribution system that has had a record of opposing imports."[487]

Others argue that, even if the law is restraining growth of large retailers, its change will not result in more imports.[488] Japanese consumers do not want to purchase more imported products anyway,[489] they claim, and foreign suppliers, particularly U.S. ones, do not make much Japan needs.[490] If the arguments made by these analysts are correct, the law's relaxation would likely have a marginal impact on retailing in Japan.[491] If consumers will not purchase more imports under any terms or at any price, distributors both large and small will have no incentive to carry or promote them.

Prospects for Change

Distribution reform no doubt pits large retailers, consumers, and foreign suppliers against the established positions of small retailers and their guardians in the Government of Japan.[492] Small shopkeepers have traditionally provided a major source of support for the LDP, and their importance grew with the defection of agricultural interests in 1989 elections.[493] Small retailers' political clout and de facto social welfare role has been translated into other forms of "protection" as well, such as national and local tax incentives[494] and financial assistance programs. With or without the Large Scale Retail Store Law, some analysts suggest, the reality is that firms

[481] Perhaps indicative of this prospect is the fact that the Japan Chain Stores Association stated in a USITC field interview on Feb. 7, 1990 that, "[T]here are 1.62 million stores and change for the smaller stores will be difficult if the Large Scale Retail Store Law is abolished. We want change to come slowly."

[482] Masuko, p. 2.

[483] USITC field interview with Agricultural Attache, U.S. Embassy Tokyo, Feb. 6, 1990.

[484] Japan's Research and Study Group on Distribution Issues states in its seventh report that, "[T]he impact of these changes [in the distribution system] is to increase competition among retailers, manufacturers and wholesalers, but in addition, it promotes competition between imported and domestically produced products. There have also been unavoidable changes caused by discount store growth which renews price competition and marketing competition among manufacturers, and among wholesalers."

[485] In the July 1989 issue of *Speaking of Japan*, William L. Brooks states, "In our [the U.S. Government's] view, such efforts will increase the potential of increased market access and sales of foreign goods in Japan." Brooks, "Japan's Distribution System in Flux," p. 20.

[486] Lincoln, pp. 124-25.

[487] Ibid., p. 128.

[488] See, for example, report by Sekiguchi, p. 6.

[489] For example, Toshio Tanaka, Managing Director of the Japan Federation of Specialty Stores, essentially argued that relaxation of the Large Scale Retail Store Law will not result in increased imports because "anything consumers really want will sell" already. As reported by Kiyoshi Ozawa, "Relaxation of Large Retail Store Act Responding to External Pressures," *Shukan Toyo Keizai*, Sept. 30, 1989.

[490] For example, U.S. firms have already licensed production of many processed food products—often identified as a good candidate for expanded U.S. sales—to local Japanese makers, one source reports. Sekiguchi, p. 6.

[491] One analyst suggests, for example, that it will remain economically efficient for certain department stores and for small scale retailers in local shopping areas to continue to rely heavily on wholesalers, notably in the field of apparel distribution. To the extent that it remains economically rational for such stores to continue to rely on wholesalers to provide services such as returns of unsold goods, the prospects for increased imports by such stores, even with a liberalization of the large stores law, may be poor, they claim, since high return rates may make wholesalers leery of carrying imported goods. Itoh, pp. 14-15.

[492] An Oct. 31, 1989 report issued by the JFTC reportedly concludes that such regulations give "the private sector a vested interest in keeping out new competitors and bureaucrats an interest in holding onto their regulatory powers." U.S. Department of State Telegram, Nov. 3, 1989, Tokyo, no. 20191.

[493] Lincoln, p. 125.

[494] Itoh, p. 5.

seeking to enter local markets will have to accommodate the interests of surrounding merchants.[495]

Nevertheless, there are forces in Japan which favor liberalization of restrictions on retail stores. Indeed, a number of proposals have been made for relaxation of the Large Scale Retail Store Law's administration. Among other things, MITI's June 1989 Distribution Vision for the 1990s proposes streamlining the notification process, sets time limits for the various stages of the notification procedure, and modestly limits the law's scope.[496] Building on those plans, as part of the Structural Impediments Initiative (SII) mid-term review in April 1990, the Government of Japan promised more liberal MITI administration of the current Large Scale Retail Store Law and set an overall time limit of 18 months from start to finish of the notification and adjustment process. Significantly, the time frames established in the proposal are "maximum" time limits for each phase of the procedure,[497] as opposed to current practice, where each stage of the process is scheduled to last for a specified minimum period, but does not have a definitive duration.[498] By the end of May 1990, the Government of Japan said it would take the following specific measures to ease restrictions on large retailers):[499]

- More flexibly implementing the current Large Scale Retail Store Law by (1) setting a one and a half year time limit for the required coordination process, (2) exempting stores expanding floor space by approximately 100 square meters for the purposes of expanding import sales from the notification/coordination requirement,[500] and (3) improving the transparency of the coordination process (i.e., by regularly publishing the status of coordination efforts). In addition, the central government announced its intention to "make its utmost efforts, by for example, directing local public authorities to take necessary corrective measures in the light of objectives of the law." The regulations needed to implement these changes have recently been issued by MITI.
- Submitting to the Diet during its next regular session an amendment to the Large Scale Retail Store Law to (1) ensure that the authorities give due consideration to consumer interests, (2) further expedite the pre-notification coordination process (limiting its duration to approximately one year), and (3) restrain the ability of local authorities to impose more restrictive requirements on larger retailers.
- Reviewing the Large Scale Retail Store Law two years after the above-mentioned amendment with a view towards determining whether a more fundamental change in the law is warranted, in light of the consumer interest and the need to ensure competition in the retail sector.

Moreover, MITI said it would study the prospect of exempting certain densely populated areas, such as parts of Tokyo, Osaka, and Nagoya, from all national restrictions on the large scale retail stores. On the other hand, a May 6, 1990 news account indicates that MITI will retain the restrictions imposed in 1982 via administrative guidance on store openings in areas it decides are saturated by large stores, on the basis of the number of department stores and supermarkets already operating in the area relative to its population. New store openings are essentially prohibited in such areas: prospective retailers are urged to exercise "self restraint" in pursuing retail opportunities and MITI informally refuses to accept required notifications. MITI's list of restricted areas has apparently not been made public, but reportedly includes all towns with populations of 30,000 or less and "some 340 cities and districts—or close to half the nation's cities and districts," including parts of Tokyo,

[495] For example, one analyst suggests, "The problems in setting up large retail outlets aren't simply legal ones; they're deeply rooted in Japanese society. It's hard to do anything new in Japan without obtaining the agreement of local residents. Whenever you try to set up a new supermarket or department store, the commercial associations and shopkeepers in the neighborhood... protest that outside interests are gearing up to drive out long-established neighborhood businesses. Although I'm in favor of abolishing the Large Scale Retail Store Law, I doubt that this alone would change the situation." Itoh, p. 30.

[496] Some of the other improvements proposed in the Vision are a shortening of the likely processing period for new store applications by establishing set intervals for each stage of the process, increasing MITI supervision of local restrictions on large stores, and waiving the requirement for MITI notification for stores modestly expanding their floor space (by 10 percent of the total space or 50 square meters, whichever is less) or staying open longer (one hour later and several extra days a year).

[497] Some analysts caution, however, that setting time limits for the consultation process may actually work against the interests of larger stores because it may effectively heighten the pressure on the large store to reach a settlement with local shopkeepers.

[498] USITC staff conversation with U.S. Department of State official, May 10, 1990.

[499] As reported in the Apr. 5, 1990 interim report of the Japanese delegation to the Japan-U.S. Structural Impediments Initiative, pp. 13-16.

[500] This is in addition to the 50 square meter exemption already announced and briefly explained in a previous footnote.

Yokohama, and Osaka. The article goes on to conclude that:[501]

> [S]o long as these restrictions . . . remain in effect . . . the improvement measures adopted before the Japan-U.S. structural talks in April—such as shortening the review period by the Business Activity Adjustment Council—will be meaningless as far as the store-opening restricted areas are concerned.

Moreover, there is strong domestic opposition to a major revision to or abolition of the law itself in the short term.[502] This opposition comes both from potentially affected small firms and their employees and from within the Japanese Government itself. The Japan Chamber of Commerce and Industry, a national confederation of local chambers of commerce, asserts that:[503]

> In view of the large number of small-and medium-sized retailers densely packed into the Japanese retail structure, allowing large-scale retailers to open stores freely would cause friction and confusion in the local communities. For this reason, it is more appropriate to leave the framework of the Large Scale Retail Store Law as is, and to plan on improving its practical application.

The Japan Federation of Commercial Workers' Unions claims that:[504]

> There would be a drastic impact if the Large Scale Retail Store Law were abolished. It would cause problems for the small-and medium-sized retailers which would have an impact on workers. It is a misconception to think that abolishing the law would be favored by large stores but not small- and medium-sized ones. If the law were abolished immediately, it would lead to a flood of excessive competition—among large stores as well.

Major political players have also announced opposition to anything more than moderate overhaul. Japan's current Minister of International Trade and Industry Kabun Muto has stated that "It is too early to talk about abolishing the law because it could endanger the livelihood of small shopkeepers."[505] Meanwhile, the Liberal Democratic Party's members of the Economic Adjustment Research Council have reportedly expressed "strong opposition to the abolition or substantial revision of the law."[506] The Japan Socialist Party actually believes that there are already too many large stores competing with small shopkeepers, and has suggested that the national law, and MITI's authority for administering it, should be scrapped in favor of more restrictive local rules.[507]

Indeed, MITI and others have warned that a vacuum in legislation at the national level might result in an upsurge in local regulations, many of which may be more restrictive and less transparent than the current regime.[508] MITI has publicly signalled a willingness to curb local regulations which run counter to distribution reform.[509] However, the Ministry of Home Affairs has declared its intention to fight such a move,[510] and there is some question about the central government's ability to legally challenge local restrictions on large retailers because of a 1963 Supreme Court decision upholding the right of local communities for autonomous rule in certain areas. MITI itself has said that it would couple relaxation of national and local restrictions on large stores with enhanced financial and other support for smaller retailers.[511] Moreover, there are some indications that MITI continues to urge "self restraint" by larger stores.[512]

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[501] "MITI to Keep Store Opening Restricted Areas," *Nihon Keizai Shimbun*, May 6, 1990, p. 1.

[502] See, for example, Kiyoshi Ozawa, "Relaxation of the Large Retail Store Act Responding to External Pressures," *Shukan Toyo Keizai*, Sept. 30, 1989, USITC translation.

[503] "Distribution System and Market Access in Japan", June 1989, p. 2.

[504] Interview with the Japan Federation of Workers Union, Tokyo, Jan. 31, 1990.

[505] As reported in "Japan to Review Law on Retail Stores," *The Journal of Commerce*, Mar. 9, 1990.

[506] As reported in "Japan Stiffens on U.S. Large Store Access," *Investor's Daily*, Mar. 30, 1990, p. 29.

[507] USITC field interview with JSP spokesperson, Tokyo, Jan. 30, 1990.

[508] Bureau of National Affairs, "MITI Chief Indicates Possible Repeal of Japan's Large-Scale Retail Stores Law," *International Trade Reporter*, Vol. 7, p. 326.

[509] A MITI survey reportedly revealed that more than one third of Japan's local governments impose their own regulations on stores technically outside the reach of the central government's Large Scale Retail Store Law: 991 cities and villages have imposed such restrictions; 105 of those cities and villages require large retailers to receive the approval of local retailers before they will accept applications for new store openings. As reported by Sekiguchi, p. 6.

[510] In a field interview with USITC staff on Feb. 5, 1990, an official at the Ministry of Home Affairs claimed that its primary goal was to make sure the central government does not intervene excessively into the affairs of local governments. The official signalled the agency's intention to intervene if MITI efforts to ease local restrictions on large stores represent too much intervention in local affairs.

[511] During a field interview on Jan. 29, 1990 with USITC staff, a MITI official stated that MITI continues to believe in the necessity for coordination with local shopkeepers on the opening of large stores, intends to offer small retailers adjustment assistance, and may favor the exemption of industry rationalization efforts from Japan's antimonopoly law.

[512] Teiichi Yamamoto, Commerce and Distribution Councillor of MITI, was quoted in the *Shukan Toyo Keizai* on Sept. 30, 1989 as saying, "Some people are concerned about the possibility that this normalization might bring an opening rush of new stores. For this reason, we would like to ask the parties who are planning new large scale stores at this time to proceed with proper self-control."

Even though opposition to scrapping or substantially revising the Large Scale Retail Store Law is likely to continue, other trends may encourage change. The law has slowed the growth of large stores since 1978, but it has not stopped their expansion entirely. Discount outlets just shy of 500 square meters in size have become so prevalent that they have earned a nickname—"yon-kyu-pa" (or 498 square meter) stores—and have frequently become the object of local regulation.[513]

Several creative entrepreneurs have found ways to circumvent the law and earned notoriety as a result. In an Osaka suburb, a large store calling itself a "wholesale house" has attracted national attention. Since the Large Scale Retail Store Law does not apply to wholesale stores, the local retail association has been unable to stop the outlet from encroaching upon their domain. An imaginative Niigata entrepreneur who was unable to obtain local concurrence for a single large-scale retail store purchased enough farm land to build four separate medium-sized stores, and put a large parking lot in the middle.[514] More recently an upstart Japanese real estate magnate sent shockwaves through the Japanese retail establishment by using American-style hostile takeover attempts in an effort to gain control over several medium-sized supermarkets and department stores.[515] But the fact that the same few examples appear in various articles about Japanese distribution[516] suggests that mavericks remain the exception, not the rule, and are thus unlikely to pose a serious challenge to the status quo.

There are also some indications of a shift in attitudes. Mom-and-pop shopkeepers in commercially depressed downtown areas are reportedly beginning to view large retailers as welcome additions to their shopping districts because they will serve as "magnet stores."[517] MITI reports that "some of Japan's shopping streets are enjoying brisk business, while others are struggling. This gap, which is increasing, is thought to be related to the degree of enthusiasm with which the store associations approach the task of modernizing the 'streets' as well as to changes in surrounding neighborhoods."[518] Another report states that "Mayors of cities and towns are now quite cognizant of the fact that, unless a city or town has adequate commercial facilities, hotels, convention centers, and sports facilities, young people will not stay."[519] Meanwhile, one analyst reports that "more and more consumers now say the ability to buy various goods at one time and at low prices ranks equally as high as proximity" when choosing to patronize a retail establishment.[520]

Foreign pressure may also result in more liberal administration of the law. The law has been singled out for attention under the so-called Structural Impediments Initiative initiated in 1989. Moreover, at least two U.S. retailing giants—Toys 'R' Us and Sears—are attempting to enter the Japanese retail market. Under a joint venture with McDonald's Japan, Toys 'R' Us is planning to open a number of large stores in Japan, the first attempt by an American retailer to open its own large store in Japan. The fate of Toys 'R' Us' efforts to obtain entry into Japan's retail industry is being viewed by some analysts as a test case for gauging U.S. access to Japan's distribution system. The U.S. company's plans have reportedly fueled concern by local toy wholesalers and industry associations who apparently hope to use the Large Scale Retail Store Law to keep the U.S. toy chain out.[521] Perhaps because of the case's precedent-setting value, MITI has reportedly intervened to make possible meetings between local merchants and Toys 'R' Us and the 12 other large retailers with applications for store openings pending in Niigata prefecture.[522]

Success for Toys 'R' Us could encourage other U.S. retailers to pursue operations in the Japanese market. In early 1990, Sears Roebuck & Co. announced plans to sell car accessories and apparel through a joint venture with Seibu Saison Group. The first store will be smaller than 500 square meters, and thus will fall outside the purview of the national Large Scale Retail Store Law. However, changes in the law or of MITI's implementation of it may well affect Sears' plans for expansion, according to one report.[523]

There are indications that the visibility of the issue on the U.S.-Japan trade agenda has prompted fresh interest in expansion by large

[513] U.S. Department of State Telegram, Mar. 28, 1989, Tokyo, no. 05508.
[514] Ibid.
[515] "Relaxation of 'Large Scale Retail Store Act' Responding to External Pressures," *Shukan Tokyo Keizai*, Sept. 30, 1989. The real estate firm Shuwa reportedly won a series of recent legal battles related to allocations of new shares to third parties of both Cujitsu-ya Col., Ltd. and Inage-ya Co., Ltd.
[516] See, for example, Paul Blustein, "Cracking Japans Small Shop Monopoly," *The Washington Post*, Aug. 13, 1989, p. H-4 and William L. Brooks, "Japan's Distribution System in Flux," p. 22.
[517] U.S. Department of State Telegram, Mar. 28, 1989, Tokyo, no. 05508.
[518] Ministry of International Trade and Industry, "Summary of MITI's Vision for the Distribution System in the 1990's," (provisional translation), p. 6.
[519] "Relaxation of Large Retail Store Act Responding to External Pressures," *Shukan Toyo Keizai*, Sept. 30, 1989.
[520] Takahashi, p. 5.
[521] Kathryn Graven, "For Toys 'R' Us, Japan Isn't Child's Play," *The Wall Street Journal*, Feb. 7, 1990, p. B-1.
[522] As reported in *The Wall Street Journal*, Mar. 27, 1990, p. A-6.
[523] Graven, p. B-1.

Japanese retailers as well. The Japan Shopping Center Association has predicted a historically high increase in the number of larger stores (those larger than 1,500 square meters). According to the Association, the number of large stores now planned is more than 1,500, which will double the current total of 1,429 large-scale outlets.[524] A recent *Nihon Keizai Shimbun* survey reportedly shows that large retailers intend to invest 81 percent more in 1991 than they did, on average, in the years 1986–88, with additions to floor space in 1991 projected to be 93 percent higher than the annual average in the 1986–88 period.[525]

Foreign pressure also appears to have emboldened some Japanese interests that claim to have been harmed by the law. On March 30, 1990, Life Store, a medium-sized supermarket chain with about 70 outlets throughout Japan, filed a $6.3 million lawsuit in Tokyo District Court against the Japanese government for restricting the firm's ability to open a store under the Large Scale Retail Store Law. The company reportedly had an application for opening a new store in Shiki City pending for nine years and filed nearly 500 requests with the local chamber of commerce to schedule the MITI-required prior explanation meeting before abandoning its request last February without such a meeting ever taking place.[526]

The likely loosening of the Law's administration may also have a somewhat unexpected side effect. *The Economist* reports that franchise chains, whose growth has not generally been checked by the Large Retail Store Law, "are already benefitting from its expected revision. Armies of small shopkeepers, threatened with extinction by the promised growth of bigger stores, are scrambling to sign up for a franchise."[527] This could be good news for foreign suppliers, since such chains appear to be even more open to imported products than department stores or large supermarkets. A survey by the private Nomura Research Institute claimed that department store imports as a share of total sales rose from 8 percent in 1987 to 9 percent in 1988 and an estimated 10 percent in 1989. For chain stores, the shares of imports in total sales were 11 percent in 1987, 12 percent in 1988, and a likely 13 percent in 1989, the survey said.[528]

While economic and demographic trends and political pressure from Japan's trading partners may ultimately move Japan towards more liberal policies on the opening and expansion of large stores, it is still unclear how much foreign suppliers, particularly U.S. ones, will benefit. Officials at several of Japan's superstores note that imports still only account for less than 20 percent of total sales[529] and suggest that the scope for further growth in the share of imports in overall sales may be limited, notably by consumer tastes and attitudes.[530] Moreover, to the extent that such firms do import, USITC field interviews suggest that third countries are more significant suppliers than the United States.[531] A substantial percentage of imports by large retailers are now accounted for by the Asian NIEs, ASEAN members, and China and, in the "up scale" market, European countries such as France and Italy.[532] [533] Reflective of these purchasing trends, the largest chain store in Japan has 11 representatives at overseas purchasing offices, 7 of which are located in Asia.[534]

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524 Japan Economic Institute, "Focus Intensifies on Large Retail Store Law," *Japan Economic Survey*, March 1990, pp. 13–14. The article states, "In response to rising expectations that some regulatory changes in the law are inevitable, many department stores, supermarkets, and discount chains have rushed to open new stores or have revealed ambitious plans to increase the number of outlets."

525 As reported in "Jumping the Gun," *The Economist*, Apr. 21, 1990, p. 76.

526 Bureau of National Affairs, "Japanese Supermarket Chain Files Lawsuit Against Government under Retail Stores Law," *International Trade Reporter*, Vol. 7, Apr. 4, 1990, p. 475.

527 "Jumping the Gun," p. 76.

528 Brooks, "Japan's Distribution System in Flux," p. 20.

529 Data from MITI and the Nomura Research Institute were reported earlier. Another source reports that in 1986, the 18 largest department stores and general merchandise stores imported almost 15 percent of their merchandise. "Marketing Strategies and Distribution Channels for Foreign Companies in Japan," (Munich: Institute for Economic Research, 1989), p. 49.

530 Daiei, one of Japan's largest general merchandise chains, reported in a field interview with USITC staff on Feb. 7, 1990 that imports accounted for only 7 percent of its total sales in fiscal year 1989, with the most significant foreign suppliers (rank order, in terms of value) being Korea, Taiwan, the United States, China, and Hong Kong. Leading imports were food, hardware, furniture, household goods, and clothing. Food was the top import item from the United States. Consumer preference, rather than price, is the most significant factor in this product mix, according to the Daiei spokesman interviewed.

531 Daiei, one of Japan's largest general merchandise chains, reported in a field interview with USITC staff on Feb. 7, 1990 that consumers' lack familiarity with U.S. products and tend to view European products as the higher in quality and more desirable than those from other countries.

532 In a field interview with USITC staff on Feb. 7, 1990, officials at one of Japan's largest general merchandise stores reported that it imports directly through its own trading company and handles indirect imports. However, the majority of its imports come from China and the NIEs, the company official said. Meat and processed food are the most significant imports from the United States. A spokesperson for a large general merchandise store reported, "Consumers prefer high quality, high image goods. The main reason for the small percentage of imports from the United States is the lack of advertisement. Most people don't know anything about U.S. fashions except jeans. They know and like European fashions," he said.

533 USITC field interviews with Daiei, Vandle, Japan Chain Store Association, Tokyo, Japan, Feb. 1990.

534 *The Daiei, Inc., 1989 Annual Report*, Mar. 1, 1988-Feb. 28, 1989, p. 17.

Even the opening of U.S.-affiliated chains may not necessarily lead to increased Japanese imports from the United States. The U.S.-affiliated convenience store 7–11 reports that it only directly imports three items from the United States for its stores in Japan: whiskey, raw ingredients for potato chips (potatoes from Idaho), and Budweiser beer. The firm claims its purchasing patterns, particularly the low level of imports, are dictated by "consumer preferences" especially for freshly-made prepared foods.[535]

The two large U.S. retailers now seeking to enter the Japanese market report that they do not intend to carry many U.S. products, and the Japanese press has reported that most of their wares will be "made in Japan."[536] It also seems that at least one of the U.S. retailing giants may have turned to Japanese partners because they felt it would be necessary to assuage Japan's still-powerful bureaucrats and local interests.[537] It is unclear what role, if any, such political realities will play in Toys 'R' Us' ultimate souring decisions.

On the other hand, imports by small shops are currently said to be nil. Even if the composition and level of imports by large retailers does not change, to the extent that retailers such as superstores and department stores gain market share relative to smaller shops, the overall level of imports by Japanese retailers should rise, and with it the actual level of sales by U.S. suppliers of consumer goods. Moreover, from 1985 to 1989, Japan's imports of consumer nondurables from the United States rose more, in percentage terms, than its imports the EC and Southeast Asia.[538] Among the U.S. products cited as likely candidates for increased sales are foodstuffs, sporting goods, and leisure equipment. However, the resolution of other problems—notably the divergence between U.S. and Japanese food additive regulations and cumbersome customs and product approval procedures—may also be needed if U.S. firms are to realize gains in a more open Japanese retail environment.[539]

In conclusion, the Large Retail Store Law and similar local regulations appear to have posed a substantial obstacle to entry for larger, potentially more efficient operators into the retailing segment of Japan's distribution industry. Such firms appear to be more independent of Japanese manufacturers and more likely to carry imported products. The law also appears to have diminished competition in the Japanese retailing sector, both between larger and smaller stores and among large retailers themselves. The long delays and high administrative burdens associated with complying with the law, including the need to assuage local interests, appear to drive up costs for successful entrants. The deleterious effects of such restrictions seem to have been most significant in recent years, as major exchange rate changes, rapid domestic growth, strong personal consumption, and shifts in consumer attitudes should have translated into lower prices for Japanese consumers and improved sales prospects for foreign suppliers. A number of current trends may move Japan in the direction of a more open retail environment. While it seems clear that such changes will result in a rise in Japan's overall level of consumer goods imports, it is uncertain whether the United States will be a major beneficiary.

The Liquor Control Law

Japan is the United States' best foreign customer for wine, beer, and distilled alcoholic beverages. Following recent changes in tariffs and taxes, distribution-related problems remain as one of the most significant obstacles to U.S. sales. Retail distribution of alcoholic beverages has been regulated by the Japanese Government since at least 1938. The Ministry of Finance's restrictive administration of the current (1953) law has apparently made it hard for supermarkets

[535] USITC field interview with Seven-Eleven, Tokyo, Japan, Feb. 6, 1990.

[536] Sekiguchi, p. 1.

[537] Among the qualifications Toys 'R' Us cited when announcing its choice of Japanese partner was the political acumen of the President of McDonald's Japan. Yuzo Yamaguchi, "Will Toys Sell Burgers, or Will Burgers Sell Toys," *Economic World*, March 1990 reports, "The U.S. company sought a Japanese partner to help it overcome these domestic difficulties [associated with obtaining approval under the Large Scale Retail Store Law], and see their salvation in the person of Den Fujita, president of McDonald's Japan. 'We needed a comfortable level of confidence that the [Japanese] government would be supportive of opening up large stores,' says Mr. Baczko.... According to Takuro Isoda, the former chairman of Daiwa Securities America Inc. who played the role of matchmaker between the two companies, he knew the expertise of McDonald's Japan in real estate surpassed that of many small real estate firms and Mr. Fujita is 'strong with MITI.' This being the case, Mr. Isoda sought out Mr. Fujita to become the partner of Toys 'R' Us, rather than one of 10 other candidates he considered for that role."

[538] Based on data from the Japan Tariff Association, as reported by the Japan Economic Institute, *Japan Economic Institute Report*, No. 19A, May 11, 1989, p. 5. The data are discussed in greater detail later in this report.

[539] During a field interview with USITC staff on Feb. 2, 1990, an official with the American Chamber of Commerce in Japan (ACCJ) claimed that discriminatory and/or unpredictable testing and certification requirements and a lack of adequate customs facilities hinder the efforts of U.S. firms to export to Japan. Problems for U.S. firms can be traced to the fact that testing associations in Japan are frequently operated by retired bureaucrats or former employees of Japanese firms that compete with U.S. companies, the official said, and U.S. firms are frequently not members of such associations. Product approval is also unpredictable, partly because of a lack of consistently applied rules for product testing and inspection procedures by central and local government agencies. The lack of adequate bonded warehouse facilities in Japan was also cited by the ACCJ representative as a problem for U.S. exporters.

and chain stores to obtain liquor licenses. The limited shelf space of neighborhood stores and retailers' links to Japanese distilleries have been blamed for putting a damper on sales by foreign suppliers in Japan's sizeable and growing market for wine and other liquors.

The Liquor Tax Law (*Shuzeiho*, 1953) requires all producers, wholesalers, retailers and importers of alcoholic beverages (including spirits, wine, and beer) to obtain a license from the Ministry of Finance (MOF) before engaging in the sale of liquor (Art. 9). One rationale for the law is to assure stable tax revenues.[540] According to the law, MOF may issue a license to retailers of "good moral character" who are in "good financial condition" as determined by the local tax office. Under Articles 10 and 11 of the law, MOF may deny licenses if: (1) the applicant has been convicted of a crime within a year of applying for a license; (2) the applicant lacks moral character; (3) the applicant is in weak financial shape; (4) the location of the proposed store would upset the balance between demand and supply of liquor products.

Up until recently, MOF, through administrative guidance, imposed two other conditions before it would issue licenses: that all liquor retailers must be over 500 meters apart from one another ("distance rules") and that applicants obtain the prior consent of liquor retailers in the area before submitting applications to MOF.[541] On June 10, 1989, the Ministry of Finance announced that it would relax criteria for issuing liquor licenses to make it easier for large supermarkets to obtain them. The changes went into effect on September 1, 1989. In particular, the Ministry of Finance abandoned its use of "distance rules" in favor of population-based criteria when evaluating whether a new store would be likely to disrupt supply and demand,[542] and thus should not be issued a liquor license. Moreover, MOF will not seek the views of local liquor retailer associations before granting licenses, a process that—much like that used by MITI in administering the Large Scale Retail Store Law—was seen by foreign observers as the biggest obstacle to new entrants.[543] Finally, MOF began choosing licensees by lottery.[544]

Impact of the Law

The Liquor Tax Law has posed an impediment to large scale retailers—particularly supermarkets and high volume discount stores—seeking to obtain licenses for the sale of liquor. Such large stores are reportedly more likely to carry imported alcoholic beverages, and to import directly, enabling them to bypass traditional distribution routes.[545] The total number of licensed liquor retailers in Japan, the bulk of which are small retailers, increased by an average of only about 284 shops a year during the 1985 to 1989 period.[546] One source reports that "as of the end of March 1988, only 371 or 5.7 percent of the total 6,455 supermarkets operated by the member firms of the Japan Chain Stores Association held permanent licenses to sell liquor, compared to 7.2 percent in 1973."[547] Furthermore, many of the companies granted licenses to distribute alcoholic beverages in Japan are themselves major producers. These firms reportedly mark up imported spirits to match the price of their own brands.[548]

As a result, the law has been blamed for limiting the number of outlets which can sell liquor the law and thus reducing the shelf space available for competing imports. In the words of one foreign observer:[549]

> The problem is that it's very hard for supermarket chains to acquire the licenses because of the Japanese government's policy to protect small independent retailers. That

[540] As reported by Yuko Inoue, "Licenses Snag Liquor Imports," *The Japan Economic Journal*, July 9, 1988, p. 3. Liquor taxes are the third largest source of tax revenue for the central government, just after corporate and personal income tax. MOF's main concern is that if too many large stores are issued liquor licenses, distillers would be forced to cut prices, thereby reducing MOF tax revenues. Liquor taxes are currently only paid by distillers and importers; retailers and wholesalers do not pay liquor taxes themselves.

[541] Inoue, p. 3. In the case of Tokyo and other large cities, the distance requirement was 100 meters; in certain other towns, the requirement was 150 meters.

[542] For small retailers, MOF will issue licenses in accordance with the following new population criteria: (1) one shop per 1,500 persons in cities with a population of 300,000 persons or more (the old rule was one shop per 300 households); (2) one shop per 1,000 persons in other cities (versus one shop per 200 households); (3) one shop per 750 persons in rural districts (versus one shop per 150 or 100 households). U.S. Department of State Telegram, Oct. 27, 1989, Tokyo, no. 19741.

[543] Remarks of Wolfgang Pape, first secretary of the EC delegation in Japan, as reported by Yuko Inoue, "Licenses Snag Liquor Imports," *The Japan Economic Journal*, July 9, 1988, p. 3.

[544] U.S. Department of State Telegram, Oct. 27, 1989, Tokyo, no. 19741.

[545] Richard Katz, "Distribution Knot Proves Tough to Untie," *The Japan Economic Journal*, July 15, 1989, A-1.

[546] The Ministry of Finance's National Tax Administration Agency reports that as of March 1988, there were 130,000 shops licensed to sell all types of liquor in Japan, 172,000 licensed to sell limited types of liquors, and 14,000 liquor wholesalers. Some liquor wholesalers are also allowed to retail liquors. U.S. Department of State Telegram, Oct. 27, 1989, Tokyo, no. 19741.

[547] Although 75 percent of Japan's total liquor sales were accounted for by independent retailers (those not controlled by makers), 90 percent of such retailers are "mom and pop" operations. Inoue, p. 3. On the other hand, convenience stores such as 7 11 are reported to be "eagerly expanding" their liquor business. Takahashi, p. 4.

[548] Katz, A-1.

[549] Remarks of Wolfgang Pape as reported by Yuko Inoue, p. 3.

makes it hard for foreign liquor makers to sell their products through supermarkets and develop the big take-home market in relatively small cities.

Moreover, to the extent that such entry barriers diminish price competition, U.S. exports may bear a disproportionate burden, since price appears to be a factor in the competitiveness of at least some U.S. alcoholic beverages.[550]

The relative importance of distribution related barriers has grown in recent years, as other obstacles to foreign alcoholic beverage exporters have been removed. Japan responded to pressure from the EC and United States by lowering tariff rates on certain alcoholic beverages. Teamed with a devaluation of their currencies against the yen, sales of foreign liquor to Japan grew by 49 percent in 1987.[551] In 1989, Japan implemented changes in its tax system that were advantageous to U.S. exports.[552]

Prospects for Change

Various interests within Japan have identified liquor licenses as one barrier to increased competition in the distribution sector and are encouraging more liberal MOF administration of the Law. The Japan Chain Store Association advocates relaxation of the regulations because, in the words of a spokesman, "It's virtually impossible for chain stores to acquire the license, and in some cases, application forms lie on the desk for a few years."[553] Keidanren called for reform of the rule in a February 1987 report.[554] Finally, on October 30, 1989, the Japan Fair Trade Commission (JFTC) issued a report by one of its study groups.[555] The report calls for a reexamination and possible liberalization of current liquor licensing laws and policies. Among the specific practices flagged for reevaluation is the present practice of exempting activities under the Law on Preservation of the Liquor Tax and Liquor Industry Associations from the Antimonopoly Law.[556] The report notes:

> Entry controls which could regulate demand and supply prevent the entry by innovative businesses which seek to provide new services and are likely to protect the vested interests of existing businesses and their organizations. As a result they could hamper businesses from making original and innovative efforts and impair economic efficiency. . . .

Partly in response to such pressure, the Japanese government indicated in April 1990 that it will issue licenses to "all large retail shops" (defined in this instance as those with floor space of more than 10,000 square meters) "and to about 5,000 average-sized shops by 1994. Moreover, the Government of Japan will consider front loading licensing to large retail shops, which are expected to sell more imported liquors, and will reach a conclusion before the final report of the SII is submitted."[557] The commitments made

[550] In the case of wine, for example, the United States exports primarily popularly priced table wines to Japan, which have traditionally been priced lower than French wines. Indeed, partly as a result of recent changes in Japanese tariffs and taxes, the value of U.S. wine and wine product exports has increased substantially over the past five years, from about $5.4 million in 1984 to $22.5 million in 1989. Spirits are a different story, where U.S. brands, such as Johnny Walker, sell at a premium and tend to be popular for gift giving. Gift liquors reportedly are often sold through department stores, which are not subject to the Ministry of Finance supply/demand rules. USITC phone conversation with USDA/FAS, Apr. 27, 1990. Data are for the years Oct. 1984-Sept. 1985 and Oct. 1988-Sept. 1989.

[551] Inoue, p. 3.

[552] According to one analyst, "Even without the tax changes, American wine sales had jumped to nearly $21 million in 1988 from $3 million in 1985, beer exports went from about $3 million to $17 million and deliveries of distilled alcoholic beverages, primarily bourbon, had climbed from $8 million to $47 million. Exports to Japan from European companies, the main foreign competitors, underwent the same dramatic growth. That combination boosted the import share on a volume basis of Japan's wine market to more than 40 percent last year and raised the foreign slice of whiskey sales to nearly 15 percent." Susan MacKnight, "The U.S. Trade Deficit with Japan: Something Must be Done," *JEI Report*, No. 17A, Apr. 28, 1989, p. 11.

[553] Inoue, p. 3.

[554] As reported in Isao Yonekura, "Proposals for Expanding Imports of Manufactured Goods," *Keidanren Review*, No. 108, December 1987, p. 2.

[555] "FTC to Promote Liberalization of Liquor Licensing," translated from *Nippon Jokai Shimbun*, Nov. 5, 1989 and reprinted in Japan/Tokyo Chambers of Commerce & Industry, *Japan-America Cooperative Committee Newsletter*, No. 39, Dec. 28, 1989, pp. 3 5.

[556] The group reports, "[T]he alcoholic beverage industry has been exempted from the provisions of the Antimonopoly Law under the "Liquor Tax and Liquor Industry and Association Law" (Law No. 7, 1953). Under the provisions of this law, with the consent of the Minister of Finance, the manufacturers or brewers of alcoholic beverages may form manufacturing or sales unions, and if certain conditions are fulfilled, they may rationalize their operations into cartels to prevent excessive competition. The manufacturers and brewers of alcoholic beverages can also conclude contracts with resellers in order to maintain retail price levels. The manufacturers did in fact form cartels to prevent excessive competition, but these efforts came to an end during the late 1960's and early 1970's, and there was never any record of formal retailer cartels or contracts to control retail price." JFTC Study Group, "Reexamination of Government Regulations from the Perspective of Competition Policy," Oct. 31, 1989, (USITC translation), p. 6. On the underlying rationale for the regulations' effort to ensure a balance between demand and supply, the JFTC report states—[R]egarding the preservation of the liquor tax system, the direct payers of the tax are the manufacturers. Moreover, the dealers are also obliged to post the accounts and report. The system has been developed to enable confirming of the tax amount... Moreover, the recent tax system reform has greatly changed the system of indirect taxes. Given such circumstances the need to preserve the liquor tax system is not believed to constitute a sufficient ground for justifying execution of entry control which could lead to demand/supply regulation.

[557] As reported in the Apr. 5, 1990 Interim Report of the Japanese Delegation to the Japan-U.S. Structural Impediments Initiative, p. 17.

essentially restate the changes announced in June 1989 and implemented on Sept. 1, 1989. At that time sources at the Ministry of Finance indicated that "the Ministry expects to issue liquor licenses using the new criteria to about 200 large stores and 5,000 to 6,000 small liquor retailers over the next five years." The officials estimated that 800 stores (mainly supermarkets but also including department stores) had floor space of 10,000 square meters or more and said that 600 of them already have been issued liquor licenses.[558] Nevertheless, local authorities will be able to declare areas "saturated" with shops and exempt from the more open regime. Moreover, large stores will only be permitted to sell Western spirits, shutting them out them from the lucrative sake and beer market.[559]

Japanese retailers are reportedly receptive to the reforms. Applications for liquor licenses have increased substantially, and major chain stores such as Ito-Yokado, Seiyu, and Niichi each have requested licenses for about two dozen of their stores.[560] However, given the influence of small retailers and distillers within the LDP, the prospects for a more fundamental overhaul of the liquor licensing system appear to be limited. Distillers in particular are reportedly in no mood for greater liberalization because they already face heightened import competition as a result of changes in the liquor taxes instituted on April 1, 1989.

Restrictions on Wholesale Distribution

The Japanese government restricts free entry into the warehousing industry and regulates price competition by warehousing firms under the so-called Warehouse Industry Law, or *Sokoho*. These restrictions have been criticized in a March 1990 Keidanren report as one factor behind the shortage of storage facilities in Japan. They have also been blamed for driving up storage charges. Bonded warehouses are subject to even tighter regulation, as will be discussed later in the report.

Under the law, all firms wishing to enter the warehousing business must obtain a permit from the Japanese government. Applicants are required to demonstrate that they have "the structural facilities required for the warehouse and the capacity to carry out the business." While no legal basis exists for using the permit system to regulate supply and demand, a JFTC study group has warned that "there is a possibility that the requirement calling for the ability to carry out business could be used to regulate supply and demand."[561]

Furthermore, the Warehouse Industry Law requires operators to register their warehouse fees with the Japanese government. Originally, warehouse operators set their fees freely and then registered them with the appropriate administrative authority. However, a combination of administrative guidance and informal practice has reportedly turned the registration system into a comprehensive fee system. Moreover, it has become common for warehouse operators to "pre-clear" their fee increases with the Japanese government in advance to ensure official concurrence, and, once the fee had been registered, for all other warehouse firms to register their fees at the same level. A JFTC study group concluded that, "in the present system, there is a very strong anticompetitive component because of the band-wagon fee registrations following the registration of a new fee level."[562]

There are some signs that steps may be taken to improve the availability and reduce the cost of warehouse facilities in Japan. In an October, 1989 report a JFTC study group called for a deregulation of entry into the warehousing industry and for closer scrutiny of the anticompetitive effects of the warehouse fee registration system. Moreover, the Japanese government has put in place several measures to promote private investment in warehouse facilities through low-interest loans and favorable tax measures.[563] Recently, a special low interest facility has been established for the construction of warehousing facilities intended for storage of imported goods. MITI claims that these measures have been a factor in the plans of warehouse firms in the Tokyo and Osaka areas to expand their facilities by 16 percent by the end of fiscal year 1991.[564]

Regulations Affecting Automobile Service Centers

An example of the type of overly restrictive and, in some instances, conflicting government regulations that affect distribution in Japan occurs in the automobile industry.[565] In this case the

[558] U.S. Department of State Telegram, Oct. 27, 1989, Tokyo, no. 19741.
[559] Ibid.
[560] As reported in U.S. Department of State Telegram, Oct. 27, 1989, Tokyo, no. 19741, based on an article in *The Japan Economic Journal*, Sept. 27, 1989.

[561] JFTC Study Group, "Review of Government Regulations from the Perspective of Competition Policy," Oct. 31, 1989, p. 1 of USITC translation.
[562] Ibid., p. 2.
[563] In a field interview with USITC staff on Feb. 5, 1990, JDB officials reported that Japan has established a low interest loan programs to finance distribution infrastructure, such as truck terminals, warehouses, wholesale centers, and handling facilities. These loans may be tied to regional development programs, urban redevelopment programs, and/or import promotion programs.
[564] "Interim Report and Assessment of the U.S.-Japan Working Group on the Structural Impediments Initiative," Apr. 5, 1990, p. 12.
[565] USITC staff interviews with representatives of General Motors, Nissan, Toyota, Mazda, and the Japanese Automobile Importers Association, Tokyo, Japan, Feb. 1990.

establishment of a support service, repair and maintenance of autos, is impeded to the detriment of both domestic and imported products. In Japan, as elsewhere, dealers' service stations have been physically incorporated with showrooms for efficiency and customer convenience. Due to urban congestion, however, it has become necessary to separate sales and service facilities in many cases.

Coping with the overcrowded conditions has been complicated by the Building Standards Act (Kenchiku Kijun Ho) which was passed in 1970 and is administered by the Ministry of Construction (MOC). In addition to establishing rigorous (excessive, some in the auto industry feel) safety standards for garages, the law sets out land-use classifications akin to the zoning laws of the various jurisdictions in the United States. One of the categories, "semi-residential/semi-commercial," carries the stipulation that no service station may be established in excess of fifty square meters in size. When the Building Standards Act was put into effect some areas that previously had looser restrictions regarding use were re-classified. Already existing facilities are grandfathered, but any modifications or refurbishments to such facilities is strictly controlled.

The restrictions placed on the disposition of service centers located in areas re-classified semi-residential/semi-commercial are complicated by a conflict with a second law, the Road Transportation Act (Doro Unso Sharyo Ho) which is administered by the Ministry of Transportation (MOT). This law requires that automobile service facilities designed to handle medium-sized and larger cars (2,000 cc and above) be at least 82 square meters in size in order to qualify for MOT certification. While it is possible to apply to the ministries (or the other municipal authorities who may become involved through additional regulations), dealers wishing to establish new service stations are caught in a "Catch-22."

The constraints on building new service facilities, or re-fitting existing ones, is especially burdensome in the Tokyo and Osaka regions, where vacant land is scarce and most prime locations are by now in need of modernization. At least several of the domestic automobile manufacturers and dealers' groups have lobbied MOC and MOT—directly and through MITI which is sympathetic to the auto industry's complaints—to loosen and harmonize the regulations.[566] And while they have not coordinated their lobbying efforts, the domestic industry is joined in its opposition to the current regulations by foreign automobile manufacturers, importers and dealers.

[566] USITC staff interview with the Japan Automobile Importers Association, Tokyo, Feb. 1990.

As in other instances of excessive, complex, or contradictory regulation in Japan, while an entire industry is burdened, newcomers, foreigners, and foreigners who are also newcomers, to successively increasing degrees, are relatively more disadvantaged. As a legacy of past protection and having retreated from a strong local presence, the foreign automobile makers are said to be about twenty years behind their domestic competitors in setting up dealer and service networks.[567] The lack of infrastructure is especially serious for foreign makers in light of consumer concerns about repairing and maintaining an imported model, in general, and an American car, in particular. The concentration of the problem around Tokyo and Osaka is also worrisome to marketers of foreign autos because these are Japan's two most lucrative markets, and because U.S. cars sell relatively better in urban than rural areas.

Restrictions on the Distribution of Agricultural Products

Quotas, tariffs, and price supports[568] may inhibit foreign access to the Japanese agricultural sector. Several studies have analyzed various elements of the Japanese agricultural sector and shown high nominal rates of protection for numerous agricultural products.[569] Some have suggested that agricultural imports into Japan would increase significantly if such trade barriers were eliminated. Japanese barriers against grains, livestock and sugar alone have been estimated to cost U.S. farmers nearly $6 billion in income.[570] There are also restrictions relating to the distribution of agricultural products.

Complete agricultural liberalization in Japan would, according to one study, increase Japan's agricultural imports by over 90 percent, and livestock imports by over 20 percent.[571] According to the study, this liberalization would mean, that based on Japan's 1987 total imports of foodstuffs of $22.4 billion, each 10 percent gain in imports would be worth roughly $2 billion. Another study concluded that "liberalization in agricultural trade would significantly alter Japanese imports of agricultural commodities." It estimated that U.S. exports of agricultural

[567] Ibid.

[568] Price supports are estimated to apply to 70 to 80 percent of the agricultural sector's output. "Deregulating Distribution: Keidanren Proposals for Transport, Trade, Retailing, and Farming, and Food Processing, KKC Brief No. 48, July 1988, p. 3. Randall S. Jones, "Political Economy of Japan's Agricultural Policies," *The World Economy*, p. 29.

[569] See, for example, D.P. Vincent, "Effects of Agriculture Protection in Japan: An Economy-Wide Analysis," Center for International Economics, Canberra, Australia, 1988.

[570] Kym Anderson and Rod Tyers, "Japan's Agricultural Policy in International Perspective", *Journal of Japanese and International Economies*, June 1987, pp. 131-146.

[571] D.P. Vincent, *op. cit.*

products to Japan could increase by $5 billion or more if Japanese agricultural trade barriers were removed.

As noted previously, there is little inventory space in Japan's small stores and supermarkets. As a result, stores sometimes phone in orders when they need to reorder supplies, including food products. Delivery of the goods takes place later that day. However, instead of delivering an entire pallet of goods on a truck as occurs in the United States, products are likely to be delivered in much smaller lots, such as case loads or even individual items. One U.S. businessperson involved in retail food distribution in Japan described the process as follows:

> In the United States, when they distribute food products, they normally deliver a pallet of something to a supermarket. Well, here the supermarkets are much smaller and the mom and pop stores even smaller. They can't take pallet loads of anything—there's no place to put it . . . . Here in Japan you have what we jokingly call a drop-kick distribution system. You have a guy dropping cases off the end of a truck sometimes and maybe another guy catching them. U.S. products and packaging are usually not designed to take that kind of punishment.[572]

Imported or domestic fresh products—such as fruit, vegetables, fish, meats, and flowers—are increasingly sold in central wholesale markets. Supermarkets and specialty shops are major buyers in such marketplaces.[573] Livestock dealers buy livestock, and then ship it to slaughterhouses, which ship the carcasses to wholesalers, who in turn distribute fairly small cuts to retailers.[574] The pork sector, which includes contract farmers associated with the general trading companies, bypasses the wholesale markets. The general trading companies supply piglets and feed, collect fatted hogs, and sell the carcasses to meat processors who distribute cuts through their own channels. Business practices in the agricultural/food sector are similar to those that exist in other parts of the economy, and may include rebates, generous financing terms, and consignment sales (allowing returns of unsold merchandise).[575] Rebates are used in the agriculture/food sector, as in other areas of the economy. For example, rebates based on volume may be offered from producers to wholesalers and from wholesalers to retailers. A rebate for food may be 1 to 2 percent and up to 5 to 6 percent for higher-priced food products. Financing in the food sector includes payment terms that may range as long as 60 to 120 days. In general, the longer the trading relationship has existed, the longer the payment period may be.

Beef and Citrus

A July 5, 1988 United States-Japan agreement set in place a plan for removing quotas on beef and citrus. Existing quotas on beef imports will gradually rise, until their elimination in April 1991. The limits will be replaced with a tariff of 70 percent, that will decline over time. Along with the increasing quota size, the agreement eliminated restrictions that required beef imports to exclusively pass through 36 designated importers.[576]

Japan's Livestock Industry Promotion (LIPC) corporation buys imported beef from a group of trading houses that purchases imports directly. Seventy percent of the beef purchased by the LIPC is chilled beef. The LIPC then marks up the beef by 96 percent and sells it to wholesalers who then resell it to retailers. The chilled beef from the United States that is finally resold at the retail level costs six to seven times its import price, or between about $14 and $18 per 2.2 pounds. On March 7, 1989, Japan's Fair Trade Commission (JFTC) raided the office of 29 of the trading houses during an investigation of price fixing during monthly auctions.[577] In July, the JFTC warned 36 trading houses against price fixing through collusive activities. The JFTC also asked the LIPC to take action to prevent pre-tender negotiations and other trade practices.[578] Prospects for increasing U.S. imports of beef to Japan lie in increasing away-from-home Japanese consumption of beef, according to one beef industry source.[579] However, another expert on Japanese agriculture expressed skepticism about how much dietary substitution away from the large variety of Japanese foods currently available to the population in favor of increased beef would actually occur in the future.[580]

Japan's quota on oranges will increase until 1991, when it will be eliminated. Existing tariffs of 20 percent during the off-season and 40 percent in season will remain in effect after removal of the quota. The quota for orange juice

[572] "What To Do With A Hot Product," *The Journal of the American Chamber of Commerce in Japan*, November 1988, p. 23.
[573] Although increasing, use of such markets may vary, from 16 percent of the pork, to 33 percent of the beef, to 90 percent of the fish and vegetables being sold through central wholesale market auctions.
[574] For a more detailed discussion of beef distribution, see Albrecht Rothacher, *Japan's Agro-food Sector: The Politics and Economics of Excess Protection*, (St. Martin's Press, 1989), pp. 98-99.
[575] Rothacher, p. 97.

[576] "Beef Wars," *The Journal of the American Chamber of Commerce in Japan*, Nov. 1988, p. 24.
[577] "Japanese Officials Raid Trading Houses in Probe into Alleged Beef Price-Fixing," *International Trade Reporter*, Mar. 15, 1989, p. 328.
[578] "FTC Warns Traders Over Alleged Price-Fixing Beef Imports," Kyodo News Service, July 26, 1989.
[579] Ibid., p. 27.
[580] Interview with professor, Faculty of Agriculture, Kyoto University, Kyoto, Feb. 9, 1990.

concentrate will also rise until April 1991.[581] According to one recent report, imports have not increased as much as originally expected under the agreement. In 1989, Japan's imports of oranges totalled 130,000 tons, a level 20 percent lower than the import quota. According to this report the primary reasons that imports have not increased further are the popularity of domestic mikan oranges and that ". . . consumers, they say, simply have not taken to the imports." Japanese oranges are more appealing to consumers because of their color and shape. They are also popular gift items even though their price is much higher than imported oranges.[582]

State-trading

State-trading takes place in certain agricultural sectors in Japan. The Food Agency is Japan's sole authorized purchaser of wheat, wheat flour, and barley. The agency purchases these commodities at prevailing prices on global markets, reselling them later in the domestic market for much higher prices.[583] The program is intended to prevent substitution of other grains for high-cost Japanese rice. Wheat imports are purchased by the Food Agency and resold for three times the world market price. Profits from domestic reselling of foreign wheat help subsidize Japanese agricultural production, including wheat. Liberalization of barley imports would provide poultry and livestock producers with greater choice in determining the most cost-effective feed.[584]

Feedgrains

Feed production levels for feedgrains are controlled through administrative guidance provided by the Ministry of Agriculture, Forestry and Fisheries which has the authority to recommend licenses for new feed mills. In the past, aside from one exception, all licensed mills in Japan are Japanese feed companies and no licenses have been granted to producers. This has inhibited the ability of U.S. feed companies to sell their products in Japan. On October 1, 1989, the requirement that MAFF had to approve licenses to build new mills or expand existing facilities was eliminated. With regard to other feedgrains, the tariff-quota on corn for single-ingredient feed was changed to a new quota to be announced bi-annually based on demand during the previous six month period.

Pork Import System

Japan employs a variable levy system which forces pork imports to enter at a minimum import price (called the gate price). The gate price is the mid-point of a stabilization range for Japanese hog carcasses. Shipments of pork are subject to a variable levy or a tariff based on a trigger level, which is 5 percent below the gate price. A variable levy boosts the price up to the gate price for shipments below the trigger level, while an ad valorem tariff of 5 percent is applied to imports above the trigger level. Hence all pork enters at or above the gate price.

Import duties for pork are applied to the combined c.i.f. price of all pork cuts in a container. The lowest duty, therefore, would be applied to containers where the combined price of all cuts of pork equals the trigger level. As a result, importers mix differently-priced cuts of pork in a container to ensure that the average price of the shipment is valued at the trigger level. The effect of the variable levy system has been to cause U.S. pork products in Japan to be priced significantly higher than Japanese pork.[585]

Dairy Products

The Livestock Industry Promotion Council (LIPC) is the only authorized importer of butter, skim milk powder, sweet condensed whole milk, sweet condensed skim milk, whole milk powder, butter milk powder, and whey powder in Japan. Price stabilization for the first four products is conducted by the LIPC. The LIPC is authorized to purchase the products at prices that are 90 percent of the stabilization price, and to sell products in its possession when prices rise above 104 percent of the stabilization price.[586]

Food Additives

The Ministry of Health maintains a list of additives, food colorings, and chemicals banned in Japan. Some of these items may have been approved for use in the United States by the U.S. Department of Agriculture.[587] In 1985, the Food and Drug Administration submitted a list of 37 food additives for approval in Japan. By late 1989, after resubmission of the list in 1988, only 2 of the additives had been approved. The

[581] In an August 2, 1988 agreement, Japan agreed to implement the "GATT-11" decision calling for the elimination of import quotas on seven categories of agricultural products and to the partial lifting of quotas and substantial liberalization for four other product categories. The products affected by the action are selected tomato and dairy products, dried leguminous vegetables, peanuts, starch, sugars, sugar syrups and sugar based food preparations, fruit puree and paste, prepared and preserved fruit, and non-citrus fruit juices. The liberalization is scheduled to be completed in April 1991.

[582] "Consumers Turn Sour on Imported Oranges," *Japan Economic Journal*, Mar. 24, 1990.

[583] Office of the U.S. Trade Representative, *National Trade Estimate Report on Foreign Trade Barriers*, 1989, p. 99.

[584] Submission of the National Corn Grower's Association to the USITC, dated Jan. 31, 1990 p. 2.

[585] As an example, the cost to purchase pork loins in the United States and ship them to Japan is about $2.60 per pound. The cost to the Japanese consumer is about $4.95 per pound, about 90 percent higher. Submission of the National Pork Producers Council to the USITC, Jan. 31, 1990, p. 1.

[586] Submission of the U.S. Feed Grains Council to the USITC, Jan. 31, 1990, p. 13.

[587] "What To Do With A Hot Product," *The Journal of the American Chamber of Commerce in Japan*, November 1988, p. 20.

Ministry reportedly maintains a restrictive policy on approval of new additives or new applications for previously approved additives. The restrictive food additives policy may have the effect of preventing imports of many processed foods into Japan.[588] In addition, newly developed processed foods, which contain levels of additives greater than preexisting tolerance levels, are also prevented from entering the market.

Wood Products

The distribution system for wood products in Japan may impede market access for foreign suppliers and may have prevented Japanese consumers of wood products from receiving the full benefit of the yen's appreciation. Reform of the distribution system, it is argued, would allow U.S. producers increased sales, and lower the costs of wood products in Japan.[589]

Imported lumber in Japan generally passes through more levels in the distribution chain than domestic lumber.[590] For example, 45 percent goes from the importer (primarily trading companies), to the wholesaler, then to the retailer, then to the consumer. Only about 30 percent of imported lumber goes directly from importer to retailer, then to the consumer. Forty-four percent of domestic lumber, however, goes directly from the mill to the consumer. Another 20 percent passes from the mill to auctions, to retailers, and then to the consumer. The U.S. lumber industry contends that "the multiple levels of distribution make it difficult for U.S. firms to communicate with the ultimate consumer and discuss quality and other issues."[591]

Another aspect of the distribution of wood products involves financing. Promissory notes are used for a large portion of purchases in the Japanese wood products market, according to the U.S. industry.[592] Financing through the distribution chain can mean that larger suppliers finance the smaller suppliers, who in turn finance their customers. Part of the financing means that suppliers may frequently accept 180 day payment terms for lumber and 120 day payment terms for plywood. Such payment terms means that suppliers may have considerable leverage over their customers, as smaller firms that switch suppliers could risk losing a significant financing source.[593] [594]

[588] Interview, Tokyo, Japan, February 1990.
[589] Statement of the Alliance for Wood Products Exports to the USITC, Jan. 30, 1990, p. 1. According to a 1987 study, Japan's Economic Planning Agency said that price declines in the 15 month period following October 1985 were less than one-fourth of the decline expected due to yen appreciation.
[590] Ibid., pp. 3-4.
[591] Ibid, p. 4.
[592] Ibid.
[593] Statement of the Alliance for Wood Products Exports, pp. 4-5.
[594] Other practices affecting imported wood products in Japan—include: tariffs on, and misclassification of, wood and paper products, building codes and products

Restrictions on Investment

Foreign investment and investment by existing foreign-controlled firms is usually allowed automatically in Japan. However, prior notification to the Ministry of Finance is required.[595] In a few sectors, restrictions actually prohibit foreigners from making an investment. In other sectors the Ministry of Finance may be statutorily required to conduct a closer examination of a proposed foreign investment before it is granted an authorization.

Sectors with specific restrictions or prohibitions for foreign investments are (1) primary industry related to agriculture, forestry and fisheries, mining, oil, leather and leather products manufacturing, broadcasting, telecommunications, marine transport, air transport, banking and securities, and insurance; (2) other sectors falling under the safeguard clauses of the Foreign Exchange and Foreign Trade Control Law, when the Ministry of Finance and other ministries deem that Japanese interests might be adversely affected by foreign investments.[596] Table 8 summarizes investment restrictions in Japan. Public monopolies effectively foreclose all investment in tobacco manufacturing, and in the purchase, import, manufacture, and sale of salt.

Foreign investment in Japan is not subject to performance requirements. However, in order to prevent further concentration in the cities of Tokyo, Osaka, and Nagoya, some restrictions exist regarding the siting of industrial investment.[597] In 1987, 75 percent of foreign investment in Japan was located in Tokyo.

Of all foreign firms in Japan in 1987, 40 percent were fully owned. The remaining foreign capital affiliated firms were evenly divided (about 18 percent each) into three general categories—those with foreign owned shares of 20-49 percent, those with 50 percent, and those

[594]—*Continued*
standards favoring nonwood construction materials, government financial assistance, industry Fair Competition Codes, government toleration of anticompetitive practices, counter liberalization measures, and Japanese government procurement policies.
[595] For proposed investments, prior notification must be given to the Ministry of Finance via the Bank of Japan. The waiting period for approval is 30 days although in practice approval is usually obtained within 15 days. "Marketing in Japan," *Overseas Business Reports*, Apr. 1987, p. 26. According to the OECD, national treatment is applied to foreign firms for local financing of inward direct investment, such as non-resident investors using various short- or long-term methods to raise funds for creation of a new enterprise, a joint venture, participation in or take over of an existing enterprise. Organization for Economic Cooperation and Development, "Controls and Impediments Affecting Inward Direct Investment in OECD member Countries." Paris, 1987, p. 29.
[596] OECD, p. 22.
[597] "Marketing in Japan," p. 26.

Table 8
Sectoral controls and obstacles to inward direct investment where measures apply specifically or more severely to non-resident investors in Japan

Sector	*Measures applying specifically or more severely to foreigners*	*Other*
Prohibitions		
Broadcasting	License required to operate radio and television broadcasting facilities, and permission to establish cable television broadcasting facilities shall not be granted to: (1). A person who is not a Japanese citizen; (2). A foreign government or its representative; (3). A foreign juridical person or body; or (4). A juridical person or body in which a person or persons mentioned in any of the three preceding items are officers who execute business or hold one-fifth or more of the voting rights.	
Marina transport	Transport of goods and passengers between Japanese ports reserved to Japanese ships.	
Telecommunications	A license to conduct telecommunications business through the establishment of telecommunication circuit facilities shall not granted to: (1). A person who is not a Japanese citizen; (2). A foreign government or its representatives; (3). A foreign juridical person or association; or (4). A juridical person or association which is represented by any of the above persons, or a third or more of whose officers are such persons, or a third or more of whose voting rights are controlled by foreigners.	Foreign participation in the share of capital of Nippon Telegraph and Telephone Corporation (NTT) and the Kokusai Denshin Denwa Kabushiki. Kaisha (KDD) is restricted.
Mining[1]	Foreigners prohibited, in principle, form acquiring mining rights.	Specified in the Mining Law.
Petroleum[2]	Foreigners prohibited from acquiring mining rights for oil and natural gas.	Specified in the Mining Law and other resources development-related laws.
Restrictions		
Air transport	Licenses to operate Air Transport only granted to firms with none of its representatives and fewer than one-third non-Japanese officers, and with less than one-third of voting rights held by non-Japanese nationals.	Foreign participants in share capital of Japan Air Lines is restricted.
Leather and leather products manufacturing	Closer examinations of foreign investments required in consideration of their economic impact due to the small scale of domestic enterprises and difficult problems caused by historical and social factors.	Specified in the Foreign Exchange and Foreign Trade Control Law.

See footnotes at end of table.

Table 8—*Continued*
Sectoral controls and obstacles to inward direct investment where measures apply specifically or more severely to non-resident investors in Japan

Sector	*Measures applying specifically or more severely to foreigners*	*Other*
Agriculture, forestry fisheries	Foreign investments specifically require closer in consideration of their impact on national economy limited land resources and the small scale of domestic industry.	Specified in the Foreign Exchange and and Foreign Trade Control Law.
Banking and securities	The establishment of branches or subsidiaries of foreign banks or foreign securities houses requires authorization and may be subject to reciprocity considerations.	
Insurance	Foreign insurers are required in all cases to lodge an initial deposit for the establishment of branches which is essentially equivalent to the share capital required of domestic companies. Initial deposits may be required of national insurers in some cases.	
Petroleum	Foreigners require authorization for establishment of enterprises and building of new oil refining facilities.[3]	Specified in the Petroleum Industry Law.
	Notification or registration required for oil distribution.	Specified in the Petroleum Industry Law and the Volatile Oil-Selling Business Law
	Applications by foreign investors specifically require closer examination from the viewpoint of securing a stable supply of oil because it is a material vital to the national economy.	Specified in the Foreign Exchange and Foreign Trade Control Law.

[1] Metal mining, non-metal mining, coal and lignite mining, etc.
[2] Oil industry, oil and natural gas drilling, oil refining, oil retailing, etc.
[3] These restrictions apply both to residents and non-residents.

Source: Organization for Economic Cooperation and Development, *Control and Impediments Affecting Inward Direct Investment in OECD Countries*, Paris, 1987.

with 50 up to 100 percent. Firms with foreign capital shares of less than 20 percent are not included in the data concerning foreign capital-affiliated firms in Japan. The size of foreign firms by capitalization in 1987 was as follows:[598]

Capitalization	Percent
(Yen)	
Up to 10 million	27
10 to 30 million	20
30 to 100 million	25
100 million to 1 billion	21
Over 1 billion	7

In 1987, there were 3,850 foreign capital-affiliated firms in Japan with foreign capital shares exceeding 20 percent. U.S. firms accounted for about 40 percent of those companies. Eighteen percent of foreign-affiliated companies were established through investment by foreign firms already in Japan. West German and British firms accounted for about 7 percent each of foreign firms, Swiss 6 percent, French 5 percent, Hong Kong 5 percent, and Dutch 3 percent.

Japan ranked fifth among destinations for U.S. foreign direct investment abroad in 1987. Of a total $308.8 billion in U.S. foreign direct investment that year, investment in Canada accounted for $56.9 billion (18 percent), the United Kingdom $44.7 billion (14 percent), West Germany $24.5 billion (8 percent), Switzerland $20.0 billion (6 percent), and Japan $14.3 billion (5 percent).[599] U.S. foreign direct investment in Japan at the end of 1989 was estimated at about $17.0 billion, but grew at a higher rate, 10.7 percent, than U.S. investment in either Britain, Holland, Canada, or West Germany.[600]

The lower level of U.S. investment activity in Japan is caused by difficulties in breaking into the Japanese market, according to some reports. Cross-shareholding among friendly companies, the low level of common stock as a share of total capital, ties between government and industry, reluctance by Japanese firms to break long-standing business relationships, and complexities of the distribution system serve to constrain foreign investment in Japan, these analysts suggest.[601] According to a recent study of Japan's distribution system:

> There have also been complete takeovers of former sole importers. . . but this practice, although quite common in other countries is the exception rather than the rule in Japan. The reason is that it is completely at variance with the Japanese mentality for a firm—which is regarded more than anything else as a kind of family, with the employees as the members of the family—to be sold to "Gaijins" (foreigners).[602]

Practices such as cross-shareholding may keep as much as 70 percent of total stocks in Japan from changing hands. Banks, for example, may own blocks of shares in companies to which they lend, or insurance companies and brokerage firms may buy stocks as a method of promoting long-term business relationships.[603] This can have the result of keeping stock prices high and making it difficult for outsiders to buy into the Japanese market.[604] The Westview study notes: "Even to acquire a substantial holding in a Japanese company is difficult."[605] A survey by the Tokyo Stock Exchange broke down such cross-holdings as 28.5 percent by other companies, 38.8 percent by lenders, and 1.4 percent by employees. As noted previously, such restrictions and practices make it virtually impossible to purchase outright an existing distribution network.

Mergers and Acquisitions

The number of mergers and acquisitions (M&As) in Japan in 1987 was estimated at 451, compared with over 3,000 in the United States.[606] One Japanese business person, responsible for acquisitions at Minebea Co. explained the relatively low number of M&As compared with the United States by saying that "to sell a company in Japan is considered shameful, in much the same way as an ancient warlord would kill himself before surrendering his castle, or as a captain would choose to go down with his ship."[607] The average debt-equity ratio of Japanese companies of about 80:20 makes them more dependent on banks than U.S. firms, with an average debt-equity ratios much closer to 50 percent. "Therefore, any M&A deal with which the controlling bank disagrees, or has not been notified of, will simply not take place," according to Abe.[608]

In the United States, acquisition of 51 percent or more of a company's stock is usually sought in order to take control of a company, however 10 to 20 percent ownership may be sufficient to exert considerable influence in Japan. Kenji

[598] "Passport to Japan: Businessman's Guide, 1988/89," p. 124.
[599] "Foreign Direct Investment in a Global Economy," *Department of State Bulletin*, June 1989, p. 32–34.
[600] "Dispelling Some Myths About Foreign Investment," *The Washington Post*, March 18, 1990.
[601] *1989 National Trade Estimate Report on Foreign Trade Barriers*, p. 108.

[602] Batzer and Laumer, p. 85.
[603] The limitations on such investments are discussed in the keiretsu section of this report. No restrictions apply to cross-shareholding by non-financial institutions.
[604] "In Corporate Japan, Cross Shareholding Remains a Useful Defense Mechanism," *Wall Street Journal*, Nov. 17, 1989.
[605] Batzer and Laumer, p. 85.
[606] "M&A Japanese-style," *Business Tokyo*, p. 8.
[607] Ibid., p. 9.
[608] Ibid.

Suganoya of corporate planning at Yamaichi advocates starting "modestly with, for instance, business cooperation and then gradually expand the influence . . . I have to explain to foreign customers that acquisition of a Japanese company requires six times as much time and patience as in the United States."[609]

The difficulties encountered by foreign as well as Japanese investors are illustrated by recent efforts to exercise shareholder rights. For example, by mid-1989, T. Boone Pickens, had acquired 20.2 percent ownership of Koito Manufacturing Co., a major producer of automotive lighting equipment. At a stockholders meeting in June 1989, he sought unsuccessfully to obtain three seats on the board of directors.[610]

For over two years, a wealthy Japanese entrepreneur, Shigeru Kobayashi, President of Shuwa Corp (an international real estate company) bought stock in several medium-sized supermarket chains. In response, two of the firms issued stock to each other at prices well below market value.[611] The swap —had the effect of diluting Koboyashi's stock.[612] In response, Mr. Kobayashi took the issue to Tokyo District Court. The court ruled that the swap was illegal and that the firms "sought to lower the shareholding ratio of Shuwa in order to maintain the control of existing management. As such it constitutes a highly unfair move"[613] that the Court ruled should have been put up for approval of shareholders in a general meeting. The ruling is expected to make it easier to initiate hostile takeovers and to exercise stockholders rights in the future.

Recent Japanese commitments made by Japan could signal improvements in the climate for foreign direct investment. As part of its commitments in the interim report on the Structural Impediments Initiative, the Government of Japan stated that it was considering issuing a statement reaffirming the openness of Japan's foreign investment policy. It also said that it "would reexamine the Foreign Exchange and Foreign Trade Control Law with a view to submitting an amending bill in the next ordinary Diet [legislative] session." In particular, Japan stated that it would revise the law to remove the legal basis for the government to restrict foreign direct investment and the importation of technology in any industrial sector on the grounds that such investments and technology imports might have an adverse effect on similar domestic activities or the smooth functioning of the Japanese economy.

The revisions would remove the requirement for prior notification of such imports and investments. Japan also said that it would submit a bill abolishing the prior notification requirement for takeover bids and eliminating the possibility of officially prolonging the takeover period. On mergers and acquisitions, Japan said it would examine the possibility of simplifying merger and acquisitions procedures. With respect to the issue of cross-shareholding, the Government of Japan said it is studying whether reporting requirements for related-party transactions were adequate.

Other Features of the Economy Affecting Distribution

Entry Procedures and Warehousing

Japan's facilities for receiving imports at port of entry are inadequate and its customs clearance process is slow, cumbersome and inflexible, resulting in delay deliveries, loss of merchandise, and higher compliance costs for foreign exporters and domestic importers. The added costs operate to the disadvantage of foreign companies compared to other firms in the market. However, it is unclear whether U.S. firms are disadvantaged more than companies from other countries. As a result of Japan's slow clearance process, U.S. exporters typically must finance the sale of their products during import clearance time. Japanese buyers sometime perceive imported products as an unreliable source of supply because in part of import clearance problems and delays. In addition, in some cases, U.S. exporters may perceive the Japanese import clearance as sufficiently complex so as to be deterred from exporting to Japan.

Customs Clearance

While Japan's imports have risen sharply since 1985 both in terms of volume and value, staffing at Japan's Customs and Tariff Bureau[614] has remained relatively steady (see tables 9 and 10). The U.S. government has argued that inadequate staffing levels result in processing delays

[609] Ibid, pp. 9-10.

[610] Takeu Matsura, "When Pickens Came to Town," *Journal of Commerce*, Dec. 1, 1989.

[611] "Tokyo Court Invalidates Defenses of Grocery Chains Against Raiders," *The Wall Street Journal*, July 26, 1989.

[612] "Shareholders find a voice," *The Economist*, July 29, 1989, p. 72, "Tokyo Court Invalidates Defenses of Grocery Chains Against Raiders," *The Wall Street Journal*, July 26, 1989.

[613] "A Court Ruling Unleashes Japan's Corporate Raiders," *Tokyo Business Today*, September 1989, pp. 34-36.

[614] Japan's Customs and Tariff Bureau was created in 1872. Japan's Customs and Tariff Bureau currently functions under the Ministry of Finance. Customs is responsible for the collection of customs duties and other taxes, administration of customs clearance procedures, enforcement of laws concerning illegal exports and imports, administration of bonded goods, and collection of trade statistics. Japan's Customs and Tariff Bureau has nine regional offices. Regional offices function with four divisions: administration, inspection, export and import. Customs offices are located at 116 seaports, 12 airports, and post offices where foreign mail is processed. Customs and Tariff Bureau, Ministry of Finance, *Japanese Customs in Brief*, April 1989, pp. 2-8.

for U.S. exports to Japan. U.S. shipping concerns report that air cargo clearance in Japan generally takes three days and sea cargo takes a week to ten days and, in some instances, can take up to three weeks.[615] Although import clearance in the United States is subject to cyclical delays, the U.S. Customs Service generally clears sea cargo at the Port of Los Angeles in an average of less than 24 hours and clears trucks carrying routine cargo through the Canadian border in 15 minutes.[616]

In July 1989, Japanese Customs conducted a survey of 150 random sea shipments and 50 random air shipments to determine an average length of time for the three stages of import clearance (pre-Customs, Customs, and post-Customs). The survey included shipments of automobiles, machinery, and processed and perishable food. The study showed that air cargo was cleared at Narita within an average of 2.8 days. When compliance with other ministries laws was required, the average was 3.4 days with pre-customs clearance procedures requiring 2.8 days. Sea cargo was cleared within an average 7.7 days.

Table 9
Export and Import declarations in Japan, 1985-89

Year	Export	Import
1985	5,846	2,642
1986	5,791	3,085
1987	6,080	3,694
1988	6,514	4,366
1989	6,853	4,875

Source: Japan's Customs and Tariff Bureau

Table 10
Change in the number of employees at Customs and Tariff Bureau and Customs, 1985-89

Year	Customs and Tariff Bureau	Customs	Export Processing	Import Processing only
1985	170	7,810	700	1,080
1986	170	7,760	680	1,080
1987	170	7,730	680	1,090
1988	170	7,730	670	1,190
1989	170	7,890	660	1,270

Source: Japan's Customs and Tariff Bureau

[615] USITC staff phone interview with U.S. State Department official, Jan. 2, 1990, Washington, D.C.; Letter of Dec. 7, 1989 of a U.S. shipping company submitted to USITC staff.

[616] USITC staff interview with international trade consultant, Dec. 19, 1989, Washington, D.C.; USITC staff phone interview with U.S. State Department official, Jan. 2, 1989, Washington, D.C. The U.S. Customs clearance system is more efficient for many reasons outlined in this section, including the use of computers to allow cargo to be cleared without any exchange of paperwork. See "Carrier-Customs Links Will Speed Air Cargo," *Journal of Commerce*, Oct. 13, 1989, p. 1A.

Air Facilities

Japan's import clearance process begins when imports arrive at Japan's crowded air and sea ports. Narita is 41 miles (70 kilometers) from central Tokyo.[617] A small percentage of cargo in terms of value, including such commodities as perishables, pharmaceuticals, liquor, and express courier shipments is cleared through Japanese customs directly at Narita. This accounts for nearly 50 percent of the cargo tonnage entering Japan, however. Approximately 80 percent (by value) of the cargo received at Narita must be transferred by truck 30 miles (a one hour trip) to the Tokyo Air Cargo City Terminal in Baraki.[618] In 1988, Japanese Customs cleared 3.4 million import entries—or 30 percent of the national total of entries—at Baraki. Baraki is 13 miles from central Tokyo.

There are several problems with clearing cargo through Narita. First, the air cargo warehouse and storage facilities at Narita are not sufficient to meet the demand for the commodities requiring clearance at Narita.[619] The cargo handling facility at Narita has floor space of about 115,000 square meters and the cold storage facility has an area of 2,000 square meters. (see table 11). As a result of inadequate cold storage facilities at Narita, fresh flower importers say that flowers wilt.[620] [621] A new cargo-handling facility is being planned, according to Japan's Customs and Tariff Bureau.[622] Second, staging cargo at Narita and then again at Baraki, coupled with the required bonded transport between Narita and Baraki, is time-consuming, often adding a day or two to the overall clearance process.[623] Third, a monopoly trucking service, in which Japan Air Lines has a significant interest, must be used for the in bond transport between Narita and Baraki.[624] U.S. suppliers have complained that the fee for such trucking is high. (see table 12).

Facilities are also inadequate at Japan's other international airports. The Itami airport at Osaka also receives a large volume of international air

[617] The annual volume of air cargo handed at Narita was 1,227,000 tons in Fiscal Year 1988. Written information provided by Japan's Customs and Tariff Bureau, Ministry of Finance, Feb. 27, 1990, p. 6.

[618] See section on trucking for information regarding transport charges.

[619] USITC staff phone interview with U.S. State Department official, Jan. 2, 1989, Washington, DC.; "U.S., Japan Ink Air Pact Expanding Cargo Rights," *Journal of Commerce*, Nov. 7, 1989, pp. 1A, 5B.

[620] "Troubled Tulips," *Business Tokyo*, June 1989, p.27.

[621] A Japanese wholesaler that imports U.S. food products also cited inadequate cold storage space as being a major deterrent to expanding their imports. Interview with Japanese food wholesale company, Tokyo, Japan, Feb. 7, 1990.

[622] Written information provided by Japan's Customs and Tariff Bureau, Ministry of Finance, Feb. 27, 1990, p. 6.

[623] USITC staff phone interview with U.S. State Department official, Jan. 2, 1989, Washington, D.C.

[624] Ibid.

Table 11
Area for handling international and domestic air cargo

Airport	*Area (in square meters)*
Narita	115,000m
Itami	29,400m
New-Chitose	8,000m
Niigata	1,100m
Komatsu	800m
Nagoya	3,800m
Fukuoka	12,600m
Nagasaki	1,200m
Kumamoto	1,900m
Kagoshima	1,200m
Naha	9,900m

Source: Japan's Customs and Tariff Bureau

Note.—At Haneda, the most of cargo handling facilities except using for China Airlines are used for domestic air cargo.

Table 12
Truck freight charge for transport from Narita Airport to Baraki

Type of Trucks	*Charge(yen)*
1-ton truck	12,990
2	14,870
3	15,890
4	16,950
5	18,760
6	20,600
8	23,250
10	25,830
12	26,670

Source: Japan's Customs and Tariff Bureau

Note.—For each additional 2 tons over 12 tons, 1990 yen is added.

cargo (1,440,000 tons in fiscal year 1988).[625] However, Itami also has inadequate air cargo warehouse and storage facilities.[626] The new Kansai International Airport near Osaka is scheduled to open in 1993. Export cargo facilities will be nearly twice as large as import facilities.[627] Kansai will also use a procedure similar to that at Narita for trucking imported cargo offsite to an examination station.[628] In addition to Narita and Itami, there are ten other airports designated by Customs for handling international flights. However, these airports primarily handle domestic flights and their handling areas are much smaller compared to Narita. Nagoya, Chitose, Hiroshima, and Fukuoka also have inadequate facilities to handle international air cargo.[629] [630]

Seaports

Japan has an extensive network of 116 seaports located throughout the country.[631] Japan's seaports have traditionally served as the point of entry of raw materials and exportation of manufactured goods. Land located near ports is typically owned by existing importers of raw materials. As Japan's imports of manufactured goods have increased in recent years, importers of manufactured goods have had difficulty in obtaining space near ports. As a result, many Japanese shippers believe that Japan needs new or improved seaport facilities to handle the recent increase in manufactured goods imports as well as raw materials.[632]

Certain government and business actions have hampered those efforts. For instance, in response to a recent boom in cold-storage warehouse construction, the Japanese Ministry of Transportation expressed concern that too many cold storage warehouses might be built in anticipation of food imports leading to an excess of facilities.[633] When U.S. soda ash exporters attempted to buy an equity stake in the Toko Terminal, Japan's only port facility dedicated to specifically handling soda ash and used exclusively by U.S. soda ash exporters, their overtures were rejected by the port's owners. The port's owners and operators are also Japan's soda ash producers and their trading company affiliates. Accordingly, when U.S. soda ash exporters utilize the Toko Terminal, they must deal with their direct competitors.[634]

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[625] Written information provided by the Customs and Tariff Bureau, Ministry of Finance, Feb. 27, 1990, p. 10.

[626] USITC staff phone interview with U.S. State Department official, Jan. 2, 1989, Washington, D.C.

[627] Export cargo facilities will be located on 17.2 hectare (42.5 acres) and import cargo facilities will be located on 9.2 hectare (22.7 acres). Export cargo will have buildings on 4.1 hectares (10.1 acres) and import cargo will have buildings on 2.8 hectares (6.9 acres).

[628] USITC staff phone interview with U.S. State Department official, Jan. 2, 1989, Washington, D.C.

[629] USITC staff phone interview with U.S. State Department official, Jan. 2, 1989, Washington, D.C. Although the United States and Japan recently entered into an agreement expanding air cargo service between the two countries, there will remain a shortage of such air cargo service. "U.S., Japan Ink Air Pact Expanding Cargo Rights," pp. 1A, 5B.

[630] Written information provided by Japan's Customs and Tariff Bureau, Ministry of Finance, Feb. 27, 1990, p. 11.

[631] Japan's principal seaports are Kobe, Yokohama, Nagoya, Osaka, Tokyo, Yokkaichi, Shimizu, Otaru, Muroran, Hakodate, Wakamatsu, Nagasaki, and Moji. *Exporters' Encyclopedia* (Dun's Marketing Services, July 1989), vol. 2, p. 2-739.

[632] USITC staff phone interview with U.S. State Department official, Jan. 2, 1990, Washington, D.C. Interestingly, three Japanese firms have jointly developed a floating warehouse facility with distribution and refrigeration facilities. The floating warehouses will be able to store up to 40,000 tons of goods. The warehouses are expected to cost 10 to 12 billion yen. A comparable land-based warehouse costs 8 billion yen, but high land prices in many congested cities will make the floating warehouse less expensive in some areas. The three firms expect to sell four warehouses in the next five years. Asahi News Service, "Three Japanese Firms Develop Floating Warehouse Facility," June 8, 1989.

[633] *Japan Economic Daily*, Sept. 1989.

[634] Statement of John M. Andrews, President, American Natural Soda Ash Corporation, before the Subcommittee on International Trade of the Committee on Finance, U.S. Senate, Washington, D.C., on Nov. 6, 1989, p. 8; *1989 National Trade Estimate Report on Foreign Trade Barriers*, p. 112.

Bonded Areas

In general, all imported cargo must be transported in-bond to a bonded area upon arrival.[635] Imported cargo may be transferred in-bond between bonded areas.[636] Japan has five types of bonded areas: (1) designated bonded areas,[637] (2) bonded sheds,[638] (3) bonded warehouses,[639] (4) bonded manufacturing factories,[640] and (5) bonded exhibition sites.[641]

[635] All countries require imported cargo to remain in a bonded area so that customs may maintain control of the goods until release is authorized and to preserve the integrity of a shipment until examination is completed.

[636] Customs Law arts. 63-65; *Exporter's Encyclopedia*, (Dun's Marketing Services July 1989), vol. 2, p. 2-737.

[637] Designated bonded areas are premises, buildings or other facilities, owned or administered by the national government, local public entities, the New Tokyo International Airport Corporation, or any other person designated by the Minister of Finance, in which foreign goods may be loaded or unloaded, conveyed or stored in order to obtain simplified and prompt handling of customs clearance. The storage period may not exceed one month. Customs Law arts. 37—41-2; Diamond, Walter and Diamond, Dorothy, *Tax-Free Trade Zones of the World*, (1989), vol. 2, p. Ryukyu Islands-3.

[638] Bonded sheds are places, approved by the Director of Customs, in which goods of foreign origin may be unloaded or loaded, conveyed, or temporarily stored to facilitate customs formalities. The maximum storage period is one month. Customs Law arts. 42 49; Diamond and Diamond Tax Free Trade Zones of the World (1989), vol. 2, p. Ryukyu Islands 3.

[639] Bonded warehouses are facilities, approved by the Director of Customs, in which goods of foreign origin may be stored for a maximum period of two years. The Director of Customs may, for "reasons deemed valid" extend the two year period. Such goods are subject to customs inspection at any time they are entered into the warehouse. Customs Law arts. 50-55; Diamond and Diamond, vol. 2., p. Ryukyo Islands-3. Ninety-five percent of Japan's bonded warehouses operate under a self-control system whereby Customs officers are not present when goods are put into or taken out of a bonded area and the warehouse operator's records are accepted. Customs Law art. 31; Customs and Tariff Bureau, Ministry of Finance, *Bonded Area Systems* (undated).

[640] Bonded factories are establishments, approved by the Director of Customs, in which goods of foreign origin may be blended, processed, manufactured, or handled in other ways. Foreign goods may by stored in these places awaiting processing for a two-year period. This time limit, however, may be extended by the Director of Customs. Goods entered into bonded factories are subject to customs inspection. Under certain conditions, permission may be obtained to remove foreign goods from the premises of bonded factories to another work site or factory for the purpose of performing operations not feasible within the bonded factory. Customs Law arts. 56-62; Diamond and Diamond, vol. 2, p. Ryukyu Islands-3. Examples of goods produced or processed in bonded manufacturing warehouses include canned fruit, canned seafood, confectionery, coffee, in-flight meals for international flights, steel materials, cables and wires, ships, automobiles, machinery, petroleum products, agricultural chemicals, chemical products, textile products, and color film. Customs and Tariff Bureau, Ministry of Finance, *The Bonded Area System of Japan: A Guide for Foreign Businesses and Institutions* (undated). For an example of burdensome procedures applied to a bonded manufacturing warehouse, see Weil, Frank and Glick, Norman, "Japan—Is the Market Open? A View of the Japanese Market Drawn from U.S. Corporate Experience," 11 *Law & Policy in International Policy*, (1979), pp. 864.

[641] Bonded exhibition sites are areas approved by the Director of Customs from time to time in which foreign

Each of the five types of facilities permit the entry of foreign goods for storage and re-export, and, in certain instances, checking of contents, repacking, sorting, exhibition and minor processing,[642] without payment of import duties. When the goods leave the bonded area and proceed through Japanese Customs, the goods become subject to import duties.[643] Japan has approximately 73 designated bonded areas, 3,640 bonded sheds, 1,268 bonded warehouses, 1,074 bonded factories and several bonded exhibition sites.[644] Most of these facilities are privately owned and are subject to the Customs and Tariff Bureau's regulations.[645]

There are several problems with the existence and operation of bonded areas in Japan. First, Japan's Customs' regulations concerning the use and designation of bonded warehouses are very restrictive. Imported products may be stored in bonded warehouses for up to two years and the use of such warehouses to maintain inventories is limited.[646] In the United States, imported merchandise may be stored in a bonded warehouse for up to five years, and may be used for maintaining inventory.[647] As a result, an importer in Japan, as compared to an importer in the United States, may find it difficult to build up an inventory of imported goods while deferring payment of duty until the goods are needed and withdrawn from the warehouse.[648]

[641]—*Continued*
goods may be stored or displayed at international trade fairs. Goods sold, consumed, or displayed for a fee are subject to Customs procedures and duties. Customs Law art. 62; Diamond and Diamond, vol. 2, p. Ryukyu Islands-3. For examples of such exhibitions, see *The Bonded Area System of Japan: A Guide for Foreign Businesses and Institutions (undated)*.

[642] Simple processing of stored goods includes heating, washing, and waxing foods. Customs and Tariff Bureau, Ministry of Finance, *The Bonded Area System of Japan: A Guide for Foreign Businesses and Institutions* (undated).

[643] Diamond and Diamond, vol. 2, p. Ryukyu Islands-2.

[644] As of January 1, 1989. *Customs Administration in Japan* (1989), p. 91. As of January 1, 1988, Japan had 72 bonded areas, 3,495 bonded sheds, 1,25 bonded warehouses, and 1,127 bonded manufacturing warehouses. *Bonded Area Systems* (undated). For previous year statistics, see Diamond and Diamond, vol. 2, p. Ryukyu Islands-3. Japan has only one foreign trade zone located at Naha, Okinawa. Many of the activities carried out in foreign trade zones in most countries are done in Japan's bonded area system. A foreign trade zone, however, offers some additional advantages, including the ability to transport goods easily between various type of facilities in the zone. See Customs and *Bonded Area Systems* (undated); Diamond and Diamond, (1989), vol. 2, p. Ryukyu Islands.

[645] Diamond and Diamond, Ryukyu Islands-2.

[646] U.S. Department of Commerce, International Trade Administration, *Business Reports: Marketing in Japan* (April 1987), pp. 22-23. The Director of Customs may, for "reasons deemed valid," extend the two year period. Customs Law arts. 50-55.

[647] 19 C.F.R. §§ 19, 144.

[648] Feller, Peter, *U.S. Customs and International Trade Guide* (1989), vol. 1, § 9.02[1], p.9 3.

Second, Japanese Customs regulations require that bonded warehouses be located within a certain distance of Customs' houses.[649] Often land is unavailable within the prescribed limitation, in part due to zoning restrictions. As a result, importers must frequently rent space in facilities which have high storage fees.[650] Customs also does not allow certain facilities to be designated as bonded warehouses.

Enforcement of Other Ministry Laws

Japanese Customs may not begin processing imported cargo until all necessary import licenses from other Japanese Government ministries are obtained from the appropriate ministry and submitted to Customs along with required documentation by Customs.[651] Approximately 30-35 percent of the value of all shipments to Japan require licenses from other ministries. About half of these shipments are food products. Some imported products, such as many food products, require licenses from two or more other agencies.[652] Import licenses must be obtained under 39 laws from the appropriate government agency.[653] For example, imports of live evergreen trees must be inspected by officials of the Ministry of Agriculture, Forestry and Fisheries (MAFF). Once MAFF completes its inspection and issues the appropriate import licence, Customs may begin its processing formalities.[654] In contrast, U.S. government agencies may delegate their import clearance authority to the U.S. Customs Service. U.S. Customs officers are cross-trained in the administration of other agency laws. Accordingly, U.S. Customs enforces or participates in the enforcement of other U.S. government agency laws as part of its import clearance process.[655]

Japanese Customs procedure for administering other agency import laws creates significant delays in import processing. A Japanese Customs survey conducted in July 1989 demonstrated that where other agency licenses are required the import clearance time is 1.3 days longer for air cargo and 3.4 days longer for sea cargo. Japanese Customs officials complain that other agencies "hold up the import line" and hence are interested in administering other agency laws more efficiently.[656]

Japan's Customs and Tariff Bureau officials report that the Government of Japan is very aware of this problem. Japanese Customs have reviewed several options for improving the situation, but have stated that most options are not currently feasible. One option that has been rejected is that Japanese Customs officers could be cross-designated to determine admissibility and issue licenses. Other Japanese ministries, however, are apparently not willing to relinquish their current authority or staffing. Japanese Customs also notes that budget constraints prevent them from increasing staffing levels or conducting training to administer other agency laws. A second, other agency officials could be

[649] USITC staff phone interview with U.S. State Department official, Jan. 2, 1989, Washington, D.C. Submission of the American Chamber of Commerce in Japan to the USITC, Dec. 11, 1989, p. 2. Although the United States has similar rules, U.S. Customs allows importers to form bonded areas irrespective of the distance to a customshouse where the importers pay the U.S. Customs officials salary at the bonded area. USITC staff phone interview with U.S. State Department official, Jan. 2, 1989, Washington, D.C. The United States also does not have the land shortage that Japan has. See also Kodak's experience as noted in the ACCJ 1989 480 p. distribution report.

[650] U.S. Department of Commerce, International Trade Administration, *Overseas Business Reports: Marketing in Japan*, April 1987, pp. 22-23.

[651] Customs Law art. 70.

[652] "How to Beat the Import Barriers," *Business Tokyo*, Nov. 1989, p. 35.

[653] The following are the most commonly involved laws: Food Sanitation Law arts. 4-7, 9, 10; Domestic Animal Infectious Disease Control Law arts. 36-38, 40, 42, 44, 45; Plant Quarantine Law arts. 6-8, 10; Pharmaceutical Affairs Law arts. 22, 23, 28, 56, 57, 60, 62, 65, 83; Poisonous and Deleterious Substances Control Law art. 3; High Pressure Gas Control Law art. 22; Law Concerning Screening of Chemical Substances and Their Manufacture arts. 3, 5, 11. The following are the remaining laws: Foreign Exchange and Foreign Trade Control Law arts. 47-49, 52; Export Trade Control Order arts. 1-4, 12; Import Trade Control Order arts. 4, 8, 10, 11, 14, 20, 21; Foreign Exchange Control Order art. 19; Export Inspection Law arts. 3, 5, 7-10, 13; Import/Export Transaction Law arts. 28, 30; Export Goods Design Law arts. 15, 18; Export Goods Design Law art. 3, 5, 7-10, 13; Uniform Trademarks Law relating to Export Products by Minor Enterprises art. 14; Staple Foods Control Law art. 11; Cultural Properties Protection Law arts. 44, 56, 65; Toxic Substance Control Law art. 3; Fertilizer Control Law arts. 4, 35; Forestry Seedlings Law art. 10; Agricultural Industry Law arts. 13, 16; Cocoon and Silk Thread Price Stabilization Law art. 12; Game Law art. 20; Pearl Culture Industry Law art. 8; Sugar Price Stabilization Law art. 5; Explosive Control Law art. 24; Firearms and Swords Control Law arts. 4, 6; Labor Safety Hygiene Law art. 55); Alcohol Patent Law art. 4;

[653]—*Continued*
Tobacco Industry Law art. 11; Salt Patent Law art. 22; Wildlife Preservation and Game Law art. 20; Law relating to regulations of Transfer of Special Birds art. 4; Livestock Infectious Diseases Prevention Law arts. 36-38, 40, 42, 44, 45; Rabies Prevention Law art. 7; Narcotic Control Law arts. 12-14, 17, 18; Hemp Control Law art. 4; Opium Control Law art. 6; Stimulant Drugs Control Law art. 13; Stamps Counterfeit Control Law art. 13; Postage Stamps Counterfeit Control Law art. 1. Japan External Trade Organization, *Japan's Tariff System and Customs Procedures* (Dec. 1978), pp. 19-21.

[654] "How to Beat the Import Barriers," *Business Tokyo*, Nov. 1989, pp. 34-35.

[655] U.S. Customs Service, Department of the Treasury, *Importing into the United States* (Jan. 1989), pp. 49-60. Some laws are administered by the principal regulatory agency with Customs playing a coordinating role, some laws are administered exclusively by Customs, and a number of laws are administered jointly by Customs and the principal regulatory agency under joint regulations. See Feller, Peter, U.S. Customs and International Trade Guide (1989), vol. 1, chp. 16.

[656] "How to Beat the Import Barriers," *Business Tokyo*, Nov. 1989, p. 35.

located at Customs sites or in joint national buildings to expedite licensing processing. Japanese Government officials, however, say that a lack of space prevents the location of other agency officers or joint buildings.[657]

In addition to the time-consuming process of obtaining import licenses from other agencies, importers encounter other problems at this point in the clearance stage. First, other agency inspections are conducted infrequently in some cases. For instance, animal quarantine inspections are conducted only four times daily at Narita Airport at 9:30 a.m., 11:00 a.m., 2:30 p.m. and 4:00 p.m. A shipment of beef may arrive at Narita at 6:00 a.m., by 7:30 the cargo of beef is loaded and verified against the invoices, and then must wait two hours, until 9:30 a.m., for the animal quarantine inspection. Second, importers sometime discover that their products do not meet Japan's exacting product standards when their goods requiring licenses from other agencies are inspected.[658] An overview of the problems importers face with respect to Japan's product and certification standards is below.

Customs Clearance, Review of Documentation, Appraisement and Evaluation

After imported cargo has been unloaded and moved to a bonded area, Customs officials verify the imported goods with the accompanying invoice and packing list. Japanese Customs will not accept packages where the invoice and packing list do not agree exactly with the physical shipment.[659] In contrast, in the United States, where invoices are unavailable or incomplete at the time of entry, the importer may file a pro forma invoice, together with a bond for the production of the missing document within six months from the date of entry.[660]

An importer submits an import declaration in triplicate and other required documents to Customs.[661] Customs officers review and verify the submitted documents to insure that the required documents are correctly completed, consistent with each other, and submitted in the requisite number of copies.[662]

Japan announced on January 10, 1982, as part of a package of new measures intended to facilitate to clearance of imports, that the required documentation would be streamlined.[663] According to the American Chamber of Commerce in Japan 1989 White Paper:

> By all reports, the documentary burden was generally lessened by the new procedures. However, explanatory letters, self-inspection reports, etc. are still demanded in many cases by customs officials before cargoes can be moved. There is, in fact, growing disappointment with the 'improvements' in customs procedures. Declarants hesitate to discontinue the use of documents 'no longer required' by the central customs authorities. Several documents remain as great a burden as before. The wording of some of the measures is vague, and their on the spot implementation becomes a matter of interpretation."[664]

Customs officers examine the submitted documents to determine whether the importer's assessment of the value of the goods, tariff classification code, duty rate, and total amount of duty is correct.[665] Some situations require "official assessment" in which Customs must assess the value of the goods, the appropriate tariff classification code, appropriate duty rate, and calculate the total amount of the duty. These situations include mail shipments, goods subject to antidumping duties, baggage collections, and if a change in use of the goods requires a new duty collection.[666]

In general, Japanese Customs uses the transaction value on a c.i.f. (cost, insurance, freight) basis to appraise the dutiable value of

[657] USITC staff interview with Japanese Customs Attache', Embassy of Japan, Washington, D.C., Dec. 12, 1989. Another option would be to link Japan's computerized customs clearance system, Nippon Air Cargo Clearance System (NACCS), as its capability expands, with other agencies so import licenses coul d be granted electronically.

[658] "How to Beat the Import Barriers," *Business Tokyo*, Nov. 1989, pp. 33 -5.

[659] The invoice must contain the exact quantities that are contained in the actual shipment. The packing list must agree in total with the commercial invoice as well as with the actual shipment. Richard Bush, *Exporting to Japan: A Practical Guide* (American Chamber of Commerce in Japan, 1981), pp 24-25.

[660] 19 C.F.R. § 141.91. Under special circumstances the District Director of Customs may waive production of an invoice. 19 C.F.R. § 141.92.

[661] The import declaration must contain importer name and number, broker, description of goods, classification of goods number under the Harmonized System, applicable duty rate, c.i.f. (cost, insurance, freight) value, applicable duty extension, and applicable three percent consumption tax. Customs Law art. 68; *Customs Administration in Japan* (1989), pp. 29-30. If an error is subsequently discovered in the import

[661]—*Continued*
declaration, an importer may file an amended declaration within two years of submission of the original declaration. The import declaration must be submitted along with the following documents: invoice, certificate of origin, packing list, freight account, insurance certificate, duty payment slip, all necessary import clearance licenses required under Japanese law (such as an import permit for a certain commodity from the Ministry of Agriculture, Forestry and Fisheries), a statement of duty reduction or exemption where applicable and any "additional documents considered necessary in order to ascertain important matters" for import clearance. Customs Law art. 68; *Customs Administration in Japan* (1989), pp. 29-30.

[662] Customs Law art. 70; *Customs Administration in Japan* (1989), p. 30.

[663] Office of the U.S. Trade Representative, *Japanese Government "External Economic Measures:" The U.S. Government's Assessment of Their Implementation and Impact*, Oct. 1984, p. 23.

[664] American Chamber of Commerce in Japan, *United States-Japan Trade White Paper*, 1989), p. iii.4.

[665] *Customs Administration in Japan*, (1989), p.30; U.S. Department of State Telegram, Oct. 24, 1989, Tokyo, No. 19434.

[666] Ibid.

imported merchandise. Japanese Customs appraise the dutiable value of imported goods to include the price actually paid for the goods (typically based on the invoice price), freight charges, costs of insurance, and other expenses incurred for transport of the goods to the port of importation (such as broker fees).[667] In contrast, the United States generally determines dutiable value on an f.o.b. (free on board), foreign port of exit basis. Thus, the United States does not include cost of freight, insurance, and other post exportation charges in dutiable value. This results in a lower dutiable value for imported goods in the United States than in Japan, especially in the case where the imported goods must travel a great distance and freight and insurance costs are high.[668]

Classification

The duty rate applicable to an imported product is determined by matching the imported product with the appropriate product description and accompanying item number in the Customs Tariff Schedule of Japan.[669] Japan's tariff schedule is based on the International Convention on the Harmonized Commodity Description and Coding System (the "Harmonized System") to which Japan, the United States and over 50 other countries are contracting parties.[670]

In addition to fewer subcategories of product descriptions in Japan's tariff schedule than in the United States' (approximately 5,000 compared to 8,700), there are several problems in the application of Japan's tariff schedule to imported products. First, certain imported products are misclassified. For instance, a number of laminated wood products are classified under heading 4412 of the Harmonized System with an applicable duty of 15 to 20 percent rather than under heading 4418 of the Harmonized System with an applicable duty of 3.9 percent. The United States, Canada, and France—all parties to the Harmonized System—classify many of these laminated wood products under heading 4418 for an applicable duty of 3.9 percent.[671]

Second, there is a lack of uniformity in classifying imported products by Japanese Customs. Japanese Customs officials have wide discretion in classifying imported products. Japan announced on January 10, 1982, as part of a package of new measures intended to facilitate to clearance of imports, the establishment of a classification center at the Tokyo Customs House to ensure uniformity of tariff classification.[672] Nevertheless, classifications still vary according to the Customs officer rendering the opinion.[673] Over a one year period, three shipments of the same lace accessories were classified in three different ways with applicable duty rates of 17.9 percent in October 1988, nine percent in January 1989, and 15.7 percent in June 1989.[674] Apparently, the classifications center in Tokyo is consulted only when Customs officers at the port, the local customs house, and the regional customshouse are all uncertain about the classification of an imported product.

Third, Japanese Customs' advance classification ruling system is underutilized. Japan's Customs and Tariff Bureau introduced an advance ruling system in April 1983 whereby importers could obtain advance rulings from Customs on tariff classification and rate, statistical code number, excise tax, and the like.[675] Formal written rulings, with some exceptions, are binding on Customs officers at all ports for a six month period.[676] In response to such requests, Japanese Customs, however, has a tendency to issue oral opinions which are not binding. Accordingly, oral opinions do not ensure the uniformity of tariff classification. In contrast, the U.S. Customs Service strongly advises importers to obtain written advance classification rulings rather than oral opinions.[677] In the United States, written advance classification rulings are generally binding on U.S. Customs officers at all ports on a permanent basis until there is a change in facts or law.[678]

[667] *Customs Administration in Japan*, 1989, pp. 58-73.

[668] 19 U.S.C. § 1401a.

[669] Customs Tariff Schedule of Japan (Japan Tariff Association [1989]).

[670] Done at Brussels June 14, 1983; entered into force Jan. 1, 1988; entry into force for Japan Jan. 1, 1988; entry into force for the United States Jan. 1, 1989 (does not yet appear in published form in TIAS).

[671] Testimony of David D. Leland, Alliance for Wood Products Exports and President of Plum Creek Timber Co. before the International Trade Subcommittee of the Senate Finance Committee on Nov. 6, 1989, at 3; Bureau of National Affairs, "U.S. Hopeful about Ability to make Progress with Japan in Super 301 Wood Product Talks," *International Trade Reporter* (June 28, 1989), p. 834; "Japan Pressed to Import More Wood Products," *Journal of Commerce* (Dec. 7, 1989), pp. 1A, 10A; Correspondence of National Forest Products Association submitted to USITC staff; U.S. Department

[671]—*Continued*
of Commerce, International Trade Administration, The Japanese Solid Wood Products Market: Profile and Outlook (April 1989), pp. 152-153; Office of the U.S. Trade Representative, *1989 National Trade Estimate Report on Foreign Trade Barriers*, p. 98. In some cases, Japanese Customs has changed the tariff classification of products to classifications with higher tariff rates pursuant to requests from the Japanese Ministry of Agriculture, Forestry and Fisheries to protect the domestic industry. USITC staff interview of international trade consultant, Dec. 19, 1989, Washington, D.C.

[672] Office of the U.S. Trade Representative, *Japanese Government "External Economic Measures:" The U.S. Government's Assessment of Their Implementation and Impact*, October 1984, p. 23.

[673] "Japan: Port of Call," *Export Today*, Feb. 1989, p.27.

[674] "How to Beat the Import Barriers," *Business Tokyo*, Nov. 1989, p. 34.

[675] American Chamber of Commerce in Japan, *United States-Japan Trade White Paper*, 1989, p. iii.3.

[676] American Chamber of Commerce in Japan, *United States-Japan Trade White Paper*, 1989, p. iii.3.

[677] *Importing into the United States*, Jan. 1989, p. 19; USITC staff interview of high level U.S. Customs Service official.

[678] 19 C.F.R. §§ 177.1—177.11.

Fourth, when imported products are reclassified by Japan's Customs and Tariff Bureau, the notice of reclassification does not necessarily precede the actual implementation of the reclassification. Japanese Customs publishes decisions to reclassify products in a weekly Customs bulletin, monthly publication, and, if necessary, in emergency circulations. These publications in some cases do not precede the effective date of the changes. In addition, Japanese Customs officials have significant discretion in collecting duties retroactively for one and a half years after a product has been reclassified to a higher duty level. Japanese Customs seldom collects the retroactive tariff, but uses this authority to coerce the importers to go along with the new tariff level.[679]

In the United States, whenever the U.S. Customs Service wishes to issues an administrative ruling which would reclassify imported products, the U.S. Customs Service will publish notice in the *Federal Register* 30 days prior to the effective date of the proposed change (as well as in the *Customs Bulletin and Decisions* which all customs brokers receive on subscription) and will afford interested parties an opportunity to make written comments.[680]

Examination of Goods

After Japanese Customs reviews and verifies the import declaration, determines the dutiable value of the imported goods, and classifies the imported products, the processing of the import declaration then follows one of three routes: simplified procedures, document review, or examination.

In recent years Japanese Customs instituted a simplified procedure whereby imported cargo which is easily identifiable and routinely traded between the same parties is issued an import permit subject to duty payment without further review or examination. Customs further reviews and verifies documents without an actual examination of goods. These shipments typically include raw materials, cereals, fuels, chemicals. and products of a consistent quality and classification. About 50 percent of Japan's imports are released in this manner.[681] Shipments which require a licence from another Japanese agency require document review. About 40 percent of Japan's imports are released in this fashion.[682]

About 10 percent of Japan's imports require actual examination. Customs may designate goods to be examined pursuant to Japan's 39 import control laws.[683] Customs also examines goods when questions arise regarding such concerns as classification, valuation, or quality.[684]

Duty Payment and Release of Goods

Duty payment is made after the collection section of the customshouse reviews the duty calculations. Duty payment is made in cash to an authorized bank at an office located in the customhouse. Customs accepts checks on weekends when banks are closed. Some brokers have established accounts where an automatic debit is recorded. Generally, duty payment is required before an import permit is issued and the goods are released.[685]

In comparison, the U.S. has a bonding system for duty liability which expedites the import clearance process. Over 95 percent of U.S. imports are cleared under the immediate release

[679] USITC staff interview with international trade consultant, Washington, D.C., Dec. 19, 1989. There have also been instances where once an imported product achieved success in the Japanese market, Japanese Customs reclassified the imported product to a product category with a substantially higher duty level. See Weil and Glick, pp.864-65 (U.S. potato chips made from dehydrated potatoes classified as "vegetable prepared or preserved" at the dutiable rate of 16 percent, then were reclassified as "pasty, biscuits, cakes and other fine baker's wares" at the dutiable rate of 35 percent. The case was resolved through the Joint U.S.-Japan Trade Facilitation Committee. This case was also prior to the Harmonized System).

[680] 19 C.F.R. § 177.10.

[681] *Customs Administration in Japan*, (1989), pp. 31-32; U.S. Department of State Telegram, Oct. 24, 1989. In accordance with a trade initiate of January 10, 1982, Japanese Customs agreed to (1) abbreviate the examination of documentation for goods regularly imported by the same importer from the same exporter and (2) exempt from repeat physical inspection repeat shipments where the goods in each shipment are identical and the importer and exporter are the same. Office of the U.S. Trade Representative, *Japanese Government "External Economic Measures:" The U.S. Government's Assessment of Their Implementation and Impact*, (October 1984), p. 23.

[682] *Customs Administration in Japan*, 1989, pp. 31-32.

[683] Ibid., pp. 32-33. Customs may conduct examinations on a random basis, and may conduct sampling examination or 100 percent examination. In some cases Japan inspects imported shipments to a greater extent than other countries. For instance, Japan conducts 100 percent examinations on all imports of used household goods. Correspondence of Nov. 28, 1989 from a U.S. shipping company submitted to USITC staff.

[684] Customs Administration in Japan, (1989), pp. 32-33. In some cases, Japanese Customs examination procedures with respect to weighing imported chemicals are burdensome. Japanese seaports typically do not have special scales for weighing some chemical. As a result, importers suggest the use of the draft survey method to calculate the weight of the chemical which involves seeing how the vessel sits in the water before and after the products is unloaded. This procedure is accurate within three percent. Many countries use the draft survey method. Japanese Customs, however, has not permitted the use of the draft survey method for chemicals such as soda ash and aluminum hydroxide although Japan does employ this method for glass beads and certain bulk products. Consequently, the imported chemical must weighted according to an expensive and time consuming process whereby each truck or train, after being filled from the vessel, is weighted. U.S. Department of State Telegram, Aug. 22, 1989, Tokyo, No. 15362.

[685] Customs Administration in Japan, 1989, pp. 36-37.

system. U.S. importers may post a single transaction or continuous transaction bond with the U.S. Customs Service. Most importers post a continuous transaction bond which covers one or more types of import transactions occurring at one or more ports of entry. The U.S. Customs Service must approve the bond. Imported cargo is processed under the immediate release system in the United States in two steps. First, when the goods arrive, the importer presents general entry documents and U.S. Customs reviews the documents, checks the goods if necessary, and releases the cargo under an appropriate bond. Second, within ten days after release of the imported cargo, the importer must pay the duty liability and complete the filing of entry documents.[686]

Collection of Consumption Tax

The Government of Japan instituted a three percent consumption tax on April 1, 1989. Japanese Customs is responsible for the collection of the consumption tax with respect to imports. Japanese Customs established a bond system in connection with collection of the consumption tax. The bond system covers approximately 25 percent of Japan's import declarations—or 50 percent of imports by value. Customs permits the release of goods without payment of the consumption tax when a bond is posted. Under the bond system, importers post security with a bank or insurance company which acts as a surety. This bond system allows importers to defer payment of the consumption tax for 120 days without any interest penalty. However, importers have complained that this bonding system is complex and involves costly bond fees. As a result, importer use of this procedure is not widespread. Importers typically extend payment terms of 120-150 days to their customers. Thus, many importers may pay the three percent consumption tax at the time of importation, finance this three percent until the goods are cleared through Customs and delivered to the customer, and then possibly for an additional period depending on the payment terms extended to the customer.

In addition, Japanese Customs officials report that collection of the consumption tax is significantly slowing the import clearance process. Prior to the implementation of the consumption tax, the approximately 40 percent of Japan's imports which are duty free could be processed expeditiously since these transactions did not need to be reviewed carefully with respect to certain assessment and valuation. With the applicability of the consumption tax to all imports, imports which are duty free must now be subjected to additional customs formalities such as valuation.[687] [688]

Duty Refund and Drawback

Japanese Customs procedures provide for refunds only under certain conditions. First, imported products which have been damaged or destroyed in transit are subject to duty payment or must be exported. Japanese Customs will not allow the damaged goods to be disposed of under Customs' supervision and escape duty payment. In contrast, any damaged imported products may be destroyed under U.S. Customs supervision and will not be subject to any duty payment.[689]

Third, Japan has a limited system for refunding duty payments on products which are subsequently exported or used in the production of an exported good.[690] Japanese Customs will refund duty only in the case of some raw materials, such as sugar and oil, used in processing certain products, such as specific foods and ammonia, for export.[691] In contrast, the United States generally provides a refund of 99 percent of duties paid on imported goods which are subsequently exported or used in the manufacture or production of exported products.[692]

Temporary Importation of Samples and Equipment

Japan has limited procedures for allowing commercial samples and professional equipment to enter temporarily without payment of import duties. Japan, the United States, and 33 other countries are parties to the international ATA carnet agreement.[693] [694] U.S. carnet-users report

[686] U.S. Customs Service, Department of the Treasury, *Importing into the United States*, Jan. 1989, pp. 7-8.

[687] USITC staff interview with representative of Embassy of Japan, Washington, D.C., Dec. 12, 1989.

[688] The consumption tax has been the subject of intensive political debate in Japan and may be modified or repealed in the future.

[689] 19 C.F.R. §§ 158, 159; *Importing into the United States*, (Jan. 1989), pp. 7-8. The same is true for damaged goods in a bonded warehouse. *Importing into the United States*, (Jan. 1989), pp. 7-8, 30-31. U.S. Customs will also make allowances in duty for deficiencies in quantity, weight, or measure of the imported goods. 19 C.F.R. §§ 158, 159.

[690] This is commonly referred to as duty drawback.

[691] *Customs Administration in Japan*, (1989), pp. 80-81; "Marketing in Japan," Apr. 1987, p. 23.

[692] 19 U.S.C. § 1313(a); *Importing into the United States*, (Jan. 1989), pp. 30-31. In addition, the U.S. Customs Service provides a 99 percent refund of duty on imported merchandise which is rejected by the buyer for a number of reasons, including that the goods fail to conform to the sample. 19 U.S.C. § 1313(c); *Importing into the United States*, (Jan. 1989), pp. 30-31.

[693] Customs Convention on the A.T.A. Carnet for the Temporary Admission of Good, Signed, Dec. 6, 1961; Entered into force for the United States Mar. 3, 1969, TIAS 6631, 20 UST 58, 473 UNTS 219.

[694] A carnet is a special customs document to streamline customs procedures for business and professional people who wish to take commercial samples, advertising matter, films, medical or other professional equipment through customs without payment of import duties. A carnet is good for one year and may be used for as many trips as desired. U.S. Council for International Business, *Carnet: Move Goods Duty-Free Through Customs* (undated).

generally that the operation of a carnet in Japan is as trouble-free as in other carnet-accepting countries.[695] There are, however, certain problems with the use of a carnet in Japan. First, Japan requires that any applicable licenses from other Japanese government agencies[696] be obtained to use a carnet. This requirement hampers the usefulness of a carnet since the purpose of a carnet is to simplify customs procedures.

Second, a carnet is limited in the type of goods that qualify. Many goods, such as plants, cleaning materials, and foods, do not qualify under a carnet.[697] All samples not qualifying under a carnet temporarily imported into Japan have a commercial value. Samples valued in excess of 5,000 yen are subject to import duties.[698] As a result, some samples brought into Japan are subject to import duties.

In comparison to Japan's procedures, the United States, in addition to the carnet system, has an extensive temporary importation under bond (TIB) system. This allows many types of goods and equipment not imported for sale to be admitted into the United States without the payment of duty, under bond, for their exportation within one year from the date of importation.[699]

Post Customs Clearance

After Japanese Customs issues an import permit and releases imported cargo, the cargo may be subject to an "after permit examination" or "post check" for up to two years after issuance of the import permit. Customs officers visit importer premises to verify transactions through a review of records. Customs attempts to visit all major importers once a year.[700] Customs instituted the after permit examination system in 1982.[701] The after permit system allows the issuance of import permits before all customs formalities are completed. Currently, this streamlined procedure applies only to imported cargo which is easily identifiable and routinely traded between the same parties. An expansion of the after permit examination procedure to other types of cargo would expedite the import clearance process. Japanese Customs is apparently not interested in expanding this procedure because it would involve additional importer premise visits and additional staff.

Computerized Customs Clearance through NACCS

The Nippon Air Cargo Clearance System (NACCS) is Japan's automated data processing system used in connection with air cargo clearance. NACCS was introduced in 1978 at the New Tokyo International Airport at Narita and the Tokyo Air Cargo City Terminal in Baraki for air cargo import clearance. In 1980, NACCS was expanded to the Itami airport at Osaka. NACCS integrated an export clearance module in 1985. NACCS currently processes about 90 percent of Japan's air cargo import/export declarations.[702]

NACCS allows (1) brokers to input import and export declarations and (2) carriers to input cargo manifests and reports on taking goods out of bonded areas. NACCS automatically determines the type of customs formalities to which the cargo will be subject (simplified procedures, document review, or examination) based on criteria tied to the product's harmonized code classification, value, country of origin, and so forth. NACCS notifies carriers and brokers of the release of goods and automatically debits a broker's account for duty payment. NACCS can also determine the exact status of a shipment.[703]

There are several problems with NACCS. First, NACCS is not a completely automated system. Where Japanese Customs procedures require document review or examination of goods (about 50 percent of Japan's imports), documents must actually be printed and presented to Customs. Second, although NACCS has the capability to target certain importers for inspection based on information already in the system, such capability is not employed. Targeting importers with the use of NACCS could reduce the total number of inspections that Customs conducts. Third, the extension of NACCS to other ports is a slow and uncertain process. Customs expects to expand NACCS to other airports and the seaports of Tokyo and Yokohama in 1991, and then to the seaports of Kobe, Osaka, and Nagoya. The extension of NACCS to these five seaports would cover 80

[695] USITC staff interviews with representatives of the U.S. Council for International Business, the U.S. carnet-issuing organization, and several U.S. carnet-users. During the late 1970's a number of carnet users in Japan reported various problems in using a carnet to clear Customs. See Weil and Glick, p. 11, *Law & Policy in International Policy*, (1979), pp. 862-64.

[696] See section on enforcement of other ministry laws, supra.

[697] U.S. Council for International Business, "Carnet: Move goods duty-free through customs", (undated), p. 3.

[698] "Marketing in Japan," p. 22; "How to Beat the Import Barriers," *Business Tokyo* (Nov. 1989), p. 35. Samples and professional equipment brought only into a bonded exhibition area, however, would not be subject to any import duties. Customs Law art. 62; Diamond and Diamond, vol. 2, p. Ryukyu Islands-3.

[699] 19 C.F.R. §§ 10.31-10.39; *Importing into the United States*, (Jan. 1989), pp. 21-21.

[700] *Customs Administration in Japan*, 1989, pp. 31, 77-78.

[701] Office of the U.S. Trade Representative, *Japanese Government "External Economic Measures: The U.S. Government's Assessment of Their Implementation and Impact,"* Oct. 1984, p. 23.

[702] *Customs Administration in Japan*, 1989, p. 54 and Government of Japan, Nippon Air Cargo Clearance System (undated).

[703] Ibid., p. 54-55.

percent of Japan's import/export sea cargo declarations. NACCS is currently paid for by the trade community in the form of a user fee. There is a ceiling on the user fee that NACCS can charge. As a result, it is unclear whether the expansion will take place as scheduled.[704]

In comparison to the United States' level of customs processing automation, NACCS is substantially less sophisticated. Japanese Customs is currently studying expanded computerization. In November 1989 Japanese Customs officials visited the U.S. Customs Service to study the United States' level of automation.

Dispute Resolution

When disagreements arise between importers and Japanese Customs concerning Customs' decisions,[705] importers may pursue several options. An importer or its customs broker typically will first endeavor to reconcile the problem with Customs at the time the imported cargo is being processed through Customs. Social values in Japan are orientated toward informal means of conflict resolution. For instance, a customs broker, who is commonly a former Customs official, may suggest that the problem be discussed over tea at which the two sides will attempt to reach a consensus.[706]

If an importer cannot reach a satisfactory resolution informally with Customs, the importer has several other options. First, an importer may pursue the problem through the customs counsellor and ombudsman systems. The customs counsellor system provides technical advice and assistance to importers in connection with Customs problems. However, the Customs Counsellor does not have any authority over Japanese Customs.[707] The Customs Ombudsman acts as an arbitrator in disputes between importers and Japanese Customs. The Ombudsman System is not widely used since the counsellor and ombudsman are often the same person and there is a disincentive to complain to the government body in Japan with whom one must continue to have a working relationship.[708]

Second, an importer may file a formal protest with the Director General of Customs within two months from the day after their disposition of the import entry is known.[709] An importer may file an appeal of the Director General's decision within one month after the decision is known with the Minister of Finance.[710] An importer may appeal the Minister of Finance's decision by filing suit under the Administrative Case Suit Law.[711] The formal protest system is rarely utilized and most often does not provide any relief to the protester. From 1984 to 1988, 58 protests were filed with the Director General of Customs, of which 2 were rejected, 40 were dismissed, six resulted in a reversal of Customs decision, five were withdrawn, and five are still pending.[712] During the same period, 15 appeals were filed with the Minister of Finance, of which one was rejected, nine were dismissed, four resulted in a cancellation of the disputed decision, and one was withdrawn.[713]

Third, importers may file complaints of a general nature with the Office of Trade and Investment Ombudsman (OTO). The Japanese Government established the OTO, as part of a series of market opening measures in January 1982, to handle and process complaints from foreign companies and other interested parties on Japanese import procedures, inspection systems, or any other specific issue.[714] Between 1982 and February 1986, the OTO had received 234 cases of which 41 specific complaints related directly to Customs import procedures. The OTO generally functions as a clearinghouse and does not have any authority or jurisdiction over the respective ministries.[715] Of the 234 OTO cases, 224 were resolved. In 79 cases, the cause of the complaint was removed, in 93 the complaint was reportedly the result of misunderstanding, and in 56 the existing practice was continued.[716]

In contrast to Japan's Customs dispute resolution mechanisms, the United States has an extensive system of formal administrative and judicial review which handles over thirty thousand

[704] *Japan's Distribution System: the Status Quo and Future Prospects*, Nov. 1989 and *Customs Administration in Japan*, (1989), p. 54-55.

[705] For example, disputes may arise concerning such matters as classification, duty assessment, and so forth.

[706] USITC staff interview of international trade consultant, Dec. 19, 1989, Washington, D.C.

[707] *Customs Administration in Japan*, (1989), p. 110.

[708] A counsellor and ombudsman is commonly the same person because of staffing shortages and technical qualifications for counsellors and ombudsmen. Japan has a cultural tradition that favors consensus building and views criticism as unproductive.

[709] Customs Law art. 89; *Customs Administration in Japan*, (1989), p. 107.

[710] Customs Law arts. 21, 90; *Customs Administration in Japan*, (1989), p. 107. The Minister of Finance makes a decision in consultation with the Customs Dissatisfaction Review Committee, whose members are private sector customs experts and representative from the government agencies concerned. *Customs Administration in Japan*, (1989), p. 108.

[711] Administrative Case Suit Law art. 14 and *Customs Administration in Japan*, p. 108.

[712] Ibid.

[713] There have been two administrative suits brought against Customs during the same period which are still pending. Ibid., p. 109.

[714] *Japanese Government "External Economic Measures:" The U.S. Government's Assessment of Their Implementation and Impact*, Oct., 1984, pp. 45-46. The OTO is composed of the administrative vice-ministers from the fourteen government ministries and agencies and is headed at a low level in the Office of the Prime Minister by the Deputy Chief Cabinet Secretary. El-Agraa, Ali M., Japan's Trade Frictions: Realities or Misconceptions (New York: St. Martin's Press 1989), p. 141.

[715] Ibid., p. 47.

[716] Maswood, p. 120.

complaints and suits each year. Since customs officials generally have broad authority in Japan and the United States as well as in other counties, the extent to which protest procedures are available and effective plays an important role in insuring that customs officials treat importers fairly. Although social norms in Japan favor informal means of conflict resolution, Japan's nominal protest procedures, which generally are not effective in reversing or do not have the authority to reverse Customs' decisions, further enhance the authority and discretion of Japanese Customs officials.[718]

As part of its commitments in the interim report on the Structural Impediments Initiative, the Government of Japan stated that it had set a goal of achieving entry procedures for imports within 24 hours for normal cargo by 1991. It agreed to ensure that budget resources were adequate and regulations changed in order to accomplish this goal. Moreover, it committed to underwrite the expansion and improvement of air and seaports, and expanded investment in other entry-related infrastructure, such as bonded warehouses.

Other Entry Related Procedures

Marking and Labeling Requirements

The labeling, marking and packing of commercial shipments to Japan are covered by specific regulations for certain items such as many food, pharmaceutical, cosmetics, and household electrical products.[719] Importers have often encountered problems with Japan's strict food labeling requirements. In some cases these regulations tend to have a disproportionate affect on imported food products. For instance, Japan requires that all synthetic foods additives, which are often used in imported processed food products, to be labeled, but exempts natural additives, which are used increasingly by Japanese manufacturers, from these labeling requirements.[720]

Standards, Testing and Certification Procedures

Japan has an extensive voluntary and mandatory product standard, certification, and testing[721] regime. Under the voluntary system, the "JIS" mark is awarded by the Japanese Industrial Standards Committee under the Ministry of International Trade and Industry (MITI) to products made in conformity with committee standards. The "JAS" mark is awarded by the Ministry of Agriculture, Forestry, and Fisheries (MAFF) to processed foods and forestry products meeting MAFF's standards.[722] These voluntary marks are very important for winning consumer acceptance and are generally required by Japanese public bodies in their procurement specifications.[723] The mandatory system entails 25 separate product standards laws which are administered by six government agencies. These 25 product standards laws cover 112 products areas and are legally binding.[724]

U.S. suppliers have complained about certain aspects of Japan's product standards process. First, they complain the standard setting process is characterized by broad Japanese government discretion and a lack of transparency. Although Japan, as a result trade negotiations with the United Sates, has implemented a number of measures to the enlarge the opportunity for public comment on proposed product standards and to include foreigners on standard-drafting committees, extensive customary relationships reportedly continue to dominate the process. As previously noted, many Japanese standards are drafted by Japanese trade associations in which U.S. firms have little participation. Consequently, foreigners are unable to effectively influence the standard-setting process.[725]

[717] Feller, vol. 1, ch. 4, 4A.

[718] USITC staff interview of international trade consultant, Dec. 19, 1989, Washington, D.C.

[719] The specific requirements are delineated respectively under Japan's Food Sanitation Law, Pharmaceutical Affairs Law, and the Electrical Appliance Law. In addition, under Japan's Measurement Law, all measurements must be in metric units and the use of the English system is prohibited for all transactions and certifications unless specifically exempted by government ordinance. *Exporters' Encyclopedia*, Dun's Marketing Services, July 1989, vol. 2, p. 2736 and *Overseas Business Reports Marketing in Japan*, April 1987, p. 22.

[720] *Exporters' Encyclopedia* (Dun's Marketing Services July 1989), vol. 2, p. 2-736 and Balassa and Noland, p. 220. In one case, Japan required that certain imported candy bars' Japanese ingredient labels be affixed after the candy's arrival in Japan, rather than in a foreign factory. "How to Beat the Import Barriers," *Business Tokyo*, Nov. 1989, p.33.

[721] Product standards, certification, and testing procedures are collectively referred to as "product standards."

[722] *Exporters' Encyclopedia* (Dun's Marketing Services July 1989), vol. 2, p. 2-731—2-732; Overseas Business Reports Marketing in Japan, April 1987, p. 25; and Christelow, Dorothy, "Japan's Intangible Barriers to Trade in Manufactures," Federal Reserve Bank of New York Quarterly Review (1985-86), p.12.

[723] "Marketing in Japan," p. 25; Christelow, Dorothy, "Japan's Intangible Barriers to Trade in Manufactures," *Federal Reserve Bank of New York Quarterly Review* (1985-86), p.12.

[724] Intra-Governmental Council on *Standards and Certification Systems, Standards and Certification Systems in Japan: Measures for Improving Market Access*, (Government of Japan 1984); Edelman, Peter, "Japanese Product Standards as Non-tariff Trade Barriers: When Regulatory Policy Becomes a Trade Issue, 24 *Stanford Journal of International Law* 389, p. 392.

[725] Edelman, p. 394; "Marketing in Japan," p. 24; Federal Reserve Bank of New York Quarterly Review (1985-86), pp. 12-13; *Exporters' Encyclopedia* (Dun's Marketing Services July 1989), vol. 2, p.2-732; Balassa and Noland, pp. 218-219; and "Report of the Advisory Committee for Trade Policy and Negotiations, Analysis of the U.S.-Japan Trade Problem," (Feb. 1989), pp. 66-67.

Second, while Japan in recent years has agreed to accept the results of tests conducted by independent U.S. testing laboratories in some product fields, Japan still requires a product to be submitted for government-authorized testing and certification in Japan before sale is allowed. Some imported products are subject to the lot inspection system in which each lot of the imported product must be tested in Japan before being sold.[726] In contrast, U.S. standards are usually based on product performance rather than design criteria, and manufacturers are often allowed to verify their own compliance. [727] Third, Japan's product standards with respect to some products vary in comparison to U.S. standards.[728] For instance, under Japan's Food Sanitation Law and Ministry of Health and Welfare regulations food additives common in western foods are prohibited with the exception of a few additives.[729] Under Japan's Plant Inspection Law, the Ministry of Forestry and Fisheries enforces a zero tolerance rule. Imported flowers, trees, or plants must be 100 percent insect-free or fumigated at the point of importation, even if the plants contain insects common to both Japan and the exporting country.[730] These three problems sometimes prevent the importation of certain products and make compliance time-consuming and costly.

There are some indications that Japan recognizes the desirability of removing remaining technical barriers to imported goods. In the April 1990 interim report on the Structural Impediments Initiative, the Government of Japan said that it would initiate a review of existing regulations and standards, including trade association standards. The objective the review would be to ensure that the process for developing such standards are transparent and that standards and testing requirements are performance- rather than design-based where appropriate. Japan also agreed to review complaints by foreign businesses with a view to achieving satisfactory resolutions of them.

Trucking

The Japanese trucking business is characterized by extensive regulations and high freight rates. Japan has over 30,000 trucking firms with 300 carriers operating fixed routes approved by the Ministry of Transportation (MOT).[731] Japan's trucking laws and regulations severely limit the entry of newcomers into the trucking business. The MOT sets mandatory fare schedules, but carriers reportedly give hidden discounts, up to 40 percent, to large users. Typically only new, uninformed foreign firms pay the Government-set rate. In addition to government regulations, freight rates are relatively high in Japan compared to other industrialized countries, in part, due to the common use of trucks designed to fit Japan's small, and generally inadequate roads.[732]

Several recent Japanese Government reports, as well as reports by Keidanren, have called for trucking deregulation to allow new firms to enter the market more easily and to allow prices to be market-driven.[733] The MOT has recently introduced legislation which would address these concerns in part. Such legislation is pending in the Japanese legislature.[734]

Functional Features of Japan's Distribution System

The following section of the report examines the "functional features" of Japan's distribution system including business practices, attitudes, and other factors influencing the behavior of participants in Japan's distribution system. The discussion focuses primarily on the reasons that vertical business practices occur within some distribution channels and their effects on access to existing distribution channels.

Business Practices

A variety of business practices involving reciprocal and interdependent relationships

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726 Edelman, Peter, "Japanese Product Standards as Non-tariff Trade Barriers: When Regulatory Policy Becomes a Trade Issue, 24 Stanford Journal of International Law 389, p. 392-393; *Overseas Business Reports Marketing in Japan*, April 1987, pp. 24-25; Federal Reserve Bank of New York Quarterly Review (1985-86), p. 13; *Exporters' Encyclopedia* (Dun's Marketing Services July 1989), vol. 2, p. 2-732—2-737; Balassa and Noland, (Washington, D.C.: Institute for International Economics 1988), pp. 219-221. For a brief review of the trade negotiations which United States has conducted with Japan concerning Japanese product standards, see, e.g., Balassa and Noland, pp. 219-221. Japan recently announced that it would abolish inspections on U.S.-made medical equipment and accept quality control data provided by U.S. manufacturers. "Import Regulations to Ease on U.S. Medical Equipment," *Japan Economic Journal*, May 27, 1989, p. 19.

727 Edelman, Peter, "Japanese Product Standards as Non-tariff Trade Barriers: When Regulatory Policy Becomes a Trade Issue, 24 Stanford Journal of International Law 389, p. 393 and footnotes 14 and 15.

728 "Marketing in Japan, p. 25.

729 *1989 National Trade Estimate Report on Foreign Trade Barriers*, p. 102.

730 "How to Beat the Import Barriers," *Business Tokyo*, Nov. 1989, p. 34-35; "Troubled Tulips," *Business Tokyo*, June 1989, pp. 26-27. According to Columbian fresh flower exporters, Japan inspects fresh flowers one by one at the port of importation. "Another Columbian Crop Takes Off: Flowers," New York Times, Oct. 1, 1989, p. 25.

731 "Here come the Just in Time Japanese Truckers," *The Economist* (Dec. 5, 1988), p. 67.

732 Keizai Koho Center, "Deregulating Distribution," KKC Brief No. 48, July 1988, p. 2; USITC staff interview of international trade consultant, Dec. 19, 1989.

733 U.S. Department of State Telegram, Tokyo, Nov. 3, 1989, No. 20191.

734 Government of Japan, *Japan's Distribution System: The Status Quo and Future Prospects*, Nov. 1989.

among trading companies, manufacturers, wholesalers, other intermediaries, and retailers appear to make it difficult for "outsiders" to compete in Japan's market with those firms linked together through preferential relationships. Vertical practices include exclusive dealings, resale price maintenance, rebates, and returns policies. They are mainly linked to the distribution keiretsu, but may occur in other distribution chains as well. Horizontal practices, mainly associated with cartels or industry and trade associations, include price fixing and market allocation. Many of these practices are not unique to Japan. However, the extent to which these practices occur, their purposes and their effects on other participants in the distribution system may be accentuated in Japan because of various characteristics of corporate behavior, rooted in social customs that were described earlier in the report. According to MITI:

> The commercial practices which have taken shape in Japan are those which place a premium on good human relations and long-term stable business relationships. They function to ensure the smooth continuation of transactions, and are characterized by features such as the current quotation system, goods-return practices, and rebate[s].[735]

Many practices such as rebates or returns policies serve to preserve or strengthen personal business relations among companies. This may explain in part why participants in the distribution system, i.e., manufacturers, wholesalers and retailers, are reluctant to acknowledge their existence or the extent to which they occur. Many U.S. businesses, too, are reluctant to discuss openly such practices for a number of reasons including possible "retaliation" which would damage their market share in Japan. Much of the evidence relating to such practices has been documented by studies done by the Government of Japan itself. "Unfair" business practices are prohibited by law, however, as noted previously, enforcement of antitrust statute is generally regarded to be weak in Japan. According to Hideto Ishida:

> Although each of these practices as separate acts are subject to challenge under the Antimonopoly and Fair Trade Law as unfair business practices prohibited by article 19, they are in fact widely employed.[736]

Some of the reasons for the occurrence of such practices is to reinforce manufacturer control over distribution channels and to maintain long-term relations. As noted earlier, there may be many benefits of perpetuating these two conditions, from the viewpoint of Japanese manufacturers, wholesalers and retailers. For manufacturers these benefits include profit maximization based on the maintenance of stable marketing relations with purchasers, ensuring the provision of information and services to potential customers, and improvements in the acquisition of marketing information. Wholesalers benefit from a consistent supply of goods and services from the manufacturers and a type of "insurance" against retailers switching suppliers. Retailers with little space and narrow operating margins, benefit from the inventory, financing, returned goods services provided by the wholesalers (and sales marketing efforts by the manufacturers).

All current participants in the distribution chain benefit to a certain extent from the reduced risks associated with sharing the various costs associated with the distribution of goods. According to a November 1989 paper by MITI reviewing the present and future status of the distribution system: "This practice of placing high value on long-term stable relationships is economically rational in that it helps to reduce future uncertainty, disperse costs, and diminish the risk burden."[737]

The following paragraphs describe and assess the effects of four types of vertical business practices within the distribution channels including exclusive dealings, resale price maintenance, returns policies and rebates. Other common practices that occur within distribution channels are the use of promissory notes (as collateral as well as actual loans)[738] and territorial restrictions which limit the area in which dealers may sell, and single-outlet, single-account systems requiring retailers to purchase from designated wholesalers and prohibiting wholesalers from selling to anyone other than the designated retailers.[739] Coercive tactics such as group boycotts and refusals to deal have also been cited by foreign businesses attempting to enter Japan's market.

Exclusive Dealings

Japanese manufacturers (particularly in the auto and electronics industries) often exercise extensive control over the distribution and marketing of their products through exclusive dealing. Exclusive dealing is often used by manufacturers to exert influence over the retailers sales and pricing practices. Dealers sometimes pass the product to third parties and warn them not to discount the price of the product.

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[735] "The Distribution System in Japan," MITI, Nov. 1989, p. 18.

[736] Ishida Hideto, "Anticompetitive Practices in the Distribution of Goods and Services in Japan: The Problem of Distribution Keiretsu", Journal of Japanese Studies, v. 2, 1983, pp. 324-25.

[737] "The Distribution System in Japan: Toward a More Open, Consumer-Oriented Distribution System," Ministry of International Trade and Industry, November 1989, p. 18.

[738] Ishida, p. 322.

[739] Ibid., p. 324.

Exclusive dealing in Japan is enforced in a number of ways. In some cases manufacturers may include exclusive clauses in their sales contracts with dealers. Exclusive dealing also occurs without contractual arrangements because some manufacturers are able to exert substantial control over retailers. Even retailers who dislike the practice, sometimes will not refuse to participate for fear of reprisals from the manufacturer. Exclusive dealerships are often associated with distribution keiretsu in Japan.[740]

Legal treatment of exclusive dealing is similar in both Japan and the United States. Exclusive dealing is not illegal unless it impedes fair competition. Thus, the legal status of exclusive dealing is determined on a case-by-case basis. However, in Japan, there is apparently less strict evaluation of exclusive dealing arrangements. In the strongest distribution keiretsu, retailers often lose nearly all their functional independence of the manufacturer.[741] [742]

Retailers that are part of distribution keiretsu often yield part of their sales and marketing functions to the manufacturer. This control is often possible because a manufacturer holds equity in the retailer.[743] When the manufacturer has no equity in the retailer, control may be gained by other means. A common way in which a retailer's independence may be reduced is the manufacturer's provision of credit to the retailer, making the retailer more susceptible to pressure to sell only the creditor's products.[744] Many of Japan's retailers are small "mom and pop" stores with very limited financial resources. Many of the small "mom and pop" stores that comprise the bulk of the retail sector are reportedly in debt to producers that often prohibit these establishments from selling competing brands,[745] further reducing the likelihood that small stores will carry imports.[746]

Rebates are often used to enforce exclusive dealing arrangements. Rebates may be paid on a sliding scale based on the proportion of a retailers' total sales that consist of one manufacturer's products, thus providing the retailers with an incentive to carry only that producer's products.[747] Some rebates are given based on the retailer's adherence to the manufacturer's sales policies.[748] [749]

Manufacturers often assume some responsibilities for the marketing and promotion of goods on behalf of their exclusive dealerships. It is common practice for Japanese manufacturers to "loan" sales personnel to retailers, many of which are often short-staffed. The manufacturer benefits by having junior-level employees gain experience in working closely with customers, by having sales personnel that promote their products in the dealership, and by obtaining direct market feedback on sales of their products. The practice may be complemented by manufacturers' providing promotional and display materials to their affiliated retailers in return for these services. A manufacturer may demand that retailers devote store space only to its own products, so that the benefits of the services are not shared with other producers.

Exclusive dealerships offer the supplying manufacturers a stable, preferential business relationship with the retailer.[750] The manufacturer gains a long-term, guaranteed outlet for its goods, and the retailers are more likely to be enthusiastic in promoting the producer's product. Detailed control of the retailer's sales and marketing methods may allow the producer to establish a uniform image among customers.[751] From the manufacturer's point of view, control of the sales and marketing of its products forces the retailers to adopt more efficient behavior.[752]

Exclusive dealing may also serve to simplify a producer's distribution channels, resulting in cost savings, economies of scale and better provision of service and information.[753] According to this viewpoint, dealers are able to devote their resources to a single brand and respond to a single producer more effectively than when they must divide their resources among a variety of brands and producers. If so, according to the views of some economists, customers' interests are best served by exclusive dealing practices, when the services being offered are those that consumers consider sufficiently valuable that they are willing to pay for them.[754]

On the other hand, while even some critics of distribution keiretsu have noted that exclusive dealing may result in market efficiencies and good customer service in Japan, they suggest that the purported cost savings are rarely passed on to

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[740] See previous discussion on distribution keiretsu earlier in this report. These are groups of firms consisting of manufacturers and retailers having strong business ties.

[741] Ishida, pp. 319-34.

[742] Czinkota and Woronoff, p. 49; Flath, March 1989, p. 17.

[743] Tsuruta, et al., Apr. 1986, p. 6.

[744] Czinkota and Woronoff, p. 49.

[745] Statement of Raymond J. Ahearn before the Joint Economic Committee, Oct. 9, 1989, p. 3.

[746] Raymond J. Ahearn, "Japan: Prospects for Greater Market Openness," Congressional Research Service, June 26, 1989, p. 12.

[747] Tsuruta, et al., p. 13.

[748] Ibid.

[749] See discussion on rebates under business practices for further information.

[750] Ahearn, "Japan: Prospects for Greater Market Openness," p. 19.

[751] Czinkota and Woronoff, pp. 52-3; MITI, *The Distribution System in Japan*, Nov. 1989, p. 21.

[752] Flath, p. 1.

[753] Ishida, pp. 329-31.

[754] Statement by the EBC in a meeting with an Advisory Committee to the JFTC, Jan. 30, 1990.

consumers, and that many of the argued benefits can be achieved without exclusive dealing.[755] Whatever cost savings may be passed to consumers are likely to be offset as a result of resale price maintenance which is often the primary objective of many exclusive dealing arrangements. Furthermore, exclusive dealerships may limit the product selection available to consumers, depending on the number of competing brands and retailers, and make comparison shopping relatively inconvenient.

The effects of exclusive dealings are often significant for new firms attempting to enter the distribution system. Specifically, exclusive dealing may impede new entrants, both foreign and Japanese, from entering a portion of the distribution system.[756] Suppliers that are kept out of the system may find that the competitive advantages their products may have with respect to price, quality, design, or service, are sometimes never realized since the products never reach the consumer. Additionally, in many cases dealerships are not exclusive, but they only sell a limited number of competing brands in order to fill out a product line, not enough to compete on a broad scale.[757]

The practice of merely filling out a product line of one manufacturer with products of a different manufacturer may lead to underestimates of the extent to which new entrants have access to existing retailers in Japan. Once a dealer carries more than one brand, technically speaking, it no longer is defined as exclusive. However, if other brands only fill limited niches in the product lines of the manufacturers, the effect on potential new entrants may be only marginally less restrictive than in circumstances where completely exclusive dealerships are pervasive. Consequently, data on the number of exclusive dealerships in any given industry may be only a partial measure of restricted access to retailers. With this qualification in mind, data on "tied" sales outlets in three industries categorized by this type of distribution system in Japan are shown in table 13.

Table 13
Number of sales outlets and extent to which they are tied to the manufacturers' own marketing system (1982)

Industry	*Total no of sales outlets*	*No. of tied sales outlets*	*Proportion of tied sales outlets (%)*
Cars	47,650	24,000	50.4
Elec. appliances	71,280	58,500	82.1
Cosmetics	110,870	74,000	66.7

Source: Batzer and Laumer, p. 112.

New entrants that are not provided sufficient access to existing dealers may be forced to consider such options as establishing independent distribution channels. Although it may be possible for new entrants, including U.S. companies, to set up their own distribution networks, this is an extremely expensive and time-consuming alternative. For example, BMW reportedly spent almost one-half of a billion dollars to set up new showrooms in establishing its own network of dealerships in Japan.[758] Moreover, the risks of failure may be comparatively high, given the network that would be required to be adequately represented in the market.[759]

The difficulties that new entrants face in establishing independent distribution channels are the primary reasons that foreign firms turn to Japanese partners to market their product. As noted previously, joint-ventures with Japanese firms allow foreign firms to work through the existing distribution system and are generally less expensive.[760]

There are some trends that could lead retail outlets operating on an exclusive or semi-exclusive basis to lose market share to non-exclusive channels if such retailers fail to respond to changing competitive conditions. Increasing numbers of discount merchandisers, diversification of consumer tastes, and the increased demand for imports, especially luxury items, could reduce the influence of exclusive dealers. Some larger retail stores may be gaining more strength relative to producers in certain areas in the distribution channels[761] which could reduce the ability of producers to demand

[755] Ishida, p. 332.
[756] According to one recent study, "The Japanese manufacturers' far-reaching vertical sales networks thus constitute a genuine barrier to market access by similar products, surmountable only with difficulty". Batzer and Laumer, p. 112.
[757] USITC staff interviews with officials of the Japan Fair Trade Commission, Tokyo, Japan, January 30, 1990. Czinkota and Woronoff, p. 29; Schoenbaum, T. and others (eds.), "Dynamics of Japanese-United States trade relations", *Dean Rusk Center Monograph*, p. 130; *Tokyo Business Today*, "The distribution system; myths and realities", July 1989, p. 57; Ishida, p. 330.

[758] *Fragile Interdependence*, p. 110.
[759] Japanese consumers tend to shop locally, forcing producers to sell their products in a relatively dense network of retail outlets if they want to be well-represented in the market. To not have an outlet in a given neighborhood may well mean that no sales are made to people in that neighborhood. Similarly, market share is strongly related to the number of sales outlets. Czinkota and Woronoff, pp. 52-4.
[760] See previous section on types of distribution channels for the advantages and disadvantages of this approach.
[761] USITC staff interview with representative of Nomura Research Institute, Tokyo, Japan, Feb. 1, 1990. Mr. Shindo noted the examples of the shoe and toy industries.

exclusive dealing. As new types of retail stores emerge, and as existing stores attempt to serve increased consumer demand for imports, competitive pressure may force less receptive retail outlets to respond. For example, Japanese producers may be forced to cut their prices at their own exclusive dealerships, and to find ways to procure products that can compete with inexpensive imports.[762] In the electrical appliances sector there have been increasing numbers of retailers that do not carry any specific brand exclusively.[763] Matsushita, known for its strong distribution keiretsu, now has "group shops" that derive over one-half of their sales from Matsushita products but sell other brands as well. However, the "group shops" exhibit some characteristics associated with exclusive dealing even in this situation. Such stores qualify for certain services such as sales promotions and strategy assistance. There is some evidence that distribution keiretsu are also showing less tendency to form exclusive dealerships, and are importing more goods.[764]

However, such opening up of dealerships to competing brands may not imply a reduction in manufacturers' dominance. For example, there is an indication that manufacturers in the consumer appliances industry are unwilling to relinquish extensive control, which has been threatened by discounters, of their distribution channels, even if they permit the limited sale of competing brands.[765] Other factors which may contribute to a business environment more susceptible to exclusive dealings, such as longstanding ties and loyalties between suppliers and purchasers, are not likely to disappear in the near term. In addition, unless discount chains become more widespread, competitive pressures on exclusive dealers are likely to be limited. The continued significance of exclusive dealing in the Japanese distribution system is evidenced by the fact that the Japan Fair Trade Commission still views exclusive dealing as a target for reform, and is currently studying proposals to eliminate the practice.[766]

Resale Price Maintenance

Manufacturers and wholesalers in Japan frequently enter into agreements with downstream wholesalers and retailers to prohibit resale of their goods below some stipulated price level.[767] [768] [769] This practice is known as resale price maintenance (RPM). In Japan, RPM occurs for a wide variety of consumer goods including food products, consumer electronics, published materials, cosmetics, and drugs, and is mainly associated with distribution keiretsu.[770] Hideto Ishida claims that:

> . . . the Japanese distribution keiretsu are unparalleled in strength and breadth. Today they function primarily as a mechanism through which resale prices can be controlled by the manufacturers and thus to preserve de facto resale price maintenance despite its prohibition under the Antimonopoly and Fair Trade Law.[771]

A recent study by Industrial Bank of Japan and interviews with major Japanese retail chains and retail trade associations, indicate that RPM may affect even a wider range of products.[772] In industries with a high level of integration of distribution keiretsu and high dealer concentration, there are apparently few

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[762] Ahearn, "Japan: Propects for Greater Market Openness", p. 33.

[763] The industry's movement away from exclusive dealing is supported by USITC staff interviews with Akio Mikuni, Mikuni & Co., Tokyo, Japan, February 2, 1990.

[764] Czinkota and Woronoff, p. 63.

[765] Yuko Inoue, "Manufacturers at war with discount retailers", The Japan Economic Journal, Aug. 19, 1989, p. 32.

[766] USITC staff interview with officials of the Japan Fair Trade Commission, Tokyo, Japan, Jan. 30, 1990.

[767] David Flath, "Vertical Restraints in Japan," *Japan and the World Economy*, 1989.

[768] In a September 1989 report, a study group for Japan's Economic Planning Agency said that "manufacturer's control over wholesalers and retailers to maintain their suggested retail prices" was an impediment to moving the system in a "favorable direction." EPA officials noted during an interview in February 1990 that one positive aspect of RPM was that consumers would know that prices were at an "appropriate level." (The term "appropriate level" refers to a situation where consumers would feel like they were getting a "fair price" or a price that reflected the quality, services and other social "costs" attached to the product. An "appropriate price" might seem like an unusual concept from the perspective of a U.S. consumer. However, in Japan, where much emphasis is placed on trust and loyalties among participants in the distribution channels consumers have every expectation that the price they are paying represents what is a "fair" for the producers, the distributor, the retailer and does not necessarily refer to the actual production costs of the product.) However, a negative effect is that it weakens price competitiveness.

[769] As reported in, "Stores Brood Over Big Ideas," *Financial Times*, September 12, 1989, "Retail price maintenance - illegal in most parts of the world - is brutally enforced by leading manufacturers and wholesalers. Most retail and wholesale groups operate an exclusive "cho-ai" system of favored suppliers. Relationships between retailers, wholesalers and suppliers, frequently cemented by cross-shareholdings, are further bonded by close personal ties between executives. Golf games and evenings in expensive hostess bars are weekly team-building events."

[770] J. Amanda Covey, "Vertical Restraints Under Japanese Law: The Antimonopoly Law Study Group Report," *Law in Japan: An Annual*, 14.1.

[771] Ishida, p. 324.

[772] According to MITI one of the reasons for the occurrence of retail price maintenance in Japan is: " Related to this is the manufacturers' suggested retail price, which both manufacturers and retailers value as a standard, according to which a wide selection of merchandise can be made available to consumers. Consumers value this as a measure which facilities 'price comparisons with other similar products' or helps evaluate the 'pricing policies of a particular retail store. "Japan's Distribution System," p. 18.

constraints on manufacturers' ability to practice resale price maintenance:

> . . . Japan's distribution keiretsu have become extremely durable. . . Within this hierarchical relationship [between manufacturers and dealers], the dealer losses any bargaining power it may have vis-a-vis the manufacturer. Even if the manufacturer does not use its consequent blank check, it is able easily to achieve desired sales polices, including resale price maintenance.[773]

Japanese firms usually encourage compliance with their RPM agreement (whether a formal contract or an informal agreement) with some manner of rewards or punishments such as delayed payments of "rebates" on sales and threats to discontinue business. RPM may also be tied to exclusive dealership agreements between manufacturers and wholesalers and wholesalers and retailers.[774] Resale price maintenance, especially as it occurs within distribution keiretsu, could therefore make entry for newcomers more difficult by increasing control over distribution and retailing by incumbent manufacturers and diminishing the incentive for retailers to carry more price competitive products.[775]

Most other industrialized nations, including the United States, have had some experience with resale price maintenance and many now outlaw the practice. Other countries that have laws against resale price maintenance in most circumstances include Canada, France, Great Britain, and West Germany.[776] In recent years, however, U.S. antitrust authorities have tended to view such practices on a case by case basis in the context of the competitive environment when enforcing U.S. antitrust laws.

Japan's antimonopoly law technically prohibits resale price maintenance except for goods protected by copyright or trademark or specifically exempted by the Japanese Federal Trade Commission.[777] Enforcement of the prohibition is weak, however, and significant punishment of violators is extremely rare.[778] [779]

[773] Ishida, p. 325.

[774] Flath, "Vertical Restraints in Japan and the World Economy."

[775] Stephen Martin, *Industrial Economics/Economic Analysis and Public Policy*, Macmillan, 1988, ch. 17.

[776] F.M. Scherer, *Industrial Market Structure and Economic Performance*, second edition, 1980, Rand McNally, pp. 590-594.

[777] J. Amanda Covey, "Vertical Restraints Under Japanese Law: The Antimonopoly Law Study Group," *Law in Japan, An Annual*, 14.49.

[778] Flath, "Vertical Restraints in Japan."

[779] According to Flath, "If there is a difference between vertical restraints in Japan and in the U.S., it is that in Japan, the ubiquity of small retailers and resulting complex distribution channels frequently complicate the enforcement of vertical restraint stipulations by makers. Countering this, in Japan antitrust laws are less of an encumbrance to makers who seek to impose vertical restraints."

The Government Japan has shown an awareness of the effects of resale price maintenance on competition. A 1980 JFTC study referred to the potential anticompetitive effects of RPM[780] with regard to the activities of manufacturers in setting up their distribution systems. The study said that, "the FTC will presume that the activity has an adverse effect to fair competition if the activity is in the form of resale price maintenance or a territory system set up by a major manufacturer."[781]

Returns Policies or Practices

Japanese manufacturers maintain liberal acceptance policies on return of unsold merchandise. Unlimited returns are allowed for books, magazines, apparel, cosmetics and electric appliances. Returns are also allowed at a high rate for records, pharmaceuticals and stationery. In the United States and Europe such practices are limited to newspapers, magazines, books and a few other items.[782] In general there appear to be two differences with returns practices in Japan compared to Western countries. First, the practice of unlimited returns seems to be more common in Japan, although the evidence of this is mostly anecdotal.[783] Second, in Japan the returns policies apply to goods that are not damaged or defective merchandise, but are merely unsold by the retailer.[784] Often the merchandise is destroyed rather than being held in inventory for sale at a later time.

Through a system of "speculative production" or "push marketing" manufacturers produce a certain volume of goods in anticipation of selling all of it to consumers. The manufacturer determines which quantity to ship to retail outlets. Retailers are expected to keep all of these products in stock to cover the manufacturer's production. However, some of these products are never sold and are returned to the manufacturers for credit, sometimes through the use of rebate arrangements. Returns are

[780] Schoenbaum, p. 1311

[781] Ibid., p. 131.

[782] According to a study prepared for MITI in April 1986, ". . . the concept of returns in the United Sates and Europe usually means products that have been returned by the consumer, and it would be highly uncommon for a wholesaler or retailer to return an item which was neither damaged nor defective simply because it had not been sold." Tsuruta, et al., p. 10.

[783] Flath argues that unlimited returns policies would be more prevalent in cases where retailers are more averse to risk than manufacturers or have no greater ability than the manufacturers to predict demand, such as in the case of newspaper carriers or small independent stores. In the case of large chain stores which may be less risk averse, they may be subject to limited returns privileges. Since there are more small stores in Japan, it follows that returns policies would be more pervasive. Flath, "The Economic Rationality of the Japanese Distribution System," p. 18.

[784] "MITI to urge Retailers to Curb Business Practices seen as Source of Trade Friction", *International Trade Reporter*, Bureau of National Affairs, Jan. 3, 1990, p. 6.

acceptable not only in consignment sales but even in cases where the transaction is based on the retailer's responsibility for reselling the product.[785]

The benefits of the "sale-or-return" system are that it allows stores to maintain a wide range of goods in stock and may facilitate the entry of new products.[786] [787] If returns were not possible, retailers might be more hesitant to stock untested, untried products. Thus, by allocating the risk of unsold goods to the manufacturer, the returns system or practices may increase the chance that a new product will be given shelf space. Secondly, returns policies can facilitate the balance between supply and demand and provide for a fast turnaround rate for products that are not selling well. If a product is not selling in a particular region, it is often easier for wholesalers and manufacturers to redistribute the product to other regions than for retailers to do so.[788] Sales risks are thereby spread throughout the distribution system.[789]

However, there are several problems associated with returns policies in Japan. According to a 1986 study prepared for MITI:

> There is the possibility that the institutionalization of returns may lead to market price rigidity. When it is *impossible* [emphasis added] for retailers to return unsold goods, these goods are often sold at a discount in order to clear the shelves and reduce inventory. In the United States, for example, there are off-price stores, outlet stores, and others selling surplus goods at discount prices.[790]

In other words, in Japan the fewer number of alternative discount retail operations may increase the likelihood that returns policies would lead to price rigidity. Returns practices may allow the manufacturer to enforce price levels, by minimizing the chances that the retailer will hold sales on the goods. The possibility of returning unsold merchandise can thus have the effect of placing a minimum floor on the market retail price because it is less likely that retailers will hold sales or offer other types of discounts to dispose of unsold merchandise.

[785] Tsuruta, p. 10.

[786] "A Distribution Innovator Who Places Consumers First", Economic Eye, Autumn, 1989, p. 18.

[787] In a February 1990 interview, representatives from the Economic Planning Agency noted that returns policies may be positive because they allow retailers to avoid the risk of unsold goods. Retail stores are not ready to bear the risk of unsold goods. However, they may "push up costs to consumers."

[788] Tusurta, p. 11.

[789] "Distribution System and Market Access in Japan," Japan Chamber of Commerce and Industry," p. 15.

[790] Tsuruta, p. 12.

In addition to the price rigidity that may result from liberal returns policies, the physical costs of distribution, administrative and processing costs associated with the product return system may drive up overall distribution costs. According to a 1986 study prepared for MITI, "When one considers the paperwork involved for manufacturer and retailer alike, the costs of actually transporting the product back and forth, and other expenses, it is clear that they are by no means negligible."[791] A 1989 study for MITI reinforces this view stating, "Physical distribution and administrative costs resulting from goods-return practices increase overall distribution costs, and, like rebates, also tend to prevent proper profit and inventory control."[792]

It is almost unheard of for foreign suppliers to accept returns. The returns system therefore might serve as a "psychological barrier" and make Japanese retailers reluctant to stock imports, especially in large quantities because of the inherent risks associated with them compared to goods for which manufacturers bear the risk of unsold merchandise.[793] In September 1989, Japan's Economic Planning Agency cited return of unsold goods as one of the "problems in the process or practices of distribution trade" that should be addressed by the government in reforming the distribution system.[794]

Rebates

One of the more confusing business practices that occurs in Japan is the rebate system.[795] In Japan, the term "rebate" refers to a cash payment made to another party apart from the price structure, including a reduction from the suggested wholesale price. Such rebates are given by manufacturers to wholesalers or retailers, but may also be given by primary wholesalers to secondary wholesalers or retailers. The use of the term "rebate" in this context does not involve payments to the consumer. There are many kinds of rebates, depending on the objective, type and method of payment. "Rebates" include practices that are known in the United States and Europe as volume discounts, cash discounts, and

[791] The 1986 study later notes ". . . Nor is this problem restricted to the retail sector. Rather, the institutionalization and ready acceptance of returns creates a climate conducive to repeated returns, and this in turn imposes considerable costs on the society and economy as a whole." Tsuruta, p. 10.

[792] "Japan's Distribution System," Nov. 1989, p. 22.

[793] Batzer and Laumer, p. 289 and "Distribution System and Market Access in Japan," p. 15.

[794] "The Framework of the Seventh Report of the Study Group on Japan's Distribution System," Economic Planning Agency, Sept., 1989.

[795] Note: Use of the terms "discounts" and "rebates" are frequently confused when referring to the practices in Japan. Discounts include cash discounts and volume discounts. These are widely applied in the camera and photo film industries. These practices occur on a confidential basis between the manufacturers and the retailers. *Distribution Systems in Japan*, 1985, p. 24

advertising allowances.[796] [797] A recent survey by the Industrial Bank of Japan of select product sectors indicates that various rebates are employed in industries such as aluminum materials for housing construction, apparel, cosmetics, bathroom products, home electrical appliances, personal computers, automobiles, cameras, copiers, beer, gasoline and machine tools.[798]

In Japan, the rebate system originated from the traditional custom of giving congratulatory money. It covered a variety of gift money which wholesalers gave to each other and to retailers to celebrate the return of profit at the mid-summer religious festival day and at year-end. The amount, date and method of payment was decided by the payer. The primary purpose was to strengthen ties and to promote sales. However, following World War II and the introduction of mass production, the financial position of manufacturers improved and they held more bargaining power over wholesalers. A system developed whereby wholesalers were obliged to deliver goods to retailers at prices lower than the manufacturers' price. In turn, manufacturers guaranteed compensation for such losses at the end of the year or other period, and the rebate system was thereby transformed from a favor or bonus to compensation or margin. As volume-sales stores began to emerge, volume rebates, yearly contracts and a fixed rebate system through open prearrangement developed.

Under the present system of rebates, the payer considers the rebate a fixed expense and the payee takes receipt of the rebate for granted. Rebates are usually paid monthly, every three months, seasonally or at the end of every fiscal year. Sometimes payers withhold rebates in order to protect their credit. Manufacturers generally attempt to handle rebates on a confidential basis to prevent having their rebates compared with those ofcompeting suppliers. There is conflicting information about how easy it is for retailers to find out about their competitor's rebates.[799]

[796] Tsuruta, et al., p. 12.

[797] According to a MITI survey, "Rebates in the United States are only given for large-volume customers as an incentive for early payment or for sales and public relations campaigns, there is no evidence of the complicated rebate systems founded on keiretsu (business groupings) or other ties as in Japan." "MITI to Urge Retailers to Curb Business Practices Seen as Source of Trade Friction", *International Trade Reporter*, The Bureau of National Affairs, January 3, 1990, p. 16.

[798] "Changing Japanese Distribution System," IBJ, p. 6.

[799] An association of chain stores reported that it is very difficult to find out about rebates among competitors. On the other hand, one of the major Japanese chain stores reported in an interview that they are able to find out about the level of rebates through informal business relationships. Interviews in Tokyo, Feb. 1990.

The three major objectives for the use of rebates in Japan are: sales promotion, selling incentives, and manufacturer control. Sales promotion rebates include target achievement rebates (paid based on the rate of growth); rebates for opening new channels (paid for new business accounts); and bad inventory clearance rebates (paid for selling off inventories of off-season goods or excessive inventories).

Rebates for incentive purposes include: sales results rebates (paid at year-end or end of fiscal year to express gratitude); special bonus rebates (similar to a bonus); madam rebate (paid to female managers of retail stores to express thanks for cooperation), and store display rebates (compensation for obtaining display space for products). Fidelity rebates or rebates for control include payment promotion rebates (paid to expedite the settlement of accounts or to impose a penalty if payment is overdue); price maintenance rebates (paid by enterprise affected by underselling to those who cooperate on price maintenance); returns prevention rebates (paid according to the rate of goods returned unsold); and exclusive sale cooperation or designated outlets rebates (paid based on share of sales among competitive items).[800]

Exclusive sales cooperation agreements or share rebates are based on the assumption that the amount or attractiveness of the rebate will influence the retailer's decision on which manufacturer's product to carry. This type of rebate may encourage the retailer to exclusively carry products of a particular manufacturer or wholesaler and discourage retailers from seeking other suppliers.

Fidelity rebates are those used for resale price maintenance, the observance of designated outlet designations, the adoption of specified sales policies and other criteria used to reinforce the retailer's fidelity to the manufacturer or wholesaler's sales policies.[801] According to the American Chamber of Commerce in Japan (ACCJ) and the large Japanese chain stores, rebates play an important role in price negotiations with the manufacturers and "loosely defined rebates are often used to enforce conformance with retailers or wholesalers." In a January 1990 presentation to the JFTC, the ACCJ noted:

> Those who do not follow manufacturers suggestions or try to create new products will find yearend rebates, often the real profit in the business, cut at the discretion of the manufacturer. Strong retailers often employ the same tactics in reverse (i.e., taking extra discounts) against weaker importers.[802]

[800] "Distribution Systems in Japan", pp. 27-28.

[801] Tsuruta, et al., p. 13.

[802] ACCJ presentation to the Japan Fair Trade Commission Advisory Group Jan. 30, 1990, p. 3.

Two of the largest retail chain stores in Japan reported that they use rebates as compensation for being pressured into buying an item at a high price and then reselling it at less than cost. According to one chain: "Basically it's true that the manufacturers set the price. The retailers have to sell (the product) at a lower price. The profit comes from the overall sale. We make up from the profit through our overall sales—through rebates."[803] Another chain reported: "In Japan the (rebate) system is for price negotiations with the manufacturer. [Name of store] negotiates its price with the manufacturer and uses rebates to make up the difference. Sometimes the rebates are paid once per month, sometimes once per year."[804] No only do rebates heighten the leverage of payers over payees, their complexity may make it hard for new entrants to match. The ACCJ has commented on the non-transparent nature of rebates:

> Rebate systems are used for some types of business in Japan as strategic tools for sales promotion, incentives, control and administration. One of the reasons the rebate system is so complicated is the custom of allowing merchandise to be returned, making it difficult to determine the actual discount rate before sales are made. According to critics, this system obstructs rationalization in the distribution industry because of its unclear payment standards and complication.[805] [806]

A November 1989 review of foreign companies' experience in Japan's market by MITI stated, ". . . rebates may become obstacles in the path of a company newly entering the market because of the ambiguity and complexity of rebate standards."[807]

Effects of Vertical Business Practices on Access to Distribution Channels

The effects of vertical practices by Japanese manufacturers, especially as they occur in some combination within the distribution keiretsu, are to reinforce manufacturers' control over distribution channels and to make it more difficult for new entrants to access existing distribution networks. [808] [809] Moreover, the use of vertical practices by manufacturers within distribution channels provides an incentive for purchasers to remain loyal to current suppliers. Examining each practice separately, exclusive dealings allow manufacturers to influence retailers' sales and pricing practices. Although there may be some customer service advantages and other efficiencies associated with exclusive dealings, such practices may effectively impede new entrants from entering existing distribution channels. Secondly, resale price maintenance is one means that manufacturers may use to reinforce their suggested retail prices. Returns policies lower the risks for retailers associated with accepting untested products or unspecified quantities of goods from domestic manufacturers. Since returns policies are not offered by importers, there is less incentive for retailers to substitute imported goods for domestic goods. Finally, rebates, especially when offered in conjunction with other practices, may help manufacturers reinforce control over distribution channels.[810]

New entrants, including suppliers of foreign goods, could adopt some of the practices used by existing Japanese firms. They could offer rebates and, while no foreign firms apparently do so, they seemingly could offer unlimited returns. In addition, a new entrant could promise its retailers the protection of resale price maintenance. A new entrant could even attempt to obtain exclusive dealing relationships with retailers carrying his products. However, the use of these practices (particularly exclusive dealing) by existing Japanese firms may still increase the difficulty a new entrant faces in obtaining distribution for its products. The potential for these practices to create problems is increased when combined with Japanese social customs emphasizing loyalty and obligation that provide disincentives to break ties with a traditional supplier.

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[803] Interview with representatives of retail chain store in Osaka, Feb. 6, 1990.

[804] Interview with Japanese chain store, Tokyo, Feb. 7, 1990.

[805] "Distribution System and Market Access in Japan," p. 15.

[806] "The employment of a rebate system more effective than those employed by one's competitors has become an important marketing strategy today when products of uniform quality from competitor manufacturers fill the market. Under such conditions, a new trend toward further complicated rebates contrary to the generally accepted system of open, reasonable and fair rebates, is seen, excepting the case of such industries as photo film." *Distribution Systems in Japan*, pp. 26-27.

[807] "Participation of Foreign Companies in the Japanese Distribution System," p. 13.

[808] "Changing Japanese Distribution System," IBJ, p. 7.

[809] According to Ishida Hideto, "By means of formal, one-sided contracts and various practices, powerful manufacturing firms have bound dealers to exclusive dealing arrangements, territorial restrictions, single-outlet-single-account sales arrangements, and other vertical restrictions. Manufacturers have also provided various types of incentives, including discriminatory rebates, retailer associations, and expanded financial and managerial assistance. As a result of this combination of carrots and sticks, dealerships at both the wholesale and retail levels have lost control over their own business operations as independent units, and have ceased to function as competing units." Ishida, p. 330.

[810] According to a 1986 study of the distribution system for MITI: On the one hand, rebates play a positive role in promoting the efficient distribution of

There are opposing views among analysts on the pro- or anticompetitive effects of vertical practices by manufacturers.[811] Some analysts believe that vertical controls allow manufacturers to correct market failures, by establishing conditions which make it possible for their vertically affiliated retailers to provide necessary information and service, while at the same time preventing "free riding" by competing retailers, who do not provide such service but enjoy the benefits of it. These analysts argue that practices that foster vertical control are not a problem per se, unless such integration makes it easier for the existing suppliers to exert market power or otherwise make it more difficult for a new supplier to enter. Indeed, according to this view, vertical practices can be pro-competitive under the right conditions.

Other analysts caution that unless there is evidence of market failure, vertical restraints may heighten the possibility of manufacturers exerting their control in ways that may limit competition. Although there is some disagreement among economists about the circumstances under which industry concentration is an indicator of relative market power, they generally agree that a positive correlation exists between the degree of concentration in an industry and the market power of dominant manufacturers.[812]

Whether or not producers actually use their market power to exploit their dominant position depends on a variety of factors. The likelihood of market power being exploited diminishes to the extent that collusive action is restricted or otherwise proscribed. The potential for abusing market power also diminishes as the elasticity of demand increases, i.e., if demand for the product is sensitive to price changes, and as competition from foreign imports in the domestic market rises.

The potential for exploiting market power rises to the degree that manufacturers are large or otherwise influential relative to suppliers, wholesalers, and retailers, for instance, where such distributors deal in relatively narrow product areas. The likelihood of manufacturers actually exploiting market power is positively correlated to the ability and willingness of manufacturers to take unchecked collusive action. It also increases to the degree that entry barriers exist at any point in the chain from manufacturer to wholesaler to distributor.

Entry may be restricted by a number of means. So-called "innocent barriers"[813] may help deter new entrants. Such barriers are most effective when entry into the industry would require a substantial, irrecoverable investment (e.g., in terms of advertising, goodwill, productive capacity, or other facilities). An example is economies of scale which dictate that for efficient operation a firm must achieve a certain, regular production level. Strategic barriers may also be deliberately erected by existing suppliers to keep new competitors out. This could include investments in good will, advertising, capacity, and choice locations, as well as brand proliferation and control over scarce inputs. Legal restrictions, such as Japan's restrictions on retailing and warehousing, may also pose barriers to entry by certain suppliers.

The following paragraph provides some insight into the opposing views on the effects of vertical practices in Japan and the United States:

> Underlying the contrast between current Japanese and U.S. antitrust policy are opposing views of the impact of resale price maintenance and other vertical restraints on competition. . . the prevailing view in Japan is that these practices reduce competition by erecting barriers to entry and reducing the number of competitive units in a market. The automobile and consumer electronic industries provide the primary examples. The opposite view has increasingly gained adherents in the United Sates. Indeed, similar marketing practices in the United States by Japanese automobile and electronics firms seem to coincide with the preferred justification for resale price maintenance or other vertical restraints. . . Thus it is believed such practices facilitate rather than impede the introduction of new products and new and more efficient marketing channels.[814]

Although it is beyond the scope of this study to evaluate the competitive implications of vertical practices in the Japanese economy, several studies by the Government of Japan and other experts on Japan's legal system and economy have noted the potential anticompetitive effects of these practices. For example, in 1980, the Antimonopoly Law Study Group issued a report ("that amounts to a formal guidance issued by the Japan Fair Trade Commission") analyzing the

[810]—*Continued*
resources, and on the other hand, they can be coupled with other business practices, depending upon market conditions, to create problems for competition policy.

[811] For a discussion of this debate see, for example, Stephen Martin, *Industrial Economics: Economic Analysis and Public Policy*, Chs. 2 and 17, (New York: Macmillan, 1988).

[812] Economists generally agree that there is a positive correlation between market shares or industry concentration and profitability. Since profit measures are sometimes used as indicators of market power, this suggests that market shares may affect market power, and hence high market shares may potentially lead to a misallocation of resources. However, not all economists accept this. Specifically, there is disagreement on the proper explanation for the positive relationship that exists between market share and profits.

[813] Salop, 1979, *American Economic Review*.

[814] "The World Seen From Japan," *Journal of Japanese Studies*, 1983, vol.

activities of major manufacturers and their distribution systems:[815]

> In general the report found that, for a competitive market, inter-brand competition and intra-brand competition must coexist. The FTC found that distribution networks made by major manufacturers possibly restrict intra-brand competition.[816]

An official 1989 MITI document also noted that as a result of vertical integration of distribution channels, wholesalers and retailers tend to lose much of their independence regarding pricing or marketing activities, and competition between them thus tends to decrease.[817] [181]

An expert on distribution at the U.S. embassy in Tokyo has stated:

> Business practices, such as rebates, return of unsold goods, and pricing systems are additional reasons for prices in Japan being significantly higher than in other countries. In some consumer product areas, such as cosmetics, electrical appliances, pharmaceuticals, beer, and automobiles, the manufacturers control price and supply by controlling distribution channels, often vertically organized down to a chain of stores (keiretsu stores) that feature the manufacturers' products. . . such controls on distribution also limit competition among manufacturers, particularly in terms of price and selection, and tend to close the distribution system of such products to newcomers or outsiders. Capital participation by the manufacturer in its wholesalers and retailers also helps keep the price intact.[819]

According to study of Japan's distribution system by Dodwell Marketing consultants:

> Manufacturers exercise powerful control over consumer prices. Manufacturers can dictate the prices at which wholesalers and retailers sell merchandise to the next tier of distributors. Hence, manufacturers can prevent consumer prices from decreasing. Some manufacturers also have the power to curb the flow of merchandise entering the Japanese market from overseas. For example, when Daiei, the country's largest supermarket chain, started to sell VCRs produced by Samsung in South Korea, the supermarket chain was pressured by Japanese electronics manufacturers not to stock Samsung products.[820]

Composition of Japan's Trade

Having discussed the structure and operation of Japan's present distribution system, this section considers which U.S. product sectors might benefit most in terms of increased U.S. sales as a result of changes in Japan's distribution system. Given the number of variables that are likely to affect products between the port of entry in Japan and to the ultimate consumer, however, predicting likely "winners" from discrete changes in distribution-related policies and practices is difficult. In order to quantify such effects, one would need to estimate the impact of trade barriers on the current level and composition of Japan's trade and, having done so, to isolate those product areas where it appears that aspects of the distribution system are a contributory problem. Such an assessment would be contingent upon numerous factors, such as quantifying the actual impact of the individual distribution-related practices or features on U.S. suppliers, the interaction of the practice with other policies or practices, and the relative competitiveness of the United States in particular products and sectors. Moreover, the ultimate impact of such changes would depend on prevailing economic conditions in the world and in the United States and Japan, actual U.S. business interest in the Japanese market, and on the preferences and needs of Japanese end-users.

There is widespread disagreement about whether Japan's current trade patterns deviate from what otherwise might be expected of a country at Japan's stage of economic development and factor endowments. Nevertheless, existing literature on the relative openness of the Japanese market may provide some clues as to the impact of trade barriers on U.S. exports to Japan, and recent trade patterns may suggest product areas where there is potential for U.S. export growth. In order to highlight those areas where distribution-related barriers may play a part in dampening current U.S. sales, an attempt is made to characterize the goods most likely to be affected by the particular Japanese distribution practices discussed in this report.

Japan's Recent Trade Patterns

For the purposes of this study, recent U.S. trade patterns were examined to uncover broad product areas where there appeared to be differences in the pattern of U.S. exports to Japan and U.S. exports to the world. Recent trends in Japanese trade were also examined with a view toward assessing U.S. performance

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[815] Thomas J. Schoenbaum, et al. "Dynamics of Japanese-United States Trade Relations," A Dean Rusk Center Monograph, p. 131.
[816] Ibid., p. 131.
[817] "Japan's Distribution System," p. 22.
[818] With regard to manufacturers ability to maintain prices, a major consulting firm claims that "these business practices tend to result in stable prices for the manufacturers, but are to the detriment of the consumer." Best and Ueno, p. 2.
[819] Brooks, "Distribution in Japan," p. 6.

[820] *Retail Distribution in Japan*, p. 66.

relative to other major Japanese trading partners in the supply of manufactured goods, particularly the sale of consumer and capital goods. It should be emphasized, however, that the existence of such differences does not necessarily imply that they can be explained by trade barriers in Japan's market. Among other things, the differences in U.S. performance in Japan and the world could be the result of a lack of U.S. comparative advantage relative to Japan, differential rates of growth between Japan and other markets, as well as any other variable that exerts an influence on trade flows. The United States is not considered to be internationally competitive in the supply of some key products as apparel, cars, and other consumer goods that have paced Japan's import growth during the past five years.

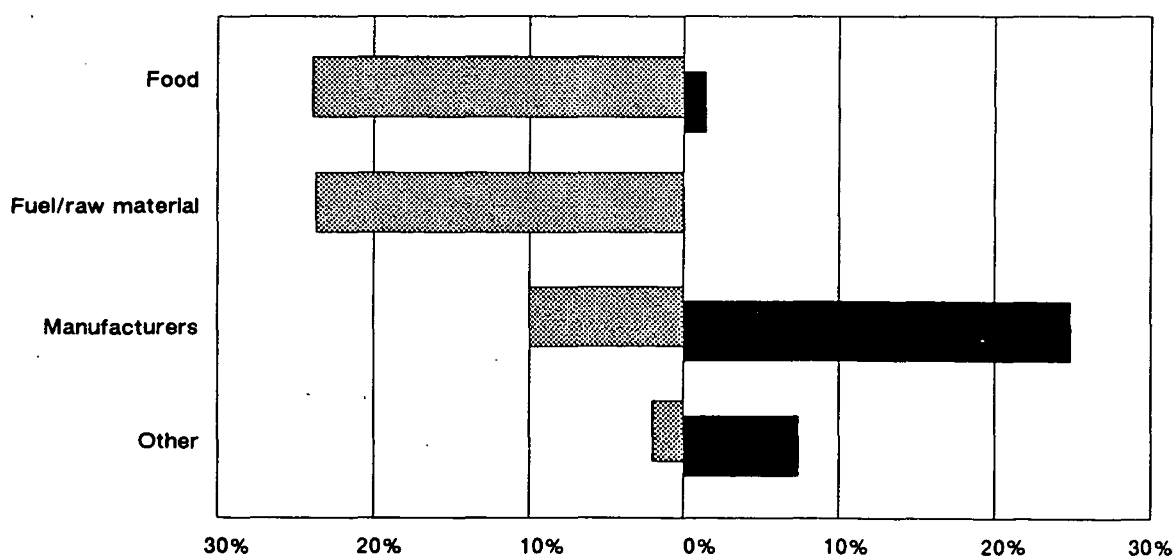
The United States has substantially increased its exports to Japan in recent years, and U.S. exports of manufactures have risen by even more than total U.S. exports to Japan. U.S. exports of capital goods and consumer goods both registered healthy increases. Japan's imports of manufactures have increased markedly in recent years. However, Southeast Asia was Japan's leading supplier of consumer goods like autos, apparel, and household appliances. Moreover, countries in that area garnered the lion's share of the increase in Japan's manufactures imports from 1985 to 1989. Southeast Asian and EC suppliers have also rapidly gained ground on U.S. suppliers in the sale of capital goods to Japan, traditionally a source of global U.S. export strength. The United States improved its trade performance in Japan somewhat in 1989. U.S. exports of manufactured goods improved more between 1988 and 1989 than Japan's imports of such goods from the EC and Asian newly industrialized countries (NIEs). Shipments of some machinery, automotive vehicles and parts, and consumer goods all registered strong gains during this period. A variety of factors will influence whether the patterns evidenced from 1985 to 1989 will hold in the future, including the composition of Japanese domestic demand, the relative competitiveness of U.S. and other foreign suppliers, and whether Japan makes policy changes or shifts in business behavior that improve the sales prospects for particular U.S. products.

Overall U.S. Trade and Exports

Japan is the second largest foreign market for U.S. goods (after Canada), and the United States' number one import supplier.[821] Japan is a particularly important market for U.S. exports of food and raw materials, and a major U.S. supplier of manufactured goods (see figure 10).

[821] It should be noted that some of the data referred to in this section are not directly comparable to each other because of differences in the basis of reporting, i.e., by end use classification versus the nomenclature found in the Standard Industrial Trade Classification (SITC); between sources of data, i.e., some data is as reported by the United States, and other data is as by Japan; and by method of valuation, i.e., customs or f.a.s. value versus c.i.f. value (which includes the value of shipping, insurance, and freight handling).

Figure 10
U.S. trade with Japan as a share of total U.S. trade, by sector, 1989



Source: Compiled from official statistics of the U.S. Department of Commerce.

U.S. exports to Japan nearly doubled in nominal terms from 1985 to 1989, rising from $21.6 billion in 1985 to $42.8 billion in 1989. After generally lagging behind the rate of growth in total U.S. exports, U.S. exports to Japan increased more rapidly in each of the past two years than did U.S. exports to the world, to the EC, and to Canada. In 1989, U.S. exports to the world totalled $349.4 billion, up by 13.0 percent from the previous year. U.S. exports to Japan rose by 18 percent from 1988 to 1989, standing at $42.8 billion in 1989. The bilateral improvement came on the heels of a 34 percent rise in total U.S. exports to Japan from 1987 to 1988.[822]

U.S. imports from Japan registered a slower rate of annual growth than U.S. imports from the world during the three years from 1986 to 1989. Nevertheless, with U.S. imports from Japan of $91.8 billion valued at more than twice the 1989 U.S. exports to Japan, the U.S. Department of Commerce estimates that, at least initially, U.S. exports have to grow at a rate two times faster than U.S. imports just to prevent a deterioration in the bilateral deficit in merchandise trade.[823] This condition was met in each of the past three years, resulting in a slight improvement in the U.S. trade deficit with Japan. However, the bilateral deficit with Japan of $49.1 billion in 1989 represented nearly half (45 percent) of the total U.S. deficit in merchandise trade. Moreover, the 13.0 percent improvement in the bilateral trade deficit from 1987 to 1989 was smaller in relative terms than the 28.6 percent decline in the overall U.S. trade deficit from 1987 to 1989.[824]

For specific product categories, the pattern of increases in U.S. exports to the world and U.S. exports to Japan were generally similar. However, the growth in U.S. sales to Japan appeared to be notably lower than U.S. sales to the world in several product categories, including some primary agricultural products, certain machinery and transportation equipment, and most chemicals. Among the products falling into this category were textile and leather machinery, printing machinery, heating and cooling equipment, mechanical handling equipment, pumps, and compressors and fans.[825]

U.S. Exports of Manufactured Goods

The composition of U.S. exports to Japan differed from the overall pattern of U.S. export trade in 1989. Manufactures accounted for a significantly smaller proportion of U.S. exports to Japan than they did in total U.S. exports. Manufactured goods represented about 57.6 percent of U.S. exports to Japan in 1989, whereas they accounted for 70.2 percent of total U.S. exports (see figure 11). On the other hand, U.S. exports of manufactures to Japan increased by 24 percent from 1988 to 1989, and total U.S. exports of manufactures grew by only 12.8 percent.[826]

Breaking down manufactures into 1 digit SITC categories, from 1985 to 1989, U.S. exports of chemicals to the world rose by 67 percent; manufactured goods classified chiefly by material, 92 percent; machinery and transportation equipment, 59 percent; and miscellaneous manufactures, 73 percent. Exports of transportation equipment registered the largest absolute increase. Broken down by 1 digit SITC categories, U.S. exports to Japan of chemicals rose by 60 percent, manufactured goods classified by chief material 190 percent, machinery and transportation equipment 114 percent, and miscellaneous manufactures 193 percent during the five year period (see Table C-1 and C-2).

Capital Versus Consumer Goods

In terms of major end-use classification, capital goods and automotive vehicles and parts

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[822] Export figures include domestic exports only. See Appendix C.

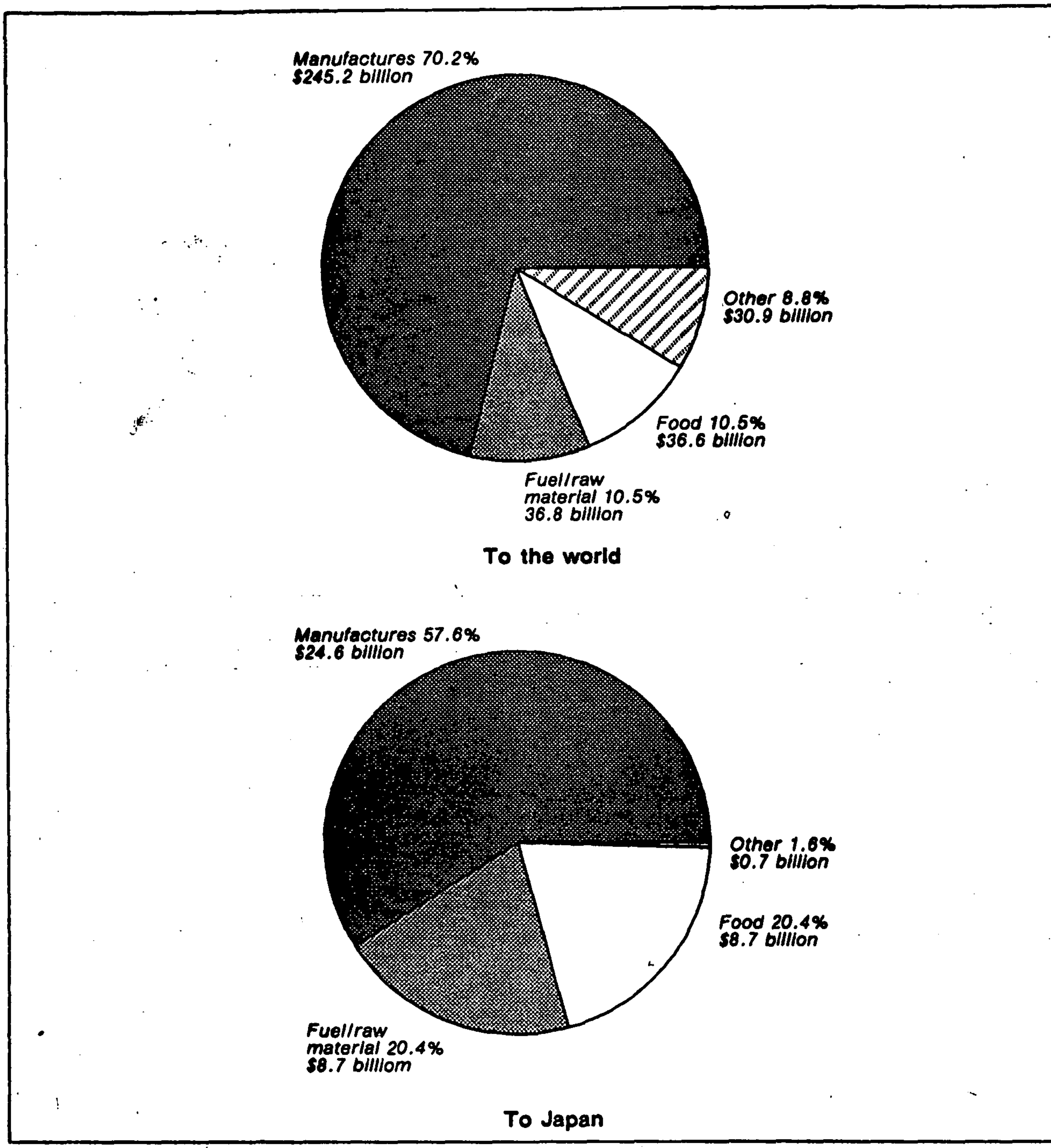
[823] U.S. Department of Commerce, "Is There a U.S.-Japan Trade Problem? Look at the Statistics," *Business America*, Mar. 26, 1990, p. 6. It should be noted that this ratio will decline over time if U.S. exports to Japan continue to grow at a higher rate than U.S. imports from Japan.

[824] Susan MacKnight, "The Debate Over U.S. Trade Policy Toward Japan," *JEI Report*, No. 19A, May 11, 1990. The Department of Commerce reports that the U.S. overall merchandise trade deficit was $108.6 billion in 1989. (Domestic and foreign exports f.a.s. value; Census basis at customs value). This is the most commonly referred to figure for the overall U.S. deficit in merchandise trade. Counting domestic exports only, the merchandise trade deficit was $118.6 billion in 1989, compared to $158.2 billion in 1987. On that basis, Japan accounted for 41 percent of the overall U.S. trade deficit.

[825] In the case of U.S. exports to the world the following product groups registered substantial absolute and relative increases during the 1985-89 period: fresh, chilled and frozen meat; fresh or simply prepared fish; wheat; corn; animal feedingstuffs; manufactured tobacco; beverages; wood in the rough or roughly shaped; non ferrous metal scrap; organic chemicals; plastic resins; medicinal products; paper and paperboard; iron and steel; aluminum; manufactures of base metal; engines and motors for automotives; other parts for motor vehicles; aircraft; all classes of non-electric machinery; electrical machinery (particularly telecommunications equipment and computers); scientific instruments and apparatus; motor vehicles; musical instruments and products; and toys and sporting goods. U.S. exports of Japan of the following product groups registered large absolute and relative increases during the 1985-89 period: fresh, chilled and frozen meat; fresh or simply prepared fish; non-alcoholic and alcoholic beverages; manufactured tobacco; wood in the rough or roughly shaped; non-ferrous metal scrap; organic chemicals; medicinal products; paper and paperboard; aluminum; motor vehicles and parts; electrical machinery n.e.s. and computers; scientific instruments and apparatus; works of art; and toys and sporting goods. All data in this paragraph derived from official U.S. exports statistics of the U.S. Department of Commerce, based on SITC revision 3. Manufactures are here defined as SITC sections 5, 6, 7, and 8. Products are as described at the 3 digit SITC level.

[826] Here defined as SITC sections 5-8. See Appendix C for data.

Figure 11
Composition of U.S. merchandise exports to the world and Japan, by product sector



Source: Compiled from official statistics of the U.S. Department of Commerce..

accounted for relatively less and other industrial supplies, consumer goods, and food and beverages for relatively more of the value of U.S. shipments to Japan than was evident in overall U.S. exports in 1989. (see table 14). In terms of the composition of total U.S. exports in 1989, capital goods were the leading category, accounting for 33.9 percent of total U.S. exports in the year. Other industrial supplies accounted for 22.4 percent of total U.S. exports; primary agriculture, 11.1 percent; food and beverages, 9.6 percent; consumer goods, 9.0 percent; automotive vehicles and parts, 8.0 percent; and

Table 14
U.S. exports to the world, to Japan, total and by major end-use classification, 1989

Item	*U.S. Exports To World*	*Share of Total U.S. Exports to the World*	*Percent change 1988 to 1989*	*U.S. Exports To Japan*	*Share of Total U.S. Exports to Japan*	*Percent Change 1988 to 1989*
	Billions of Dollars	*Percent*		*Billions of Dollars*	*Percent*	
Capital goods	$123.7	33.9%	13%	$11.3	25.3%	14%
Consumer goods	32.8	9.0	42	5.0	11.2	39
Automotive vehicles and parts	29.3	8.0	0	1.0	2.2	25
Food and beverages	35.0	9.6	9	8.4	18.8	6
Petroleum and products	5.3	1.5	23	-	-	-
Other industrial supplies	81.7	22.4	1	15.4	34.5	18
Total, U.S. exports	364.4	100.0	13	44.6	100.0	18

Note: Export data are domestic and foreign exports, by end-use classification, and are thus not directly comparable to the data reported in Appendix C.

Source: U.S. Department of Commerce, *Current International Trade Position of the United States*, March 1990.

other products, 6.0 percent.[827] In terms of the composition of U.S. exports to Japan in 1989, industrial supplies was the leading category, accounting for 34.5 percent of total U.S. exports to Japan in the year. Capital goods accounted for 25.3 percent of total U.S. exports; food and beverages, 18.8 percent; consumer goods, 11.2 percent; automotive vehicles and parts, 2.2 percent; and other products, 7.8 percent.[828]

On the other hand, U.S. exports to Japan of capital goods and automotive vehicles and parts as well as of other industrial supplies increased at a faster rate from 1988 to 1989 than did overall U.S. exports of such goods. Total U.S. exports of consumer goods rose by 42 percent, to $32.8 billion, and exports of capital goods rose by 13 percent, to $123.7 billion. Consumer goods registered the largest relative increase among U.S. exports to Japan from 1988 to 1989, rising by 39 percent to $5.0 billion. U.S. exports to Japan of capital goods increased by 14 percent, to $11.3 billion; automotive vehicles and parts, by 25 percent, to $1.0 billion; and other industrial supplies, by 18 percent, to $15.4 billion.[829]

Japan's Overall Trade

Japan's imports have increased faster than its exports in each of the past three years, resulting in a narrowing of its global surplus in merchandise trade. Japan's total exports rose by 3.8 percent from 1988 to 1989. Its imports increased by 16.8 percent during the same period.[830] Japan recorded a $77.1 billion overall surplus in its merchandise trade in 1989, down 18.7 percent from 1988's surplus of $94.8 billion.[831] The United States accounted for roughly 60 percent of Japan's total trade surplus in 1989.

The United States, the EC, and the East Asian NIEs are Japan's three major trading partners. During the five years from 1984-88, Japan's imports from all three of these partners increased substantially, largely as a result of the near doubling of the yen's value against the dollar from February 1985 to late 1988. However, the increases registered by the EC and the NIEs during the period were relatively higher in percentage terms than were the increases recorded by the United States.

From 1984 to 1988, Japan's imports from the United States rose from $27.0 billion to $42.2 billion, or by 56 percent. In 1988, the leading U.S. exports to Japan were electrical machinery ($2.5 billion), office machines ($2.4 billion), fresh fish ($2.1 billion), unmilled maize ($1.9 billion), aircraft ($1.8 billion), wood in the rough ($1.7 billion), fresh meat ($1.5 billion), organic chemicals ($1.3 billion), instruments and apparatus ($1.2 billion), and miscellaneous nonelectric machinery ($1.2 billion). In total, the top 10 items accounted for 41 percent of Japan's 1988 imports from the United States.[832]

From 1984 to 1988, Japan's total imports from the NIEs rose from $10 billion to $24.9 billion. Seventy percent of all of Japan's imports

[827] There may be some overlap between the primary agriculture and food and beverages categories.
[828] All data in this paragraph from U.S. Department of Commerce, Current International Trade Position of the United States, March 1990 reprinted in *Business America*, Mar. 26, 1990, pp. 4-5.
[829] U.S. Department of Commerce, "Current International Trade Position of the United States", Mar. 1990, reprinted in *Business America*, Mar. 26, 1990, pp. 4-5. Data ar domestic and foreign exports.
[830] U.S. Department of Commerce, "Current International Trade Position of the United States," Mar. 1990 reprinted in *Business America*, Mar. 26, 1990, pp. 4-5.
[831] Ibid, pp. 4-5.
[832] All data in this paragraph based on the U.N. Trade Data system, imports as reported by Japan. Manufactures are here defined as SITC sections 5, 6, 7, and 8. Products are as described at the 3 digit SITC level.

from the NIEs in 1988 were manufactured goods. Leading items imported from the NIEs were clothing ($3.7 billion), fresh fish ($2.0 billion), petroleum products ($1.4 billion), footwear ($781 million), and telecommunications equipment ($756 million).[833]

Japan's imports from the European Community rose by 162 percent during 1984 to 1988, from $9.0 billion to $23.7 billion. In 1988, 85 percent of Japan's imports from the EC were manufactured goods. Japan's top categories of imports from the EC were motor vehicles ($2.9 billion), organic chemicals ($1.5 billion), works of art ($1.3 billion), medicinal products ($1.3 billion) and miscellaneous nonelectric machinery ($997 million).[834]

Japan's Imports of Manufactured Products

Japan's imports of manufactured goods have increased sharply since 1986 in dollar terms and since 1987 in yen terms.[835] At $106.1 billion, the level of Japan's imports of manufactures in 1989 was 164.2 percent higher than that recorded in 1985. (see table 15). Moreover, the share of Japan's total imports accounted for by manufactures rose from 31 percent in 1985 to 48 percent in 1989. Among manufactured goods, broken down by 1 digit SITC category, imports of chemicals rose by 97.6 percent from 1985 to 1989, manufactured goods classified chiefly by material by 182.6 percent, machinery and transport equipment by 169.2 percent, and miscellaneous manufactures by 273.6 percent.[836] (See table 16) The yen's appreciation on world currency markets and Japan's relatively strong, domestically-driven economic growth both contributed to the rise.[837] On a per capita basis, however, imports of manufactured goods in Japan remain far below the levels of the United States and Germany.[838]

[833] All data in this paragraph based on the U.N. Trade Data system, imports as reported by Japan. Manufactures are here defined as SITC sections 5, 6, 7, and 8. Products are as described at the 3 digit SITC level.

[834] All data in this paragraph based on the U.N. Trade Data system, imports as reported by Japan. Manufactures are here defined as SITC sections 5, 6, 7, and 8. Products are as described at the 3 digit SITC level.

[835] There is a slight discrepancy between the data reported here and that reported in table 16. Data reported here include SITC category 9, whereas table 16 does not. SITC 9 includes various items, such as returned goods, not normally categorized as manufactures by the USITC.

[836] Based on data from the Japan Tariff Association, as reported in Japan Economic Institute.

[837] Ibid., p. 9.

[838] The U.S. Department of Commerce reports that, "In 1988, Japan imported only $749 worth of manufactures per person, compared to $1,468 for the United States and $3,075 for West Germany. (All countries had a roughly equivalent per capita GNP of $20,000.) This disparity remains virtually unchanged since 1980, when the comparable figures were: $275 per capita in Japan, $582 in the United States and $1,761 in West Germany." U.S. Department of Commerce, "Is There a U.S. Japan Trade Problem? Look at the Statistics," Business America, Apr. 9, 1990, p. 6.

Table 15
Japan's imports of manufactured products[1] in dollars and yen, 1980 and 1985-89

(c.i.f. value)

Year	*Dollar terms*		*Yen terms*		
	Value	*Percent Change*	*Value*	*Percent Change*	*Share of Total Imports*
	(Million) (dollars)		*(Billion) (yen)*		
1980	$32,110	6.2%	Y7,304	16.5%	22.8%
1985	40,157	-1.1	9,636	0.2	31.0
1986	52,781	31.4	8,896	-7.7	41.8
1987	65,961	25.0	9,575	7.6	44.1
1988	91,838	39.2	11,770	22.9	49.0
1989	106,111	15.5	14,588	23.9	50.3

[1] Manufactured goods are here defined as SITC categories 5-9, and thus are not directly comparable to table 16.

Source: Japan Tariff Association, as reported by Japan Economic Institute, *JEI Report*, No. 19A, May 11, 1990, p. 5.

Table 16
Japan's imports of manufactured products,[1] 1980 and 1985-89.

(In millions of dollars, c.i.f. value)

Item	*1980*	*1985*	*1986*	*1987*	*1988*	*1989*
Chemicals	$6,202	$8,072	$9,733	$11,845	$14,830	$15,948
Manufactured goods classified by material	10,579	10,886	12,390	18,055	27,340	30,767
Machinery and transport equipment	8,756	11,106	13,283	17,264	24,727	29,894
Miscellaneous manufactures	5,031	6,349	8,634	13,396	18,702	23,722
Total, manufactures imports	30,568	36,413	44,040	60,560	85,599	100,331
Total imports	140,528	129,539	126,408	149,515	187,354	210,956
Manufactures/total imports	21.8%	28.1%	34.8%	40.5%	45.7%	47.5%

[1] SITC categories 5-8

Source: Japan Tariff Association, as reported by Japan Economic Institute in JEI Report, No. 42B, Nov. 3, 1989, p. 5. as updated in May 1990.

The United States was still Japan's leading supplier of manufactured goods in 1989, but its significance as a supplier of manufactured goods diminished as suppliers in the EC and the NIEs made inroads in the five years from 1985 to 1989. (see table 17). The $65.9 billion absolute increase in Japan's imports of manufactures during the period was actually fairly evenly divided among the EC (which garnered 25.0 percent of the absolute increase), the Asian NIEs (22.4 percent), and the United States (21.0 percent). However, the U.S. share of Japan's total manufactured imports declined from 35.5 percent in 1985 to 26.5 percent in 1989. The EC's share of Japan's imports of manufactured goods rose from 19.2 percent to 22.8 percent during the same period, while the NIEs share grew from 14.2 percent in 1985 to 19.3 percent in 1989.[839]

Japan's imports of manufactures from the EC and the Asian NIEs grew more rapidly than its imports of manufactures from the United States in each of the three years from 1986 to 1988. However, that pattern reversed in 1989, when Japan's imports of manufactures from the United States grew by 19.5 percent, compared to the EC's 16.5 percent gain and the Asian NIE's 12.4 percent increase. The level of Japan's imports of manufactures from the United States in 1989 was nearly double the level registered in 1985 (up by 97.4 percent). The level of Japan's imports of manufactures from the EC in 1989 was more than triple (up by 214.6 percent) the level recorded in 1985, while the level of manufactured imports from the Asian NIEs were three and a half (up 260.3 percent) times higher than 1985 levels.

Broken down by 1 digit SITC category, Japan's imports of miscellaneous manufactured goods from the United States grew at nearly double the rate of overall Japanese imports of manufactures (SITC 6) from the United States during 1985-88, while imports of basic manufactures from the United States also registered above-average gains. (see appendix C). U.S. exports of chemicals, meanwhile, grew at about half the pace of overall U.S. exports to Japan of manufactures. The EC's exports of miscellaneous manufactured goods and

[839] All data in this paragraph are Ministry of Finance data as reported by the Japan Economic Institute.

Table 17
Japan's imports of manufactured products[1] by major supplier, 1985-89

(In millions of dollars, c.i.f. value)

	Total		*United States*		*European Community*		*Asian NIEs[2]*	
Year	*Value*	*Percent Change*	*Value*	*Percent Change*	*Value*	*Percent Change*	*Value*	*Percent Change*
1985	$40,157	-1.1%	$14,243	1.9%	$7,691	-5.8%	$5,689	0.8%
1986	52,781	31.4	17,645	23.9	11,956	55.4	7,803	37.2
1987	65,961	25.0	17,672	0.2	15,146	26.7	12,459	59.7
1988	91,838	39.2	23,540	33.2	20,770	37.1	18,234	46.4
1989	106,111	15.5	28,119	19.5	24,193	16.5	20,495	12.4

[1] Manufactured goods are here defined as SITC categories 5-9.
[2] Hong Kong, South Korea, Singapore and Taiwan.

Source: Ministry of Finance as reported by Japan Economic Institute, *JEI Report*, No. 19A May 11, 1990, p. 5.

machinery and transport equipment both grew at a faster clip than overall Japanese imports of manufactures from the EC. EC exports of basic manufactures and chemicals both grew by less than average. Japan's imports of manufactures from the NIEs demonstrated the same pattern as its imports from the EC.[840]

Capital Versus Consumer Goods

Broken down by major end-use classification, capital goods remained Japan's most significant class of manufactured imports in terms of value in 1989, followed by consumer durables and consumer nondurables. The United States was Japan's leading supplier of capital goods. (see table 18). The EC supplied nearly half of Japan's consumer durables, with cars accounting for the bulk of EC exports in this category. Southeast Asian countries supplied almost half of Japan's consumer nondurables, notably clothing and other manufactured textile products.

In terms of the U.S. performance relative to other major Japanese trading partners, from 1985 to 1988, the United States lost ground to its EC and Southeast Asian competitors in the sale of capital goods and consumer durables, and registered a slight increase in its market share in the supply of consumer nondurables. Southeast Asian exports of capital goods rose higher than EC exports of such products, while the EC's exports of consumer durables grew more than did Southeast Asian exports during the period. A slight shift in the overall pattern was evident in 1989. The United States registered a 35.9 percent gain in consumer durables from 1988 to 1989, compared to the EC's 34.8 percent increase and the NIE's 11.3 percent gain. The EC registered a sharp increase in its shipments of consumer nondurables (42.2 percent) and a slowing (to 13.2 percent) of its growth in exports of capital goods.[841]

Japan's imports of consumer durables from all suppliers rose more than three times as much (418.9 percent) as its imports of capital goods (130.8 percent) during the 1985 to 1989 period, while imports of consumer nondurables grew twice as high (309.9 percent) as imports of capital goods. In absolute terms, the increase in Japan's imports of capital goods from 1985 to 1989, at $15.1 billion, was more than the absolute increase in its imports of consumer durables ($12.5 billion) and consumer nondurables ($10.3 billion). In terms of their share of the absolute increase in Japan's imports from 1985 to 1989, the United States garnered the highest percent of Japan's absolute increase in capital goods imports during the period (45.9 percent), Southeast Asia the highest share of Japan's absolute increase in consumer nondurables imports (47.1 percent), and the EC the highest share of Japan's absolute increase in consumer durables imports (48.7 percent).

Japan's imports from U.S. suppliers differed slightly from the overall trend. In absolute terms, purchases from the United States tracked the overall pattern: the increase in Japan's imports of capital goods from the United States from 1985 to 1989 ($6.9 billion) was significantly higher than the increase in purchases of U.S. consumer durables ($1.7 billion) and nondurables ($1.2 billion). But, in contrast to the overall pattern, Japan's imports of consumer nondurables from the United States grew the most from 1985 to 1989 in percentage terms, followed by its imports of consumer durables and imports of capital goods. Indeed, in the consumer nondurables category the United States registered a higher rate of growth (387.6 percent from 1985 to 1989) than the overall average (309.9 percent) or the growth shown by Asian NIEs (307.7 percent) and the EC (296.1 percent).

The United States lost ground to the NIEs and the EC in the sale of capital goods during the period. U.S. exports of capital goods rose by 92.4 percent from 1985 to 1989, compared to the 176.8 percent increase registered by the EC and the 317.8 percent increase registered by Southeast Asian suppliers. The United States' 1989 market share stood at just 54.2 percent, compared to its 65.0 percent share of total Japanese imports in 1985. During the same period, the EC's share of Japan's total imports of capital goods rose from 16.0 percent in 1985 to 19.2 percent in 1989 and the share accounted for by Southeast Asian countries rose from 10.2 percent to 18.5 percent.

The rise in imports of consumer durables from the United States (294.2 percent) was below average, resulting in a decline in the share of the United States in total Japanese consumer durables imports from 19.8 percent in 1985 to 15.1 percent in 1989. The EC meanwhile registered above average growth in shipments of consumer durables (549.4 percent from 1985 to 1989, compared to the overall average of 418.9 percent). It thereby raised the EC's share of total Japanese imports of consumer durables from 37.2 percent in 1985 to 46.5 percent in 1989.

Impact of the Distribution System on Particular Types of Products

Many of the features and practices associated with Japan's distribution system discussed in this report appear to have a differential effect on capital goods and consumer goods. Japan's

[840] All data in this paragraph is derived from the U.N. trade data system.

[841] Based on data from the Japan Tariff Association, *The Summary Report: Trade of Japan*, as reported in Japan Economic Institute, *JEI Report*, No. 11A, p. 3.

Table 18
Japan's imports of capital and consumer goods by major supplier, 1980 and 1985-89

(In millions of dollars; c.i.f. value)

	1980	*1985*	*1986*	*1987*	*1988*	*1989*
Capital Goods	$9,096	$11,541	$13,229	$16,328	$22,341	$26,637
United States	4,888	7,504	7,785	9,025	12,250	14,434
European Community	2,247	1,845	2,736	3,606	4,513	5,107
Southeast Asia[1]	790	1,179	1,473	2,313	3,662	4,926
Consumer Nondurables	2,677	3,319	4,711	7,718	10,706	13,603
United States	322	314	403	857	1,200	1,531
European Community	697	692	1,008	1,400	1,928	2,741
Southeast Asia[1]	1,167	1,574	2,368	4,093	5,548	6,417
Consumer Durables	2,395	2,974	4,601	7,977	11,938	15,431
United States	561	590	740	1,086	1,711	2,326
European Community	855	1,105	1,949	3,575	5,322	7,176
Southeast Asia	1672	873	1,393	2,538	3,809	4,241

[1] Southeast Asia includes South Korea, Taiwan, Hong Kong, Thailand, Singapore, Malaysia, Brunei, Philippines, Indonesia, Cambodia, Laos, Burma, India, Pakistan, Sri Lanka, Bangladesh, Macau, Afghanistan, Nepal, and Bhutan.

Source: Japan Tariff Association, as reported by Japan Economic Institute, *JEI Report*, No. 19A, May 11, 1990, p. 5.

distribution channels for capital goods and industrial supplies appear to be less complex than those for consumer goods. However, they are more likely to be affected by the interwoven relationships among members of industrial groupings and by horizontal business practices. Consumer goods, on the other hand, may be more impacted by the vertical business practices of distribution keiretsu and by legal restrictions on the retail sector. Moreover, agricultural products appear to be affected by distribution-related barriers associated with various government and business practices.

Intermediate and capital goods are distributed among Japanese producers through channels which are relatively direct and efficient, from a transactions cost perspective.[842] Raw materials, bulk commodities, and some capital goods tend to be handled primarily by the nine major trading companies. Foreign businessmen have alleged that the ties of general trading companies to other Japanese firms, including potential Japanese competitors with which they are affiliated, result in less than enthusiastic sales efforts.

With some exceptions capital goods appear to be less likely to be affected by practices such as exclusive dealings, rebates,[843] and returns, since these practices are more common in consumer goods distribution. However, given the often high "engineering" component of capital goods, foreign suppliers may be particularly disadvantaged by the tightly interwoven industrial groupings and networks common in the distribution of capital goods. Many capital goods and some intermediate products like high-value added auto parts must be "designed into" an existing system or are specially built for a particular purpose. They thus are often developed by suppliers working closely with the ultimate purchaser. In this sense, the strong linkages between Japanese manufacturers and particular "families" of suppliers evidenced in Japan's distribution system may mean that it is difficult for foreign firms to penetrate the Japanese market. The close, intense nature of these business relationships can sometimes be witnessed in the dealings of inter-market keiretsu, but tend to be tighter in origin in the case of subcontracting networks through which the major share of intermediate goods is channelled.[844] Another major characteristic of capital goods distribution in Japan is the importance of "repetitive trading" through implicit long-term contracts between firms. The JFTC has reported that about 80 percent of capital goods purchases are of a repetitive nature.[845] This characteristic of Japanese distribution would appear to place foreign suppliers of capital goods at a particular disadvantage.

Any potential increase in U.S. exports of capital and intermediate goods would probably be contingent upon a weakening of the commitment of such firms to the maintenance of long-term supplier relationships with closely affiliated firms.

[842] Thomas Roehl, "A Transactions Cost Approach to International Trading Structures: The Case of the Japanese General Trading Companies," *Hitotsubashi Journal of Economics*, December 1983. Current trends suggest that these channels are becoming shorter as manufacturers take an aggressive role in eliminating superfluous middlemen, in part, through more widespread use of data from computer information systems. This same trend may also lead to greater control of the distribution channels by manufacturers.

[843] Rebates have been reported in some capital goods and intermediate products, including machine tools, gasoline, and copiers.

[844] Many large Japanese companies depend for more than half of the value added of their output on subcontracting networks consisting of small and medium sized firms compared with Western firms which depend more on own-firm production. Caves and Uekusa.

[845] JFTC, "Long-Term Relationships Among Japanese Companies: Report by the Study Group on Trade Frictions and Market Structure," April 1987.

Strengthened enforcement of Japan's antitrust laws may also be a factor in increasing U.S. sales. However, Japan's levels of intra-industry trade in capital goods appear to be relatively low. Edward Lincoln estimates that Japan's intra-industry trade is particularly low in some major U.S. product export categories, all of them capital goods. He finds particularly low ratios in motor vehicles, office machines, aircraft, electrical machinery, machinery and parts, power generating equipment, special machinery, telecommunications equipment and scientific instruments.[846] Import penetration ratios in such products do not appear to have risen as fast in recent years as they have in consumer goods. It is difficult to determine the reasons for the recent sharp advances made by Southeast Asian suppliers in the sale of capital goods. It is unclear whether some of the recent rise in Japan's imports from such suppliers is linked to increased investment by and original equipment manufacturing for Japanese firms. Such suppliers may have a better "in" into the distribution system to the extent that is true.

Consumer goods appear more likely to be affected by manufacturer dominance over distribution chains and legal barriers. The distribution channels for consumer goods are generally longer than for capital goods, with goods often passing through several layers of intermediate distributors before reaching the ultimate consumer. As noted earlier, Japan's imports of consumer goods have increased rapidly over the past five years. Although the Japanese government has indicated a greater willingness to initiate change in practices and policies affecting the distribution of consumer goods, trends in Japan's distribution channels for these goods suggest that manufacturer control over distribution channels may be increasing, posing more intractable barriers to new entrants in the long term.

A number of consumer goods appear to be affected by vertical relationships and practices currently common among Japanese firms. Distribution keiretsu are common in the distribution of autos, consumer electronics, optics, cosmetics, pharmaceuticals, newspapers, and processed foods. Foreign suppliers of consumer goods may also be affected by the vertical business practices of manufacturers, such as resale price maintenance, exclusive dealerships, and rebates. Resale price maintenance reportedly affects a variety of consumer goods, including food products, consumer electronics, published materials, cosmetics, and drugs. Exclusive dealerships appear to be particularly common in the auto and electric appliance industries, and partially exclusive dealerships affect a number of other products, including cosmetics. Unlimited returns policies are common in the distribution of books, magazines, apparel, cosmetics, and appliances. Particularly high rates of return are evident in the distribution of records, pharmaceuticals, and stationery. Rebates are common in the distribution of a diverse range of products, including some consumer goods such as apparel, cosmetics, toiletries, electric appliances, personal computers, automobiles, cameras, and beer.

Legal barriers appear to exert a disproportionate effect on consumer goods. Restrictions on the expansion of larger stores, such as department stores and supermarkets, may affect the ability of foreign suppliers to sell products such as processed foods, apparel, and other consumer nondurables. However, Southeast Asian suppliers and the EC—which are currently Japan's most significant sources of imported apparel, footwear, and other consumer products—may stand to gain more in actual terms than the United States from liberalized administration of the Law. On the other hand, more liberal administration of the Law may well pave the way for the opening and expansion of U.S. retailers in Japan. Moreover, some U.S. consumer goods may be good candidates for expanded U.S. sales, such as processed foods and sporting goods. The difficulties faced by supermarkets in obtaining liquor licenses may affect foreign, particularly U.S., sales of wine, beer, and distilled spirits. The EC, Japan's leading supplier of such goods, might gain more in absolute terms from changes in distribution, but U.S. suppliers, which compete largely on the basis of price in some categories, also stand to gain. A variety of distribution practices affect agricultural products including state-trading of beef, wheat, wheat flour, barley, and pork. These practices may pose distribution-related impediments to further U.S. exports to Japan. Entry procedures affecting perishable goods, restrictive policies on food additives, and lack of adequate warehouse facilities such as cold storage warehouses may hinder U.S. exports of these products.

The Effects of Japan's Distribution System on U.S. Exports

This section assesses the potential effects of Japan's distribution system on U.S. exports. The main question that will be examined is whether any features or practices, singularly or in some combination, impede access by new entrants, particularly foreign firms. In general, this study has described a number of formal and informal practices which either overtly restrict entry into the various levels of the distribution chain, or raise its associated cost. A summary of the most important findings follows.

[846] Lincoln, p. 56.

Many of the policies and practices associated with Japan's distribution system discussed in this report have the effect of solidifying manufacturers' control over existing distribution channels and/or limiting the ability of firms to access existing distribution channels. In particular, vertical business practices, especially as they occur in some combination or within industries characterized by a high incidence of distribution keiretsu, may reinforce manufacturers' control over distribution channels and place new entrants at a disadvantage relative to firms already established in the market, most of whom are Japanese. As noted in the report, various other characteristics of Japanese corporate behavior (as influenced by certain Japanese social customs) may make it more difficult for foreign companies, compared to domestic firms, to break into already established supplier-purchaser relationships within distribution chains. While conclusive evidence of anticompetitive activity has not been the primary concern of this report, study groups commissioned by the Government of Japan itself have pointed to the possible anticompetitive effects of business practices within vertically integrated distribution chains and their potentially adverse effects on new entrants. Some economists argue that vertical linkages in the distribution chain may actually facilitate the introduction of new products and the provision of services to the consumer.[847] On the other hand, the widespread use of these practices by existing firms, combined with the Japanese preference for maintaining long-term relationships, is likely to increase the difficulty new firms face in attempting to distribute products through existing distribution networks.

Horizontal collusive activities, mainly associated with cartels or trade associations, have been the subject of JFTC attention in the past and may impede foreign access to distribution channels. Although unfair business practices are prohibited under Japan's Antimonopoly Law, the JFTC's relative lack of political clout and consequent weak enforcement of antitrust policies appears to create a legal climate that is tolerant of practices that are considered anticompetitive in the United States. In *Japan's Unequal Trade,* Ed Lincoln assesses the effects of these vertical and horizonal linkages on exports as follows:

> Vertical ties—between parts suppliers and major manufacturers, or between manufacturers and distributors—involve unequal, hierarchical social relationships used to exclude foreign (and domestic) outsiders from markets in ways that are illegal in the United States. Horizontal ties among members of manufacturing industries also involve collusion to exclude or limit the role of foreigners, often with the informal approval of the government. The Japanese Fair Trade Commission has opposed some of these activities, but as a small agency it often loses in competition with the Ministry of International Trade and Industry or other powerful government ministries.[484]

[847] Hadley, cite.

Linkages in the Distribution System

Some aspects of Japanese corporate behavior—such as an emphasis on long-standing reciprocal relations, loyalty and obligation—may create solid purchaser-supplier relationships outside of the distribution keiretsu. Such linkages may further reduce the risks of doing business for firms already operating in the market, discourage purchasers from switching suppliers and make it difficult, or very risky, for new entrants, especially foreign firms, to break into Japan's market, either through existing channels or by setting up their own. According to Ray Ahearn of the Congressional Research Service:

> This buying within the family orientation covers a wide spectrum of the Japanese manufacturing sector. It provides Japanese industry with a certain "natural immunity" to imports, making protection unnecessary in industries characterized by a nexus of intercorporate relationships where price is not the most important consideration.[849]

The distribution keiretsu appear to have the most relevance to consumer goods' distribution. However, the overlapping linkages of the various types of keiretsu, based on debt, equity and personnel, may add to the difficulties of foreign suppliers of other products in accessing firms within existing distribution networks. The effects of these linkages may differ for consumer, capital and intermediate goods. The subcontracting system in Japan also serves to tie thousands of other firms together in long-term stable relationships with lead manufacturing firms, and lessens the chances that foreign companies will be able to locate independent purchasers for their products.

The apparent widespread interrelationships between purchasers and suppliers within the distribution chain, whether through the use of equity ties, formalized business practices or through informal relations, suggests that there are few independent marketing channels or "noncaptive" outlets open to foreign suppliers. However, the costs of setting up an independent distribution chain—often considered the most desirable alternative to the established

[848] Lincoln, p. 92.

[849] Ahearn, Statement before the Joint Economic Committee, Oct. 9, 1989, p. 6.

distribution channels—are extremely high. According to the European Business Council:

> It is a well known fact that rental costs are 50 to 100 percent higher [in Japan] than in all [other] industrial countries. This applies to office and warehouse. In the case of rent for retail stores, restaurants, etc., prices are 100 to 200 percent higher.[850]

Even if a company has the wherewithal to set up independent channels, legal restrictions on retailing and wholesaling and on the use of sales promotions may deter foreign firms from setting up their own distribution channels. Moreover, it is often difficult to engage in complete takeovers or even acquire substantial holding in Japanese companies. Therefore, purchasing a "foothold" in the distribution system, a popular method in other countries, is generally not feasible in Japan. In addition, the risks associated with such investments may deter entry.

Public Policies

The study has also found that legal restrictions on retailing and wholesaling may impede the access of new entrants to Japan's distribution channels. Of those laws affecting distribution activities, the Large Scale Retail Store Law appears to be the most important in terms of its direct effects on foreign sales of consumer goods in Japan. The Law limits the expansion of large retail stores which carry the highest proportion of imported consumer goods' in Japan. There have been no cases of foreign ownership of large scale retail stores in Japan under the law, although an application by a major U.S. retailer is currently pending. Other laws also impede entry by foreign firms into Japan's distribution system.

Legal restrictions on entry into warehousing, and administrative guidance and informal practices that have created a comprehensive fee system limit the ability of newcomers to establish warehouse facilities or utilize low-cost warehousing. Restrictions on bonded warehouses have resulted in a shortage of storage space, particularly for perishable products, and also raise the cost of entry to Japan's distribution channels for foreign companies. State-trading of certain agricultural products and other barriers such as tariffs and quotas appear to inhibit the ability of foreign firms to access Japan's channels for distribution of agricultural products. Although legal restrictions on investment are not generally recognized to be a major barrier to Japan's distribution system, cross-shareholding practices and restrictions on acquisitions appear to be a problem for new entrants attempting to enter existing distribution channels by purchasing stock in Japanese companies.

[850] Statement by the EBC before the JFTC Advisory Committee, Jan. 30, 1990, p. 9.

Foreign Companies' Encounter with "The System"

As documented in this study, regardless of the degree to which certain features or practices are inefficient or discriminate against new entrants, the sheer magnitude of the costs, regulations and linkages within the "system" (according to the expanded definition used in this study) may be psychologically daunting for new entrants. A simple listing of those features and practices which any potential newcomer to Japan's distribution system may face could be enough to invoke second thoughts by even the largest or most determined corporations.

From the perspective of a potential foreign entrant, when their products arrive in Japan they could face delays, costs and inconsistencies associated with entry and customs clearance procedures and warehousing and transportation fees. Next, there are choices to be made regarding the type of distribution channel and marketing strategy to be pursued—many of which may offer short-term gains, but often at the risk of long-term limits on market share. Even after a marketing channel has been selected, enforcement of restrictive laws on retailing, wholesaling, and agriculture (to name a few) may thwart the distribution plans of the newcomer. Other practices associated with friendly cross-shareholding among firms, debt, and personnel linkages associated primarily with keiretsu may further inhibit the ability of firms to pursue their marketing strategy. Perhaps most importantly, the tolerance of certain anticompetitive business practices within and among distribution chains, the informal ties among purchasers and suppliers, and consumer preferences may ultimately limit the success of a newcomer.

If the distribution strategy of a firm calls for setting up an independent distribution system (or if this appears to be the only option available to maximize sales), all of the above features and practices in addition to high land, rent or other operating costs must also be considered. Furthermore, customer demands for prompt before and after service and the need to compete with established Japanese brands may necessitate heavy expenditures for sales promotions and advertising, as well as for the training and recruitment of service personnel. This may be particularly the case of foreign products, towards which Japanese customers may have negative attitudes or perceptions. Moreover, social traditions that place heavy emphasis on personal contact, long-term commitment, and demonstrated reliability may mean that new entrants must spend substantial amounts of time, effort, and money to establish good will with potential purchasers. Such costs would not be recoverable in the event of failure, a prospect which is not unheard of where producers are often required to work through numerous intermediaries and retailers in order to achieve the sales required to break even, and in situations where the existing suppliers can coerce potential customers.

Breaking the hold of current relationships between such purchasers and dominant Japanese suppliers is likely to require more than just lower prices, but other incentives as well, a difficult proposition given the lack of transparency of such practices as rebates and returns. At times Japanese customers have questioned the reliability of foreign suppliers based on reports of delayed shipments or problems associated with quality. They may ultimately agree to purchase commercially viable quantities only after a long series of small trial shipments or upon the storage of significant quantities of the good in Japan, both of which add to unit costs and diminish the competitiveness of the foreign product. In the end, a foreign company may decide that the amount of time, energy, persistence and money required to market their products in Japan is too high and the risks too great, despite the potential for large profits over the long-term.

In conclusion, Japan's system for moving goods from port of entry to ultimate consumer appears to contain certain elements which create problems for new firms, particularly foreign firms, seeking to enter Japan's market. However, it is still unclear to what extent the system's functioning is itself the problem as opposed to the preferences and biases of Japanese end users or to the firms attempting to enter the system. To the extent that Japanese end users are freely willing to pay more for service, reliability, stability, and convenience, and freely decide that they do not wish to purchase more imports, the Japanese distribution system may still be largely a product of "market forces," though it remains difficult to enter. However, it appears that many decisions of end users are actually influenced by governmental policies, or the activities of powerful manufacturers and other domestic interest groups, such as small retailers or agriculture interests.

In addition, there is a general perception among both Japanese and especially U.S. businesses that a contributing factor to the difficulties faced by U.S. firms in accessing the Japanese market is the failure to develop high-quality products suited to Japanese consumer tastes, failure to do sufficient "homework" when developing an effective marketing strategy, and a general lack of familiarity with the legal and business environment in Japan. In the words of one foreign observer:

> . . . Western firms' perceptions of problems and inefficiencies in distribution in Japan often reflect a failure to grasp that it is a very different kind of place indeed, in which the roles expected of different parties in the distribution chain, the motivations and relationships of all of those in the chain, and the demands placed on all concerned, are often profoundly different from the patterns commonly seen in the West. Of course, there are indeed many problems and high costs associated with distribution in Japan. Considerable scope exists for action by the Japanese authorities to remove restrictive practices in distribution and encourage greater play of market forces. Japan still has a long way to go before it comes close to placing its faith in decontrolled distribution to the same extent as we do here in the U.K. . . . [851]

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[851] "The Japanese Distribution System: A Guide to Distribution", The Anglo Japanese Economic Institute, 1989, p. 7.

APPENDIX A
LETTER OF REQUEST FROM COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, DC 20515

RECEIVED

89 OCT 23 P4:14

OFFICE OF THE CHAIRMAN

October 12, 1989

The Honorable Anne E. Brunsdale
Chairman
U.S. International Trade Commission
500 E Street, S.W.
Washington, D.C. 20436

Dear Madam Chairman:

In recent years, the United States Government has conducted a variety of negotiations with the Government of Japan to reduce or eliminate trade barriers in that country and to encourage Japan to play a greater role in shouldering the responsibilities of the international trading system, in light of the tremendous benefits which that country has realized from the system. As you know, the Administration recently launched a Structural Impediments Initiative (SII) with Japan, which is designed to focus on systemic barriers to trade, rather than sectorial or border measures which may affect imports into Japan.

One of the central elements of the SII effort is a discussion of Japan's distribution system, which has been characterized by many observers as a complex, multilayered collection of large and small wholesalers, retailers, and other middlemen. It often is cited as one factor in the difficulty experienced by foreign exporters in penetrating the Japanese market, in part due to its inefficiency and inflexibility.

As you know, the Committee on Ways and Means has primary jurisdiction in the House of Representatives over U.S. international trade policy. An important element of the Committee's responsibilities is active oversight of the activities of the Administration in this area. As part of that oversight effort, it is important that Committee members have an in-depth understanding of the issues being pursued in international negotiations and consultations. I, therefore, am requesting, on behalf of the Committee on Ways and Means, a fact-finding study and analysis of the Japanese distribution system, to be conducted by you under authority of section 332(g) of the Tariff Act of 1930.

We would like the study to provide an overview of the Japanese distribution system, including discussion of its structural features; official policies and practices affecting it; and business practices. The study also should analyze the composition of Japanese imports from United States and other countries (e.g., capital goods, consumer goods), with a view to determining the sorts of changes in Japan's distribution system which are most likely to benefit U.S. exporters. We would appreciate receiving this phase of the study within eight months of receipt of this letter.

The second phase of the study should seek experts' views on options for improving U.S. access to the Japanese distribution system. What has been the experience of U.S. and foreign businesses with the distribution system (both successes and failures)? What forces are most likely to promote or oppose reform of the system -- e.g., political forces; industry groups; and consumers? What products or services do these experts feel are most likely to benefit from improved access to the distribution system, and why? In which areas of the distribution system would change be most beneficial to these export interests? The Committee would like to receive the second phase of the study no later than twelve months after receipt of this letter.

Thank you for your consideration of this request. Please let me know if my staff or I can be of any assistance.

Sincerely yours,

Dan Rostenkowski
Chairman

cc: The Honorable Bill Archer

APPENDIX B
FEDERAL REGISTER NOTICE AND LIST OF HEARING PARTICIPANTS

INTERNATIONAL TRADE COMMISSION

[Investigation No. 332-283]

Japan's Distribution System and Options for Improving U.S. Access

AGENCY: United States International Trade Commission.

ACTION: Institution of investigation and scheduling of public hearing.

EFFECTIVE DATE: November 13, 1989.

FOR FURTHER INFORMATION CONTACT: Diane Manifold, Trade Reports Division, Office of Economics, U.S. International Trade Commission, Washington, DC 20436, (202) 252-1271.

Background

The Commission instituted investigation No. 332-283 following receipt of a letter on October 23, 1989 from the House Committee on Ways and Means, requesting that the Commission conduct an investigation, in two phases, under section 332(g) of the Tariff Act of 1930 (19 U.S.C. 1332(g)) with respect to Japan's distribution system and options for improving U.S. access to that system. The Committee requested that the Commission submit Phase I of the report by June 22, 1990 and Phase II of the report by October 23, 1990.

Phase I of the Commission's study will provide an overview of the Japanese distribution system, including a discussion of its structural features, official policies and practices affecting it, and business practices. The first phase of the study will also analyze the composition of Japanese imports from the United States and other countries (e.g., capital goods, consumer goods), with a view to determining which types of changes in Japan's distribution system which are most likely to benefit U.S. exporters.

Phase II of the study will seek experts' views on options for improving U.S. access to the Japanese distribution system, including, but not limited to: (1) Experiences of U.S. and foreign businesses with the distribution system, (2) political, industry, or consumer forces likely to promote or oppose reform of the distribution system; and (3) products or services most likely to benefit from improved access to the distribution system.

Public hearing

A public hearing in connection with this investigation will be held in the Commission Hearing Room, 500 E Street, SW., Washington, DC 20436, beginning at 9:30 a.m. on January 26, 1990. All persons shall have the right to appear by counsel or in person, to present information, and to be heard. Requests to appear at the public hearing should be filed with the Secretary, United States International Trade Commission, 500 E Street, SW., Washington, DC 20436, no later than noon, January 19, 1990. Prehearing briefs (original and 14 copies) should be filed not later than noon, January 20, 1990. Post-hearing briefs are required by February 2, 1990.

Written submission

In lieu of or in addition to appearances at the public hearing, interested persons are invited to submit written statements concerning the matters to be addressed in the report. Commercial or financial information that a party desires the Commission to treat as confidential must be submitted on separate sheets of paper, each clearly marked "Confidential Business Information" at the top. All submissions requesting confidential treatment must conform with the requirements of § 201.6 of the Commission's *Rules of Practice and Procedure* (19 CFR 201.6). All written submissions, except for confidential business information, will be made available for inspection by interested persons in the Office of the Secretary to the Commission. To be assured of consideration by the Commission, written statements relating to the Commission's report should be submitted at the earliest practical date and should be received no later than February 2, 1990. All submissions should be addressed to the Secretary of the Commission at the Commission's office in Washington, DC. Hearing impaired individuals are advised that information on this matter can be obtained by contacting the TDD terminal on 202-252-1107.

Issued: November 14, 1989.

By order of the Commission.

Kenneth R. Mason,

Secretary.

[FR Doc. 89-27455 Filed 11-21-89; 8:45 am]

BILLING CODE 7020-02-M

CALENDAR OF PUBLIC HEARING

Those listed below are scheduled to appear as witnesses at the United States International Trade Commission's hearing:

Subject: JAPAN'S DISTRIBUTION SYSTEM AND OPTIONS FOR IMPROVING U.S. ACCESS

Inv. no.: 332-283

Date and Time: January 26, 1990 - 9:30 a.m.

Sessions will be held in connection with the investigation in the Main Hearing Room 101 of the United States International Trade Commission, 500 E Street, S.W., in Washington, D.C.

<u>Witness and Organization</u>	<u>Time Constraints</u>
Skadden, Arps, Slate, Meager & Flom Washington, D.C. <u>On behalf of</u>	10 minutes
Allied-Signal Incorporated	
Thomas R. Graham))--OF COUNSEL William E. Perry)	
Timex Corporation Waterbury, Connecticut	10 minutes
Frank T. Judge, III, Assistant General Counsel and Assistant Secretary	

APPENDIX C
TRADE AND ECONOMIC DATA

Table C-1
Leading U.S. exports to Japan, 1985-89.

(In thousand of dollars)

SITC No.	Description	1985	1986	1987
0	Food and live animals	$4,002,948	$4,129,271	$4,677,732
1	Beverages and tobacco	418,682	392,131	866,624
2	Crude materials, inedible, except fuels	3,909,376	4,053,048	4,936,990
3	Mineral fuels, lubricants and related materials	1,803,447	1,340,148	1,320,219
4	Animal and vegetable oils, fats and waxes	54,874	53,667	44,919
5	Chemicals and related products, n.e.s	2,914,027	3,062,087	3,400,669
6	Manufactured goods classified chiefly by material	1,280,012	1,333,984	1,843,550
7	Machinery and transport equipment	5,349,027	6,072,193	6,877,981
8	Miscellaneous manufactured articles	1,630,002	1,933,179	2,543,900
9	Commodities & transact not class elsewhere in sitc	240,534	521,139	391,049
	Total U.S. exports to Japan	21,602,930	22,890,847	26,903,632

(In thousands of dollars)

SITC No	Description	1988	1989	Percent change 1985-1989
0	Food and live animals	$6,740,484	$7,283,424	81.95%
1	Beverages and tobacco	971,005	1,387,231	231.33
2	Crude materials, inedible, except fuels	6,419,223	7,232,707	85.01
3	Mineral fuels, lubricants and related materials	1,451,287	1,509,649	-16.29
4	Animal and vegetable oils, fats and waxes	72,687	67,535	23.07
5	Chemicals and related products, n.e.s	3,981,594	4,663,893	60.05
6	Manufactured goods classified chiefly by material	2,844,761	3,712,407	190.03
7	Machinery and transport equipment	9,547,804	11,460,290	114.25
8	Miscellaneous manufactured articles	3,477,766	4,782,880	193.43
9	Commodities & transact not class elsewhere in sitc	534,964	664,256	176.16
	Total U.S. exports to Japan	36,041,575	42,764,273	97.96

Note: Export statistics in this table are SITC basis domestic exports only, at f.a.s. value. Data before 1989 are estimated.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table C-2
Leading U.S. exports to the world, 1985-89.

(In thousands of dollars)

SITC No	Description	1985	1986	1987
0	Food and live animals	$19,123,022	$17,151,180	$18,946,721
1	Beverages and tobacco	2,975,148	2,941,467	3,689,680
2	Crude materials, inedible, except fuels	16,714,751	17,352,989	20,528,727
3	Mineral fuels, lubricants and related materials	10,165,275	8,335,272	7,930,785
4	Animal and vegetable oils, fats and waxes	1,467,979	1,046,310	1,033,559
5	Chemicals and related products, n.e.s	21,828,598	22,522,037	26,022,722
6	Manufactured goods classified chiefly by material	14,188,848	14,324,740	17,597,579
7	Machinery and transport equipment	93,444,779	94,354,039	107,442,860
8	Miscellaneous manufactured articles	18,838,466	19,531,314	22,536,418
9	Commodities & transact not class elsewhere in sitc	14,214,446	18,995,853	18,129,873
	Total U.S. exports to the world	212,961,312	216,555,202	243,858,925

(In thousands of dollars)

SITC No	Description	1988	1989	Percent change 1985-1989
0	Food and live animals	$26,151,901	$29,723,794	55.43%
1	Beverages and tobacco	4,576,536	5,509,717	85.19
2	Crude materials, inedible, except fuels	25,255,375	26,946,743	61.22
3	Mineral fuels, lubricants and related materials	8,431,725	9,865,423	-2.95
4	Animal and vegetable oils, fats and waxes	1,519,030	1,349,767	-8.05
5	Chemicals and related products, n.e.s	31,908,878	36,485,048	67.14
6	Manufactured goods classified chiefly by material	23,362,714	27,242,809	92.00
7	Machinery and transport equipment	133,668,885	148,799,872	59.24
8	Miscellaneous manufactured articles	28,338,850	32,637,417	73.25
9	Commodities & transact not class elsewhere in sitc	27,132,432	30,872,356	117.19
	Total U.S. exports to the world	310,346,325	349,432,947	64.08

Note: Export statistics in this table are SITC basis domestic exports only, at f.a.s. value. Data before 1989 are estimated.

Source: Compiled from official statistics of the U.S. Department of Commerce.

Table C-3
Japan's imports from the East Asian NIEs[1], 1984-88

(thousands of dollars)

Commodity	Year 1984	1985	1986	1987	1988
All commodities	10,004,818	9,828,426	12,486,771	18,765,916	24,931,342
0 Food and live animals	1,952,919	2,011,167	3,052,756	3,987,545	4,196,437
1 Beverages and tobacco	12,641	13,491	16,865	43,962	67,618
2 Crude matls excl fuels	481,696	468,035	516,363	762,123	1,120,978
3 Mineral fuels etc	1,838,338	1,642,710	1,119,030	1,548,815	1,371,031
4 Animal,vegetable oil,fat	15,880	14,260	11,184	10,575	11,333
5 Chemicals	525,305	498,450	758,774	921,036	1,148,387
6 Basic manufactures	1,567,581	1,464,342	1,838,665	2,836,522	4,510,940
7 Machines,transport equip	1,044,685	1,003,581	1,333,375	2,282,207	3,546,528
8 Misc manufactured goods	2,302,760	2,320,091	3,485,080	5,940,659	8,351,790
9 Goods not classd by kind	263,012	392,298	354,681	432,471	606,299

[1] The East Asian Newly Industrializing Economies are Taiwan, South Korea, Singapore, and Hong Kong.

Source: U.N. Trade Data System.

Table C-4
Japan's imports from the United States, 1984-88

(thousands of dollars)

Commodity	Year 1984	1985	1986	1987	1988
All commodities	26,971,030	25,885,418	26,541,216	31,691,154	42,189,712
0 Food and live animals	5,308,779	4,690,629	4,868,745	5,855,258	8,379,407
1 Beverages and tobacco	438,687	394,610	460,909	924,240	1,179,022
2 Crude matls excl fuels	4,978,877	4,440,933	4,431,131	5,597,629	7,197,954
3 Mineral fuels etc	2,096,520	1,956,085	1,608,099	1,394,612	1,646,840
4 Animal,vegetable oil,fat	67,413	68,030	50,388	49,012	76,151
5 Chemicals	3,832,381	3,478,962	3,695,278	4,205,800	4,781,400
6 Basic manufactures	1,899,554	1,771,382	1,788,962	2,403,835	3,645,220
7 Machines,transport equip	6,404,359	6,947,381	7,297,221	8,445,355	11,200,388
8 Misc manufactured goods	1,511,629	1,469,581	1,679,917	2,175,167	3,413,176
9 Goods not classd by kind	432,833	667,826	660,565	640,245	670,153

Source: U.N. Trade Data System.

Table C-5
Japan's imports from the European Community, 1984-88

(thousands of dollars)

	Commodity	Year 1984	1985	1986	1987	1988
	All commodities	9,032,295	8,848,586	12,513,370	17,420,686	23,663,852
0	Food and live animals	856,334	867,648	1,151,202	1,397,953	1,855,964
1	Beverages and tobacco	280,794	257,147	332,751	491,542	645,780
2	Crude matls excl fuels	480,326	384,628	424,119	616,919	706,626
3	Mineral fuels etc	29,182	80,111	191,921	104,316	161,105
4	Animal,vegetable oil,fat	15,914	17,250	18,365	12,901	17,094
5	Chemicals	2,229,549	2,193,514	2,917,985	3,872,317	4,989,267
6	Basic manufactures	1,452,241	1,349,714	1,861,943	2,485,227	3,752,257
7	Machines,transport equip	2,235,271	2,126,479	3,373,242	5,063,804	6,515,442
8	Misc manufactured goods	1,266,735	1,391,900	2,024,701	3,069,726	4,738,412
9	Goods not classd by kind	185,950	180,196	217,142	305,979	281,906

Source: U.N. Trade Data System.

APPENDIX D
REGULATIONS AFFECTING DISTRIBUTION

流通関連公的規制の代表例 I
THE OFFICIAL REGULATIONS TO THE DISTRIBUTION ACTIVITIES - EXAMPLES I

法律等 LAWS	所轄官庁等 BY THE MINISTRY OF
1. 酒 税 法 Liquor Tax Law	大蔵省（国税庁） Finance (National Tax Administration Agency)
2. 食糧管理法 Food Control Law	農水省（食糧庁） Agriculture, Forestry and Fisheries (Food Agency)
3. 薬 事 法 Pharmaceutical Affairs Law	厚生省 Health and Welfare
4. たばこ事業法 Tabacco Monopoly Law	大蔵省 Finance
5. 塩専売法 Salt Monopoly Law	大蔵省 Finance
6. 古物営業法 Antique Business Law	自治省（公安委員会） Home Affairs (Public Safety Commission)
7. 大 店 法 Large Scale Retail Stores Law	通産省 International Trade & Industry
8. 都市計画法 City Planning Law	自治省（知事・市長） Home Affairs (Governor ・Mayor)
9. 建築基準法 Building Standards Law	建設省・自治省（知事） Construction・Home Affairs (Governor)
10. 地方税法 Local Tax Law	自治省 Home Affairs

流通関連公的規制の代表例 I

THE OFFICIAL REGULATIONS TO THE DISTRIBUTION ACTIVITIES - EXAMPLES I (CONTINUED)

法律等 LAWS	所轄官庁等 BY THE MINISTRY OF
11. 建設業法 Constructors Law	建設省 Construction
12. 食品衛生法 Food Hygienic Law	厚生省 Health and Welfare
13. 畜産物の価格安定等に関する法律 Laws Concerning the Stabilization of Livestock Prices	農水省 Agriculture, Forestry and Fisheries
14. 加工原料乳生産者補助金等暫定措置法 Law Concerning Temporary Measures on Deficiency Payment for Manufacturing Milk Producers	農水省 Agriculture, Forestry and Fisheries
15. 砂糖等の価格安定等に関する法律 Law Concerning the Stabilization of Sugar Price	農水省 Agriculture, Forestry and Fisheries
16. 駐車場 Parking Place Law	建設省 Construction
17. 消 防 法 Fire Service Law	建設省・自治省（消防庁） Construction・Home Affairs (Fire Defence Agency
18. 関 税 法 Customs Law	大蔵省（税関） Finance (Customs House)
19. 関税定率法 Customs Tariff Law	大蔵省（税関） Finance (Customs House)

流通関連公的規制の代表例 II

THE OFFICIAL REGULATIONS TO THE DISTRIBUTION ACTIVITIES - EXAMPLES II

法律等 LAWS	所轄官庁等 BY THE MINISTRY OF
20. 外 為 法 Foreign Exchange and Foreign Trade Control Law	大蔵省 Finance
21. 旅行業法 Travel Agency Law	運輸省 Transportation
22. IATA規制 Regulation of IATA	運輸省 Transportation
23. 医 療 法 Medical Service Law	厚生省 Health and Welfare
24. 風 営 法 Entertainment & Amusement Trade Law	自治省（公安委員会） Home Affairs (Public Safety Commission)
25. 公衆浴場法 Public Bath-House Law	厚生省 Health and Welfare
26. 按摩マッサージ指圧師針灸師等の法律 Law Concerning Massager, Therapist, Acupuncturator, et. al.	厚生省 Health and Welfare
27. 国際観光ホテル整備法 Law for Improvement of International Tourist Hotel Facilities	運輸省 Transportation
28. 郵 便 法 Postal Law	郵政省 Posts and Communications

流通関連公的規制の代表例 II
THE OFFICIAL REGULATIONS TO THE DISTRIBUTION ACTIVITIES - EXAMPLES II (CONTINUED)

法律等 LAWS	所轄官庁等 BY THE MINISTRY OF
29.～32. 銀行法・保険業法・証券業法・信託業法 Bank Law・Insurance Business Law・Securities and Exchange Law・Trust Business Law	大蔵省 Finance
33. 植物防疫法 Plant Protection Law	農水省 Agriculture, Forestry and Fisheries
34. 家畜伝染病予防法 Domestic Animal Infectious Diseases Control Law	農水省 Agriculture, Forestry and Fisheries
35. 道路運送法 Road Transport Act	運輸省 Transportation
36. 車両法 Road Vehicle Act	運輸省 Transportation
37. 道路交通法 Road Traffic Law	運輸省 Transportation
38. 倉庫業法 Warehousing Industry Law	運輸省 Transportation
39.～43. 電気工事士法・製品安全法・公衆電気通信法・高圧ガス取締法・ガス事業法 Electric Constructors Law・Consumer Product Safety Law・Public Telecommunications Law・High Pressure Gas Control Law・Gas Utility Industry Law	通産省 International Trade & Industry 郵政省 Posts and Communications

流通関連公的規制の代表例 III

THE OFFICIAL REGULATIONS TO THE DISTRIBUTION ACTIVITIES - EXAMPLES III

法律等　LAWS	所轄官庁等 BY THE MINISTRY OF
44. 有害物質を含有する家庭用品の規制に関する法律 Law for the Control of Household Products Containing Harmful Substances	厚生省 Health and Welfare
45. 不当景品類及び不当表示防止法 Law for Preventing Unjustifiable Lagniapples and Misleading Representation	公取委 Fair Trade Commission
46.～48. 著作権法・意匠法・商標法 Copyright Law · Design Law · Trade Mark Law	公取委　Fair Trade Commission 大蔵省（税関） Finance (Custom Houses)
49.～50. 土地区画整理法・都市開発法 Land Adjustment Law · Urban Renewal Law	建設省・自治省（知事） Construction · Home Affairs(Governor)
51. 宅地建物取引業法 Building Lots and Building Transaction Business Law	建設省 Consturction
52. 興行場法 Entertainment Facilities Law	厚生省 Health and Welfare
53. 計量法 Measurement Law	通産省 International Trade & Industry

流通関連公的規制の代表例 III

THE OFFICIAL REGULATIONS TO THE DISTRIBUTION ACTIVITIES - EXAMPLES III (CONTINUED)

法律等 LAWS	所轄官庁等 BY THE MINISTRY OF
54. 郵便切手類売さばき所及び印紙売さばき所に関する法律 Postal and Revenue Stamps Sales Agency Law	郵政省 Posts and Telecommunications
55. クリーニング業法 Cleaning Business Law	厚生省 Health and Welfare
56.～57. 理容師法・美容師法 Barbers' Law・Hairdressers' Law	厚生省 Health and Welfare
58. 毒物及び劇物取締法 Toxic and Poisonous Substance Control Law	厚生省 Health and Welfare
59. 鳥獣の保護及び狩猟に関する法律 Law Concerning Wildlife Protection and Hunting	農水省 Agriculture, Forestry and Fisheries
60, 肥料取締法 Fertilizer Control Law	農水省 Agriculture, Forestry and Fisheries
61. 農薬取締法 Agricultural Chemical Regulation Law	農水省 Agriculture, Forestry and Fisheries