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*THE KODAK-FUJI FILM CASE AT THE WTO AND
THE OPENNESS OF JAPAN'S FILM MARKET*

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The Kodak-Fuji Film Case at the WTO and the Openness of Japan's Film Market

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Summary

On March 31, 1998, the World Trade Organization released a decision in a U.S.-initiated dispute involving access by Kodak to the photographic film and paper market in Japan. The WTO panel decided against the United States, but it did not address the more general question of market barriers in Japan. In the process of arguing its position at the WTO, Japan made representations that its market for photographic film and paper is open. Rather than appeal the case, one U.S. strategy is to hold Japan to its representations about the openness of its markets. In the 105th Congress, S.Con.Res. 88 (D'Amato) and H.Con.Res. 233 (Houghton) call on Japan to establish and maintain an open, competitive market for consumer photographic film and paper and other products that face similar market access barriers there, such as autos and auto parts, glass, and telecommunications. For details on the Kodak-Fuji Film market access issue, see CRS Report 96-297, *The Kodak-Fuji Film Trade Dispute*. For information on the WTO Dispute Settlement Mechanism, see CRS Report 94-627, *World Trade Organization: Institutional Issues and Dispute Settlement*. This report will be updated as events warrant.

Background

The trade dispute with Japan over photographic film began on May 18, 1995, when the Eastman Kodak Company filed a petition with the Office of the U.S. Trade Representative (USTR) alleging that certain acts, policies and practices of Japan deny access to the market for photographic film and paper there. On July 2, 1995, the USTR initiated an investigation to determine whether those acts, policies and practices were actionable under Section 301 (unfair trade practices) of the Trade Act of 1974 and requested consultations with the Japanese government. The two nations held preliminary discussions on October 3, 1995, but the Japanese government refused to discuss the issue further.

Kodak claimed that its market share in Japan has been kept to less than 10% by anticompetitive actions by the Fuji Photo Film Company and counter-liberalization

measures taken by the Japanese government. In particular, the four largest wholesale distributors of photographic film products in Japan handle Fuji products exclusively. These exclusive relationships allegedly resulted from various government actions and regulations designed to offset the opening of Japan's film market to foreign firms and from certain actions by Fuji that may violate Japan's Anti-Monopoly Law.

Fuji claimed that it had not engaged in anticompetitive behavior and asserted that Kodak actually has access to all film retailers in Japan. The fact that Fuji has exclusive ties to the major wholesalers does not keep Kodak from distributing to retailers through its own channels. Fuji pointed out that Kodak engages in similar actions in the U.S. market to maintain its high market share here.

On June 13, 1996, as the one-year deadline for action under Section 301 approached, the Acting USTR announced that she had determined that certain of Japan's actions with respect to the sale and distribution of consumer photographic materials in Japan are unreasonable and burden or restrict U.S. commerce. Specifically, the Acting USTR found that "the government of Japan established and tolerated a market structure that impedes U.S. exports of consumer photographic materials to Japan, and in which practices occur that also impede U.S. exports of these products to Japan, thereby denying fair and equitable market opportunities." The USTR also concluded that there is reason to believe based on strong evidence that certain Japanese government liberalization countermeasures, including *inter alia*, distribution guidelines and related measures, the Law Pertaining to Adjustment of Business Activities of the Retail Industry for Large Scale Retail Stores¹ (LSRS) and the Law Against Unjustifiable Premiums and Misleading Representations² (Premiums Law) contravene Japan's obligations under the WTO and nullify or impair benefits accruing to the United States under the WTO agreements.³

The WTO Case

Rather than retaliating unilaterally against Japan using Section 301 authority, the U.S. government initiated dispute settlement proceedings against Japan under the WTO and advised Kodak to take certain antitrust issues to Japan's Fair Trade Commission.⁴ With respect to the WTO dispute settlement mechanism, the U.S. made three separate requests for consultations under WTO auspices on the broad range of market access barriers in the consumer photographic materials sector in Japan.

¹ This law requires certain approvals before a retail store exceeding a certain size can be opened. Even with recent revisions to the law, obtaining those approvals still is expensive and time-consuming.

² This law regulates the prizes or incentives that can be given away as marketing promotions.

³ United States Trade Representative. *Report to Congress on Section 301 Developments Required By Section 390(a)(3) of the Trade Act of 1974 (January 1995-June 1996)*. p. 5. Available on the Internet at <<http://www.ustr.gov/reports/301report/report.html>>.

⁴ Under the WTO Dispute Settlement Understanding, member nations are to take disputes covered by WTO agreements to the WTO for resolution rather than to retaliate unilaterally. The WTO has no agreement on competition policy.

First, the United States requested consultations regarding violations of the GATT (General Agreement on Tariffs and Trade -- included in the WTO) and nullification and impairment of GATT benefits arising from the full panoply of liberalization countermeasures that the government of Japan has put in place and maintained to thwart imports in this sector.

Second, the United States requested consultations regarding violations of the GATS (General Agreement on Trade in Services) arising from the requirements and operation of Japan's Large Scale Retail Store Law (LSRS). The United States alleges that the LSRS constitutes a serious barrier to foreign service suppliers as well as imports of film and other consumer products.

Third, the United States requested consultations under a GATT decision concerning restrictive business practices. Through this mechanism, the United States intended to discuss the significant evidence of anticompetitive activities that it has uncovered in this sector and to ask the government of Japan to take appropriate action.⁵

In addition, the United States requested that Kodak submit information to Japan's Fair Trade Commission concerning anticompetitive activities in this sector. In August 1966, Kodak filed a complaint with the JFTC and formally requested the Commission to take enforcement action to insure greater competition in the market.

The two nations held the first round of consultations on the WTO cases on July 10-11, 1996, in Geneva, Switzerland. The consultations did not resolve the disputes, so on September 20, the United States requested that the WTO Dispute Settlement Body form an international panel to consider the complaint. The panel was formed on October 16, 1996. Further consultations were requested on the GATS case dealing with Japan's Large-scale Retail Store Law.

On February 20, 1997, the United States submitted a brief to the WTO dispute settlement panel examining Japan's film market. The brief ran more than 200 pages and was supported by 10 volumes of documents. The USTR claimed that for over 30 years, Japan had limited the sale of imported consumer photographic film and paper in the Japanese market. It was a case of "classic protectionism accomplished through novel means."⁶

According to the USTR, Japan's liberalization countermeasures included:

- **Distribution Countermeasures.** Japan's Ministry of International Trade and Industry (MITI) consolidated wholesale operations in the photographic materials sector and changed what formerly had been a dynamic and open system to one with narrow distribution channels under the control of domestic manufacturers. In the early 1960s, foreign manufacturers of film and paper, like their domestic counterparts, distributed their products through Japan's large

⁵ Office of the United States Trade Representative. Acting USTR Charlene Barshefsky Announces Action on Film. Press Release 96-48, June 13, 1996. P. 2.

⁶ Office of the United States Trade Representative. Statement by USTR-Designate Charlene Barshefsky. Press Release No. 97-12, February 20, 1997. pp. 1-2.

photospecialty wholesalers, which were uniquely positioned to sell photographic materials to thousands of retailers throughout Japan. As a result of MITI's restructuring plan, by the mid-1970s the leading photospecialty wholesalers — as well as many smaller wholesalers, retailers and photo finishing laboratories — handled only domestic film and paper, excluding imports from the distribution system.

- **Restrictions on Large Retail Stores.** In addition to denying foreign film and paper access to the primary distribution network, Japan closed off the next best available alternative: large retail stores. Whereas wholesalers are needed to reach Japan's multitude of photospecialty retailers, large retail stores have sufficient economies of scale to make direct-to-retail sales efficient. Moreover, the greater amount of shelf space in large stores increases the likelihood that imports will be displayed beside domestic brands. Japan, however, has established a highly restrictive regulatory system limiting the expansion and operation of large retail stores. This has had an adverse effect on access to the Japanese market for imported film and paper.⁷
- **Promotion Countermeasures.** Japan has reinforced the foregoing measures affecting wholesalers and retailers by limiting the extent to which foreign producers might rely upon their marketing strength to promote sales through the use of economic inducements, or "premiums," and other marketing techniques. Such promotions stimulate demand for products and thereby serve as incentives for wholesalers and retailers to carry them. Japan adopted a series of "promotion countermeasures" restricting the ability of suppliers to use certain discounts, coupons, lotteries, give-aways or other economic incentives, and particular representations in advertising, especially where price or price discounts are discussed. The United States claimed that these measures have limited the sale of imported photographic materials.

Japan responded with various arguments and counterpoints. The initial burden of proof was on the United States. The United States primarily pursued a GATT remedy that comes into play when another WTO member has imposed measures that do not violate a WTO agreement but that allegedly negate the effect of or "nullify and impair" the benefits of tariff reductions that the member has previously negotiated. It took this track because the WTO has no agreement on competition policy. Under this nonviolative track (a case not involving a violation of a WTO agreement), the United States argued that the Japanese government took measures that nullified or impaired benefits expected to accrue to this country under the Kennedy, Tokyo, and Uruguay Rounds of Multilateral Tariff Negotiations which reduced import tariffs in Japan on photographic film and paper. The panel examined sixteen specific Japanese government measures. (Fuji Film Company's private and allegedly anticompetitive practices were not considered.)

The United States also argued that even though the individual measures standing alone may not have been sufficient to accomplish Japan's goal of restructuring the distribution system for film to the detriment of imports, they worked as an "organic

⁷ Japan has announced plans to phase out this law and shift responsibility to regulate large stores to the prefectural or city level.

whole” to accomplish that purpose. Scholars in Japan agree that one way that Japanese government administrative guidance (formal and informal direction to the private sector) is made effective is through a continuous process of studying, surveying, cajoling, and targeting the use of fiscal incentives that keeps the private sector focused on the goals set by the government. The United States alleged that some of the measures actually were designed to work in conjunction with other measures, not alone.

The WTO panel report released on March 31, 1998, concluded that the United States failed to prove its case for all sixteen of the Japanese government measures considered. The panel examined the arguments on both sides, but the crucial one seemed to be that the measures in question were enacted and should have been known to the United States before the relevant tariff concessions were made.⁸ The decision in the case, therefore, turned as much on questions of timing as on whether barriers in Japan’s film market actually existed or not. It also may imply for future WTO tariff reductions that, for products being negotiated, countries are responsible to know about the existence of countermeasures in other countries as of the date of their publication (§6.20, 10.80).

The panel noted that in nonviolative cases, countries ordinarily claim that the impaired benefit is that of “legitimate expectations of improved market access opportunities” resulting from tariff concessions. For expectations to be legitimate, “they must take into account all measures of the party making the concession that could have been reasonably anticipated at the time of the concession” (§10.61).

With respect to the U.S. charge that the measures by Japan worked as an “organic whole” (§10.350-351), the panel stated that this legal theory was not implausible. It concluded, however, that the U.S. side did not present sufficient evidence or argument to support its claim that all these measures have worked in concert to upset U.S. market-access expectations (§10.353).

Results of the Case

Even though the United States did not succeed in this instance, the case did make certain findings that may benefit the United States in future cases or may reduce Japanese government intervention into its economy on behalf of domestic companies. The WTO panel established that in nullification cases it was not inappropriate to consider government actions (either financial or non-financial) that are not laws or regulations as “measures” (§10.43, 10.38). These include actions designed to strengthen the competitiveness of certain distribution or industrial sectors and encompass a government’s industrial policy with a goal of increased efficiency in a sector. The panel concluded that such policies could upset the competitive relationship between domestic and imported products in a way that could violate obligations under the WTO. Even if they do not infringe upon WTO rules, they still could be implemented in a manner that results in a disproportionate impact on market conditions for imported products (§10.38). This interpretation appears to open many of the less-formal items of Japan’s

⁸ World Trade Organization. *Japan — Measures Affecting Consumer Photographic Film and Paper, Report of the Panel*. Report No. WT/DS44/R, March 31, 1998. On Internet at <<http://www.wto.org/wto/dispute/distab.htm>>. Textual references refer to paragraphs in this WTO report.

administrative guidance to action under the WTO dispute settlement process using the nullification and impairment clause. It also may allow action to be brought against Japan's industrial policy which often is aimed at strengthening the competitiveness of domestic products relative to imports. The evidentiary standard, however, would be quite high. The panel clarified, to some extent, what types of evidence and information would be necessary if the United States were to take similar disputes to the WTO in the future.

In the process of arguing its case, the Japanese government also asserted that certain conditions existed in its market. For example, it maintained that there are no government-imposed barriers in Japan that prevent foreign market penetration from improving (§5.21). Japan also asserted that its domestic market for consumer photographic film and paper reflects the outcome of normal market forces (§5.23) and maintained that there are no current government measures of any kind that would in any way stop a foreign manufacturer from expanding or improving its distribution network there (§5.41). The country further asserted that there is no market barrier preventing access to imported products by retailers (§5.59) and that the actions of its Fair Trade Commission (antitrust watchdog agency) in enforcing rules dealing with excessive premiums (and other matters) are trade neutral and apply equally to foreign and domestic producers (§10.273). According to the U.S. Trade Representative, Japan also represented to the panel that the Japanese government actually encourages imports of foreign photographic film and paper, does not tolerate restraints on competition in this sector, prohibits practices that discourage the opening of large stores, does not discriminate against foreign firms in this sector, and does not restrain price competition in the photographic film and paper sector.⁹

In February 1998, the Clinton Administration announced that it was establishing a monitoring and enforcement committee, co-chaired by the USTR and the Department of Commerce, to monitor developments in the Japanese photographic materials market.¹⁰ The United States decided not to appeal the panel report, and the WTO adopted it.

Legislation

In the 105th Congress, S.Con.Res.88 (D'Amato) and H.Con.Res. 233 (Houghton) call on Japan to (1) live up to the standards it has set for open competitive markets and (2) fully implement the representations that it made to the WTO dispute settlement panel regarding deregulation, transparency, nondiscrimination, open distribution systems, and vigorous enforcement of competition laws with respect to consumer photographic film and paper as well as other sectors that face similar market access barriers. These other sectors include automobiles and automobile parts, glass, and telecommunications. The bills also request the President to report periodically to the Congress on progress in eliminating market restrictions in Japan for consumer photographic film and paper.

⁹ Office of the United States Trade Representative. USTR and Department of Commerce Announce Next Steps on Improving Access to the Japanese Market for Film. Press Release 98-10, February 3, 1998. On Internet at <<http://www.ustr.gov/releases/1998/02/index.html>>.

¹⁰ *Ibid.*