

FACT SHEET

Third Report to the Leaders on the U.S.-Japan Regulatory Reform and Competition Policy Initiative

June 8, 2004

OVERVIEW

The U.S. Government welcomes Prime Minister Koizumi's continuing commitment to bold regulatory and structural reform, an essential prerequisite for Japan's return to long-term growth. The United States also welcomes the recent improvement in the Japanese economy, which demonstrates that Japan's economic reform policies are beginning to show positive results.

The Third Report to the Leaders on the U.S.-Japan Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) details important steps Japan is taking to further these reform policies, which are not only helping the Japanese economy return to long-term growth but are also opening its markets to U.S. companies. These measures address reforms in key areas such as telecommunications, information technologies, energy, medical devices and pharmaceuticals, financial services, competition policy, transparency, legal reform, commercial law revision, and distribution.

The measures specified in this 67-page report represent significant progress in Japan's continuing efforts to create a regulatory environment conducive to smoothly functioning markets and the efficient allocation of resources. By implementing these measures, Japan will help to increase consumer choice, lower prices, and encourage the introduction of more innovative goods and services. In addition, the Regulatory Reform Initiative serves as an important mechanism to increase access to Japanese markets for U.S. businesses by reducing regulatory barriers and streamlining governmental practices.

The Regulatory Reform Initiative was launched by President Bush and Prime Minister Koizumi at Camp David in June 2001 as a key component of the U.S.-Japan Economic Partnership for Growth.

TELECOMMUNICATIONS

Background: Evident by the spreading popularity of advanced telecommunications technologies such as Digital Subscriber Line (DSL) and Fiber-to-the-Home (FTTH), the Japanese Government's policies to promote regulatory reform in this sector have begun to yield tangible results. Under a more flexible regulatory regime, Japan is moving towards a telecommunications market where new products and services are unhindered by excessive regulation and anticompetitive behavior by the dominant carrier. The United States urges the Japanese Government to demonstrate its continuing commitment to ongoing reform in this sector by taking vigorous steps to reduce interconnection rates and other impediments in the wireline and mobile markets. The United States will also seek further improvement in transparency, due process, and regulatory independence, particularly in regard to decisions related to spectrum use.

Progress: The United States welcomes the significant steps the Japanese Government is taking to spur growth and encourage competition in the telecommunications sector, including:

- Creating a mechanism for consumer choice in rate-setting for calls connecting to mobile networks from fixed line phones, thereby facilitating competition and resulting in retail rate reductions of up to 55 percent.
- Working to revise Japan's interconnection rate-setting methodology (to be implemented from 2005) so that rates are more comparable to those of other competitive markets. This would include eliminating the fixed costs that NTT charges competitors and other fundamental flaws in Japan's implementation of the current methodology, known as Long Run Incremental Costs (LRIC).
- Easing the burden on competitive carriers for advance disclosure of technical information, and encouraging the use of international standards while retaining safeguards on NTT by agreeing to streamline the requirements for the deployment of Network Channel Terminating Equipment (NCTE), which is largely Internet equipment such as modems. The revised requirements will help ensure continued access to Japan's NCTE market, estimated to be worth around \$1.2 billion in 2003.
- Reducing red tape by eliminating tariff and interconnection filing requirements for competitive carriers through revisions to the Telecommunications Business Law and related regulations.
- Initiating an annual competition review process for selected markets – beginning with Internet access (DSL and FTTH) – and ensuring transparency and private sector input for this review.
- Facilitating testing in the UHF spectrum band of radio frequency identification (RFID, also known as e-tags), the first step in gaining approval and cross-border interoperability for innovative U.S. technology to track global shipments.

INFORMATION TECHNOLOGIES

Background: The primary objective of the United States' work with Japan in this sector is to help unleash the tremendous growth potential of Japan's e-commerce market and IT sector, key to strengthening the Japanese economy and creating new commercial opportunities for U.S. firms. The United States commends and supports Japan's goals of removing legal and other barriers that hinder e-commerce, strengthening protection of intellectual property in the digital age, promoting public and private sector use of e-commerce, and reforming IT procurement. As Japan moves forward on these fronts, the United States urges it to expand opportunities for private-sector input for the development of IT policy, an essential element to the creation of a thriving IT sector.

Progress: The United States welcomes the significant steps the Japanese Government is taking to spur growth in the IT sector and promote the use of e-commerce, including:

- Ensuring consistent, government-wide implementation of reforms for the procurement of information systems, improving transparency and fairness in such procurement, and working with the United States to improve private sector input into this reform process.
- Convening a public-private sector roundtable in May 2004 with the United States that provided U.S. and Japanese industry a timely opportunity to offer valuable input on Japan's forthcoming implementation of its new Privacy Law.
- Taking steps to ensure that IT policy is developed in a coordinated manner and implemented consistently across ministries, such as through establishment in February 2004 of an inter-ministerial task force to facilitate strong communication across the bureaucracy on IT policy.
- Deliberating the extension of the term of copyright protection for sound recordings and all other subject matter protected under the Copyright Law, which would build on Japan's recent extension of the term of copyright protection for cinematographic works from 50 to 70 years.
- Considering establishment of a statutory damages system that would act as an effective deterrent against infringing activities, ensure that right holders are fairly compensated for losses suffered by infringement, and enhance judicial efficiency by eliminating the costly and difficult burden of having to establish damages and profits.
- Agreeing to examine the inclusion of measures in upcoming Alternative Dispute Resolution (ADR) legislation that would promote the use of online dispute resolution in the cross-border context, including whether non-lawyers should be allowed to act as neutrals in ADR proceedings. This would be an important step to promote e-commerce.
- Improving the security and reliability of information systems used by local and central government entities through developing network security guidelines and standards, and affirming the importance of obtaining private sector input in this process.
- Endorsing key principles in developing IT policy such as revising and developing regulations in a manner that promotes technology neutrality and creating an environment where the private sector can maximize its leadership potential in this sector.

ENERGY

Background: Japan is in the midst of significant reform of its energy market that will expand liberalization from 26 to 63 percent in the retail electricity market by 2005, and from 40 to 50 percent in the natural gas market by 2007. These reforms, rooted in sweeping legislation enacted by the Japanese Diet in June 2003, will help spur domestic economic growth and increase opportunities for U.S. companies to produce, sell, and trade energy products and services in Japan's electricity and gas markets. The changes will also expand opportunities for U.S. exports of electrical generation equipment. In addition, the Japanese Government is taking important steps to foster investor confidence by providing opportunities for public comment on new or revised ordinances to implement the legislative reforms.

Progress: The Japanese Government has taken the initial steps toward implementation of the energy sector reform legislation, including:

Fostering reliability and transparency in the electricity sector by:

- Establishing in an open manner a Neutral System Organization (NSO) designed to create fair and non-discriminatory rules for the transmission/distribution sector, as well as committing to actively supervise the NSO and take necessary actions to correct any inadequacies;
- Working to revise the Guidelines for Fair Power Trades to help ensure effective information firewalls and to prohibit discriminatory wheeling;
- Developing ordinances to effectively implement separation of transmission/distribution accounts from other accounts;
- Streamlining rate setting, clarifying standards for and ensuring enforcement of fair network regulation, and relaxing balancing rules for wheeling service that will aid new entrants; and
- Reviewing the efficiency of the electricity market and whether additional steps are necessary to ensure the reformed regulatory environment is generating greater competition.

Ensuring transparency and fairness in the natural gas sector by:

- Establishing ordinances for setting and enforcing Third-Party Access (TPA) tariffs and providing incentives to build and operate new pipelines;
- Issuing in June 2004 ministerial ordinances setting out rules for accounting separation in and publication of pipeline financial statements;
- Working to revise the Guidelines for Fair Gas Trades to help ensure effective information firewalls and prohibit discriminatory treatment against TPA users; and
- Promoting Third-Party Access to liquefied natural gas (LNG) facilities by developing guidelines to establish a framework for negotiating third-party use of LNG terminals.

MEDICAL DEVICES AND PHARMACEUTICALS

Background: Japan is striving to improve the international competitiveness of its medical device and pharmaceutical industries while meeting the challenges of an aging population. Accordingly, the Japanese Government is undertaking comprehensive healthcare reform that includes significant changes in its regulatory and pricing systems for medical devices and pharmaceuticals. Discussions between the U.S. and Japanese Governments this year have focused on ensuring these changes are implemented in a transparent manner, leading to expanded consumer choice and to a more competitive landscape in this sector. World leaders in developing and marketing innovative devices and medicines, U.S. companies have a nearly 20 percent share of Japan's approximately \$60 billion drug market and about a 25 percent share of Japan's approximately \$20 billion medical device market.

Progress: Significant new steps Japan has taken or will take in these sectors include:

- Taking steps to ensure Japan's newly created Pharmaceuticals and Medical Devices Agency (PMDA) provides a speedier and more transparent regulatory process that helps bring products to market faster, increases consumer choice, and expands access for U.S. companies to Japan's healthcare market.
- Establishing a user fee system on April 1, 2004 to fund an increase in PMDA staff and other resources dedicated to improving reviews and speeding approvals of new medical devices and drugs.
- Setting targets for faster product approvals (for example, concluding by 2009 approvals for 90 percent of new medical device applications and 80 percent of new drug applications within one year of administrative time) and agreeing to publish annual progress reports.
- Implementing pricing reforms and premiums that more effectively recognize the value of innovative medical devices and drugs, including:
 - increasing the frequency of granting reimbursement prices to innovative medical devices, a step intended to raise the number of premiums granted that will both reward makers of innovative products and speed the introduction of state-of-the-art devices into Japan; and
 - introducing two important new premium pricing rules (Inter-Specification Adjustment and Usefulness II) for particularly effective drugs.
- Ensuring greater transparency of the medical device and drug regulatory and reimbursement pricing processes by, for example:
 - providing manufacturers with opportunities for involvement in addressing "adverse events;" and
 - including diagnostic industry representatives in meetings on pricing issues.
- Accelerating implementation of action plans in policy papers, known as the "Visions," which outline major reforms to promote innovation in the medical device and drug markets.
- Agreeing to convene a meeting with all interested parties by the end of 2004 on patient care, declining demand, and other issues related to blood products.
- Studying whether to increase the number of approved food additives for sale in Japan.

FINANCIAL SERVICES

Background: Over the past year, Japan has made further progress in opening and liberalizing its financial services market. This process started with the 1995 U.S.-Japan Financial Services Agreement and accelerated under Japan's "Big Bang" financial liberalization initiative, which committed Japan to fundamental deregulation of the financial sector. Those reforms deregulated brokerage commissions, eliminated many of the artificial distinctions among financial services firms, allowed the introduction of new financial products and services, and opened the market to new financial service providers.

Those and subsequent financial market reforms have provided new opportunities for innovation by firms offering financial services to Japanese corporations. They have also increased transparency, strengthened accounting standards and enhanced the transparency of corporate financial reporting, and allowed for better evaluation of investment performance in selecting asset managers or other investments. Those changes will, over time, provide important benefits for Japanese savers and investors and allow for higher returns on Japan's pool of individual savings, the largest outside the United States at more than \$10 trillion.

Bilateral financial services discussions under the Financial Dialogue of the Economic Partnership for Growth have contributed to continued progress in the opening of Japan's financial markets and increasing the transparency of the financial regulatory process over the past year.

Progress: Notable regulatory reform steps the Japanese Government has taken over the past year include:

- Raising the contribution limits on defined contribution pensions, a move with great potential to expand Japan's investment trust market, encourage individual investment, and promote labor mobility.
- Enhancing the transparency of Japan's financial regulatory regime by making more active use of the No Action Letter System and introducing measures intended to increase the volume of No Action Letter requests from the financial services industry.
- Moving toward global best practices by Investment Trust Association adherence to new guidelines for disclosure of investment performance.
- Continuing to carefully consider proposals to allow consumer lenders to utilize electronic notification for clients who chose to receive notices electronically.

COMPETITION POLICY

Background: Active promotion and protection of competition will spur Japan's economic recovery by creating a climate that encourages new entry and innovation and fosters efficient, internationally competitive companies. Of utmost importance is the elimination and deterrence of Antimonopoly Act (AMA) violations through strengthened Japan Fair Trade Commission (JFTC) enforcement powers and resources and stiffened AMA penalties. It is also necessary for the Japanese Government to augment its efforts to eliminate the bid rigging (*dango*) system, which saps public funds from needed revitalization programs and undermines the restructuring of the economy. Finally, Japan would benefit from ensuring that the effectiveness of its regulatory reform measures maximized by incorporating market-based competition principles in its deregulation programs.

Progress: Significant new measures Japan has taken or will take to address these problems include:

- Undertaking to submit a bill to the next Diet session to amend the AMA to increase deterrence of AMA violations and strengthen JFTC enforcement powers by:
 - roughly doubling administrative fines (surcharges) on violating firms, increasing the surcharge rate even more for recidivists, extending the cap on surcharges from three years to four years of sales, and enlarging the scope of conduct subject to surcharges;
 - introducing a corporate leniency program for the first and second firms that report their participation in a price-fixing or bid rigging conspiracy;
 - giving the JFTC strengthened powers for criminal investigations; and
 - raising the criminal fine 100-fold for violating JFTC orders to approximately \$3 million.
- Increasing from nine months to one year the maximum period in which companies found to have engaged in bid rigging are prohibited from bidding on local or central government projects, and expanding nationwide the geographic scope of the prohibition where executives or members of the board of directors were complicit in bid rigging activities.
- Including in all Ministry of Land, Infrastructure and Transport (MLIT) construction and design/consultation services contracts a clause specifying pre-established damages of 10 percent of the contract price that must be paid to the government by contractors that commit bid rigging.
- Introducing a mechanism for close cooperation between the JFTC and the Council for Promotion of Regulatory Reform (CPRR), including a system under which:
 - the JFTC will convey to the CPRR its reports and recommendations to relevant ministries concerning the promotion of competition in regulated sectors; and
 - CPRR will follow-up on the status of implementation of those recommendations.

TRANSPARENCY AND OTHER GOVERNMENT PRACTICES

Background: Japan's plans to privatize Japan Post and other public corporations create many challenges and opportunities for the private sector. To ensure this process is open and fair, it is vital for Japan to make more transparent and accountable its regulatory system so that all players have equal access to government information and the policymaking process. To this end, the United States welcomes efforts by the Japanese Government to reform its public comment procedure in ways that would provide more meaningful opportunities for public input. While this would be a significant step forward, more needs to be done to increase the transparency of the regulatory process, make the bureaucracy more accountable, curb onerous discretionary powers of the ministries and agencies, and shift power to the public. Further reforms would help level the playing field for foreign firms and reduce the special advantages traditionally enjoyed by Japan's domestic firms.

Progress: The Japanese Government has taken and will take a number of steps to improve transparency in its regulatory system, including:

- Agreeing to new and meaningful opportunities for U.S. companies to provide input into the Japan Post privatization process.
- Confirming that Japan Post has no plans now to introduce new or altered *Kampo* insurance products in response to strong concern that a level playing field must first be established between *Kampo* postal insurance and private sector insurers.
- Actively pursuing proposals endorsed by the Cabinet to improve the Public Comment Procedure (PCP) in FY2004 so the private sector can more meaningfully input into the development and revision of regulations. The numerous reform proposals are part of Japan's Three-Year Program for the Promotion of Regulatory Reform and include steps to:
 - bolster the principle of making public comment periods 30 days in length by, for example, requiring that all ministries make public the reason for not adhering to this principle when they provide shorter comment periods;
 - require the ministries to provide detailed explanations in cases where public comments are not incorporated into final regulations;
 - require that regulatory proposals subject to the PCP should include Regulatory Impact Analyses as often as possible;
 - require ministries to make public on their websites the entire texts of comments and information submitted as comment by the public;
 - conduct improved reviews of the implementation and effectiveness of the PCP to help ensure comments are fully taken into account, and as appropriate, incorporated into final regulations; and
 - strengthen the PCP by incorporating it into Japan's Administrative Procedure Law.
- Improving the Japanese Government web portal (www.e-gov.go.jp/) to allow the public to more easily find PCP solicitations for draft rules and regulations.

SPECIAL ZONES FOR STRUCTURAL REFORM (DEREGULATION ZONES)

Background: In April 2003, Prime Minister Koizumi launched an effort to accelerate the pace of structural and regulatory reform in Japan with the establishment of the first 57 Special Zones for Structural Reform (Special Zones). This initiative has been empowering local governments to take the lead on deregulation by establishing zones where business can operate unencumbered by burdensome regulations. Prime Minister Koizumi has made this initiative a central pillar of his regulatory reform agenda and has thus far approved 324 zones, including zones in which U.S. companies are operating. Express carriers, for instance, have been enjoying significantly lower customs processing fees at the International Distribution and Logistic zone at Narita International Airport.

The U.S. Government welcomes the expansion of the Special Zones and the opportunity through the Regulatory Reform Initiative to cooperate in helping ensure the success of this innovative new approach to promoting growth through deregulation at the local level. The U.S. Government looks forward the first nationwide expansion of the Special Zones in the fall of this year.

Progress: In implementing the Special Zones initiative, the Japanese Government is:

- Encouraging U.S. and other foreign companies to develop and submit zone ideas to the Headquarters for Special Zones for Structural Reform and actively participate in zones.
- Planning to expand successful measures used in the Special Zones nationwide later this summer so that the rest of the country can reap the benefits of greater regulatory and structural reform.
- Continuing to ensure transparency in development of the Special Zones initiative, including in the zone application process, and in establishing procedures to implement the zones.
- Ensuring that domestic and foreign companies alike have equal opportunity to submit zone proposals, to have proposals approved, and to operate in the zones, including producing materials in English to assist interested companies.
- Ensuring that the deliberations and actions of the evaluation committee that determines which zones are deemed successes and which zones will be terminated are open and transparent.
- Increasing the number of regulations to be suspended under the Special Zones initiative so that deregulatory benefits can have the maximum positive and widespread impact on the economy.

LEGAL SYSTEM AND INFRASTRUCTURE

Background: The creation of a legal environment in Japan that supports regulatory and structural reform and meets the needs of international business is a critical element for Japan's economic recovery and restructuring. The Japanese legal system must be able to respond to the market's need for the efficient provision of international legal services and provide a sound and effective foundation for the conduct of business transactions in an increasingly deregulated environment. The United States commends Japan for its recent enactment of amendments to the Foreign Lawyers Law that will substantially eliminate restrictions on the freedom of association between foreign lawyers (*gaiben*) and Japanese lawyers (*bengoshi*). Further liberalization measures are still necessary to ensure that consumers of legal services in Japan are able to enjoy the maximum benefits of these recent amendments. In that same spirit, the United States commends the progress Japan is making in the area of judicial system reform, and looks forward to continued efforts in this area, particularly with respect to increasing the effectiveness of judicial oversight of the actions taken by administrative agencies.

Progress: Significant new measures Japan has taken or will take to address these problems include:

- Enacting amendments to the Foreign Lawyers Law that, when made effective in 2005, will substantially allow freedom of association between *gaiben* and *bengoshi*, including by allowing partnerships between *gaiben* and *bengoshi* and allowing *gaiben* to employ *bengoshi*.
- Working with the Japanese Federation of Bar Associations so that it promulgates implementing rules and regulations consistent with the letter and spirit of the new amendments to the Foreign Lawyers Law.
- Conducting a study of whether *gaiben* should be permitted to establish professional corporations that can open multiple offices in Japan, as *bengoshi* are already permitted to do.
- Submitting legislation to the Diet in March 2004 that substantially expands the standing of third parties to challenge in court administrative actions adversely affecting them, thereby providing improved judicial oversight of Japan's administrative agencies.

COMMERCIAL LAW

Background: Aggressive corporate restructuring and improved corporate management is helping to revitalize the Japanese economy and return it to a path of sustainable growth. To promote this restructuring, modern merger techniques must be more readily available in Japan. Japan has recently taken a useful first step by permitting use of triangular mergers and cash mergers under the Revised Special Measures Law for Industrial Revitalization. Impediments to the use of these techniques remain, however. They are not, for example, yet available to companies seeking to merge outside the parameters of the Industrial Revitalization Law. The introduction of good corporate governance mechanisms will also improve the performance of Japanese companies by ensuring that management strives to maximize shareholder value through increased productivity and economically sound business decisions. Good corporate governance requires active shareholder participation, including by large institutional shareholders such as pension funds and mutual funds. In addition, good corporate governance is promoted by encouraging and protecting whistleblowers who report non-compliance with laws and regulations aimed at ensuring that shareholders and regulators can exercise appropriate oversight over management. Finally, Japan would benefit from creating an environment conducive to Alternative Dispute Resolution (ADR), which will help businesses resolve disputes in an efficient and economical manner.

Progress: Significant new measures Japan has taken or will take to address these problems include:

- Preparing to submit legislation to the Diet in early 2005 that would introduce into Japan's corporate law modern merger techniques, such as triangular mergers, cash mergers and short form (squeeze out) mergers.
- Actively studying ways to facilitate corporate restructuring and investment in Japan, including tax treatment of modern merger techniques.
- Promoting proxy voting by pension fund and mutual fund managers as a mechanism for strengthening corporate governance and shareholder value to the benefit of fund beneficiaries, including through:
 - issuance of guidelines requiring outside managers of the Government Pension Insurance Fund (GPIF) to exercise their proxy voting rights;
 - study of whether to make public the proxy voting policies of those managers; and
 - issuance of detailed proxy voting guidelines by the Pension Fund Association, other government-related pension funds, and the Investment Trust Association (an association of nearly all mutual fund companies in Japan).
- Submitting whistleblower protection legislation to the Diet in March 2004 that would promote more effective corporate governance by protecting employees who report violations of Japan's securities laws.
- Actively examining ways to strengthen and revitalize ADR mechanisms in Japan, with the goal of creating a flexible and open legal environment that facilitates the development of ADR services in Japan.

DISTRIBUTION

Background: Global demand for the express delivery of goods and information is growing at a rapid pace. Many dynamic and relatively young industries, including the express carrier industry, are now a vital component of global trade and an integral part of the smooth development of international logistics. Efficient global trade requires that regulatory and other impediments to distribution are minimized, that customs procedures are seamless, and that costs inhibiting the free exchange of goods and information through the express carrier industry are kept to a minimum. Although more remains to be done to create a truly seamless distribution system, the Japanese Government has implemented a number of measures that will enhance the ability of U.S. express carriers to more efficiently and quickly deliver goods and information to the benefit the Japanese economy through reduced costs.

Progress: Significant measures Japan has taken or will take in these sector include:

- Reducing by another 50 percent certain customs processing fees in the spring of 2004 at seven major international ports (in addition to a 50 percent cut last year), and a 50 percent reduction of these same fees at all other ports throughout Japan.
- Acknowledging that the Narita Airport Corporation has included in its mid-term management plan a goal of reducing landing fees at Narita International Airport as soon as possible once it can assess its business conditions. A reduction in landing fees at Narita and Kansai International Airports would annually save passenger and cargo airlines millions of dollars, decrease the cost of doing business in Japan, and benefit consumers through cheaper international and domestic air-fares.
- Working in a transparent manner to improve the user fee system for clearance of air cargo at Japan's airports, including:
 - permitting participation by both domestic and foreign interests on the panel conducting a review of the system, which is scheduled to release a report in June or July 2004; and
 - opening for public comment user fee reform proposals deriving from that report.
- Discussing airline pricing issues with the U.S. Government for the first time in the Regulatory Reform Initiative. The issues specifically relate to sales distribution and double disapproval pricing.
- Reaffirming the importance of maintaining a sufficient level of security standards in ATM networks for banks to protect credit and debit card transactions, strengthening regulations related to credit/debit card fraud, and discussing with the U.S. Government promotion of the use of credit and debit cards to pay for government services in Japan.