

FACT SHEET

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

May 23, 2003

OVERVIEW

Recognizing that significant structural and regulatory reform are essential prerequisites for Japan's return to long-term growth, Prime Minister Junichiro Koizumi has embraced a bold agenda of "reform without sanctuaries." In his most recent effort to advance this agenda, the Prime Minister has launched an initiative, called the Special Zones for Structural Reform, that empowers local governments in Japan to take the lead on deregulation by establishing zones where businesses can be unfettered by onerous regulations. To date, the Prime Minister has approved 117 of these zones. The Government of the United States welcomes this innovative new approach to promoting growth through structural reform and deregulation at the local level and looks forward to cooperating with Japan to help ensure the success of the Special Zones initiative.

The Special Zones and many other reform measures Japan has taken or will take are included in the Second Report to the Leaders under the U.S.-Japan Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative). The other key sectors and areas covered in this Report include telecommunications, information technologies, energy, medical devices and pharmaceuticals, financial services, competition policy, transparency, legal reform, commercial law revision, and distribution.

While more remains to be done, the measures specified in this report will both help Japan return to sustainable growth and open markets to U.S. companies. By implementing these measures, Japan will also help to increase consumer choice, lower prices, and encourage the introduction of more innovative goods and services.

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

TELECOMMUNICATIONS

Background: Over the past year, the Japanese telecommunications market demonstrated broad receptivity to innovative technologies. This highlights the importance of a regulatory regime that not only encourages equipment and service providers to introduce new products and services unhindered by excessive regulation, but also guards against abuses of market power. The United States will continue to seek action from the Japanese Government to curtail anti-competitive practices, such as high interconnection rates and other impediments in the wireline and mobile telecommunications market. The United States continues to urge Japan to separate market regulation from industrial promotion in order to give regulatory bodies the independence they need to more effectively address competition policy issues.

Accomplishments: Significant measures Japan has taken or will take in this sector include:

- Establishing that fixed line carriers have the right to set retail charges for their customers' calls to mobile networks, thereby introducing competition to an increasingly important segment of the telecommunications market (fixed-line to mobile phone calling), which has long been characterized by its anti-competitive rate-setting practices.
- Clarifying the methodology for measuring whether high-speed Internet access equipment degrades the performance of existing digital subscriber line (DSL) services. NTT East and West had been claiming that high-speed equipment installed by competitors created interference in DSL calls on lines owned by NTT. Once Japan clarified how interference should be fairly determined, NTT became less able to use this as a pretext for raising interconnection rates and discouraging new players from entering the market with innovative technologies.
- Commencing a process of identifying and addressing structural causes of high interconnection rates and agreeing to consult with the United States this important issue.
- Introducing to the Diet amendments to the Telecommunications Business Law that would:
 - Eliminate regulatory distinctions based on whether or not competitive carriers own their own facilities. Once approved, this will give competitive carriers greater flexibility in their business plans, allowing them to more readily combine owned and leased networks and tailor services to customers' needs.
 - Reduce burdensome filing requirements by eliminating prior government approval of: (1) licenses and tariffs for carriers that compete with NTT; (2) interconnection agreements between competitive carriers; and (3) tariffed rates for contract-based services.
 - Reaffirm the importance of dominant carrier regulation in the wireline and mobile segments of the telecommunications services market and ensuring that dominant local carriers' adhere to established competition promotion measures.
- Initiating a dialogue with the United States on the development of advanced technologies such as IP telephony and wireless local area networks (WLANs) and their role in the market.

INFORMATION TECHNOLOGIES

Background: The primary objective of our work with Japan in this sector is to unleash the tremendous growth potential of Japan's e-commerce market and IT sector, which is key to revitalizing Japan's economy and creating new commercial opportunities for U.S. firms. The United States commends and supports Japan's goals to facilitate and promote e-commerce by removing legal and other barriers, to strengthen protection of intellectual property in the digital age, to expand e-government, and to ensure security and reliability of information networks. The United States is also urging Japan to expand private-sector input and the use of public comment in the policy-making and regulatory processes to facilitate the type of private-sector/government relationship needed to create a thriving IT sector.

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

- Submitting legislation in May 2003 to extend the term of copyright protection for cinematographic works from 50 to 70 years; and continuing to deliberate on the extension of terms for all other subject matter protected by Japan's copyright law.
- Supporting a high-level U.S.-Japan government/private sector network security forum in late 2003 to raise awareness of key issues, highlight best practices, and strengthen the cooperation of public-private partnerships in promoting network security.
- Examining measures to allow qualified non-lawyers to provide Alternative Dispute Resolution (ADR) services for profit for online dispute settlement as part of a legal framework for ADR that will be created by March 2004.
- Passing privacy legislation in May 2003 that supports self-regulatory approaches to privacy (including dispute resolution mechanisms) and recognizes the importance of maintaining cross-border flows of information.
- Initiating discussions with the United States on protecting all intellectual property communicated on government-supported IT resources.
- Facilitating meaningful private sector input into the development of key IT policy and regulatory processes by providing adequate public comment periods and ensuring that comments received are seriously considered for policies and initiatives relevant to this important sector.
- Ensuring that ministries will continue to revise existing regulations that hinder e-commerce and confirming that current and future revisions to the regulations allowing the use of electronic signatures will always maintain technological neutrality so to promote an open infrastructure for cross-border transactions to flourish.
- Ensuring that all ministries will adopt concrete measures to promote non-discriminatory, transparent, and fair procurement of information systems; and expanding the use and availability of interactive online procurement systems.
- Enhancing opportunities for e-education technology providers by holding symposia in Tokyo and Kyoto with the United States in March 2003 that promoted IT solutions in education.

ENERGY

Background: The Japanese Diet is poised to pass sweeping legislation that would further liberalize Japan's energy sector (the third largest in the world after the United States and China) and bring the government's regulation of utilities substantially closer to practices in other developed countries. This legislation – likely to win approval in the current session of the Diet – will pave the way for expanding the liberalized retail electricity sector from 26 percent to 63 percent of the market by 2005 and expanding the liberalized retail gas sector from 40 percent to 50 percent of the market by 2007. Importantly, as Japan developed this legislation, it provided ample opportunities for public comment, fostering the kind of investor confidence that is so important to maintaining a stable, competitive energy market. A truly competitive Japanese energy sector will spur domestic economic growth and increase opportunities for U.S. firms to produce, sell, and trade energy products and services in Japan's electricity and gas markets. It will also provide opportunities for increasing U.S. exports to Japan's electrical generation equipment market.

Accomplishments: The liberalization process to be set in motion with passage of the energy reform legislation being deliberated in the Diet will lead to important steps forward in this sector, including:

- *Fostering reliability and transparency in the transmission/distribution electricity sector by:*
 - Prohibiting integrated electric utilities from using transmission information to disadvantage third-party generators;
 - Requiring a separation of transmission/distribution accounts from generation and sales accounts to prevent cross-subsidization of other utility operations;
 - Prohibiting discrimination by the transmission/distribution sector against other players in the electricity sector;
 - Establishing a neutral organization to create fair and non-discriminatory rules for the transmission/distribution sector; and
 - Creating a competitive electric wholesale market by establishing a nationwide wholesale power exchange that will allow transparent pricing to help market participants make sound investment decisions.

- *Improving natural gas supply by:*
 - Providing non-utilities with eminent domain to construct gas supply pipelines;
 - Giving third parties access to non-utility as well as utility gas supply pipelines;
 - Ensuring fair and transparent gas transportation service through accounting separation of transmission from sales, information firewalls, and prohibition of discrimination against third parties; and
 - Facilitating fair negotiations between owners and users of LNG facilities by issuing joint METI/JFTC guidelines on acceptable practices.

- *Ensuring that these measures succeed in creating a competitive energy sector by:*
 - Strictly enforcing regulations by establishing and strengthening adequately staffed, independent mechanisms that would conduct vigilant, ex-post market oversight; and
 - Ensuring that implementing regulations and other measures necessary to enforce the expanded liberalization of the electricity and gas sectors are subject to the Public Comment Procedure.

MEDICAL DEVICES AND PHARMACEUTICALS

Background: Japan is undertaking comprehensive healthcare reform that includes important discussions regarding medical device and pharmaceutical pricing policies and regulatory reform. Through these and other reform efforts, Japan is striving to meet the challenges of an aging population while making its medical device and pharmaceutical markets globally attractive and competitive. In both sectors, U.S. firms are the dominant worldwide suppliers of innovative products and are committed to the Japanese market. Therefore, it is critical that U.S. firms continue to have access to medical device and pharmaceutical pricing and regulatory reform discussions. These reforms are expected to foster a market-based environment that encourages and rewards innovative products as well as increases the speed and efficiency of regulatory approvals.

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

- Confirming that U.S. industry will have meaningful access to discussions regarding the reform of the medical device and pharmaceutical pricing and regulatory systems as well as nutritional supplement regulations.
- Using the market-mechanism when implementing the Ministry of Health, Labor and Welfare's medical device and pharmaceutical industry "Visions" in a non-discriminatory manner. These "Visions" policy papers, which include five-year action plans, address improving the international competitiveness of Japan's medical device and pharmaceutical sectors.
- Creating a dynamic environment for research and development that encourages and rewards innovation by, for example, expanding basic research and promoting technology transfers and industry/university/government coordination.
- Taking a more comprehensive look at the nature of the cost structures of the medical device and pharmaceutical markets and how they relate to the overall Japanese healthcare costs to determine how to improve the quality and efficiency of health services.
- Recognizing that pharmaceutical and medical device pricing rules should fairly assess the value of innovative products through methods such as premium pricing, and giving careful attention to new pricing approaches that could better recognize innovation.
- Improving the speed and efficiency of the approval processes through the establishment of a new review organization to conduct medical device and pharmaceutical approvals.
- Developing user-fees (paid by applicants for new product approvals to the review organization) as well as methods for assessing the efficiency of the new review organization through a cooperative process with all stakeholders, including U.S. industry. This would be done to ensure that fee structures and levels are transparent, predictable, and equitable.
- Committing to continuing meaningful discussions with U.S. industry regarding blood-product labeling regulations, and ensuring that the implementation of such regulations is consistent with Japan's international trade obligations.

FINANCIAL SERVICES

Background: Japan has made rapid progress in recent years in opening and liberalizing its financial services market. This process, which started with the 1995 U.S.-Japan Financial Services Agreement, accelerated under Japan's "Big Bang" financial liberalization initiative, which committed Japan to a fundamental deregulation of the financial sector. These reforms have 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.

Japan's financial market reforms have provided new opportunities for innovation for firms offering financial services to Japanese corporations. They have also increased transparency, allowing 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, allowing for higher returns on Japan's pool of individual savings, the largest outside the United States at more than \$10 trillion.

Foreign firms, and U.S. firms in particular, have taken advantage of those new opportunities to increase their share of Japan's financial services market. Foreign-owned firms now account for more than 40 percent of trading on the Tokyo Stock Exchange, up from 20 percent before the liberalization process began in 1995. Foreign firms have also increased their share of the pension fund management and investment trust (i.e., mutual fund) business in recent years.

Bilateral financial services discussions under 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. In addition, Japan has made significant improvements in the transparency of financial services regulation by making broader use of public comment procedures in reviewing possible legal and regulatory changes.

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

- Introducing legislation to allow Japan Post to use the asset management services of investment advisory companies in managing Postal Savings (*Yucho*) and Postal Life Insurance (*Kampo*) assets.
- Announcing that it will consider 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.
- Increasing its use of public comment procedures when considering financial regulatory issues.
 - One example is the efforts by the Financial Services Agency (FSA) to seek public comment on legal changes to allow electronic notification by consumer lenders.
 - Another is the Government's commitment in this report to inform the public of and provide opportunities for comment on any proposals to allow Japan Post to originate or distribute non-principal-guaranteed investment products.

COMPETITION POLICY

Background: Active promotion and preservation of competition in Japanese markets will create a climate that encourages new entry and innovation and fosters the kind of healthy competitive environment essential to Japanese economic recovery. The foremost challenge to the Japanese Government in this regard is to ensure that the Japan Fair Trade Commission (JFTC) has the tools, resources, government-wide support and administrative independence to effectively and aggressively enforce the Antimonopoly Act (AMA). Also crucial to this goal is the adoption by Japan of a meaningful program aimed at eliminating bid rigging, which undermines the credibility of Japan's competition policy regime, siphons government resources from other important government programs, and impedes access by U.S. construction and related firms to Japan's large government procurement market.

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

- Reestablishing the JFTC's independence by moving it out of the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) and making it an independent agency under the Cabinet Office.
- Strengthening the JFTC's enforcement capabilities by: (1) studying measures in JFY2003 toward introduction of a corporate leniency program and toward expansion of the types of violations that would subject violators to payment of surcharges (administrative fines); and (2) studying a variety of other possible measures aimed at achieving that goal, with recommendations to be issued by the fall of 2003.
- Taking strong action to prevent complicity of government officials in bid rigging conspiracies through aggressive implementation by the JFTC of the new Bid Rigging Involvement Prevention Act. The JFTC, for example, will demand that the heads of ministries and agencies (including those of local governments), in which such complicity is found, take corrective measures to prevent recurrence of such complicity and report back to the JFTC in a timely manner.
- Increasing deterrence of bid rigging by ensuring the collection of damages from bid rigging participants by undertaking to add a clause in Ministry of Land, Infrastructure and Transport construction contracts specifying pre-established monetary damages that participants in bid rigging must pay to the government.
- Revising joint guidelines between the JFTC and the Ministry of Economics, Trade and Industry (METI), and between the JFTC and MPHPT, to ensure that they promote competition in the electric power and telecommunications sectors, respectively.

SPECIAL ZONES FOR STRUCTURAL REFORM (DEREGULATION ZONES)

Background: In an effort to accelerate the pace of structural and regulatory reform, Prime Minister Koizumi launched a new initiative last year to empower local governments in Japan to take the lead on deregulation by establishing zones where business can operate unencumbered by burdensome regulations. Prime Minister Koizumi has made this initiative, formally called the Special Zones for Structural Reform, the central pillar of his regulatory reform agenda. On April 21, 2003, the Prime Minister approved establishment of the first 57 zones, which fall into several broad categories, including international logistics/distribution, industry/academic cooperation, industry promotion, and IT promotion. On May 23, he approved the establishment of an additional 60 zones in areas such as healthcare, welfare, and education.

The U.S. Government welcomes the launch of 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. For investment related matters, such cooperation can also be achieved through the U.S.-Japan Investment Initiative.

Accomplishments: 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.
- Aiming to expand successful measures used in the zones nationwide expeditiously so that the rest of the country can reap the benefits of greater structural and regulatory 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.
- Ensuring that the deliberations and actions of the council (yet to be formed) that determines which zones are deemed successes and which zones will be terminated are open and transparent.
- Working to establish as many of Special Zones as are needed to fulfill the Prime Minister's structural and regulatory reform objectives.
- 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.

TRANSPARENCY AND OTHER GOVERNMENT PRACTICES

Background: Despite improvements in recent years, Japan's regulatory system continues to lack the transparency and accountability necessary to ensure that all players have the same access to government information and the policymaking process. Reforms that increase the transparency of the regulatory process and make the bureaucracy more accountable would help curb onerous discretionary powers of the bureaucracy and shift power to the public. Such reforms also would help level the playing field for foreign firms, reducing the special advantages traditionally enjoyed by Japan's domestic firms.

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

- Improving the application of the Public Comment Procedure (PCP) by requesting that all ministries and agencies gather a broader range of opinions and information when formulating, amending, or appealing regulations by allowing for appropriate comment periods and using more effective means to solicit public comments.
- Enhancing the Japanese e-government portal (www.e-gov.go.jp/) by including more and better organized information on public comment solicitations as well as summaries of government policies and administrative procedures relating to Japan's ministries and agencies.
- Highlighting the ministries and agencies that are actively seeking public input on draft legislation during its development and before being submitted to the Diet.
- Continuing to conduct the restructuring and privatization of its public corporations (*tokushu hojin*) in a transparent manner.
- Committing to the principle of transparency for private sector consultation now that postal savings (*yucho*) and postal insurance (*kampo*) belong to the new public corporation "Japan Post." In particular, the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) recognizes the importance of informing the public and providing interested parties opportunities to exchange views if the postal financial institutions seek to modify or expand the range of products offered.
- Committing to providing opportunities for the private sector to contribute actively to any review of the structure of the insurance industry safety net, the Policyholder Protection Corporations (PPCs).

LEGAL SYSTEM AND INFRASTRUCTURE

Background: The creation of a legal environment in Japan that supports regulatory and structural reforms and that meets the needs of international business is a critical element for successful economic recovery and restructuring in Japan. The Japanese legal system must be able to respond to the market's need for the efficient provision of legal services, and provide a sound and effective foundation for business transactions in Japan. Of particular concern have been the restrictions on relationships between Japanese lawyers (*bengoshi*) and foreign legal consultants in Japan (*gaiben*). These restrictions have had a detrimental impact on the ability of U.S. law firms to provide integrated legal services in Japan and on the ability of Japanese consumers of legal services to obtain necessary international legal expertise in an efficient and timely manner.

Accomplishments: The Japanese Government has taken significant steps this year to liberalize the legal services market and to allow freedom of association between *gaiben* and Japanese lawyers, including:

- Permitting *gaiben* and their law firms to enter into partnership relationships with *bengoshi* and *bengoshi* professional corporations in Foreign Law Joint Enterprises (*gaikokuho kyodo jigyo*).
- Allowing *gaiben* either individually or through their law firms to employ Japanese lawyers as associates.
- Eliminating all restrictions that would prevent *gaiben* and *bengoshi* from establishing a single law firm that will be able to provide integrated legal advice and legal services on any and all matters within the competence of the members of the law firm, or from determining the profit sharing among them freely.
- Authorizing *gaiben-bengoshi* law firms to operate under a single law firm name of their choice, where the *gaiben* and *bengoshi* share an office and their partnership agreement places no restrictions on the scope of practice of the law firm.
- Conducting a preliminary study of whether to permit *gaiben* – as *bengoshi* are already permitted to do – to form professional corporations (which would also allow such *gaiben* professional corporations to establish branch offices in Japan.)
- Submitting to the Diet, in the context of judicial system reform, a bill that would increase the speed and efficiency of civil litigation by establishing mechanisms to reduce by half the length of time required to complete court trials. Such mechanisms would include giving prospective litigants the ability to make inquiries for information from the other prospective party even before the institution of the lawsuit, and empowering the court to request the holder of a document to transmit it to the court at the pre-litigation stage.

COMMERCIAL LAW

Background: Changes in commercial law designed to facilitate merger and acquisition activities by both foreign and Japanese firms would contribute to needed corporate restructuring in Japan and bring crucial technologies, know-how and employment to Japan's economy. In particular, changes in the legal system are needed to permit modern merger and acquisition techniques, such as triangular mergers, cash mergers and short form (squeeze out) mergers. In addition, measures to improve the corporate governance of Japanese companies, such as increased disclosure of information to shareholders necessary for them to exercise oversight vis-a-vis management, will improve the performance of Japanese companies by ensuring that management strives to increase shareholder value through increased productivity and economically sound business decisions.

Accomplishments: Significant new measures that Japan has taken or will take in this area include:

- Amending the Industrial Revitalization Law, effective April 9, 2003, to allow eligible firms to use the stock of an acquiring party (including foreign parent companies) and/or cash as consideration in merger and acquisition transactions. This will allow foreign merger parties to use modern triangular merger and cash merger techniques to accomplish M&A transactions in Japan that qualify under the Law.
- Agreeing to examine the introduction into the Commercial Code of modern merger techniques that can be used by all firms, including providing for the use of the stock of foreign parent firms and/or cash as consideration in merger transactions and the introduction of short form (squeeze out) merger transactions. A tentative outline of the government's bill will be made available for public comment by the end of 2003.
- Making available for public review on the Internet at the Financial Services Agency's Edinet website (www.fsa.go.jp/edinet/edinet.html) by mid-2004 virtually all mandatory securities law-related reports and filings by publicly-traded corporations in Japan.
- Requiring companies that adopt U.S.-style board committee systems to register the names of each member of its board committees and to disclose the number of shares they hold, their career summary, whether they are an independent board member and if not, the nature of the relationship with the company that makes the member not independent.

DISTRIBUTION

Background: The global demand for the rapid delivery of goods and information is growing at a dramatic pace. Many new 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. It is important for global trade and national security to minimize the regulations, procedures, and costs that could inhibit the free exchange of goods and information through the express carrier industry while simultaneously enhancing security. Although more remains to be done to create a truly seamless system, the Japanese Government has implemented several measures and provided a number of assurances that will enhance the ability of U.S. express carriers to more efficiently and quickly deliver goods and information to benefit the Japanese economy at reduced costs.

Accomplishments: New Japanese measures include:

- Reducing by 50 percent overtime fees associated with customs processing at seven major international ports (Narita International Airport, Kansai International Airport and the seaports of Tokyo, Yokohama, Nagoya, Osaka-Kobe, and Kitakyu-shu). This fee reduction will save express carriers operating in Japan millions of dollars annually.
- Extending the hours of operation of these seven key port facilities to 24-hours a day, seven days a week.
- Increasing the number of Customs Officials on duty at Japan's major international air and sea ports.
- Examining how to accelerate prior approval clearance by granting clearance upon final approach to Narita or Kansai international airports instead of at "wheels down." This would provide express carriers roughly two additional hours to clear goods through customs, meaning faster delivery and greater efficiency.
- Discussing with the U.S. Government for the first time in the Regulatory Reform Initiative the reduction of landing fees at Narita and Kansai, which are the highest in the world. A reduction in landing fees would save passenger and cargo airlines millions of dollars a year, decrease the cost of doing business in Japan, and benefit consumers through cheaper international and domestic air-fares.