

Annual Reform Recommendations from the
Government of the United States to the Government of Japan under the
U.S.-Japan Regulatory Reform and Competition Policy Initiative

October 24, 2003

Now in its third year, the U.S.-Japan Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) was established by President George W. Bush and Prime Minister Junichiro Koizumi to promote economic growth and open markets by focusing on sectoral and cross-sectoral issues related to regulatory reform and competition policy.

The United States welcomes Japan's continuing efforts to achieve meaningful economic reform and is encouraged by Prime Minister Koizumi's statement on September 22, 2003 that his new Cabinet will "continue to put its energies" into regulatory reform and that he remains committed to his policy of "no growth without reform."

The recommendations included in this submission put an emphasis on reform measures pertaining to key sectors and cross-cutting areas and are designed to facilitate a return to sustainable growth and to further open markets in Japan. Furthermore, the United States has made a concerted effort to focus on issues that Prime Minister Koizumi and his Administration have identified as important areas for reform, such as telecommunications, information technologies, medical, energy, and competition policy.

In this year's recommendations, the United States has placed a particular focus on the Special Zones for Structural Reform, which are an innovative approach to promoting growth through structural reform and deregulation at the local level. The United States applauds Prime Minister Koizumi's expeditious approval of 164 zones to date and looks forward to continuing to work with the Headquarters for Promotion of Special Zones for Structural Reform to help ensure the success of this initiative. The United States urges Japan to quickly expand on a nationwide basis successful deregulatory measures applied in the local zones.

In addition, the United States applauds the work of the Council for Regulatory Reform (CRR), which has been a strong and vocal advocate for wide-ranging regulatory and structural reform. The United States urges Japan to renew and strengthen the CRR's mandate (which expires on March 31, 2004) so that it can play an active and significant role in implementing the reform recommendations it makes. The United States also urges Japan to provide greater staffing and funding to the CRR, enabling it to more effectively carry on the important work of helping to sweep away burdensome regulations.

The proposals included in the Summary of Recommendations and the Annex are being provided to the Government of Japan to serve as the basis for discussions over the coming year in the High-level Officials Group and the Working Groups established under the Regulatory Reform Initiative. These Groups will in turn develop a third annual report to the President and Prime Minister specifying the progress made under this Initiative, including reform measures to be taken by each Government.

During the first two years of this Initiative, private-sector representatives joined the Working Groups to provide valuable expertise, observations, and recommendations on a wide range of issues. The United States looks forward to working with Japan in the coming months to continue to actively integrate the private sector in this Initiative.

The Government of the United States is pleased to present these reform recommendations to the Japanese Government and looks forward to receiving Japan's reform proposals to the United States.

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SUMMARY OF RECOMMENDATIONS

TELECOMMUNICATIONS

The competitive environment of Japan's telecom sector has steadily evolved over the past several years as the Japanese Government's efforts to promote policy and regulatory reform have begun to yield some positive results. This is evident in the roll-out of numerous advanced telecommunications technologies, including the spreading popularity of services such as Digital Subscriber Line (DSL) and Fiber-to-the-Home (FTTH). Japan also remains on the forefront of wireless Internet services, identified as a key area in both the IT Strategic Headquarters' recently finalized "e-Japan Strategy II," and the Telecommunications Council's July 2003 "Radio Policy Vision." Revisions to the Telecommunications Business Law (TBL), approved by the Diet in July 2003, contributed to the momentum by deregulating competing carriers while upholding dominant carrier regulation.

The "e-Japan Strategy II" is based on the assumption that Japan's policy focus should shift from competition at the infrastructure level to competition in services and applications. In both areas, however, bold reforms are still needed to challenge the status quo, facilitate a transition to advanced networks and services, allow market forces to be the primary agent of change, and sweep away obsolete regulations that have hindered the development of a competitive environment. While recognizing the structural changes currently underway in Japan that have been stimulated by reform and technological innovation, the United States urges Japan in this year's recommendations to examine more closely how it maintains the principles of non-discriminatory treatment, transparency, regulatory independence, and accountability.

Building on the progress achieved in the previous year, the United States suggests that the Telecommunications Working Group continue to invite experts from government and the private sector to provide their perspectives on new and mutually important issues, such as advanced wireless technologies and services. In addition, the United States recommends that Japan implement the following reforms in CY2004:

SUMMARY OF RECOMMENDATIONS

- **Deregulation of Non-Dominant Carriers:** Link regulatory obligations to market power and eliminate or reduce filing and reporting requirements for carriers without market power.
- **Regulatory Independence:** Take steps to transfer regulatory functions to an independent agency not under ministerial authority, and end Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) control over NTT's business decisions.
- **Transparency and Accountability:** Increase public participation in MPHPT's regulatory and policy decisions, and adopt measures to facilitate reconsideration and judicial review of MPHPT's regulatory decisions.
- **Strengthening of Competition Safeguards:** Reinforce dominant carrier safeguards to prevent abuses by carriers with market power.
- **Wireline Interconnection:** Address structural flaws in the 2003-2004 interconnection rate methodology through a transparent and objective review, with the aim of encouraging cost-oriented and reasonable interconnection rates that promote efficient competition.
- **Mobile Termination Rates:** Investigate if rates for termination to the NTT DoCoMo network are set at reasonable, competitive levels, and ensure competitive neutrality in retail rate setting.

INFORMATION TECHNOLOGIES

Japan has accomplished several of the key policy objectives laid out in the original e-Japan Strategy to become a global IT leader by 2005, and has succeeded in developing an advanced infrastructure for IT, such as high-speed broadband access. As part of the second stage of the e-Japan Strategy, Japan's IT Strategic Headquarters (ITSH) released the "e-Japan Priority Policy Program 2003" (2003 Priority Policies), which focuses on expanding the use of IT. The United States supports ITSH's recognition of the key role that the IT sector has in encouraging structural and regulatory reform. The United States also commends the Japanese Government for recognizing the need to spur growth in the IT sector and the importance of protecting intellectual property (IP), including digital content, as a foundation for revitalizing the Japanese economy.

In developing its 2003 Priority Policies, the Japanese Government recognized that IT remains underutilized in both the public and private sectors, and that there remains a need to promote the use of e-commerce and develop the use of IT in several key sectors. This year's recommendations are designed to complement and support the 2003 Priority Policies by focusing on: 1) facilitating online business-to-business and business-to-consumer transactions; 2) developing attractive content; 3) fostering new information systems for government online services linked to people's daily needs; and 4) enhancing efficiency and security. In addition, the United States urges Japan to complete the implementation of removing persistent legal and other barriers that continue to hinder e-commerce, which was a key objective of the original e-Japan Strategy.

As enshrined by the 2003 Priority Policies, Japan is at a critical juncture for successfully realizing the tremendous growth potential of its IT sector, which can in turn revitalize Japan's economy. In order to maximize the use of IT, the United States urges the Japanese Government to ensure technological neutrality, private sector leadership, and transparency (i.e. meaningful public comment opportunities) throughout the implementation process for the 2003 Priority Policies and the Chief Information Officer (CIO) Council's "E-Government Establishment Plan" (E-Gov Plan). Finally, given the integral and growing role that IP has in expanding the utilization of IT, the United States urges the IP Strategy Headquarters (IPSH) and ITSH to coordinate closely in developing concrete measures to ensure that intellectual property rights are adequately protected and enforced. The United States looks forward to working with the Japanese Government, ITSH, IPSH, and the CIO Council in a constructive and productive manner.

SUMMARY OF RECOMMENDATIONS

- **Regulatory and Other Barriers:** Expand nationally and make permanent the Special Zones to promote IT and e-education; remove existing barriers that impede B-to-B and B-to-C e-commerce; increase private sector input at all stages of the IT policy-making process.
- **IPR Protection:** Extend Japan's terms of copyright protection for sound recordings and all other works; strengthen protection of digital content and the enforcement system against IPR infringement.
- **Promotion of E-Commerce:** Support private sector self-regulatory mechanisms for privacy and Alternative Dispute Resolution; ensure transparency and inter-ministerial coordination in the implementation of guidelines and standards for Japan's new privacy law and network security.
- **Government IT Procurement:** Implement reforms in IT procurement procedures based on the principles of open competition, technological neutrality, transparency, and private sector-led innovation.

ENERGY

The U.S. Government commends the Japanese Government's promulgation of the Law for the Partial Revision of the Electricity Utility Industry Law and Gas Utility Industry Law (the Law) in June 2003. The reform puts Japan on track to expand liberalization of its retail electricity market to about 63 percent (2.4 times the current level) by 2005 and its retail gas market to about 50 percent (1.25 times the current level) by 2007.

Continued energy market liberalization will help Japan lower electricity costs to internationally competitive levels and give consumers and commercial users access to lower cost electricity. This, in turn, can help Japan's industries gain a greater degree of competitiveness and more quickly return the economy to sustainable growth. To achieve a genuinely competitive market, increase efficiency, and improve the environment for investment, the United States urges Japan to expeditiously and transparently implement concrete and detailed ordinances/regulations in ways that ensure the objectives of the new energy reform Law are fully met. The recommendations set out below by the U.S. Government are intended to support the Japanese Government's efforts to facilitate the fair, transparent, competitive, and vibrant energy market envisioned in the Law and, more generally, the ongoing reform process in this important sector.

SUMMARY OF RECOMMENDATIONS

- **Independent Regulatory Authority:** Take concrete measures to ensure that the Electricity and Gas Market Divisions of METI are free from undue political and industry influences.
- **Reform Timetable:** Ensure expeditious reform for the electricity and gas markets by codifying the liberalization timetables set forth by the Electricity Industry Subcommittee and the Urban Heat Energy Subcommittee.
- **Adequacy of Infrastructure in Electricity and Gas Sectors:** Undertake studies to evaluate whether there are inadequacies in interconnection capability needed to support a competitive power market; establish incentives for investment in new gas pipeline construction in regions where the network is not sufficiently developed.
- **Fairness and Transparency in the Electricity Sector:** Take steps to foster market participants' confidence by, for example, separating accounts of the transmission/distribution sector; turning to operational unbundling if this fails to produce a fair and transparent market.
- **Neutrality and Access in the Electricity Sector:** Ensure meaningful government oversight of the neutral transmission system organization (NSO); revise transmission rules to facilitate greater access to transmission lines for all market participants.
- **Fairness and Transparency in the Gas Sector:** Establish and strengthen a mechanism to conduct more rigorous rate approval examinations and audits; conduct neutral and fair ex-post facto monitoring.
- **Neutrality and Access in the Gas Sector:** Promote construction and improvement of pipelines for gas supply use by parties other than general gas utilities; establish detailed rules to ensure non-discriminatory negotiations between LNG terminal owners and third-party users of LNG terminals.

MEDICAL DEVICES AND PHARMACEUTICALS

Japan is carrying out major healthcare reform while confronting demographic challenges that place immense pressure on its healthcare system. There are now five workers for every retiree in Japan, but there are expected to be only two workers per retiree in 25 years. Japan is responding to the challenge with a sweeping healthcare reform plan focusing on transformation of the insurance system structure, creation of a new health insurance program for the elderly, and a review of the medical fee system. Japan has also issued major policy papers, called “Visions,” which focus on improving the international competitiveness of its medical device and pharmaceutical sectors. The U.S. Government welcomes the healthcare reform plan and Visions as evidence that Japan is committed to promoting rapid access to the most innovative medical devices and pharmaceuticals. The United States urges Japan to transform its Visions into government policy by reforming its budgetary, regulatory, reimbursement pricing, and intellectual property systems.

In the Visions, Japan outlined its comprehensive approach to pricing reform, which includes discussing with industry the health insurance coverage of medical devices and pharmaceuticals and implementing pricing policies that recognize the value of innovation. The U.S. Government welcomes this approach and is encouraged that Japan is examining structural problems such as the links between medical fees, long hospital stays, and high healthcare costs. The U.S. Government urges the Japanese Government to eliminate and avoid promulgating arbitrary policies that are put into effect for short-term budgetary savings, but have the result of discouraging innovation.

In another major step to reform the healthcare system, Japan has revised the Pharmaceutical Affairs Law to create a new agency to oversee premarketing and approval of drugs and devices. The U.S. Government welcomes the creation of the new Pharmaceuticals and Medical Devices Organization, as it is expected to speed the approval process, improve healthcare administration, and enable Japan to adapt to the new challenges of the bio-genomic age. As Japan works to create a healthcare system that embraces efficiency, accountability, global harmonization, and use of the latest internationally accepted science, the United States urges Japan to expeditiously adopt new measures based on these principles.

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- **Pricing Reform:** Develop medical device and pharmaceutical pricing rules that fully recognize the value of innovative products and consider the needs of patients who seek fast access to innovative and safe products; make full use of pricing rules, including premium-pricing rules, to reward and stimulate advances in drug research and medical technology; abolish rules that penalize or fail to recognize the value of innovation.
- **Regulatory Reform:** Speed the pre-marketing and approval of medical devices and pharmaceuticals through the new Pharmaceuticals and Medical Devices Organization; continue to engage in an open dialogue with industry as the new organization is created; establish a user fee system that is based on performance and transparency, and leads directly to improvement in speed and quality in the approval process and in postmarketing safety.
- **Blood Products:** Ensure that implementation of the Supply and Demand Plan does not discriminate against foreign products and that pricing rules are applied fairly and transparently.
- **Nutritional Supplement Liberalization:** Further deregulate the sale of nutritional supplements.

FINANCIAL SERVICES

The U.S. Government welcomes the progress Japan has achieved in opening its financial system to foreign and domestic competition in recent years, including the actions taken under the 1995 U.S.-Japan Measures Regarding Financial Services and under the “Big Bang” financial deregulation initiative. In addition, the Financial Services Agency, which was established in 1998, has made steady progress in increasing the professionalism and transparency of financial regulation in Japan.

Improved supervision, accounting standards, and regulatory transparency – as well the elimination of a number of regulatory barriers to competition – have helped “level the playing field” and contributed to notable changes in Japan’s financial sector. Foreign firms have increased their presence in Japan’s financial markets, in part through important acquisitions in the securities brokerage, insurance, and banking industries.

However, while supervision and disclosure have improved, it is important that Japan continue to move forward in establishing clear and consistent regulation and supervision of financial institutions, in line with international standards and best practice. It is also important that Japan continue to eliminate unnecessary regulatory barriers to competition, consistent with the objectives of ensuring safety and soundness as well as consumer protection. A more efficient and competitive financial sector can play a crucial role in returning Japan to its full growth potential.

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- **No Action Letters:** Promote truly transparent and effective regulatory processes by taking the measures necessary to make the No Action Letter process a useful means of establishing regulatory clarity in the financial services sector.
- **Defined Contribution Pensions:** Encourage the development and adoption of defined contribution pension plans by increasing contribution limits, by allowing employees to match the contributions of their employers, and by allowing plan providers to gain regulatory approval for prototype plans that can be used cost effectively by small- and medium-sized businesses.
- **Investment Trusts:** Eliminate any inconsistencies or duplication in the regulatory framework governing investment advisory and investment trust management activities, and set standards for investment trust performance based on global best practices.
- **Electronic Notification:** Promote borrower security, privacy, and ease of access to information by allowing lenders to satisfy disclosure requirements under the Money Lending Business Law by electronic notices where customers have agreed.
- **Self-Regulatory Associations:** Increase the transparency and openness of the operations and decision-making of industry associations that have a self-regulatory, investor protection, or other public policy role.

COMPETITION POLICY

The Chairman of the Japan Fair Trade Commission (JFTC) recently pointed out the need to “reinforce competition policy as a key component in Japan’s overall program for structural change.” 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 JFTC enforcement powers and resources and stiffened AMA penalties. It is also necessary for the Japanese Government to augment its efforts to eliminate the big rigging (*dango*) system, which saps public funds from needed revitalization programs and undermines the restructuring of the economy. Finally, Japan needs to ensure that the effectiveness of its regulatory reform measures is maximized by incorporating market-based, competition principles in its deregulation programs.

The United States therefore recommends that Japan take the measures set forth below:

SUMMARY OF RECOMMENDATIONS

- **Deterrence of AMA Violations:** Increase the administrative fine (surcharge) level to around 20 percent of sales and eliminate the three-year cap on sales subject to surcharge; impose more stringent measures on repeat offenders; bring more criminal prosecutions and encourage judges to sentence AMA violators to serve time in prison.
- **Strengthened JFTC Enforcement Powers:** Introduce an AMA corporate leniency program; give JFTC enhanced investigatory powers like the National Tax Authority; improve JFTC’s economic analysis ability; normalize criminal accusation procedures; extend the prescription period for cease-and-desist orders to three years.
- **JFTC Resources:** Increase the staff and budget of JFTC, including added personnel with advanced legal and economic training and with detailed knowledge of public utility markets.
- **Eliminating Bid Rigging:** Suspend bid riggers from government contracts nationwide for at least nine months; make public investigation reports completed by heads of ministries, agencies, and local governments under the law prohibiting official involvement in bid rigging; publicize measures taken by the Ministry of Land, Infrastructure and Transport to prevent recurrence of bid rigging by its affiliates – the Economic Research Association and the Construction Research Institute.
- **Promoting Competition:** Implement measures to permit JFTC to enforce the AMA against incumbent dominant firms that engage in anticompetitive exclusion of new entrants in the telecommunications, energy, and other deregulated industries; bolster JFTC’s role to ensure that competition principles and analysis are integrated into the deregulation process.

TRANSPARENCY AND OTHER GOVERNMENT PRACTICES

Over the years, Japan has made progress in its efforts to create a more transparent regulatory system that guarantees fairness, predictability, and accountability. More needs to be done, however, particularly as Japan struggles to return to long-term growth, which is highly dependent on consumer, investor, and business confidence. By providing ways for both domestic and foreign firms to gain full access to information and opportunities to participate in regulatory and decision making processes, Japan would create a more attractive business and investment environment and thereby spur economic growth. In addition, transparency is vital to a wide range of economic reform measures, including the establishment and expansion of the Special Zones for Structural Reform and the privatization of public corporations.

Continuing concerns over the lack of transparency in Japan's regulatory system are often focused on implementation of the Public Comment Procedures (PCP). If effectively used, the PCP could serve as the backbone for achieving a transparent regulatory and decision making system. While the Japanese Government has made some advances toward implementing a more effective and fair PCP since its adoption in 1999, surveys by the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) have repeatedly shown deficiencies. MPHPT's fourth Report on the Implementation Status of Japan's Public Comment Procedures for FY2002 reinforces concerns that Japan's rulemaking process remains opaque and overly subject to the discretion of ministries and agencies. Results of that report show that incorporation of comments into final regulations continues to be infrequent and largely non-substantive. Furthermore, only about half the total number of public comment periods in FY2002 were at least 30 days, while 34.6 percent of the cases provided comment periods of less than 21 days. This is clearly an inadequate amount of time for the public to provide substantive comments on what are often extremely complicated topics. The United States therefore recommends that the Japanese Government undertake the following improvements to provide adequate, effective and equal access to all participants to government information and the policymaking process.

SUMMARY OF RECOMMENDATIONS

- **Public Comment Procedures (PCP):** Improve the effectiveness of the PCP by requiring a minimum 30-day comment period; convene a public conference with government, business and other interested parties to openly discuss the functioning of the PCP.
- **Special Zones for Structural Reform:** Ensure that establishment of these zones continues to be carried out in a transparent, non-discriminatory manner, with focus placed on encouraging market entry; ensure that the newly established Special Zone Evaluation Committee undertakes its determinations in a transparent, forward-leaning manner so zone measures can be expanded nationally as expeditiously as possible.
- **Public Input into the Development of Legislation:** Take steps to further facilitate public input into draft legislation while it is being developed by the Government and before it is submitted to the Diet.
- **Privatization of Public Corporations:** Ensure the process to restructure and privatize public corporations is transparent and the private sector has meaningful opportunities to provide input.
- **Postal Financial Institutions:** Ensure that the privatization of postal services is undertaken in a transparent manner, curb expansion of product offerings of postal financial institutions, and subject the postal financial institutions to the same standards as their private-sector counterparts.

LEGAL SERVICES AND JUDICIAL SYSTEM REFORM

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 Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers and to the Attorneys 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 of administrative agencies.

For these reasons, the United States recommends that Japan take the following measures:

SUMMARY OF RECOMMENDATIONS

- **Freedom of Association:** Take necessary steps to make the recent amendments permitting freedom of association between Japanese and foreign lawyers come into effect by September 2004; ensure that the Japan Federation of Bar Associations (*Nichibenren*) and the local bar associations permit *gaiben* to participate as full voting members in the adoption of rules and regulations implementing the amendments and publish any draft rules and regulations for public comment.
- **Qualification Criteria for Foreign Lawyers:** Allow all of the time foreign lawyers spend in Japan practicing their home country law to count toward the three-year experience requirement to qualify as a *gaiben*.
- **Professional Corporations and Branches:** Permit foreign lawyers to form professional corporations on the same basis as Japanese lawyers; allow law firms composed of Japanese and foreign lawyers, or of foreign lawyers only, to establish branch offices throughout Japan on an equal footing as *bengoshi* professional corporations.
- **Judicial Oversight of Administrative Agencies:** Review necessary modification to standing requirements for persons seeking judicial review of administrative rules and decisions so that all persons that suffer injury as a result of a regulatory action may file an appeal with the courts.

COMMERCIAL LAW

Aggressive corporate restructuring and improved corporate management will help revitalize the Japanese economy and return it to a path of sustainable growth. To achieve this restructuring, modern merger techniques must be more readily available in Japan. Japan has taken a useful first step recently by permitting use of triangular mergers and cash mergers under the Revised Special Measures Law for Industrial Revitalization, but impediments to the use of these techniques remain, and they are not yet available to companies seeking to merge outside the parameters of that 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, particularly by large institutional shareholders such as pension funds and mutual funds. Good corporate governance is also 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 needs to create an environment for Alternative Dispute Resolution that will help businesses resolve conflicts in an efficient and economical manner.

For these reasons, the United States urges Japan to build on the actions it has already taken to reform its commercial law by taking the following measures:

SUMMARY OF RECOMMENDATIONS

- **Adoption of Modern Merger Techniques:** Ensure that proposals to permit broader use of modern merger techniques are included in the preliminary outline of FY2004 commercial law revisions to be published by the end of 2003; eliminate impediments to using these merger techniques.
 - **Promoting Shareholder Value through Proxy Voting:** Ensure that all government-related pension funds, mutual funds, and registered management investment companies adopt shareholder proxy voting policies aimed at maximizing the value of their investments, and publicly disclose those policies and their actual voting records; encourage private pension fund managers to adopt proxy voting policies or guidelines and to exercise their proxy voting rights for the benefit of their beneficiaries.
 - **Promoting Good Corporate Governance through Whistleblower Protection:** Introduce legislation by March 2004 that protects employees from retaliation for reporting evidence of violation of laws and regulations relating to securities law or to fraud or misrepresentation to shareholders;
- require publicly traded companies to set up mechanisms so that their employees can report acts of fraud or violations of securities laws or regulations in a confidential and anonymous manner.
 - **Fostering Alternative Dispute Resolution (ADR) Mechanisms:** Submit legislation in 2004 that will permit non-lawyers to act as arbitrators, mediators or other neutral roles in ADR proceedings; ensure that any ADR regime proposed by Japan does not include a mandatory licensing system for ADR neutrals or service organizations and allows ADR rules, processes, and standards to be flexibly tailored by the parties to ADR procedures.

DISTRIBUTION

The ability to move goods quickly and inexpensively is essential to a modern economy. Retailers, manufacturers, and consumers, for example, benefit from the “just-in-time” supply systems made possible by a healthy air cargo industry. The air cargo industry has seen exponential growth in recent years and is now an essential tool for the conduct of international business and for the timely distribution of goods and information. The United States applauds the reduction in overtime charges in international physical distribution special zones implemented earlier this year. More needs to be done, however, in order to take full advantage of the economic benefits provided by the air cargo industry. In addition to further modernizing customs clearance procedures, the United States urges Japan to rationalize the landing fees charged at its international airports.

Worldwide, the use of credit, debt, and ATM cards is expanding at a rapid rate, which benefits the retail sector by increasing consumer convenience. In North America and Europe, 34 percent of all purchases are made using these cards, while the figure for Japan is only 8 percent. The U.S. Government has the following regulatory and policy recommendations that, if implemented, will expedite the movement of goods, improve consumer convenience, and expand consumer choice.

SUMMARY OF RECOMMENDATIONS

- **Airport Landing Fee Reform:** Promptly reduce landing fees at Narita and Kansai International Airports; formulate the level of landing fees in an open and transparent manner based on the actual cost of providing services.
- **Airline Sales Distribution:** Abandon enforcement of the IATA 70 percent low band on airline tickets to create a competitive market that benefits consumers.
- **Double Disapproval Pricing:** Eliminate the regulation stipulating fares be filed 30 days in advance to give companies greater flexibility to respond to market conciliations.
- **Reduce Customs Overtime Charges:** Further reduce overtime charges in International Physical Distribution Special Zones.
- **U-Clearance:** Extend the U-Clearance system to warehouses other than the Tokyo Air Cargo Terminal.
- **Nippon Automated Cargo Clearance System (NACCS):** Make available for public comment both the interim and draft final reports on modification and improvement of the Air-NACCS fee system.
- **Freight Forwarder Contracts:** Allow foreign carriers the right to contract with Japanese airlines for domestic express package shipments.
- **Free on Board (FOB) Method of Duty Calculation:** Adopt the FOB method of duty calculation, which would lower the cost of importing goods.
- **Credit/Debit Card and ATM Services:** Facilitate the acceptance of credit and debit cards, a move that would benefit both retailers and consumers in Japan.

ANNEX

TELECOMMUNICATIONS

I. Eliminating Unnecessary Rules, Strengthening Regulatory Independence, and Promoting Greater Transparency. Based on reforms initiated last year, the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) has established a legal basis for eliminating a range of unnecessary regulations that can reduce the cost of doing business and allow carriers to more quickly provide the services that customers want. Specific steps MPHPT could take to implement this deregulatory mandate include:

A. Deregulating Competitive Carriers. The United States recommends that for non-dominant carriers in competitive markets, MPHPT:

1. Institute class licenses, which do not require any application by telecommunications service providers;
2. Replace tariff filing requirements with Internet-based public notifications, eliminating MPHPT *ex-ante* procedures;
3. Eliminate all filing and notification requirements for contract-based services;
4. For interconnection, entrustment, and other business arrangements between competitive carriers, eliminate all filing and notification requirements;
5. For initial licensing requirements for wireline service providers, eliminate requirements to provide detailed cost justifications, financial assumptions, and network planning information beyond the general scope of services and description of network;
6. For network expansion for wireline service providers, eliminate approval processes, and limit any notification requirements to brief general descriptions; and
7. Permit carriers to acquire and use wavelength-based IRU's (indefeasible rights of use) for the provision of services.

B. Promoting Transparency and Strengthening Regulatory Independence. MPHPT and its predecessor, MPT, have long had difficulty shielding the regulatory decision-making process from partisan influences. Recent decisions that have benefited larger companies with histories of government ties, at the expense of new entrants, underscore the critical need for measures to bolster regulatory independence and accountability. To foster regulatory independence and transparency the United States urges Japan to:

1. Develop a plan for removing regulatory functions outside the purview of a ministerial agency subject to direct political control, to a fully independent organization;
2. Eliminate any requirement that the Japanese Government own a specified amount of NTT shares and that foreign shareholding or a management role be restricted;
3. Eliminate ministerial interference in management operations of NTT, including business plans and personnel decisions;
4. Establish and exercise meaningful sanction authority by the regulator (imposition of fines, payments of damages, license restrictions) to punish anti-competitive behavior;
5. Take interim steps towards achieving these goals that would include:
 - a. Implementing measures to strengthen the operation, effectiveness, and purview of Japan's Dispute Resolution Commission, including steps to maximize transparency in dispute settlement actions;
 - b. Publishing criteria to ensure that officials with any financial ties to specific telecommunications carriers play no role in decisions affecting the competitive position of such carriers; and
 - c. Requiring senior-level MPHPT officials with any role in regulatory matters to file financial affidavits documenting their relationships with firms under their regulatory purview.
6. To foster greater regulatory accountability, take concrete steps to facilitate reconsideration and judicial review of regulatory decisions, and ensure that the regulator and the courts have the resources to address such issues effectively within a reasonable timeframe. Specifically, this should include:
 - a. Adopting and publishing transparent procedures to ensure that any person aggrieved by a determination or decision of the regulator be able to petition for reconsideration of that determination or decision;
 - b. Adopting and publishing transparent procedures to ensure that any person aggrieved by a determination or decision of the regulator may obtain judicial review of such determination or decision;
 - c. Adopting and publishing transparent procedures to ensure that a full, public record supporting decisions and determinations is

available, and that special interests are not accorded privileged access to the regulatory process; and

- d. Opening the selection process for MPHPT-sponsored study groups such that any interested stakeholders are given the opportunity to participate.

II. Network Access and Promotion of Competition. Competitors' access to bottleneck facilities remains essential to promote both facilities-based and service-based competition, which are key Japanese Government goals. In accordance with the July 2003 recommendations of its "Study Group on Methods for Evaluating Competition in the Telecommunications Field as IP Evolves," MPHPT has recognized the importance of reviewing pro-competitive policies in a changing market. With due consideration to this context, the United States will continue to identify areas in which it believes Japan can take concrete measures to improve the competitive environment for telecommunications. Relevant issues include:

- A. Dominant Carrier Regulation and Competition Safeguards. The United States recommends that Japan ensure that regulations and ministerial ordinances under the revised Telecommunications Business Law retain obligations specific to carriers with a dominant position in Japan's market and give the appropriate entity the authority to enforce these obligations. In particular, the United States urges Japan to:
 1. Ensure in law and/or regulation non-discriminatory cost-based access to poles, ducts, conduits, and rights of way and provide transparent pricing methodology for such access;
 2. Establish methods for evaluating pricing abuses by dominant suppliers (e.g. imputation tests) for voice as well as data services;
 3. In the annual review of whether NTT East and West are complying with the parameters governing expansion into new lines of businesses, publish quantitative data relating to network access and treatment accorded competitors;
 4. Institute transparent means, based on information to be made publicly available, for evaluating whether leased lines used by competitors are offered at reasonable, competitive rates;
 5. Consider rules (e.g. separate affiliate transaction rules) to ensure that a dominant supplier does not use revenues from a regulated service to subsidize a non-regulated service in an anticompetitive manner;
 6. Develop competition-related performance metrics, including reporting requirements, and financial penalties for missing such metrics. Such

metrics should ensure that a dominant carrier treats competitors no less favorably than it treats itself or its affiliates in matters such as provisioning, quality of service, and repair and maintenance of all network services and facilities needed by competitors; and

7. Ensure that dominant carriers seeking to expand the scope of their services outside their traditional monopoly services be subject to appropriate safeguards to ensure that dominant position in one market is not leveraged with anticompetitive effects.

B. Wireline Interconnection. MPHPT's recent changes in implementation of its LRIC methodology (as a matter of sovereign choice) raises the prospect of major increases in interconnection rates and serious erosion in new entrants' ability to compete against NTT companies. Reforming this rate-setting process to ensure efficient competition is thus a key priority for all competitors, foreign and Japanese alike. Specifically, the United States urges MPHPT to:

1. Undertake a public review, open to the comments and views of all interested stakeholders, of interconnection rates and structure, to determine how to remove non-traffic sensitive costs from metered interconnection rates, starting in FY2003;
2. Initiate, and conclude before any new system is introduced, an objective evaluation of NTT East's and West's ability to absorb non-traffic sensitive costs out of existing monthly rates;
3. Require NTT East and West to document, in a transparent, publically verifiable manner:
 - a. Precisely which costs are currently recovered from monthly subscriber line charges;
 - b. How such costs are identified and allocated between different services (e.g. ISDN, DSL, leased lines etc.); and
 - c. The assumptions behind such cost recovery, including *inter alia* cost recovery already achieved through initial subscriber line charges (*kanyu kenri* or *shisetsu secchi futankin*), depreciation rates and methodologies used, and allowable profit margins.
4. If traffic data indicate that rates should be adjusted, prior to any such adjustment, require that:
 - a. Such data be independently audited by the regulator and that measurement methodologies be publicly documented, subject to notice and comment;

- b. In conjunction with changes to traffic data inputs, the opportunity to adjust other input data such as equipment pricing also be provided and any changes incorporated prior to any such changes; and
 - c. Any network cost calculations affected by changes such as a shift to IP telephony and other advanced technological services take into account additional revenue NTT earns from network elements supporting the growth of such new services.
- 5. Require NTT East and West to each set a cost-oriented interconnection rate, taking into account differing costs of the respective regions; and, as necessary, permit differential interconnection rates between the regional carriers, taking into account dangers of (and methods to prevent) anti-competitive price squeezes;
 - 6. Consider transitioning to a bill-and-keep cost-recovery mechanism for a range of network access functions;
 - 7. Eliminate the current use of interconnection revenue as a source of cross-subsidization between NTT East and West, and require that any such subsidies be paid out of a competitively neutral universal service fund; and
 - 8. Ensure that carriers can request assistance from the Telecommunications Business Dispute Settlement Commission to resolve disputes regarding negotiated interconnection for voice calls carried between analog systems and IP-based networks, as well as between carriers providing IP-based voice telephony, taking into account the market power of dominant carriers.

C. Mobile Termination Rates. The United States urges Japan to:

- 1. In accordance with Japan's Telecommunications Business Law and Japan's 2002 commitment to ensure competitive interconnection rates for dominant wireless networks, institute an objective and transparent means for evaluating whether mobile wireless termination rates are set at cost-oriented levels, and to provide a basis for arbitration if negotiations fail; and
- 2. For wireline carriers seeking to interconnect with mobile operators, institute competitive neutrality by eliminating the default right of mobile carriers setting the retail rate.

D. Non-Discrimination in Service Quality. For facilities where unbundling is required, the United States urges Japan to require NTT East and West to:

1. Include among their interconnection terms and conditions a service level agreements (SLA) similar to those offered to retail customers, specifying the period within which NTT East and West must respond to a disruption or deterioration of service; and
 2. Permit wholesale customers the option of maintaining facilities themselves, subject to reasonable access to such facilities.
- E. Network Channel Terminating Equipment. The Japanese Government is invited to propose options to streamline the 1990 NCTE Agreement, consistent with the goal of ensuring competition in the market for terminal equipment. This should include safeguards against abuse of control over interfaces deployed in the public network by dominant carriers.

III. Measures to Promote Advanced Wireless Technologies and Services. In its “e-Japan Strategy II,” Japan recognized that emerging wireless technologies such as Radio Frequency Identification (RFID) and Wireless Local Area Networks (WLANs) will each play their own particular role in the creation of an “ubiquitous network society.” The Telecommunications Working Group provides a timely opportunity to exchange views on the experience of both countries, identify market-based approaches that contribute to expansion and use of emerging advanced wireless technologies, and facilitate the mutual understanding of regulatory processes in both countries.

- A. Private Sector Input. The United States proposes that, where possible, the Working Group enhance its dialogue by inviting experts from government and the private sector as guest speakers to share their views.
- B. Special Zones. The United States proposes that Japan report on its experience in promoting the use of 5GHz-based Wireless Access systems in Special Zones, and its plans to permit nationwide expansion of such systems, in accordance with the June 2003 World Radiocommunication Conference (WRC) agreement.
- C. Spectrum Use by Unlicensed Low-Power Devices. Consistent with Japan’s policy goal of flexible spectrum allocation, the United States urges the Japanese Government to take steps to ensure the availability of a timely, objective, and transparent process for companies to seek use of spectrum on license-exempt basis for low-power devices, taking into careful consideration existing users in the band. MPHPT should authorize additional tests and/or pilot projects to assess interference if sufficient data is unavailable.

INFORMATION TECHNOLOGIES

- I. Removing Regulatory and Non-Regulatory Barriers.** Promotion of e-commerce is one of Japan's priority policies in its "e-Japan Priority Policy Program 2003" (2003 Priority Policies). Japan has made significant progress in fostering an environment that promotes the use of the Internet for electronic transactions; however, legal and other barriers remain which hinder the growth of e-commerce. In addition, as Japan begins to promote the use of IT in key sectors such as medical care and finance under the 2003 Priority Policies, successful implementation will require transparency and meaningful public comment opportunities, as well as avoidance of over-regulation. In line with Japan's priority policies, the United States urges the Japanese Government to:
- A. Remove barriers in existing laws and regulations that hinder e-commerce, such as requirements for face-to-face or paper-based transactions and other hindrances to business-to-business (B-to-B) and business-to-consumer (B-to-C) e-commerce; and amend laws and regulations as necessary to allow electronic notifications and transactions in sectors in which they are currently barred.
 - B. Ensure that new laws, ordinances, and guidelines enacted to implement the 2003 Priority Policies and "e-Japan Strategy II" follow the U.S.-Japan mutually recognized principle of private sector self-regulation, maintain technological neutrality, and provide real, concrete reforms that promote the use of IT and do not over-regulate or hinder e-commerce.
 - C. Expand nationally and make permanent where appropriate the current deregulation measures implemented to create the Special Zones for Promotion of IT and the Special Zones for Education that utilize e-education.
 - D. Provide and support the IT Strategic Headquarters with the resources and coordination mechanisms needed to successfully manage and coordinate the necessary implementing measures for "e-Japan" between the relevant ministries and agencies.
 - E. Implement measures to increase private sector input at all stages of the policy-making process, from conceptualization to implementation, including:
 - 1. Utilizing information technology to make public/private-sector dialogue interactive and transparent;
 - 2. Ensuring that any Cabinet orders, ministerial ordinances, notifications, guidelines or other measures prepared for the purpose of implementing the 2003 Priority Policies, the policy goals of the "e-Japan Strategy II," and any related subsequent measures and goals are subject to the Public Comment Procedures; that a minimum period of 30 days is provided for comments, and that comments received are seriously considered and

reflected as appropriate in the final measures and actions that are implemented; and

3. Facilitating and ensuring the selection and participation of experts from non-Japanese entities on the new Evaluation Experts Subcommittee under the IT Strategic Headquarters.

II. Strengthening the Protection of Intellectual Property Rights. Japan has recognized the economic importance of intellectual property along with IT in revitalizing Japan's economy, and is striving to become a leader in the creation, utilization and protection of IP through the IP Promotion Plan. In line with these goals and the IP Promotion Plan, the United States urges the Japanese Government to adopt the following recommendations:

- A. Copyright Term Extension. Extend Japan's terms of copyright protection for sound recordings and all other subject matter protected under the Copyright Law in alignment with the current global trend to life of the author plus seventy years for works generally, and to 95 years from publication for works for which the term is not based on a human life.
- B. Statutory Damages. Strengthen the enforcement system against intellectual property infringement by adopting a statutory damage system that will act as a deterrent against infringing activities, ensure that right holders are fairly compensated for the losses suffered by infringement, and enhance judicial efficiency by eliminating the costly and difficult burden of having to establish and calculate actual damages or profits.
- C. Protection of Digital Content. Build on the progress the Japanese Government has achieved in strengthening the protection of digital content and preventing online piracy by:
 1. Implementing measures to ensure that all government agencies and public institutions effectively prevent and punish the storage or transmission of pirated copies of works or any other infringing activities on government-supported IT resources.
 2. Monitoring and strengthening as necessary current measures to prevent digital content piracy, including Internet Service Provider Liability Rules.
 3. Issuing a publicly available official statement on the Japanese Government's important recognition that "temporary storage" implicates the reproduction right which clarifies the scope of protection for temporary copies and provides certainty and clear guidance to right holders.
 4. Strengthening technological protection measures.

- D. Implementation of Education Exception Amendment to Copyright Law. Issue authoritative government regulations and/or guidelines and examples for educational institutions, teachers, and students which will clarify and explain the limitations of the exception for reproduction and transmission under the Amendments to Articles 35 and 36 of Japan's Copyright Law.
- E. Transmission of Broadcast Television Signals and Content over the Internet. Ensure that: the "copyright contract system" under the e-Japan Strategy II does not include compulsory, non-voluntary or statutory licenses under which broadcast television signals and content could be distributed over the Internet; the copyright contract system for Internet distribution would require the consent of both the broadcasting entity and the copyright owner; the specific measures for such a system are made available for meaningful public comment.
- F. Digital Rights Management System. Ensure that any digital rights management system is market-driven and not government-imposed.
- G. IP Promotion Plan and Intellectual Property Policies. The IP Strategy Headquarters (IPSH) issued the "Draft Promotion Plan Regarding the Creation, Protection and Utilization of IP" for public comment on June 20, 2003. In implementing the finalized Promotion Plan and other IP policies the United States urges the IPSH and the Japanese Government to ensure that:
1. Any Cabinet orders, ministerial ordinances, notifications, guidelines or other measures prepared for the purpose of implementing the final IP Promotion Plan, the policy goals of the "Intellectual Property Policy Outline," and any other IP-related measures are subject to the Public Comment Procedures; that a minimum period of 30 days is provided for comments, and that comments received are seriously considered and reflected as appropriate in the final measures and actions that are implemented.
 2. The implementation of the measures and policy goals are in compliance with international obligations, standards, and norms.
 3. Experts from non-Japanese entities will be included in the new "special committee" under Government Ordinance No. 45 to review and discuss the especially important IP policy issues.
 4. The IPSH is provided the support, resources and coordination mechanisms needed to successfully manage and coordinate the implementing measures between the relevant ministries and agencies.

III. Promoting and Facilitating Public and Private Sector Use of E-Commerce. Japan has successfully developed an advanced infrastructure for e-commerce, however, the medium remains underutilized. Improving efficiency and security will help bolster

confidence in the online environment and stimulate demand and supply of online services linked to people's daily needs. While the private sector is primarily responsible for the growth of e-commerce, governments can promote the use of e-commerce by adopting policies that facilitate growth of private sector e-commerce without being heavy-handed. The United States urges the Japanese Government to play an important role in encouraging the development of e-commerce by emphasizing private sector self-regulatory mechanisms and technology-neutral solutions driven by innovation and market forces.

A. Privacy. On May 23, 2003, the Diet passed the Law on the Protection of Personal Information to establish a basic and common framework for the protection of personal information in the private sector. The United States urges Japan to:

1. Ensure that any implementing guidelines are developed in a transparent and coordinated manner so as to prevent overly burdensome or contradictory requirements, which would hinder B-to-B and B-to-C e-commerce. To facilitate transparency and realize the full benefit of private sector input, the United States recommends that Japan identify as quickly as possible which ministries will issue implementing guidelines, and urges that all draft implementing guidelines be made available for meaningful public comment that will be appropriately reflected in the final guidelines.
2. Clarify whether the Law on Protection of Personal Information and its implementing guidelines apply to all personal information that may be shared by all current and future technologies. The United States urges Japan to ensure that input from industry and non-governmental organizations is seriously considered in the implementation of any privacy guidelines for new technologies.
3. Consider opportunities to hold a joint U.S.-Japan public and private sector roundtable on privacy-related issues by the end of 2004.

B. Promotion of Alternative Dispute Resolution. In August 2003, the Judicial System Reform Promotion Headquarters issued a report for public comment on Alternative Dispute Resolution (ADR). The report and comments will form the foundation of ADR legislation. The United States urges Japan to respond to specific comments from interested parties on this report by reflecting appropriate comments and suggestions in any final legislation or regulations. For the purposes of promoting online dispute settlement mechanisms, which are necessary for the development of online B-to-B and B-to-C transactions, the United States urges the Japanese Government to adopt an ADR regime that is open and flexible, so that online dispute settlement mechanisms can:

1. Rely primarily on self-regulation and voluntary private certification systems for ADR neutrals and organizations; and

2. Allow the parties generally to determine the rules, processes and standards to be applied in ADR proceedings.

C. Network Security. The United States welcomes Japan's efforts to improve and ensure the security and reliability of information systems used by central and local government entities. In the spirit of the September 9, 2003 U.S.-Japan Joint Statement on Promoting Global Cyber Security, the United States and Japan should further cooperate with the private sector through appropriate bilateral and multilateral fora. In addition, the United States understands that some ministries have begun to develop network security standards and guidelines for their own use. It is critical that standards and guidelines be consistent so as to provide predictability in the private sector. Therefore, as the various separate ministries move forward, the United States urges Japan to ensure that these standards and guidelines are:

1. Developed in a coordinated fashion, to ensure a comprehensive framework for establishing and ensuring the effectiveness of controls over information resources that support central government operations and assets;
2. Technologically neutral, non-trade-restrictive, and will promote the use of e-commerce;
3. Consistent to the maximum extent practicable with standards developed by voluntary industry consensus standards bodies, including International Standards Organization (ISO); and
4. Developed and implemented in a transparent manner, ensuring that all interested parties both domestic and foreign have the opportunity to review and participate in a meaningful public comment process.

IV. Promoting Procurement Reforms for Information Systems. As indicated in both the E-Gov Plan and the 2003 Priority Policies, Japan continues to digitize administrative procedures at all levels of government. In addition, according to the E-Gov Plan, all ministries aim to completely replace their “legacy systems” and increase interoperability across the Government. The United States notes that through this transformation, Japan may reduce its dependence on proprietary technologies in the development of its e-government systems. The shift to greater use of commercial off-the-shelf products by the Government can also stimulate innovation and competition among vendors, which in turn can create market access opportunities. To ensure a level playing field in IT procurement, Japan must continue to promote the principles of open competition, transparency, technological neutrality, and private sector-led innovation by vigorously implementing reforms in the IT procurement procedures. The United States urges the Japanese Government to:

- A. Monitor and evaluate the implementation and effectiveness of the measures listed in the memorandum of agreement adopted by the ministries on March 19, 2003. In particular, the United States recommends that Japan:
1. Authorize the Chief Information Officer (CIO) Council to oversee IT procurement reform in order to improve coordination among ministries and ensure non-discriminatory, transparent and fair procurements of information systems (both products and services);
 2. Institute methods to objectively evaluate the effectiveness of measures that are designed to prevent low-priced bids and other anti-competitive behavior;
 3. Release publicly the data compiled from the follow-up survey (in accordance with the 2003 Report to the Leaders) on how ministries are implementing all the new procedures;
 4. Use the Public Comment Procedures within FY2003 to solicit feedback from the private sector on ways to improve the IT procurement procedures being implemented by the memorandum; and
 5. Ensure that CIO Assistants, who bring valuable private sector expertise to the government, are given clear guidelines to conduct their jobs fairly and objectively.
- B. Adopt additional measures to strengthen government IT procurement reform, including:
1. Disclose information about procurement awards in a timely, transparent, and accessible manner;
 2. Lower the SDR (Special Drawing Rights) threshold for Overall Greatest Value Method (OGVM) procurements so that it can be put into practice more extensively; and
 3. Promote more flexible budget procedures (e.g., multi-year contracts) to encourage the use of life-cycle cost in procurement of information systems, basing bid evaluations on the total cost of ownership rather than the budget for the initial year of the project.

ENERGY

- I. Independent Regulatory Authority.** In the 2003 Report to the Leaders, the Japanese Government recognized the importance of an enforcement mechanism supported by sufficient staff, expertise, and independence necessary to ensure vigilant market oversight. The effectiveness of Japan's new energy reform legislation in ensuring a fair, efficient and stable energy market depends on such stringent market oversight and the ability of Japan's regulatory authority to vigorously enforce established guidelines and regulations. The U.S. Government therefore urges the Japanese Government to:
- A. Develop concrete steps – based on a review of the adequacy of expert staffing assigned to the Electricity Market Division and the Gas Market Division of the Ministry of Economy, Trade and Industry (METI) – to ensure that staffing is consistent with the sizable monitoring and enforcement responsibilities required by the Law for the Partial Revision of the Electricity Utility Industry Law and Gas Utility Industry Law (the Law);
 - B. Provide these Divisions with an independent budget sufficient to ensure adequate enforcement and monitoring;
 - C. Refrain from accepting detailees from any energy or energy service provider and require staff of these Divisions to disclose any financial interest in energy or energy service providers, and recuse themselves from any decision in which they have a financial interest; and
 - D. In the implementing ordinances/regulations for the Law, clearly define the scope and division of regulatory powers and responsibilities between these Divisions on the one hand, and the policy making divisions within METI on the other.
- II. Reform Process.** The U.S. Government urges the Japanese Government to continue to provide meaningful opportunities for public input (such as through the use of Public Comment Procedures) as the regulatory reform process in the electricity and gas sectors moves forward, as it did during development of the Law by, for example, soliciting public comments on draft reports issued by the Electricity Industry Committee (Framework of the Desirable Future Electricity Industry System) and by the Urban Heat Energy Subcommittee (Framework of the Desirable Future Gas Industry System).
- III. Electricity Sector**
- A. The success of the Law toward development of a healthy, competitive, stable electricity market in Japan largely depends on the transparent development and effective enforcement of implementing ordinances/regulations. The U.S. Government therefore urges the Japanese Government to expeditiously issue concrete and detailed implementing ordinances/regulations to meet the objectives established in the Law.

1. *Fairness and Transparency.* The Law aims to strengthen the regulatory framework in Japan that fosters market participants' confidence through fairness and transparency in the transmission/distribution sector. To effectively implement this aspect of the Law, the U.S. Government urges METI to adopt concrete and detailed ordinances/regulations to:
 - a. Prohibit information obtained through wheeling services from being used for purposes other than providing such services;
 - b. Separate the accounts of the transmission/distribution sector from those of other electricity sectors in order to prevent cross-subsidization, and publish the accounting rules and the details of the separated accounts;
 - c. Prohibit unjust discriminatory treatment by the transmission/distribution operations of the utilities against specific electricity industry firms;
 - d. Eliminate pancaking of transmission rates and replace pancaked rates with a transmission rate calculation method that has been adopted through a public comment process;
 - e. Conduct vigilant ex-post market oversight and settle regulatory disputes in a neutral and fair manner, and ensure that METI possesses the number of staff, expertise, and independence necessary to effectively perform these tasks;
 - f. Allocate costs for transmission facility expansion, taking into account the market participants' benefits and cost burden;
 - g. Create access to numerous generation sources through an interconnected transmission network which is essential to gaining the full benefits of liberalization to consumers by:
 - (1) Establishing a system to enable economically efficient electricity transactions over wider geographic areas and timely construction of grid-related facilities if needed to support such transactions, by providing transparent interconnection procedures and charges to transmission facilities for all market participants and issuing regulations for pricing and provision of transmission support network services (i.e., ancillary services), such as load-balancing and load-following.
 - (2) Undertaking studies to determine the pattern of generation that would result if the nation's existing generation capacity

were always used optimally to meet fluctuations in demand (i.e., regional economic dispatch) and if transmission capacity were always available at reasonable cost. Specifically, undertake a power flow study to demonstrate that Japan has adequate interconnection capability to operate its generation infrastructure in such an economically optimal manner, as would occur if a national power market were established. If such a study reveals inadequacies in interconnection capability needed to support a competitive national power market, develop concrete measures to remedy such inadequacies where economical.

- h. Implement a review of the effectiveness of behavioral regulations and ex-post monitoring; and
- i. Provide for more structural methods (such as transferring control of the numerous transmission systems to an independent neutral operator that would become the sole provider of transmission services offering a single transmission tariff) for prohibiting unjust discriminatory treatment should behavioral regulations and ex-post monitoring prove insufficient.

2. *Neutrality and Access.* The Law provides for establishment of a neutral transmission system organization (NSO) to foster market neutrality and open access. The U.S. Government recommends that METI implement concrete and detailed ordinances/regulations to:

- a. Ensure meaningful governmental oversight of the fairness and transparency of the NSO's decision-making process, supported by strong enforcement capability;
- b. Establish enforceable standards for appointment of the membership of the NSO, which should be comprised of a diverse mix where no one sector has the ability to dominate the decision-making process (i.e. members would include not only power utilities, but also new entrants, distributed generators with connections to networks and wholesale power companies, and scholars with expert knowledge);
- c. Require that the NSO establishes published rules to promote the efficient and stable operation and construction of transmission facilities through a fair and transparent process;
- d. Require that the NSO operate a transparent information disclosure system on power transmission networks on behalf of transmission

customers everywhere, which would include the available capacity of transmission lines; and

- e. Require a periodic review of the NSO's effectiveness and a provision to consider disbanding the NSO should it prove unable to reach timely, clear decisions, and to replace it with a truly independent, unbiased body containing no market participants.

3. *New Entry.* To foster consumer choice, promote new entry into the Japanese electricity market, and improve competitive market conditions, the U.S. Government recommends that the Japanese Government privatize the Electric Power Development Company (EPDC) in a manner consistent with the Anti-Monopoly Law, with sufficient consideration given to the market impact of the EPDC's privatization.

B. In the 2003 Report to the Leaders, the Japanese Government highlighted several pivotal recommendations from the Electricity Industry Committee's Framework of the Desirable Future Electricity Industry System. Accordingly, the U.S. Government urges the Japanese Government to codify these recommendations in the implementing ordinances/regulations of the Law.

1. *Fairness and Transparency.* To ensure fairness and transparency in Japan's electricity market, the U.S. Government recommends that the Japanese Government implement concrete and detailed ordinances/regulations and instructions to create a private-sector, nationwide, voluntary wholesale power exchange to handle spot market transactions.
2. *Neutrality and Access.* To provide greater access to transmission lines for all market participants, the U.S. Government recommends that the Japanese Government implement concrete and detailed ordinances/regulations to revise the transmission access rules, providing for measures such as relaxation of the existing balancing rule applicable to deviations between scheduled and actual power injections from 30-minute/3-percent to a range of 3 percent to 10 percent of demand, and abolition of the accidental back-up charge for imbalances that exceed the fluctuation range.
3. *Continued Liberalization.* To expand consumer choice and investor confidence in Japan's electricity market, the U.S. Government urges the Japanese Government to establish concrete and detailed ordinances/regulations consistent with the liberalization timetables set forth in the Framework of the Desirable Future Electricity Industry System to:

- a. Expand the scope of retail electricity liberalization to approximately 40 percent of the market by April 2004 by including customers using high voltage electric service at 500 kW or more; and
- b. Expand the scope of retail electricity liberalization to approximately 63 percent of the market by April 2005 by including all customers using high voltage electric service at 50 kW or more.

IV. Natural Gas Sector

- A. The success of the Law toward development of a healthy, competitive, stable gas market in Japan largely depends on the transparent development and effective enforcement of implementing ordinances/regulations. The U.S. Government therefore urges the Japanese Government to expeditiously issue concrete and detailed implementing ordinances/regulations to meet the objectives established in the Law.
 - 1. *Fairness and Transparency.* To ensure fairness and transparency in Japan's gas market, the U.S. Government recommends that the Japanese Government implement concrete and detailed ordinances/regulations that:
 - a. Establish and strengthen a mechanism to conduct more rigorous rate approval examinations and audits, settle disputes that occur as a result of free competition in the market, and conduct neutral and fair ex-post facto monitoring and dispute settlement, with a high degree of expertise and independence; and
 - b. Require that any such mechanism within METI possesses the number of staff, expertise, and independence necessary to effectively perform these tasks.
 - 2. *Neutrality and Access.* The U.S. Government urges the Japanese Government to promulgate detailed and concrete ordinances/regulations to implement the objectives of the Law that will:
 - a. Promote construction and improvement of pipelines for gas supply use by parties other than the general gas utilities by giving third parties that construct gas supply pipelines the public utility privilege (such as eminent domain), which is afforded only to general gas utilities under the current system;
 - b. Apply third-party access obligation, which is applied only to the four major domestic utilities under the current system, to all parties that own or operate pipelines for gas supply;

- c. Obligate all pipeline owners and operators for gas supply in principle to draft, file, and disclose standard terms, conditions, and rates for third-party access;
- d. Require the regulatory authority to establish implementing regulations or other measures to provide for separation of accounts, information firewalls, and prohibition of discriminatory treatment against specific third-party access users;
- e. Implement a review of the effectiveness of behavioral regulations and ex-post monitoring; and
- f. Provide for more structural methods of prohibiting unjust discriminatory treatment should behavioral regulations and ex-post monitoring prove insufficient.

3. *Continued Liberalization.* To expand consumer choice and improve investor confidence in Japan's gas market, the U.S. Government urges the Japanese Government to establish concrete and detailed implementing ordinances/regulations to:

- a. Change the current prior permission system for large-scale retail supply to a notification system, with the regulatory authority maintaining the authority to give change orders or termination orders;
- b. Bolster the wholesale market by expanding the application of the obligation to draft standard terms, conditions, and rates – currently only required for large-scale retail gas supply – to third-party access for wholesale purposes; and
- c. Terminate the current notification system for wholesale gas supply.

B. In the 2003 Report to the Leaders, the Japanese Government highlighted several pivotal recommendations from the Urban Heat Energy Subcommittee's Framework of the Desirable Future Gas Industry System. Accordingly, the U.S. Government urges the Japanese Government to codify these recommendations in implementing ordinances/regulations relevant to the Law.

1. *Neutrality and Access.* To provide greater access for all market participants to all parts of the gas pipeline system, including LNG terminals, the U.S. Government recommends that the Japanese Government include concrete and detailed implementing ordinances/regulations to ensure non-discriminatory negotiations between LNG terminal owners (or operators) and third-party users of LNG terminals by publishing joint METI/Japan Fair Trade Commission

guidelines. The U.S. Government urges that in order to achieve the aim of non-discriminatory access, the Japanese Government should:

- a. Require that LNG terminal owners create and make available to all applicants documents clearly detailing conditions and procedures for terminal use;
- b. Require that LNG terminal owners provide written explanations to parties denied use of these terminals;
- c. Establish guidelines for public disclosure of pipeline network and LNG terminal usage information;
- d. Clearly delineate government responsibilities and clearly define the enforcement mechanism necessary to prevent LNG terminal owners from discriminating against potential users; and
- e. Clarify the obligations imposed by the Law on pipeline networks to respond to interconnection requests by competing gas suppliers.

2. *New Entry.* To foster consumer choice, promote new entry into the Japanese gas market, and improve competitive market conditions, the U.S. Government recommends that the Japanese Government issue concrete and detailed implementing ordinances/regulations to:

- a. Establish incentives for investment in new pipeline construction in regions where the pipeline network is not fully developed, as well as trunk pipelines that connect several demand regions;
- b. Specify in such regulations which pipeline projects qualify for incentives and the duration of incentives. Such incentives could include:
 - (1) Relieving qualifying pipeline owners and operators of such pipelines of the obligation to draft, file, or disclose standard terms, conditions, and rates for third-party access; and
 - (2) Allowing owners and operators of qualifying pipelines to adopt a higher rate of return in setting rates for third-party access.
- c. Vigilantly monitor the decision-making process regarding effective use of existing pipelines in constructing new pipelines, to ensure that owners of existing pipelines do not use such regulation as a means of blocking or delaying needed construction of new lines.

3. *Continued Liberalization.* To expand consumer choice and investor confidence in Japan's gas market, the U.S. Government urges the Japanese Government to establish concrete and detailed ordinances/regulations consistent with the liberalization timetables set forth in the Framework of the Desirable Future Gas Industry System issued by the Urban Heat Energy Subcommittee:
 - a. Expand the scope of retail liberalization to approximately 44 percent of the market by including users with an annual demand of 500 thousand cubic meters and higher by 2004;
 - b. Expand the scope of retail liberalization to approximately 50 percent of the market by including users with an annual demand of 100 thousand cubic meters and higher by 2007; and
 - c. Determine in a timely manner when and how to liberalize gas retail for household and small commercial users with an annual demand of less than 100 thousand cubic meters, while evaluating and examining the results and problems of previous liberalization, and taking into account the changes in the gas procurement structure and the experiences of liberalization in other countries.

MEDICAL DEVICES AND PHARMACEUTICALS

- I. Medical Device and Pharmaceutical Pricing Reform and Related Issues.** Japan is undergoing comprehensive healthcare reform and further developing its medical device and pharmaceutical markets and industries. Japan outlined its proposals in its healthcare reform plan and Visions policy papers for the medical device and pharmaceutical industries. Speedier availability and broader use of innovative medical devices and pharmaceuticals can improve healthcare quality while containing overall costs. The U.S. Government encourages Japan to implement the Visions' principle of the importance of innovation, and to eliminate arbitrary policies put into effect for short-term budgetary savings but which result in discouraging innovation. As Japan carries out reform, it is important that industry, including U.S. industry, is granted opportunities for meaningful comment. The U.S. Government asks the Japanese Government to consider the recommendations of the 2003 U.S.-Japan Private Sector/Government Commission that Japan accelerate implementation of the Visions' proposals and implement reimbursement policies that provide globally competitive returns over the life of the patent or product. The United States recommends that Japan work toward carrying out the Commission's recommendations by increasing its use of pricing premiums for innovative products, eliminating measures that unfairly reduce the reimbursement prices of the most effective and popular products, and refraining from counterproductive changes in the cost-calculation method and other pricing rules. As the Japanese Government reforms its healthcare system and fosters the development of its medical device and pharmaceutical industries, the U.S. Government urges Japan to:
- A. Eliminate the repricing criteria of market expansion, either for a product's initial or additional indications based on the sales of a product or its comparator. Use of this market-expansion criteria for repricing works against Japan's goal of fostering innovation since it uses price reductions to punish innovative high-demand products that have succeeded in the market.
 - B. Make full use of pricing rules, including premium-pricing rules, to recognize and encourage innovation, including advances in drug research and medical technology. Review periodically the results of the application of the new and expanded premiums to ensure that they are being used to fully recognize and encourage innovation. Apply the premiums only after all other pricing rules and calculations have been applied – this would prevent the reduction of the premium through subsequent calculations.
 - C. Stop the practice of evaluating a product's innovativeness based on its order of introduction into the market. When determining the price of a new product, consider only its complete package of attributes rather than its introduction date. Such a policy would enhance the pricing system's ability to recognize the value of innovation because innovativeness is not dependent on order of market entry.
 - D. Foster innovation in the medical-device sector by increasing the number of new price categories adopted, and by using a more transparent and timely system for

new product price listings. Accelerate the timing for insurance coverage decisions to four times per year for C1-category devices and once a year for C2-category devices.

- E. Establish a transparent reimbursement procedure for diagnostics (e.g., IVDs and imaging equipment). Ensure that diagnostics that are innovative and provide enhanced value to physicians and patients are properly rewarded.
- F. Improve the transparency of the reimbursement price-setting process, including price data collection methods. Facilitate active industry input and participation in that process by:
 - 1. Giving applicants the opportunity to discuss issues with all relevant MHLW pricing officials during the preparation of pricing recommendations; and
 - 2. Enhancing the efficiency and transparency of the price-determining process by allowing applicants to make presentations at the first meeting of the Drug Pricing Organization (DPO) and Special Organization for Insurance-covered Medical Materials (SOIMM).
- G. Continue to provide industry, including U.S. industry, with meaningful opportunities to provide input and with access to consultations prior to any changes in reimbursement policy.
- H. Refrain from imposing price caps that fail to take into account the market-specific costs of bringing products to the Japanese market.
- I. Encourage the continued development and introduction of innovative biologic products by rejecting a potential plan to reprice “long-listed products” that lack generic competition. Implementing such a plan would undermine the value of future life sciences innovation.
- J. Continue to provide industry, including U.S. industry, with meaningful opportunities to provide input and with access to consultations regarding the Diagnosis Procedure Combination (DPC) and possible adoption of other payment systems, such as Diagnostic Related Group (DRG), Prospective Payment System (PPS), etc. Promote the adoption of treatment guidelines to ensure patient care is not adversely affected.

II. Medical Device and Pharmaceutical Regulatory Reform and Related Issues. The reform of the Pharmaceutical Affairs Law and the formation by April 2004 of the Pharmaceuticals and Medical Devices Organization (PMDO) present a historic opportunity to improve the speed and efficiency of Japan’s regulatory system and provide patients with wider and faster access to innovative products. The U.S. Government supports Japan’s efforts to develop a regulatory system that embraces accountability,

efficiency, harmonization and the latest globally accepted science, and encourages the Japanese Government to take steps to carry out the goals outlined in the Visions to foster the development of better, safer, and more innovative products. The U.S. Government also asks Japan to consider the recommendations of the 2003 U.S.-Japan Private Sector/Government Commission that Japan accelerate implementation of the Visions and strengthen the protection and enforcement of intellectual property. As Japan implements the reformed Pharmaceutical Affairs Law and establishes the PMDO, the U.S. Government urges Japan to:

- A. Continue the open dialogue already established with industry regarding formation of the PMDO, development of user fees, and reform of the Pharmaceutical Affairs Law. Ensure that industry has meaningful opportunities to comment on reform of regulations.
- B. Ensure that the PMDO will be formed through a full, functional integration of the pre-market and approval activities of the Organization for Pharmaceutical Safety and Research and the Pharmaceutical and Medical Device Evaluation Center, and will support postmarketing safety activities. Establish within PMDO therapeutic-area review teams with appropriate technical expertise to manage reviews, approvals, and consultations.
- C. Utilize all user fees to supplement the new agency's budget for the purpose of increasing resources, including staff with relevant expertise, dedicated to faster approvals of new medical devices and pharmaceuticals. Establish a simple, clearly defined user-fee system for its various services, and publish the fees. Ensure that any proposed fee changes are discussed with industry, and are linked directly to the PMDO's achievement of agreed performance measures.
- D. Develop and implement from April 1, 2004, transparent performance measures, with established baselines. Include in the measures specific and quantitative goals for improvement in the approval time of product applications. Report annually on the progress toward meeting performance measures and on the utilization of user-fee revenues.
 1. Pharmaceutical Performance Measures. Include among various performance measures for New Drug Application (NDA) reviews a maximum time of 180 days for the period from application to Interview Review Meeting. Ensure the completion of New Chemical Entity (NCE) review approvals in 12 elapsed months through staged improvements in the five years starting from April 1, 2004. For example, complete within 12 months 10 percent of reviews by JFY2004, 60 percent by JFY2006, and 90 percent by JFY2008. Ensure that reviews are not delayed beyond the baseline review and approval time. Develop through discussions with industry new criteria for "priority reviews" that would be completed in six elapsed months. Use the same five-year schedule of performance goals for priority reviews as will be used for NCEs.

2. Medical Device Performance Measures. Include among various performance measures for medical device applications a maximum of 150 days for the period from a “New” device application submission to the mid-review meeting. Ensure the completion of approvals in specified times through staged improvements in the five years beginning April 1, 2004, for all application types.
- E. Institute a timely, transparent, and efficient appeals mechanism to arbitrate disagreements between applicants and PMDO during the development, approval and postmarketing phases.
 - F. Ensure that manufacturers have a primary role and are significantly involved in consultations with MHLW/PMDO safety officials (internal and external) throughout the process of analyzing and responding to adverse events. Evaluate suspected adverse events in a timely, thorough, science-based manner using internationally accepted best practices.
 - G. As the Quality Systems (QS) program is established, the U.S. Government suggests that Japan:
 1. Conserve its limited inspectional resources by, for example, conducting pre-approval QS audits only for higher-risk products that require clinical data.
 2. Use the services of third-party organizations as a means of obtaining auditing and conformity assessment reports from foreign manufacturing facilities, and in the interest of further harmonization, allow such third parties to conduct audits and report their findings according to the Global Harmonization Task Force recommendations.
 - H. Adhere to the concept of a common format (for example, “Common Technical Document” for New Drug Application submissions and STED for medical device submissions), and avoid requests for additional summaries or documents.

III. Blood Products. Japan has adopted a Supply and Demand Plan to “ensure a stable supply of blood products to Japanese patients.” The U.S. Government urges Japan to:

- A. Ensure that implementation of the Supply and Demand Plan does not discriminate against foreign products and is fully consistent with Japan's international trade obligations.
- B. Apply pricing rules in a fair and transparent manner.

C. Provide industry, including U.S. industry, with meaningful opportunities to provide input and regular and transparent access to consultations regarding regulation of blood and blood products.

IV. Nutritional Supplements Liberalization. As Japan continues to liberalize its market for nutritional supplements, the U.S. Government urges Japan to:

A. Provide industry, including U.S. industry, with meaningful opportunities to provide input and regular and transparent access to consultations regarding regulation of nutritional supplements.

B. Ensure that decisions on whether to include ingredients on MHLW's approved list are based on sound science.

V. Proposed Zones for Structural Reform. The U.S. Government is supporting the Special Zones for Structural Reform initiative, and urges MHLW to seriously consider Zone measures provided for its review that relate to these important sectors.

FINANCIAL SERVICES

- I. Specific Measures.** The United States welcomes regulatory reform in the following areas at the earliest possible date:
- A. Review the regulatory framework governing investment advisory and investment trust management activities and eliminate any inconsistencies or duplication.
 - B. Strengthen disclosure rules for investment trust performance by setting standards based on global best practices.
 - C. Further improve rules governing Money Management Funds (MMFs) with respect to mark-to-market accounting, maturity, credit quality, and diversification.
 - D. Increase the Defined Contribution (DC) pension plan contribution limits to a level that makes DC pension plans a viable retirement savings option for employees. Permit employees to match the contributions of their employers as one mechanism to increase contribution limits. Assure that contribution limits for defined contribution plans make them a competitive alternative to defined benefit plans in corporations that offer their employees a choice between DC and Defined Benefit (DB) plans.
 - E. Allow defined contribution plan providers to submit for review and approval a basic prototype “safe harbor” DC pension plan that, once approved, could then be adopted cost effectively by small- and medium-sized companies after notification of the authorities and a waiting period, without requiring further review and approval of the basic plan structure.
 - F. Allow lenders to satisfy disclosure requirements under the Money Lending Business Law by electronic notices where customers have agreed. Such revision is appropriate given: i) the new Personal Information Protection Law promoting a customer choice approach to data protection; ii) that three years have passed since the revision of disclosure requirements relating to loan guarantors; and iii) new legislation to improve practices of money lenders.
- II. Transparency.** To improve transparency in financial sector regulatory and supervisory practice, the United States would welcome measures in the following areas at the earliest possible date:
- A. In line with the announced goal of carefully reviewing the activities of public sector corporations and avoiding competition with the private sector, the United States requests that any proposed report, request for product/service approval, or legislative action relating to the provision of financial services by the Postal Financial Institutions (*yucho* and *kampo*) that will affect the existing conditions of

competition be the subject of timely, full public notice and comment and consideration before their introduction.

- B. The operations and decision making of industry associations (self regulatory organizations) that have a self-regulatory, investor protection, or other public policy role should be conducted in a transparent and open fashion. Specifically, the United States recommends that:
1. All proposed rulemaking by industry associations should be made available for public comment, and that comments received from the public should be taken seriously in the formation of final rules governing association members; and
 2. Written materials – including regulations, supervisory standards and other guidance, operating rules and procedures, market studies, and other statistical compendia – should be made available to the public at reasonable costs of production and duplication.
- C. As a complement to self-regulatory organizations, the United States requests that the Japanese financial authorities encourage and work with private sector financial industry associations that fully represent the views and the expertise of their members.
- D. The No Action Letter process that has been established is limited and has not been widely used. It has therefore not made a sufficient contribution to reducing regulatory barriers to innovation and improved efficiency in Japan's financial markets. We United States urges the Japanese Government to take the measures necessary to make the No Action Letter process an effective means for promoting regulatory transparency in the financial services sector, including actions recommended in the Transparency and other Government Practices section of this submission.
- E. The U.S. Government requests that the Japanese Government review proposals to adopt formal Financial Services Agency (FSA) Rulemaking Procedures, including public hearings, under the Administrative Procedures Act (APA) in connection with existing and new regulations or guidelines, to replace the insufficiently transparent and narrowly focused (wherein only a select group of financial firms are sometimes consulted) manner by which new financial regulations are adopted and implemented by the FSA.

COMPETITION POLICY

- I. Deterrence of AMA Violations.** The deterrence of serious Antimonopoly Act (AMA) violations is of the utmost importance to a successful competition law enforcement system. However, the current level of surcharges provided by the AMA is far too low to constitute an effective deterrent. Moreover, the infrequent criminal prosecution of even egregious AMA violators, and the low penalties imposed by the Tokyo High Court on companies and individuals convicted of criminal AMA violations, have limited the effectiveness of the AMA in deterring serious violations. Therefore, the United States urges Japan to:
- A. Increase surcharge payment levels significantly (in the neighborhood of 20 percent of the sales involved in the conspiracy);
 - B. Apply surcharge payment orders to sales occurring during the full term of an illegal conspiracy, not just to the last three years as the AMA provides for currently;
 - C. Explore methods for imposing even more stringent measures on companies that are repeat offenders of the AMA;
 - D. More actively enforce the criminal provisions of the AMA; and
 - E. Encourage judges to impose sentences of imprisonment on individuals convicted of criminal AMA violations that require the convicted individuals to actually serve time in prison.
- II. Strengthened JFTC Enforcement Powers.** If the Japan Fair Trade Commission (JFTC) is to be effective in enforcing the AMA against often secret anticompetitive behavior, it must have at its disposal the full arsenal of investigatory and enforcement powers enjoyed by the antitrust enforcement authorities of other major countries. Therefore, the United States urges Japan to:
- A. Authorize JFTC to adopt a corporate leniency program that allows JFTC to reduce or eliminate surcharge payment orders and to forebear from filing criminal accusations against whistleblowers;
 - B. Provide JFTC with enhanced investigation powers, equivalent to those currently enjoyed by Japan's National Tax Authority and Securities and Exchange Surveillance Committee;
 - C. Increase efforts to further improve the economic analysis ability of JFTC;

- D. Revise criminal accusation procedures to be consistent with procedures used for other economic crimes in Japan;
- E. Increase penalties for interference or non-compliance with JFTC investigations; and
- F. Allow JFTC to issue cease and desist orders up to three years after illegal conduct has been terminated.

III. Eliminating Bid Rigging. Bid rigging remains a rampant problem in Japan that undermines necessary restructuring of the economy and harms Japanese consumers and taxpayers. In order to more effectively dismantle the bid rigging system in Japan, the United States urges Japan to:

- A. Increase substantially, to at least nine months, the minimum period of suspension of designation of firms that engage in bid rigging;
- B. Require that suspension of designation for firms found to have engaged in bid rigging be imposed on a nationwide basis;
- C. Ensure that upon completion of investigations by the heads of ministries, agencies and local governments into the involvement of government officials in bid rigging – as required by the Act concerning Elimination and Prevention of Involvement in Bid Rigging – the final report of the investigation is made public; and
- D. Publish a report of the measures the Ministry of Land, Infrastructure and Transport has taken to prevent recurrence of the unlawful bid rigging activities of the Economic Research Association and the Construction Research Institute, including the actions taken against the officials responsible for the unlawful activities.

IV. Promoting Competition in Industries Undergoing Deregulation. Regulatory reform in Japan will be most successful if it is undertaken with an appreciation of market principles and in a manner consistent with Japan’s antimonopoly policy. In order to maximize the effectiveness of Japan’s regulatory reform efforts, the United States urges Japan to:

- A. Implement necessary measures so that JFTC may effectively enforce the AMA to ensure that new entry in industries undergoing deregulation, such as telecommunications and energy, is not foreclosed by anticompetitive exclusionary behavior of incumbent dominant firms; and
- B. Bolster the role of JFTC in the development and implementation of regulatory reform programs in Japan so as to ensure that competition principles and analysis are fully incorporated into the deregulation process.

- V. **JFTC Resources.** JFTC continues to need additional resources to be able to effectively investigate and redress anticompetitive activities and to promote competition in the Japanese economy. In particular, JFTC needs increased staff with legal and economic expertise, and with sophisticated knowledge of the structure and workings of complex public utility sectors. Therefore, the United States urges Japan to continue to increase the staff and budget of JFTC substantially and steadily, and to increase the number of JFTC personnel with advanced legal and economic training, and with detailed knowledge of public utility markets, including telecommunications and energy.

TRANSPARENCY AND OTHER GOVERNMENT PRACTICES

I. Public Comment Procedures. Japan's Public Comment Procedures (PCP) have been in place since 1999. They have generally not, however, been implemented in a manner that has significantly improved transparency in Japan's regulatory system. The Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) has released yet another annual survey (August 22, 2003) revealing serious and persistent deficiencies in the PCP. That survey showed that only about half the total number of public comment periods in FY2002 were at least 30 days. Also of concern, the percentage of cases in which government ministries and agencies incorporated comments into final regulations remained very low at 14.5 percent of the 399 rules and regulations open for comment in FY2002. The survey results fuel a growing perception that the PCP, as currently used, is inadequate and that governmental agencies are working out (and for all intents and purposes finalizing) draft regulations with special interests before they are published for public comment. To address these concerns, and to make the PCP a useful and effective regulatory mechanism, the United States urges the Japanese Government to take the following measures:

- A. To further improve the application of the PCP and promote its effective and widespread use, require that all ministries and agencies make vigorous efforts to gather a broader range of opinions and information through the PCP when formulating, amending or repealing a regulation by:
1. Requiring the use of a minimum 30-day comment period, except in urgent cases, and recommending a 60-period as standard practice;
 2. Requiring that all comments received be reflected in final regulations, to the extent appropriate;
 3. Eliminating the practice of placing overly rigid parameters on the public comment submissions, such as substantially limiting page length, requiring an 80-character summary, and other impediments that undermine the spirit of the PCP;
 4. Establish a centralized system that would allow the public to easily find solicitations of public comments in one location that would include solicitations of public comments (whether or not they are covered by the PCP) by *shingikai*, *kenkyukai*, *benkyokai* and other study groups;
 5. Require that all proposed rule making by government-established or authorized self-regulatory organizations be made available for public comment, and comments received should be seriously considered as appropriate in the final draft; and

6. Undertake the legal steps necessary to incorporate the PCP into the Administrative Procedure Act, which would strengthen it from being a mere guideline to being a law.

B. In a continuing effort to recommend ways to further promote the fairness and transparency in Japan's decision-making process and to increase the effectiveness of the PCP, the United States urges MPHPT to co-sponsor, with the U.S. Embassy, a seminar on the value of public participation in Japan's rulemaking process. At the seminar, MPHPT could explain its updated web site, how the PCP works, how comments are incorporated or dismissed, and what is being considered for improving the rulemaking procedures. Participants could raise issues with MPHPT, ask for clarifications on the PCP, and offer suggestions on how the system could be improved.

II. Special Zones for Structural Reform. The U.S. Government continues to follow with great interest the Japanese Government's ongoing efforts to establish Special Zones for Structural Reform throughout Japan. In particular, the United States commends the establishment of 164 zones to date by Prime Minister Koizumi. This new, innovative approach to deregulation and structural reform can provide important opportunities for Japan to return to sustainable growth. As Japan moves forward with this initiative, the United States recommends that:

A. The zones continue to be selected and established in a transparent manner;

B. A focus be placed on expanding market-entry opportunities;

C. Domestic and foreign companies alike have non-discriminatory access to operate in the zones;

D. Successful measures used in the zones should be applied on a national basis as expeditiously as possible;

E. The Special Zones Headquarters continue to work with U.S. and other foreign companies to submit zone ideas, participate in existing zones, and participate in the zones process at every stage; and

F. The Special Zones Evaluation Committee undertake the following in determining which zones are "successful" or "unsuccessful" and which zones should be expanded nationally:

1. Ensure that its decision making processes are transparent by making the meetings and information used to determine a zone's success open to the public, and when appropriate, by soliciting public input into the evaluation process; and

2. Publish the decisions and supporting information on zone evaluations after the decisions are made so that the public and those involved in the zones fully understand the process.

III. Public Input into the Development of Legislation. The United States commends the growing frequency of ministries and agencies opting to solicit public input into draft legislation during its development and before submitting it to the Diet. The United States encourages Japan's ministries and agencies to continue this practice and looks forward to greater opportunities to comment on legislation in the early stages of its formation. Two specific examples of the need for providing sufficient public input in this regard are:

- A. Life Insurance Policyholder Protection Corporation. The current structure to finance the Life Insurance Policyholder Protection Corporation (Life PPC) will expire in March 2006. The United States urges the Japanese Government to carry out its commitment to promptly convene the Financial System Council to conduct a thorough review of the safety net system, and ensure that subsequent legislation is enacted in time to establish a more efficient, sustainable safety net system before current stop-gap measures expire in March 2006. Legislation to reform the Life PPC has the potential to impact public confidence in the industry as well as the financial health and operations of both domestic and foreign life insurance companies. Therefore, the United States urges the Japanese Government to fully utilize and implement the PCP and ensure that the insurance industry (both domestic and foreign) and all interested parties are provided meaningful opportunities to be informed of, comment on, and exchange views with officials on proposed amendments to the Insurance Business Law, the Life PPC reform legislation or other existing laws and regulations related to the Life PPC prior to their implementation and/or submission to the Diet. These opportunities include actively contributing to the deliberations, on reforming the Life PPC, including contributing to working groups or components of these groups which might be convened by the Japanese Government.
- B. Non-Life PPC. In the event legislation is considered to address funding of the Non-Life PPC, the U.S. Government urges the Japanese Government to follow a similar approach as recommended above in Section III A.

IV. Privatization of Public Corporations. The United States continues to take interest in Prime Minister Koizumi's efforts to restructure and privatize Japan's public corporations, including his pledge to privatize the Japan Highway Corporation and Japan Post. The United States also recognizes that, if implemented vigorously, this reform effort could have a major impact on the Japanese economy, stimulating competition and leading to a more productive use of resources. As reform of the public corporations advances, the United States continues to urge Japan to:

- A. Conduct the restructuring and privatization in a transparent manner; and

- B. Ensure that domestic and foreign private sector entities that will or may be affected by the reform have meaningful opportunities to provide input, such as through use of the Public Comment Procedures.

V. **Postal Financial Institutions.** The U.S. Government continues to share concerns voiced by Keidanren and others related to the effect of the postal financial institutions – postal savings (*yucho*) and postal insurance (*kampo*) – on the efficient operation of Japan's financial markets.

- A. Transparency. With regard to the formulation of proposed amendments to the law related to *kampo* products and distribution or origination by Japan Post of non-principal-guaranteed *yucho* investment products, the U.S. Government urges MPHPT to take steps to sufficiently inform and seek input from the public (including foreign insurers) on all aspects that may affect private sector operations in the relevant sectors. This includes providing the insurance industry and other private sector interested parties (both domestic and foreign) meaningful opportunities to comment on and exchange views with MPHPT officials on:

1. MPHPT-proposed plans and draft legislation prior to their submission to the Diet; and
2. Draft guidelines and other regulatory measures prior to their implementation, with full utilization and implementation of the Public Comment Procedures.

- B. Same Standards. The United States recommends that, in order to create a level playing field between the postal financial institutions and their private sector competitors, Japan subject the postal financial institutions to the same laws, level of taxation, level of safety net contributions, reserve requirements, standards and regulatory oversight as their private sector counterparts.

- C. Curb Expansion. The United States urges Japan to prohibit the postal financial institutions (*kampo* and *yucho*) from underwriting any new insurance products that the private sector can provide, or originating any new non-principal-guaranteed investment products, until measures to ensure a level playing field (as recommended immediately above) are implemented. Towards this end, the United States urges the Japanese Government to reaffirm Japan's commitment to the new product review and approval process outlined in the U.S.-Japan Insurance Agreement of 1994 with regard to new *kampo*-underwritten policies.

- D. Privatization. The U.S. Government notes that Prime Minister Koizumi has tasked Economy and Fiscal Policy Minister Takenaka to compile a postal-privatization plan for the three postal services including *kampo* and *yucho* by the fall of 2004, with the goal of privatizing the postal services in April 2007. As any

modifications to the existing system could have a significant impact on competition in, and the effective operation of, the broader insurance market in Japan, it is important that any decisions on privatization be made and implemented in an open and transparent manner. This would include the same measures as outlined above in Section V A.

- VI. Insurance Cooperatives – Same Standards.** Insurance cooperatives (*kyosai*) provide a range of insurance products that compete directly with the private sector and occupy substantial market share in the Japanese insurance market. Some *kyosai* are regulated by their respective agencies of jurisdiction (for example, the Ministry of Agriculture, Forestry and Fisheries regulates *Nogyo Kyosai*, the agricultural *kyosai*); some *kyosai* are not regulated at all. The lack of a regulatory regime for unregulated *kyosai* and weak regulatory regimes for other *kyosai* undermine the ability of the Japanese Government to provide companies and policyholders with a sound, transparent regulatory environment, and afford the *kyosai* significant business, regulatory and tax advantages over their private sector competitors. The United States recommends that, in order to create a level playing field between *kyosai* and their private sector competitors, Japan subject all *kyosai* to the same laws, level of taxation, safety net contribution requirements, reserve requirements, standards and regulatory oversight as their private sector counterparts.
- VII. No Action Letters.** A regulated business entity with concerns about an administrative agency's interpretation of laws/regulations, or about whether proposed transactions or practices would require a license or official approval, can seek advance clarification from the regulator under the no-action letter procedure. Since the introduction of this system more than two years ago, there have been few official no-action letters. The United States believes this pattern may be due to three primary factors: a) applicants withdraw no-action letter requests following informal discussions with the regulating agency during which they learn that an official interpretation would likely be negative; b) applicants are told by the regulating agency that the agency cannot accept the no-action letter request because the question is one for self determination by the applicant; that is, the applicant should interpret the law for itself, subject to subsequent review by regulators upon inspection; and c) applicants are told by the regulating agency that the agency cannot accept the no-action letter request because the question falls within the scope of an existing business activity and does not relate to the commencement of a new business. The pattern of informal rejection and/or pre-screening of no-action letters means that no body of interpretation is built up and made available to guide the public; this pattern also detracts from the clarity and transparency of the regulatory process. As an example, with reference to the self-determination response, in the face of ambiguity, regulated entities may reasonably be reluctant to make a self-determination where the agency is unwilling to respond for fear of being sanctioned during a subsequent inspection or enforcement action.
- A. Transparency. The United States asks that the Japanese authorities clearly indicate that they welcome no-action letter requests, and all requests should be

accepted for formal review by the regulator unless the issue presented lies outside the agency jurisdiction or has been previously addressed (including in prior no-action letters). Additionally, the United States recommends that any agency response that a no-action letter request is a matter for self-determination be made in writing and published as a matter of public record. The United States also recommends broadening the scope of eligible topics for a no-action letter or an interpretive ruling to include clarification of rules regarding existing business activities as well as new business.

- B. Regulatory Efficiency. The United States recommends that the regulating agencies significantly expand their use of the no-action letter procedure to enhance the efficiency of their own regulatory processes. The no-action letter procedure offers the regulator and requesting entities an efficient channel to reach agreement on specific regulatory interpretations in a highly-focused and fact-based manner, while at the same time providing general guidance to similarly-situated regulated entities. The public format of the no-action letter procedure ensures an even playing field among regulated entities and, over time, will assist these entities in achieving self-compliance, thereby allowing the regulating agencies to focus their resources on broader rule-making and policy concerns.
- C. Corrective Measures. The U.S. Government urges the Administration Evaluation Board (EAB) of MPHPT to conduct a confidential evaluation of those industries in which the no-action letter has not been widely used to provide meaningful guidance to firms on regulatory policy. That review should focus on the causes of the under-use of the no-action letter system and implement corrective measures, including meaningful goals, to create an effective system wherein a large number of no-action letters and requests are processed by regulating agencies. Such measures may include:
1. Permitting industry organizations and associations, including the American Chamber of Commerce in Japan (ACCJ) and the International Bankers Association (IBA), to submit no-action letters on issues of particular interest to their members;
 2. Permitting professional service organizations – including law firms, accounting firms, business consulting firms and other similar firms – to submit requests on behalf of undisclosed clients (provided that they certify that such inquiries are not hypothetical and with the understanding that approval for a particular transaction will require disclosure of the parties involved); and
 3. Encouraging MPHPT and the regulatory agencies to hold an annual joint forum to seek industry input on how to improve the no-action letter system and how it can be used to improve Japan’s regulatory system.

LEGAL SERVICES AND JUDICIAL SYSTEM REFORM

I. Legal Services

- A. Freedom of Association. The United States commends Japan for enactment in the summer of 2003 of amendments to the Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers that will substantially eliminate restrictions on the freedom of association between foreign lawyers and Japanese lawyers, or *bengoshi*. This is a far-reaching and much needed step to ensure that consumers in Japan are able to obtain integrated international legal services in an efficient and timely manner. However, the amendments must be implemented as early as possible and in a manner that does not undermine the liberalization objectives of the revised law. Therefore, the United States recommends that Japan:
1. Take all necessary action so that the freedom of association provisions of the amended Special Measures Law can come into effect by September 2004; and
 2. Ensure that the Japan Federation of Bar Associations (*Nichibenren*) and the local bar associations permit registered foreign lawyers (*gaiben*) to be voting members of, and to participate fully in, all committees and study groups charged with considering or drafting rules and regulations to implement the new amendments to the Special Measures Law and accompanying amendments to the Attorneys Law, and that *Nichibenren* publishes any such draft rules and regulations for public comment reasonably in advance of the Board of Governors (*daigiin*) meetings and/or General Meetings (*sokai*) in which they are to be finalized.
- B. Professional Corporations and Branches. *Gaiben* and foreign law firms should be able to choose the same business structures as *bengoshi* in providing legal services in Japan. The United States welcomes Japan's commitment to examine the introduction of professional corporations for *gaiben*. In this regard, the United States urges that Japan:
1. Permit *gaiben* to form professional corporations as an alternative to establishing branch offices of home country entities on the same basis and with the same benefits as *bengoshi* professional corporations; and
 2. Allow *gaiben* law firms and *kyodo jigyo* to establish branch offices throughout Japan on an equal footing with *bengoshi* professional corporations.

- C. Minimizing Qualification Criteria for *Gaiben*. In order to encourage foreign lawyers with a long-term interest in Japan to seek qualification as a *gaiben*, the United States urges that Japan count all of the time that a foreign lawyer spends practicing the law of his home jurisdiction in Japan toward the three-year experience requirement.

II. Judicial System Reform: Judicial Oversight of Administrative Agencies. A fundamental principle of modern legal systems based on the rule of law is that parties adversely affected by an administrative decision or action should have recourse to effective review of that decision by a court or other independent body. In that context, the United States commends the commitment of Japan to undertake a comprehensive review of the administrative litigation system and to make needed improvements by November 30, 2004. The United States urges Japan to:

- A. Include in its review necessary modification to standing requirements for persons seeking judicial review of administrative rules and decisions so that persons who – as a result of the regulatory action – suffer injury that is within the broad zone of interest of the underlying legislation may appeal such action to the appropriate court; and
- B. Publish for public comment the details of any amendments that the Office of Promotion of Justice System Reform proposes in this area.

COMMERCIAL LAW

- I. Adoption of Modern Merger Techniques.** Revitalization of Japan's economy will be promoted by encouraging corporate restructuring and increased investment from both domestic and foreign sources. The availability of modern merger techniques, which rely on various forms of consideration and transactional structures, are crucial to this process. Japan has taken a first step by permitting the use of triangular mergers and cash mergers in corporate restructuring taken under the Revised Special Measures Law for Industrial Revitalization. However, there are impediments to the use of these techniques by foreign investors and they are not yet available to companies seeking to merge or restructure outside of the parameters of that Law. Therefore, the United States recommends that Japan take necessary steps to ensure that modern merger techniques, in particular triangular mergers and cash mergers (including short-form mergers) are both legally and practically available for all companies operating or investing in Japan. For this purpose, the United States urges that Japan:
- A. Include proposals to introduce flexibility in merger currency (to enable triangular merger and cash merger transactions) and to introduce short-form (squeeze out) mergers in the preliminary outline of FY2004 commercial law revisions to be published for public comment by the end of 2003; and
 - B. Review the implementation of the relevant provisions of the Revised Special Measures Law for Industrial Revitalization to determine what impediments exist that prevent full utilization of these merger techniques for both domestic and cross-border transactions, and take appropriate action by the end of FY2003 to reduce or eliminate impediments to using these merger techniques pursuant to either the Revised Special Measures Law or the expected revisions to the Commercial Code.
- II. Promoting Shareholder Value through Active Proxy Voting.** Japan faces many serious challenges as it seeks to ensure the comfortable retirement of its aging population. One important way to address this issue is to ensure that the investments of public and private pension funds, and of mutual funds, obtain the highest returns prudentially possible. Studies have demonstrated that companies with good corporate governance systems – that ensure that management is held accountable to shareholders through active shareholder voting – outperform companies that have not adopted such systems. The active exercise of shareholder rights by large institutional investors such as pension funds and mutual funds can have a direct effect on investment returns that Japanese citizens will accrue. Therefore, the United States urges Japan to:
- A. Public Pension Funds. Ensure that the Government Pension Investment Fund, National Pension Funds, Employees Pension Funds and other government-related pension funds adopt, or require their pension fund managers to adopt, shareholder

proxy voting policies or guidelines aimed at maximizing the value of their investments on behalf of their beneficiaries, and publicly disclose those policies or guidelines and the record of their actual proxy votes;

- B. Private Pension Fund Managers. Encourage private pension fund managers to adopt and make available to their clients and beneficiaries proxy voting policies or guidelines and to exercise proxy voting rights for the benefit of their beneficiaries; and
- C. Mutual Funds and Registered Management Investment Companies. Require mutual funds and other registered management investment companies to adopt and publicly disclose their proxy voting policies and procedures, and to maintain and publicly disclose the records of their actual proxy votes.

III. Promoting Good Corporate Governance Through Protection of Whistleblowers.

Corporate cultures that impede the flow of information to shareholders and management concern the company's compliance with laws and regulations prevent companies from correcting problems quickly and efficiently, and harm Japanese (and foreign) shareholders that rely on honest disclosures of information in making their investment decisions. Companies themselves, and society as a whole, benefit when company employees can convey information about a company's failure to comply with laws and regulations to management, or to regulatory or investigatory authorities, without fear of retaliation or discrimination. Therefore, the United States urges Japan to:

- A. Introduce legislation by the end of FY2003 that prohibits companies and their officers and employees from discharging, demoting, or otherwise taking disadvantageous action against employees that report evidence of violation of laws, rules or regulations relating to securities law or to fraud or misrepresentations to shareholders. Such legislation should provide for:
 - 1. Civil remedies for whistleblowing employees, including compensatory damages and reinstatement with the same seniority status as the employee would have had in absence of the unlawful behavior; and
 - 2. Criminal penalties against natural and legal persons that engage in the prohibited conduct.
- B. Require publicly traded companies to set up mechanisms for employees to report to appropriate officials acts of fraud or violations of securities laws or regulations in a confidential and anonymous manner.

IV. Fostering Alternative Dispute Resolution (ADR) Mechanisms. Alternative dispute resolution mechanisms can play an important role in helping individuals and businesses resolve conflicts in an efficient and economical manner. The United States is encouraged

by the steps that Japan is taking to improve the role of ADR in Japan. An ADR regime in Japan that is fully consistent with accepted international practice and that allows ADR mechanisms to freely develop in a manner that enables them to respond flexibly to the needs of users would be of great benefit to the commercial sector and to Japanese society as a whole. In this regard, the United States urges Japan to:

- A. Submit legislation to the Diet in 2004 that will permit non-lawyers, as a general matter, to act as neutrals in arbitration, mediation or other ADR proceedings; and
- B. Move toward an ADR regime that is based on the policy of “freedom in principle, restriction only as an exception where necessary” and that, as a general matter, relies on self-regulation and on competitive market pressure to ensure that ADR services are made available at high standards. In particular, any new ADR regime should:
 - 1. Refrain from instituting a mandatory ADR neutral licensing system for ADR neutrals or ADR service organizations; and
 - 2. Ensure that ADR procedures can be flexibly tailored to particular circumstances by allowing the parties to ADR procedures to agree, as a general matter, upon the rules, process and standards to be applied.

DISTRIBUTION

- I. **Airport Landing Fees.** Landing fees at Narita and Kansai international airports are the world's highest. Lower landing fees will benefit consumers and promote a financially healthy airline industry that could in turn help stimulate growth in the wider economy. The United States urges Japan to:
 - A. Promptly reduce landing fees at Narita and Kansai International Airports, which would benefit both Japanese consumers and industry;
 - B. Provide opportunities for public comment on the formula used to calculate landing fees at Japan's international airports; and
 - C. Ensure that the landing fee calculation is transparent, and includes only those costs associated with the use of airport runways and facilities, in accordance with IATA's principle of no cross-subsidization.
- II. **Airline Sales Distribution.** Japan is one of few countries that enforces the IATA 70 percent low pricing band on tickets sold by airlines, preventing them from offering competitive discount fares. Ending this practice would create a travel stimulus by giving the public access to a wider array of fares with greater control of their travel choices. The United States urges Japan to create a competitive market for Internet and other published airline ticket sales by eliminating the practice of enforcing the IATA 70 percent low band on airline tickets.
- III. **Double Disapproval Pricing.** Current Ministry of Labor, Infrastructure and Land regulation stipulates that all airline ticket fare changes "must" be filed 30 days in advance. In reality, this regulation is only enforced on an ad hoc basis and, moreover, is out-of-date with the emergence of the Internet and computer filing systems. The global pace of business necessitates that Japan remove this antiquated practice that limits airlines' abilities to price fares in a competitive market that changes daily. The current system raises costs to consumers and airlines. Furthermore, just as in the instance of IATA pricing, Japan is one of only a few nations that maintains such an antiquated practice. In order to align its body of regulations with current practice, the United States urges Japan to eliminate the regulation that stipulates fares be filed 30-days in advance.
- IV. **Further Reduce Overtime Charges in International Physical Distribution Special Zones.** The reduction of overtime charges in the International Physical Distribution Special Zones in April 2003 increased the competitiveness of Japan's international ports. The United States urges Japan to continue its pro-growth actions by reducing customs overtime charges to zero.

V. **Expand U-Clearance.** The United States urges Japan to extend the U-Clearance system for cargo that is transported by bonded transportation to Hozei warehouses other than TACT (Tokyo Air Cargo Terminal).

VI. **Nippon Automated Cargo Clearance System (NACCS)**

A. The United States urges Japan to make available for public comment its interim report (expected around March 2004) on modification and improvement of the Air-NACCS fee system.

B. The United States also urges Japan to make available for public comment an early draft of the final report, due in June 2004, before Japan finalizes the report and implements any recommendations in September of 2004.

VII. **Freight Forwarder Contracts.** The United States urges Japan to allow foreign carriers the right to contract with Japanese airlines for domestic express package shipments, in order to allow foreign carriers to offer “door-to-door service.”

VIII. **Move from Cost, Insurance and Freight (CIF) to Free on Board (FOB) for Duty Calculation.** Japan's use of CIF to calculate duty on international shipments adds the cost of insurance and shipping to the value of the good being shipped. This increases the number of shipments over the 10,000 yen *de minimis* line subject to duty. The United States urges Japan to adopt the FOB method for valuing goods at entry in order to facilitate efficient processing of shipments by the Customs and Tariff Bureau officials and to reduce the cost of importing to Japan.

IX. **Facilitation of Credit/Debit Card Acceptance and ATM Services.** Worldwide, the use of credit, debt, and ATM cards is expanding at a rapid rate, which benefits the retail sector by increasing consumer convenience. In North America and Europe, credit/debit card penetration rates reach 90 percent of all merchants while in these same three regions over 34 percent of all purchases are made with these cards. Japan lags with only a 45 percent penetration rate and 8 percent of all purchases made with credit/debit cards. Low rates of card acceptance at both traditional merchants and ATMs is a common complaint of foreign visitors to Japan. The United States urges Japan to:

A. Promote the use of credit and debit cards by businesses and as payment for government services;

B. Mandate compliance with international PIN security and network encryption standards across ATM networks in Japan;

C. Relieve the Japan Credit Card Association (JCCA) of its role in the standardization and management of credit card transaction terminals and to

promote the acceptance of internationally accepted systems, rather than the Credit Authorization Terminal system; and

- D. Strictly enforce laws and regulations relating to credit card fraud.