

## FACT SHEET

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

June 25, 2002

### OVERVIEW

This First Report to the Leaders on the U.S.-Japan Regulatory Reform and Competition Policy Initiative (Regulatory Reform Initiative) details important steps Japan will take to help its economy return to sustainable growth and open its markets to U.S. companies. The measures contained in this report address regulatory reforms in key sectors and areas such as telecommunications, information technologies, energy, medical devices and pharmaceuticals, financial services, competition policy, transparency, legal reform, commercial law revision, and distribution.

While much remains to be done, the measures specified in this report represent significant progress in Japan's continuing efforts to create a regulatory environment conducive to smoothly functioning markets and the efficient allocation of resources. By implementing these measures, Japan will help to increase consumer choice, lower prices, and encourage the introduction of more innovative goods and services. The Regulatory Reform Initiative also serves as a mechanism to increase access to Japanese markets for U.S. businesses by reducing onerous regulations and burdensome governmental practices.

This year's report places a special emphasis on expanding our work with Japan in the information technologies sector. Numerous achievements in this area are specified in the report, including measures to liberalize trade in digital products, promote e-government, and strengthen cyber-security.

Another salient feature of this report is that it incorporates substantial input from private-sector representatives. Several of the Working Groups under the Regulatory Reform Initiative invited formal input from private sector representatives, who provided their valuable expertise, observations, and recommendations on important topics under consideration.

The Regulatory Reform Initiative was launched by President Bush and Prime Minister Koizumi at Camp David in June 2001 as an important component of the U.S.-Japan Economic Partnership for Growth. Though forward leaning, the Regulatory Reform Initiative also places a focus on implementing measures achieved under previous work with Japan to deregulate its economy.

## TELECOMMUNICATIONS

**Background:** Market access opportunities and consumer service benefits in Japan's \$130 billion telecommunications services market have long been hampered by anachronistic regulations limiting new entrants' ability to build networks and offer services, and by practices of NTT – Japan's largely government-owned telecommunications group which controls 99 percent of subscriber lines and 59 percent of mobile subscribers. Having set ambitious goals for reform, the Japanese Government undertook a number of initiatives that should significantly improve the investment and business environment in this sector.

**Accomplishments:** Reform measures Japan has taken in this sector include:

- Implementing measures to ease filing and notification requirements for competitive carriers.
- Reaffirming a commitment to lower rates for interconnection to NTT East's and West's wireline network. A decision on this critical issue is expected this Fall, which will be an indication of the Ministry of Public Management, Home Affairs, Posts and Telecommunication's (MPHPT's) ability to act independently from NTT.
- Developing recommendations for introduction of stronger safeguards against anti-competitive pricing, more efficient means for competitors to order wholesale service from NTT, and better terms on which competitors might re-sell NTT services to their own customers.
- Affirming that if NTT unreasonably denies local competitors interconnection for access to emergency services (so they can provide their subscribers access to police, fire service, etc.), the regulator (MPHPT) can arbitrate any resulting dispute in a manner consistent with Japan's WTO commitments.
- Reaffirming that Japan's dominant mobile carrier, NTT DoCoMo, is required to offer cost-based, non-discriminatory interconnection rates to other operators. This issue is of growing concern since about one-quarter of all international calls entering Japan now connect to mobile networks at rates that appear excessive.
- Initiating a process to abolish the regulatory classification based on whether operators own or lease facilities (Type I vs. Type II), which limits innovation and flexibility in corporate structures and services offerings.
- Facilitating access to rights of way controlled by a major electric power company to prevent it from leveraging dominance in power delivery in the telecommunications market and promotion of public infrastructure projects as a means to ensure low-cost access to conduits for installation of fiber-optic networks.

## INFORMATION TECHNOLOGIES

**Background:** The primary aim of the information technologies sector under the Regulatory Reform Initiative is to work with Japan to establish and promote a competitive and innovative IT sector which can benefit both our economies, as well as provide global leadership in this area. The United States is urging Japan to establish a regulatory framework that ensures competition, promotes innovation, allows private sector-led regulation, and protects intellectual property rights in the digital age. Establishing such a framework will promote the development of IT-related businesses and cutting-edge technologies that can be used to spur growth in other key sectors of Japan's economy and create new market opportunities for U.S. firms.

**Accomplishments:** The Japanese Government has taken significant steps to address the need to further promote IT growth, including:

- Working with the United States on “e-initiatives” in three areas:
  - *E-commerce*: recognizing and supporting important principles and objectives in the multilateral framework for liberalizing trade of digital products;
  - *E-government*: promoting the expansion of e-government services; and
  - *Cybersecurity*: strengthening cyber-security by cooperating to facilitate broader acceptance and use of the Convention on Cybercrime.
- Approving for ratification the WIPO Performances and Phonograms Treaty (WPPT), which protects performances and sound recordings online. This will significantly strengthen protection of intellectual property rights on the Internet.
- Taking steps to protect copyrighted intellectual property when it is temporarily stored in a digital form (such as software and music held in the RAM of a computer) so that the right holder's reproduction rights are preserved.
- Continuing to hold discussions with the U.S. Government and consult with the private sector on implementation issues for the new law on Internet Service Provider liability to examine if it adequately protects copyright holders from Internet piracy.
- Confirming that all technologies for secured electronic signatures will be treated equally, that electronic records will have the same legal effect as written documents, and that certification providers do not have to be accredited by the government.
- Supporting the development of private sector self-regulatory mechanisms for online consumer protection and management of personal data, and continuing to work with the U.S. Government about the role these mechanisms can play in boosting consumer confidence in e-commerce.
- Promoting the use of interactive online procurement in both central and local governments as one of several measures to improve the openness, fairness, and transparency for government procurement of information systems.
- Cooperating with the U.S. Government in the areas of e-education, network security, and the promotion of IT and e-commerce technologies for start-ups and small firms.

## ENERGY

**Background:** Dominated by ten regional utilities, Japan's energy market is the third largest in the world after the United States and China. Through continued regulatory reform, Japan aims to increase efficiency in its power sector and reduce its energy prices, still the highest in the OECD. Since the March 2000 liberalization of one-third of its electricity market – which has generated disappointingly limited new entry by competitors – Japan has been gradually moving toward another phase of reform to further its twin goals of increased efficiency and lower prices. A truly competitive Japanese energy sector would not only spur economic growth domestically, but would also expand opportunities for U.S. firms to produce, sell and trade energy products and services in Japan's electricity and gas markets. Regulatory reform will also help generate new opportunities for U.S. firms to export to the electrical generation equipment market.

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

- Actively working to establish important principles and objectives for reforming the electricity sector through official deliberations of the Electricity Industry Committee. The Committee is scheduled by the end of FY2002 to issue a final report, which will serve as a basis for legislation to reform this sector. To date, principles and objectives articulated by the Committee include:
  - ensuring that the electricity network guarantees transparent and fair competition;
  - considering establishment of a wholesale power exchange over a broader geographic market;
  - examining existing transmission capacity and interregional transmission links to facilitate power transactions nationwide;
  - establishing a retail market environment where consumers can choose from multiple suppliers through competition; and
  - clarifying a plan and schedule for expanded retail choice.
- Formally developing important objectives for reforming the gas sector through the Study Group on Gas Market Reform, which issued an extensive report in April 2002 that includes key reform recommendations and principles, such as:
  - creating an efficient, transparent, fair, and competitive gas market;
  - fostering third-party usage of gas infrastructure;
  - promoting incentives for investing in gas infrastructure;
  - promoting construction and interconnection of gas pipelines;
  - fostering transparency measures to enhance third-party usage of pipelines and Liquefied Natural Gas terminals; and
  - expanding the scope of retail liberalization in the gas sector.
- In addition, Japan intends to establish an Advisory Committee in 2002 to officially examine regulatory reform of the gas sector, which will draw on the conclusions of the Study Group on Gas Market Reform.
- To promote competition in the electricity sector and to clarify the conduct by incumbent utilities and other enterprises that may contravene the Antimonopoly Act or the Electricity Utilities Industry Law, the Japan Fair Trade Commission and Ministry of Economy, Trade and Industry will review their joint Guidelines on Fair Transaction and issue new, final guidelines by the end of 2002.

## MEDICAL DEVICES AND PHARMACEUTICALS

**Background:** Japan continues to comprehensively review its national healthcare payment system as well as undertake a major reform of the law covering the regulatory approval of medical devices and pharmaceuticals. These combined exercises will have a profound impact on the future of Japan's market for medical devices and pharmaceuticals. In both sectors, U.S. firms are the dominant worldwide suppliers of innovative products and have considerable stakes in the Japanese market. It is therefore important that U.S. firms have opportunities to provide input into the reform efforts, and that these processes seek to improve the recognition of innovation in pricing as well as the speed of regulatory approvals.

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

- Applying premiums to the prices of innovative medical devices and pharmaceuticals to better reflect the value of innovation as well as to encourage new development of such products.
- Allowing pharmaceutical companies to propose their own product prices when no similar product is available for comparison on the Japanese market. This gives increased pricing flexibility to industry.
- Increasing the frequency of designating reimbursement prices for innovative medical devices (C1) from once every two years to twice-a-year.
- Continuing to provide U.S. industry with meaningful opportunities to discuss and make proposals visa-a-vis Japan's ongoing medical device and pharmaceutical reimbursement and regulatory reform discussions.
- Taking active steps to ensure the proper classification of medical devices for approval purposes. This will help prevent misclassifications of devices which can delay getting them to market.
- Seeking with U.S. industry a concrete resolution to the problem of pharmaceuticals that are available globally, but are not yet available in Japan (the "legacy products" issue).
- Ensuring that any implementation of the proposed Demand and Supply Plan for plasma products will be undertaken in a transparent and non-discriminatory manner.
- Enhancing transparency of the system that allows nutritional supplement manufacturers to make nutritional benefits claims on their products' labels.

## FINANCIAL SERVICES

**Background:** Japan's pool of individual savings, valued at over \$11 trillion, is the largest outside the United States. Until recently, however, Japanese investors had a very limited range of investment choices, and most of these funds have been held in low-return assets. Strict regulations narrowly defined the scope of financial firm activities, reducing competition and innovation in the sector, as well as limiting the opportunities available to American financial services providers.

Drawing on their technological and innovative strengths, American financial services providers continue to expand on significant commercial opportunities arising from the liberalization of Japanese financial markets. American firms have also entered the Japanese banking, securities, and insurance sector through the acquisition of Japanese firms. The share of the Tokyo stock market held by foreign institutions and individuals has steadily grown to almost 20 percent, compared with about 5 percent in the late 1980s. American financial services providers are playing increasingly prominent roles as financial advisors in Japan, particularly in areas such as mergers and acquisitions. Opportunities for U.S. firms will continue to expand in the future as Japanese savers and corporations seek an increasingly sophisticated range of financial products to meet their needs.

**Accomplishments:** Japan's "Big Bang" financial liberalization initiative, which builds on and extends Japan's undertakings in the 1995 U.S.-Japan Financial Services Agreement, commits Japan to a fundamental deregulation of the financial sector. Bilateral financial services discussions have sought to ensure that Big Bang measures were extended and fully implemented, and that foreign firms share fully in the new opportunities opening up. Notable regulatory reform steps over the past year include:

- Broader use of public comment procedures by financial authorities and self-regulatory organizations (SROs), which will improve transparency and regulatory clarity.
- Further liberalization of the financial industry to remove segmentation in the banking, securities, insurance, and trust sectors, which will increase competition among financial service providers as it has in other financial markets.
- Introduction of defined contribution pension plans (on October 1, 2001), which will provide a wider selection of employee benefit packages to Japanese corporations, pension portability, and more options to meet retirement needs of Japanese workers and greater business opportunities to domestic and foreign investment firms.
- Greater use of information technology in the financial sector – for disclosure and reporting requirements, and applications and registration procedures – which will increase efficiency, reduce burdens on firms and enhance the overall operating environment.
- Increased recording of financial assets at market value (mark-to-market), including cross-held equities, and introduction of mandatory impairment accounting for fixed assets. These steps will improve confidence in corporate balance sheets and increase overall economic efficiency.
- Introduction of a real-time gross settlement system, and the decision to eliminate the requirement for physical securities certificates and to introduce a single book-entry registration/settlement system (regardless of types of securities). These steps will enhance risk management capability and increase the efficiency of the securities market.

## COMPETITION POLICY

**Background:** Vigorous promotion and preservation of competition throughout the Japanese market is essential to promote Japan's economic recovery and to eliminate practices and policies that can impede the functioning of an efficient market. These goals can only be achieved by ensuring that the Japan Fair Trade Commission (JFTC) has necessary the tools, resources, administrative independence, and will to effectively enforce the Antimonopoly Act (AMA). It also will require a government-wide program to seriously address the bid rigging or *dango* system, which undermines the credibility of Japan's commitment to sound competition policy principles and impedes access to the huge government procurement market by U.S. construction and related firms.

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

- Increasing the JFTC's enforcement activities to a 25-year high of 41 actions in 2001 and augmenting its investigative staff by nearly 10 percent in FY2002.
- Multiplying the maximum corporate criminal fine for AMA violations five-fold to ¥500 million (approximately \$3.8 million).
- Attacking complicity in bid rigging activities by government officials (*kansei dango*) through the introduction of legislation in June 2002 by the ruling coalition and an opposition party that would address this problem.
- Committing to apply the AMA to international cartel activities and to examine ways to improve the JFTC's enforcement capabilities and effectiveness, such as potentially providing criminal investigation powers to the JFTC, introducing a cooperation leniency program, and expanding the scope of administrative fines (surcharge orders).
- Preparing a bid rigging countermeasures manual – to be published on the Ministry of Land, Infrastructure and Transport website – that will provide a model for all central government, quasi-governmental and local government commissioning entities on such issues as reporting suspected bid rigging to the JFTC, suspending bidding rights of firms that engage in bid rigging, and collecting damages for overcharges from bid rigging.
- Issuing guidelines to promote competition in sectors undergoing deregulation, including joint JFTC-MPHPT Guidelines in the telecommunications sector in November 2001 and a May 2002 proposed supplement to joint JFTC-METI Guidelines in the electricity sector.

## TRANSPARENCY AND OTHER GOVERNMENT PRACTICES

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

### **Accomplishments:**

- Implementing an information disclosure law in October 2002 that will provide the right to request the disclosure of information held by Independent Administrative Institutions (*dokuritsu gyosei hojin*), public corporations (*tokushu hojin*), and similar entities. This law is similar to the U.S. Freedom of Information Act and the central government information disclosure law which Japan implemented in April 2001.
- On April 1, 2002, Japan implemented a Government Policy Evaluation Act aimed at enhancing the effectiveness of its policy evaluation system and government accountability. Ministries and agencies are conducting policy evaluations based on the new Law and "Basic Guidelines for Policy Evaluation" adopted in December 2001.
- Taking active steps to increase the use of the use of the "No Action Letter" (NAL) system, which Japan introduced last year. As of this year, twelve ministries and agencies have adopted detailed rules to implement the NAL system. That system allows businesses to submit inquiries to ministries and agencies on the interpretation and application of laws and ordinances. The ministries and agencies respond in writing to inquiries and make their responses public. Japan will soon publish a survey on the implementation of the NAL system. It will include a list of the laws and ordinances that may be subject to NAL requests and information on the NALs that have been issued.
- To respond to ongoing U.S. concerns with implementation of the Public Comment Procedure (PCP) introduced three years ago, Japan will continue to increase the effectiveness of the PCP. The PCP provides the public the opportunity to submit comments on draft regulations.
- Japan will conduct the restructuring and privatization of its public corporations (*tokushu hojin*) in a transparent manner.
- Relating to the postal financial institutions, legislation pending before the Diet provides that when the new Postal Services Public Corporation is formed in 2003, Diet approval will still be required for any changes in product offerings, and the new Corporation will be subject to inspection and taxation requirements similar to those imposed on the private sector. In addition, the new Corporation will not be authorized to originate any non-principal-guaranteed investment products.



## LEGAL SYSTEM AND INFRASTRUCTURE

**Background:** As restructuring of Japan's economy continues, the ability of the business community to rely on the Japanese legal system to facilitate business transactions and resolve disputes will become increasingly important. Reform of Japan's legal system is essential to create a legal environment that is conducive to international business and investment and meets the needs of both Japanese citizens and the global business community. By continuing to prohibit freedom of association between Japanese and foreign lawyers, Japan has limited the ability of businesses to obtain the integrated transnational legal services they need.

**Accomplishments:** The Japanese Government has taken significant steps this year to modernize and liberalize its legal system:

- In March 2002, Japan adopted a Program for Promoting Justice System Reform. To implement this Program, the Japanese Government is now preparing legislation for submission to the next ordinary session of the Diet, expected to convene January 2003, which will:
  - Reform its arbitration law, including revising its existing Arbitration Law and improving the legal framework for international commercial arbitration; and
  - Increase the speed and efficiency of civil litigation by cutting in half the length of trials through measures to promote efficient scheduling of hearings and facilitate litigants' collection of evidence at early stages of litigation.
- Regarding legal services, the Japanese Government is:
  - Preparing legislation to promote cooperation and collaboration between Japanese lawyers (*bengoshi*) and foreign legal consultants (*gaikokuho-jimu-bengoshi*), aimed at deregulating the requirements for specified joint enterprises (*tokutei kyodo jigyo*). In doing so, the Japanese Government is providing opportunities for foreign lawyers and other interested parties to input into that process; and
  - Studying how to respond to the recommendation of the Justice System Reform Council that "(c)ontinued consideration should be given to abolishing the prohibition on the employment of Japanese lawyers" by foreign lawyers. It is also reviewing the regulation that restricts foreign lawyers' handling of third-country legal issues. In this review, Japan will exchange views with the Foreign Lawyers Association of Japan and the American Chamber of Commerce in Japan.
- To strengthen judicial review of administrative agencies, Japan is undertaking a comprehensive study, including review of the Administrative Case Litigation Law, and will take necessary reform measures by November 30, 2004.

## COMMERCIAL LAW

**Background:** A myriad of restrictions in Japan's antiquated Commercial Code had been impeding the development of capital markets in Japan. More specifically, it fostered a corporate governance system that was insulating corporate management from shareholder and market pressure to operate efficiently, resulting in a poor allocation of corporate resources. Commercial Code restrictions and limitations have also been undermining the ability of foreign firms to invest and operate effectively in the Japanese market. Comprehensive revision of Japan's commercial law has therefore been a prerequisite to facilitating merger and acquisition activities in Japan and to creating an economic and legal climate where firms can acquire the capital necessary for needed restructuring and new investment. Recent legislation substantially revising Japan's Commercial Code is a welcome development that should have a profound effect on Japan's economy and on the ability of U.S. companies to operate and effectively invest in Japan. One key remaining impediment to increased foreign investment in Japan, however, is the inability of companies to use the most modern merger and acquisition techniques, such as cross-border share exchanges, triangular mergers, and cash mergers.

**Accomplishments:** Significant new measures to address these problems include:

- Amending the Commercial Code to increase flexibility in corporate capital structure, such as by substantially liberalizing the issuance of stock options, authorizing the issuance of tracking stock, permitting companies to issue non-voting stock and classes of stock with rights to appoint a specific number of directors, and providing an alternative to court-supervised valuation of in-kind capital contributions.
- Revising the Commercial Code to improve corporate governance by giving large companies the option to adopt a U.S.-style corporate governance system, which would require the appointment of corporate or executive officers and the creation of audit, nominating, and compensation committees of the board of directors that are composed of a majority of outside directors.
- Committing to initiate a study in FY2002 on introduction into Japanese commercial law of such important merger and acquisition techniques as triangular mergers, cash mergers, and short-form (squeeze-out) mergers. The Ministry of Justice will provide the international business and legal communities with opportunities to provide input into that study, and will make every effort to take that input into account before reaching its conclusions.
- Undertaking to implement high-quality, internationally acceptable accounting standards and supplement those standards with strict enforcement in order to ensure that financial statements accurately reflect the financial condition of a company.

## DISTRIBUTION

**Background:** The demand for the rapid delivery of goods and information has produced a number of new industries, including the express carrier industry, that are now seen as vital for the smooth development of the global economy. It is important therefore, to minimize the regulations, procedures, and costs that could inhibit the free exchange of goods and information through the express carrier industry. While more remains to be done, the Japanese Government has implemented several measures and provided a number of assurances in the context of the Regulatory Reform Initiative that will enhance the ability of U.S. express carriers to provide an efficient, speedy exchange of goods and information to benefit the Japanese economy.

**Accomplishments:** New Japanese measures and assurances include:

- Consulting with American express carriers before deciding on measures to be adopted to replace the current temporary fee structure employed by the Nippon Automated Customs Clearance System (NACCS) Center.
- Undertaking to use the Public Comment Procedure whenever the Air-NACCS fee structure is revised in the future.
- Pledging that the NACCS Center will in the future provide information to the public about its operations in a timely fashion when requested to do so.
- Implementing the Pre-Arrival Examination System for import cargoes (the system that allows the instant issuance of import permits for air cargo upon arrival) and the manifest declaration system for express consignments of a certain value.
- Pledging to continue to simplify Japan's customs procedures.