2. Revitalising Japan's Economy

When submitting its proposals in October 2001, the EU drew attention to the very low level of new company start-ups. Experience in the European Union, particularly in the last two decades, suggests that stimulating new business start-ups and the provision of competitive goods and services to domestic and international consumers can best be ensured where: dominant market positions blocking market entry and new firms are challenged; transport and telecommunications services are flexible and costs low; financial and other key business services are efficient and innovative. Indeed, these sectors, together with energy, are the subject of major current deregulation and competition-enhancing initiatives in the EU.

2.1. Competition Policy

The European Union fully supports the Japan Fair Trade Commission's (JFTC) objective strictly to enforce competition rules, and welcomes the JFTC's positive ongoing efforts to eliminate exceptions and exemptions from the Anti-Monopoly Act (AMA), the new civil litigation system for those who are harmed by anti-competitive practices, and renewed efforts to clamp down on bid-rigging. Vigorous and pro-active pursuit of competition policy is at the heart of a healthy, open, balanced and modern economy. It not only vital in order to create conditions which ensure that investment decisions are made on a rational and efficient basis, but also for improving the domestic and international competitiveness of Japanese companies, removing barriers for new entrants to the market (be they domestic or foreign), and bringing down basic input costs. Weak competition policy, on the other hand, gives incumbent suppliers, often with monopolistic tendencies, the upper hand over new entrants to the economy, and all too often snuffs out the sparks of innovation.

The EU welcomes the increased vigilance of the JFTC, and recent positive steps towards giving Japan's competition authorities the tools they need to do the job:

- During FY 2001, enforcement activities rose to a 25-year high of 38 legal actions, while in FY 2002 the government of Japan has announced its intention to increase JFTC staff by 40 with the main focus on strengthening investigation activities. Recent actions with regard to countering unfair pricing by in the domestic airline sector would be one example of stronger JFTC activity.
- Multiplying the maximum corporate fine for AMA violations five-fold to ¥ 500 million (approximately € 3,5 million). Plans to propose a reduction of penalties for companies or individuals who bring violations to the attention of the JFTC are also welcome.
- Preparing a bid-rigging countermeasures manual that will provide a model for all central government and local government contracting entities.
- Attacking complicity in bid-rigging by Government officials (*kansei dango*) through the announcement in June 2002 of a study on measures to tackle it, with the subsequent intention of introducing legislation.
- Committing to apply the AMA to international cartel activities and already taking the legislative steps to apply the Code of Civil Procedure, Article.108 to cover the delivery of documents to another party located in a foreign country.
- Implementing guidelines to promote competition in sectors undergoing deregulation.
- Progress towards limiting exemptions and exceptions from competition rules.

The European Union considers that it is essential pro-actively to target core violations and arrangements that keep prices at higher than competitive levels. Violators should

not feel safe from prosecution in the absence of a specific complaint against them. It must be noted that in the case of hard core violations, evidence is typically difficult to uncover. Often it becomes available during investigations of other, seemingly unrelated violations. For reasons of deterrence, therefore, the prescription period needs to be extended. Very short prescriptions convey the message that it is enough to cease (or suspend) the infringement for a while in order to be immune from prosecution. Furthermore, despite the welcome increase in the maximum fines applicable to AMA violations, it should be noted that in principle the relative level of fines in Japan are still low. Moreover, a statutory cap of the kind which still exists may make it all too easy for companies to budget to pay the fine, thus seriously diminishing its deterrent effect.

The new civil remedy system which came into force in April 2001 as a result of the amendment of the AMA in May 2000 is welcome. However, both as regards core infringements by private firms as well as administrative guidance which may encourage or tolerate such practices, civil litigation is in itself not sufficient to replace a tough enforcement policy by relevant government agencies. Essential complements to vigorous enforcement policies are both competition advocacy at all government levels and a review of all administrative guidance currently in force with the aim of eliminating guidance which has anti-competitive effects.

The EU welcomes the recommendation of 28 August 2002 by the Council on Economic and Fiscal Policy (CEFP) that the JFTC be moved to a more independent position in the Cabinet Office, outside the administrative remit of MPHPT, which still retains responsibilities for the promotion of certain sectors of the economy. It is to be hoped that this change can be achieved within FY 2003, as the CEFP recommends.

Priority reform proposals:

a. Ensure that the resources of the JFTC are equal to the reinforced role that it should be playing, notably by:

- *(i) ensuring adequate staff numbers: the EU hopes that there will be another increase in staff in FY 2003 despite competing budget pressures;*
- *(ii) building on the recommendations of the Regulatory Reform Programme and CCR Interim Report to pursue more rigorously cases of abuse of dominant market position (as distinct from price-fixing), and to focus more closely on the competitive effects of mergers and acquisitions, including looking at moves by former monopoly suppliers to diversify into gradually liberalising sectors (e.g. recent acquisitions of telecoms companies by energy companies);*
- *(iii) enhancing the JFTC's investigative powers;*
- *(iv) continuing to work towards restoring the JFTC to a position of greater independence.*

b. Continue the vigorous pursuit and elimination of violations of the Anti-monopoly Act (AMA). The prescription period for such violations should be extended to 5 years from the discontinuation of the violations.

c. The impact of the increased penalties should be monitored as part of an ongoing process of upwards review of sanctions and penalties, including consideration

of the abolition of the statutory cap on fines.

d. The JFTC should continue to review exemptions and exceptions to the AMA in the direction of their eventual abolition

e. The JFTC should review all administrative guidance currently in force in order to verify its conformity with anti-monopoly guidelines. Results of the review should be published. Private parties negatively affected by anti-competitive administrative guidance should have the right to challenge it before the courts.

2.2. Government Procurement

2.2.1. Public works and Public construction in Japan

In 1999 the Government of Japan awarded 580 contracts of above 6.7 million euro each in value for public works and public construction, amounting in total to 7.8 billion euro. Only two of these contracts were awarded to foreign companies, a total amount of 13 million euro. No EU construction company was awarded with public works contracts in Japan in 1999 (or indeed in 1998 - these are the latest figures available to the EU).

The WTO Agreement on Government Procurement provides access to EU companies for public construction contracts in Japan. Despite the value of this sector and the significant amount of works falling under the scope of this Agreement, European companies continue to be effectively excluded from this sector. The European Union would like to explore together with the Japanese Government the reasons for this disappointing situation and would like to improve the situation in the short term. The European Union therefore requests the Government of Japan to simplify the qualification system for public works and public construction, in order to make public works and public construction tenders more accessible to foreign companies.

Priority Reform Proposal:

Action should initially take place to:

(i) increase transparency on the qualification criteria and harmonise them with the so-called "business evaluation" system of qualification conducted annually;
(ii) modify, in the medium term, the "business evaluation" by introducing a qualification system more closely related to the concrete work/construction to be conducted;
(iii) progressively introduce harmonised guidelines for procurement in all public works and construction, including standard forms for bids and contracts.

2.2.2. Openness of tendering process for new-style Public-Private Partnership projects

EU companies are handicapped by low transparency in the procedures for calls for tenders, in particular those launched by local authorities. The criteria for evaluating tenders are not very detailed, while juries are not very qualified technically and seldom read the files. Often, the principal is interested in the technical features of the projects, rather than in the performance expected of the proposal, however clearly these are explained in tender bids. This lack of clarity opens the door to informal discussions between the contracting body and the tenderers, and therefore to serious distortions of competition. It contributes to maintaining a *status quo* which hinders new market entrants and constitutes *de facto* obstacle to market access.

For example, in November 2001, a prefecture launched a call for tender for the design, financing, realisation and use of an incineration factory for industrial refuse, within the framework of a public-private partnership. A European company tendered in response to the call for tender in association with Japanese partners. The winning consortium – 100% Japanese – proposed experimental technology, whose effectiveness is disputed. The European company which tendered considers that the call for tender was biased in favour of technology which was still not proven, while disregarding objective performance criteria, in particular economic criteria. In fact, the prefecture proceeded in a cursory way: a very simple evaluation grid appeared in the call for tender; a committee of experts looked at each one of the criteria; this committee examined each tender according to the evaluation grid, but without checking the data (declared performance etc.) provided by the competitors. The prefecture had planned to make use of two specialist advisers, one technical, one financial, but apparently their services were not in fact used. The committee worked only on the written offer. Competitors had to insist on having an interview. They finally obtained the right to a 20-minute presentation. Moreover, the members of the evaluation committee did not have access to all the information. The file given to the members of the evaluation committee was apparently a file prepared by the prefecture, and not the original tender file submitted by the bidders.

Priority proposal

The body of European rules as regards public calls for tenders is compact and detailed (directives on work, services and supplies in force for approximately ten years). It subjects all parties, governing body and competitors, to precise and rigorous procedures. Japan could usefully respect the following points:

(i) transparency of the procedures (clearly posted selection criteria and weighting, interview with tenderers, publication of the results of the evaluation);
(ii) professionalisation of the evaluation;
(iii) independence of the evaluator.

2.3. Journalism: freedom and equality of access to information

Access to press conferences, briefings and other media events in Japan organised by official bodies (from central government ministries through prefectural governments to local police headquarters) is generally restricted to the membership of that body's *kisha club*. There are innumerable *kisha clubs* in Japan at national and local level. The club usually consists of a room provided by the body concerned on its own premises,

which is shared by the journalists belonging to the club and functions in practice both as their office and as a briefing venue.

With the exception of a limited number of wire services (which, if they are members at all, often have only associate membership and therefore can listen but have no right to ask questions), membership is denied to journalists from foreign media organisations. It is worth noting that *shukan-shi*, or mass circulation weekly magazines, as well as other weekly, monthly or bi-monthly magazines are also excluded, as well as specialised press covering sectors other than those directly relating to the host body. Membership matters, while ostensibly in the hands of the hierarchy of the club in question, are in fact closely controlled by the host body, with which the club has a symbiotic relationship. Club members are in constant physical proximity to their briefers and thus also enjoy privileged access to off-the-record information.

There have been numerous instances where restrictions on foreign journalists' access, including the *kisha club* system, have impeded reporting outside Japan of events of widespread international interest and significance. Examples include the Lucie Blackman murder case and the recent visit to North Korea by PM Koizumi. By denying foreign correspondents first-hand access to briefings, the system acts as a *de facto* competitive hindrance to foreign media organisations. It unfairly makes them slower to bring information to their audience than domestic organisations, and, unable to put questions on the spot, forces them to rely on second-hand information. In effect, the system works as a restraint on free trade in information.

The system also has broader negative consequences for both the domestic and international consumer of information about Japan:

- Officials and the hierarchy of the *kisha club* have the means to prevent the spread of information they may consider disadvantageous, on pain of exclusion of the offending journalist from the club. The system thus acts against the public interest, since it may deny or delay access to important information, including for example information of direct relevance to public health and safety. Reporting on the discovery of BSE in Japan was a case in point.

- By giving both officials and journalists a vested interest in maintaining the exclusivity of a story, the system encourages over-reliance on a single source of information and a lack of cross-checking, thus diminishing the quality of information available to the wider public.

- The system encourages the widespread and undesirable practice of split briefings for domestic and foreign journalists, increasing the potential for information to be tailored to one or the other audience by the briefing party, and exacerbating the risk of spreading inaccurate and biased information about Japan.

The disservice being done to consumers of information by the *kisha club* system can only be addressed by its abolition in the interests of fair and equal access to media events for all media organisations, domestic and foreign. In any case, all holders of a Ministry of Foreign Affairs press card should have the right to attend media events

organised by official bodies on an equal footing with domestic journalists. Legitimate problems with numbers of attendees can easily be dealt with through the existing pool structure - the FPIJ, or Foreign Press in Japan - which was itself created at the behest of the Japanese government to deal with just such situations.

Priority reform proposals:

a. *Accept the Ministry of Foreign Affairs press card issued to correspondents of foreign media organisations as accreditation for all media events held by Japan's official bodies, to enable access on an equal footing with all domestic journalists.*

b. *Remove the restraint on free trade in information by abolishing the* kisha club *system.*

2.4. Information Society

The EU notes that in 2002 Japan has initiated major reforms for the regulation of the Information Society and in particular the removal of the distinction between type I and Type II licences as well as the requirement for the filing of tariffs currently applying to both designated and non designated carriers. The EU welcomes these initiatives and considers that these could contribute to the improvement of the promotion of competition in Japan provided that certain conditions outlined below are fulfilled.

The EU considers that some progress still needs to be made to ensure that the regulatory framework is technologically neutral regarding the rights and obligations applying to designated carriers in all market segments, that the regulator is independent and not accountable to any service supplier, and that the notion of joint dominance is recognised in the regulatory framework in Japan.

The EU also recommends that particular attention be paid to: (i) the establishment of a list of product markets to assess the level of competition and identify designated carriers, (ii) the clarification of the conditions under which designated carriers have the ability to affect terms of participation in the market, and (iii) the prevention of anti-competitive practices by designated carriers. Moreover, to prevent any legal vacuum in the case of a withdrawal of the distinction between Type I and Type II licences, MPHPT should ensure that adequate competitive safeguards are put in place prior to authorising business expansion by designated carriers.

Priority Reform Proposals

a. *Establish a technologically neutral regulatory framework for electronic communications services so that designated carriers operating services in the local and/or long distance wire-line markets as well as in the wireless market can be subject where appropriate to the same rights and obligations, notably in relation to the prevention of anti-competitive conduct and interconnection.*

b. *The telecommunications regulatory authority should be fully independent from business suppliers, impartial, and devoted to the promotion of competition in the Japanese market. It is important that the legislative texts show clearly that the*

regulator is only in charge of regulation (promotion of competition, universal service, licensing …) and does not interfere in the management of an operator. Therefore, the EU considers that the NTT law should be repealed since all necessary regulatory controls should be carried out on dominant suppliers or providers of universal service pursuant to the Telecom Business law (amended accordingly) and State/Public Sector shareholder's must not be treated in the telecom sector differently from that in other sectors.

c. *The designation of dominant carriers should be made possible in all service markets (including the long distance wire-line market) on a technologically neutral basis. It should be based on the ability to affect terms of participation in the market and not on specific criteria set a priori (as is the case in the mobile market). The designation of carriers having the ability to affect terms of participation in a market should be subject to a competition investigation* inter alia *in the long distance and mobile markets before regulatory obligations apply. An indicative list of relevant product markets should also be published. The tasks for the designation of dominant carriers and the definition of markets should preferably be carried out by different authorities, respectively the regulatory authority (MPHPT) and the competition authority (JFTC).*

d. *The notion of joint dominance should also be recognised in Japan's regulatory framework as it is currently not so recognised in the revised TBL.*

e. *Ex-ante measures to prevent anti competitive practices should apply primarily and systematically to all designated carriers. An evidential threshold that must be met by the regulator that an operator is engaging in anti-competitive conduct should apply in Japan. Consistent with the principle of asymmetric regulation, anti-competitive practices by non-dominant carriers should preferably be subject to ex-post intervention by relevant competition authorities in Japan.*

f. *Wholesale and retail tariffs notification requirements should be lifted for Type I carriers without significant market power. Consistent with the principle of asymmetric regulation, notification requirements should only be imposed on Type I designated carriers.*

g. *Eliminate Type I (facilities based) and Type II (resale-based) licensing distinction.*

h. *The provision of universal service should fulfil in particular the principles of transparency, non-discrimination and competitive neutrality. Given the state of development of the telecommunications networks in Japan, and since competitive supply is the best instrument to increase universal availability of telecommunications services and thereby promoting social inclusion, the scope of universal services in the telecommunications sector cannot result in costs, if any. The cost of universal services should be based on LRIC while the benefits of providing universal service (network externalities, brand name and presence) should be taken fully into account in the computation of the costs. The funding of the universal service mechanism should prevent it being extracted from customers located in third countries. The criteria and the selection procedure of the universal service providers must be made public. All provisions of universal service should be addressed by the TBL as they should be non-discriminatory and not prejudge which operators will be tasked to carry it out.*

i. Harmonise spectrum allocation for the additional IMT-2000 bands (especially 2.5GHz band) and bands for post 3G mobile communication systems.

2.5 Financial Services

2.5.1. Insurance Sector

The financial Big Bang programme of the Japanese Government has contributed considerably to improving the regulatory framework of the Japanese insurance market.

The EU welcomes the fact that Regulatory reform has made notable progress in the insurance sector in recent years. For example, in July 2001, the Implementation Order for the Insurance Business Law was revised so as to expand the scope of commercial lines under the notification system and all commercial lines have in principle shifted to the notification system. The Order was revised in April 2002 to move fire insurance products for personal lines from the approval system to the notification system. Furthermore, in March 2002, administrative guidelines were revised to shorten the processing period from 90 days to 60 days in principle. The EU warmly welcomes this change, but believes that further reduction of the processing period – to 30 days – should be possible. Meanwhile, in July 2002, the Diet approved a set of bills for establishing the Postal Service Corporation in April 2003. The Corporation will be subject to accounting rules that are similar to those applicable to the private sector.

However, market share figures indicate that foreign firms still hold a relatively small share of the total risk premium, with European insurers' share being a minor proportion, in spite of recent acquisitions by foreign companies in the life sector. Ongoing mergers and alliances between Japanese insurers will consolidate more premiums in fewer groups to the detriment of genuine competition. The EU is therefore seeking further genuine and effective deregulation of the Japanese insurance market.

As from July 1998, the obligation for non-life insurance companies to use rates calculated by the rating organisations has been abolished. But as long as individual product and rate approval is maintained, competition will be stifled and the level of economic regulation will be administratively burdensome for insurers, with delayed delivery of innovative products to consumers. Even relatively small changes to policy wordings are often treated as if approval was being sought for a new product. Despite the progress that has taken place, therefore the scope of liberalisation of the non-life market should be expanded. The move away from the concept of product approval for most commercial products represents a positive step, but it should be extended to all lines of insurance. The move away from the concept of product approval for most commercial products represents a positive step, but it should be extended to all lines of insurance. In order to introduce genuine and transparent regulatory reform, the process of micro level individual product and rate approvals should ultimately be fully abolished and replaced with macro supervision of the solvency margins and capital adequacy of insurance companies. Japan should apply here its announced principle of transforming its administrative approach from *a priori* regulation and supervision to *ex post facto* checking and scrutiny. Indeed, the need for repeated and costly replenishment of the Policyholders' Protection Fund by soundly managed companies

when less soundly managed rivals go out of business could largely be avoided were more thorough macro-level supervision of insurers' fundamentals in place.

The EU appreciates the Government of Japan's aim to ensure a fair degree of consumer protection in the insurance market. However, meeting consumer concerns does not require an approval-in-principle system. Consumer protection and soundness of the insurance market can be adequately guaranteed by a notification system, which is much less cumbersome. A notification system also offers the necessary flexibility to business, allowing for innovation and the placement of new products on the market, thus addressing consumer needs better and enhancing economic growth. Consumer protection can be ensured through specific "transparency" measures, such as publication of the terms and conditions for the products, including rates and details of the liable person, as well as anti-trust safeguards. In any case, the file and use system should be applied to all insurance products that are sold to sophisticated commercial buyers, as these policyholders do not need such far-reaching consumer protection measures as individuals do.

Provisions governing insurance schemes that are arranged through or sold by public entities, such as the Housing Loan Corporation (HLC), need to be rendered more transparent in order to ensure a non-discriminatory basis for all participants in the insurance market. There should be an open and transparent tender process for business involving the allocation of non-life products by the HLC Committee.

In principle, public sector entities such as *kampo* should not be engaged in the creation of any new products that could be provided by the private sector, especially when they are not subject to the same regulatory oversight as are licensed insurers. Regarding *kampo* funds, there is legitimate private sector concern that the increased managerial independence of the forthcoming Postal Services Public Corporation (PSPC) will be used to develop further new insurance products. The PSPC should not be involved in any new underwriting activity. In addition, distribution of and/or participation in existing product offerings should be available equally to all private sector companies, be they domestic or foreign.

Finally, the brokerage system has not been liberalised in practice. Currently, under Financial Services Agency (FSA) rules, brokers to are not allowed to work with agents nor are they allowed to collect premiums on behalf of their clients. In other major insurance markets, brokers are able to compete with agents in the same lines and they are allowed to work with agents in the distribution and sales process. Collecting premiums should be a normal part of the broker's professional activities. Japan should align its practice to conform to international standards. The Financial Services Agency (FSA) should commit to creating a modern brokerage system under which brokers are granted direct and effective access to the insured, and are allowed to collect premiums from policy holders. Brokers should have the right to submit their tailor-made policies directly to FSA, and not via an insurance company. There are a number of other requirements which hinder the development of the insurance brokerage sector in Japan. A combination of stringent financial requirements, such as the out-of-proportion compulsory legal deposit, and various administrative and processing issues, such as the limited-in-time validity of brokers qualifications, discriminate against brokers and encourage intermediaries to remain as agents. These issues should be addressed so as to encourage the development of brokers and so give customers access to professional, independent advice.

Priority reform proposals:

a. Abolish product and rate approval for insurance products by completing the move to a notification system. This is crucial in order to allow services suppliers to operate on a commercial basis. The file and use system should be extended to personal lines. In addition, the processing period should be reduced to 30 days.

b. The EU urges Japan to move over time to a system of regulation based on solvency ratios and overall financial stability comparable with international practice.

c. Insurance arranged through government-related undertakings such as the HLC should allow open, transparent and non-discriminatory opportunities for all private insurers, including foreign companies, to participate and compete. Kampo should be made subject to the same regulatory regime as licensed private sector insurers, and should refrain from taking advantage of its privileged regulatory and taxation position to develop new underwriting activities .

d. Remaining restrictions on the sale of insurance products through financial institutions should be abolished (see also banking, below).

e. Modify the legislation and regulations on brokerage in order to allow brokers to work with agents and to engage in the collection of premiums, as a normal part of their activities. Brokers should also be allowed to submit their tailor-made policies directly to FSA, and not via an insurance company, bearing in mind that brokers are representing industrial and sophisticated commercial clients rather than private individuals.

2.5.2. Banking & Securities

Recent reforms by Japan of the prudential framework governing the banking sector, as well as the supervision thereof, does not appear to have created the necessary market discipline, nor to have ensured market confidence. As financial stability constitutes the main objective to pursue in a world-wide economy, there is a growing need for a dialogue with Japan on issues of common interest related to banking regulation. Preliminary steps have been taken with the establishment in May 2002 of an informal dialogue between the European Commission's Internal Market Directorate-General and Japan's Financial Services Agency. The following topics are highly relevant :

- Banking Sector reform in Japan and the EU. The European Union would particularly like to be informed about reforms addressing the non-performing loan stock of Japanese banks, their exposure to shareholdings in other companies, and the capital adequacy requirements of banks. The European Union is also interested in knowing more about the results of this policy and Japan's assessment of its sustainability in view of the sombre expectations of the international economy. The EU is ready to offer Japan an exchange of views on its banking legislation, current plans and key issues.

- Exchange of updated views and information on current and planned Japan and EU regulatory treatment concerning financial conglomerates.

- Possibilities/interest in setting up a mutual exchange of information between EU and Japanese supervisors on regulation of cross-border subsidiaries with a view to facilitating group-wide consolidation.

The Financial System Reform Law of 1998 allows banks to conduct insurance business through subsidiaries as from October 2000. Furthermore, revision of the Insurance Business Law in 2000 made it possible for banks to engage in retail sales of certain kinds of insurance products from April 2001. While these changes are welcome they do not meet the requirements of universal banking. The establishment of subsidiaries is a lengthy and expensive process which acts as a market access deterrent, as do limitations on the scope of insurance products that may be sold by banks. Furthermore, the requirements such as stipulating that all staff dealing with customers in a bank branch selling insurance products are licensed to sell insurance products even if only one or two staff actually engage in selling them is too burdensome. Any consumer protection concerns can be adequately dealt with through proper prudential legislation.

Article 65 of the Securities and Exchange Law forbids securities firms from conducting banking transactions and banks from conducting securities transactions without establishing a subsidiary. This necessitates a duplication of functions which increases costs for the consumer and the financial group alike. Furthermore, industry reports that firewalls legislation is more strictly enforced for wholesale than retail operations, thus even running counter to the original purpose of already obsolete legislation, and creating further regulatory inconsistencies. European securities firms are by and large part of a larger banking group. While recent legal changes allowing the establishment of holding companies can be regarded as positive, this will be of limited value in the financial services sector unless the holding company is allowed to operate as an integrated business in the banking and securities sector. Again, consumer protection concerns can be dealt with through proper prudential legislation.

Priority reform proposal

a. *Abolish the provisions of Article 65 of the Securities and Exchange Law which prohibit integrated management of banking and securities businesses. As a minimum, holding companies should be allowed to operate as an integrated business in both banking and securities. Furthermore, FSA should implement the inspection guidelines under the "Securities Market Reform Promotion Programme" in a way which would diminish the reporting requirements.*

b. *Abolish the restrictions which prevent banks from carrying out insurance business.*

c. *Establish the modalities for the informal dialogue on issues of common interest related to the financial services sector, as agreed in May 2002.*

2.5.3. Asset Management

Much has been achieved in terms of opening the Japanese pension funds market to Investment Advisory Companies (IACs). Access to Japanese pension fund and mutual fund markets by IACs began in 1990 and has been substantially improved. Access by IACs to Tax Qualified Pension Plans, a private pension system built on tax exemptions and supplementary to the public pension system (value approximately ¥ 20 trillion) has been granted since October 1997. From April 2001, IAC's have been granted direct access to the management of both Employee's Pension insurance and National Pension funds (value approximately ¥ 178 trillion).

However, some restrictions still prevent a significant part of Japanese public assets from being managed by IACs.

Postal savings (*yucho*) and postal life insurance (*kampo)* funds, managed at the moment by MPHPT, will from April 2003 come under the management of the new Postal Services Public Corporation. The law establishing the PSPC was enacted in July 2002. It stipulates how yucho and kampo funds should be managed, but makes no explicit provision for access by IACs to these funds. The European Union welcomes the overall postal services reform, and requests that full direct access be granted to IACs, as regards both advisory and discretionary investment services.

Finally, the EU requests, in the interest of the Japanese pensioners, investors and the financial services industry, that regulations governing the asset management sector in Japan should be clarified and simplified in order to put the emphasis on macro-level prudential regulation, and eliminate needless duplication of regulatory effort. In particular:

- The separate legal and regulatory requirements covering the management of investment trusts and that of investment advisory services, which duplicate licensing, filing and customer disclosure requirements, should be eliminated and a single regulatory regime established for the asset management sector. The sale and marketing of funds outside Japan managed by affiliates of the same financial groups is a core part of an asset manager's business, and as such should not require a cumbersome additional system of side-licensing.

- Rules on the calculation of Net Asset Values (NAV) should make it clear that they need to be calculated only once, independently of the asset management company, rather than twice (i.e. by both the investment trust managers and the trust bank holding the assets), as is now the case.

Priority reform proposals:

a. *Regarding the management of* yucho *and* kampo *funds under the Postal Services Public Corporation from April 2003, IACs should have full access to advisory and discretionary investment services. Operational rules should be made transparent, and opportunities provided to all interested parties to make public comments.*

b. Simplify and clarify the regulatory environment by creating a single regulatory regime for the asset management sector and removing costly and cumbersome regulatory requirements such the side-business licensing still needed for some core activities, and the unnecessary duplication of NAV calculations.

2.6. Postal services

The EU welcomes the ongoing reform of postal services and the conversion of the Postal Services Agency into the Postal Services Public Corporation (PSPC). This is a highly positive, market-oriented step, and should in principle pave the way for a more open domestic postal market, allowing private firms to offer mail services, to the benefit of customers. This places its development in line with similar trends world-wide, and with Universal Postal Union (UPU) recommendations. However, the EU would like to raise a number of issues, the most significant being that of the balance between the two main governmental roles, i.e. its powers to regulate the postal services market and its handling of the ownership rights of the new entity.

This issue is important with regard to Reserved Services (RS) – it is important to strike a balance between, on the one hand, the rights of users to have access to universal postal services of high quality and, on the other, the running of a profitable entity. However, this issue is even more important as far as the non-reserved area is concerned, where competitors providing, or willing to provide, non-reserved services need to know how their rights would be protected.

Lastly, to be effective, the new legal framework should not impose unreasonable access conditions on new entrants, for example the requirement to establish post boxes at about 99,000 locations across the country .

Priority reform proposal:

In the context of the ongoing reform of the Postal Services Agency and the creation of the PSPC, the Government of Japan should aim at ensuring the independence of the regulator. Also, licenses and authorisations should be granted on the basis of reasonable, transparent, and non discriminatory criteria.

2.7. Transport

2.7.1. Air Transport

Narita airport is the only airport in the Tokyo area open to international scheduled services. The demand for additional flight services to and from Tokyo is great and there is a recognised need to increase capacity. The provision of such services is vital to the economies of both Japan and Europe. The long-awaited second runway at Narita came into operation on 18 April. However, although there are plans to lengthen it, it is only 2180 metres long – too short for most of the aircraft used on long-haul services and which remain, for the most part, on Narita's original 4000m runway.

Narita slots are a very scarce resource, and this scarcity creates a serious bottleneck effect on the development of business and tourist relations between Japan and third countries. The strangling effect is particularly strong in relation to Europe, since the overall number of slots allocated for Europe-Japan services is particularly low in relation to demand. While welcoming the new runway in principle, the European Union therefore regrets that it has been put into operation in a manner that did not seize the opportunity to ensure the most cost-effective use of slots and optimisation of capacity. When the new runway came into operation at Narita, the only EU airlines that could use it for landing (with takeoffs continuing from the longer runway) were those whose fleet contained aircraft such as the Airbus A340. Others, who operate only B747s on routes to Japan, remain disappointed that they cannot increase the numbers of flights per week to Tokyo that they offer.

By operating the two runways at Narita as separate airports and not requiring the transfer of current operations with smaller aircraft to the new shorter runway, MLIT has realised the EU's sombre prediction. Such a transfer would have released slots on runway "A" for reallocation to operators unable to use runway "B" because of aircraft operating restrictions (size and weight). While the operation of such services with smaller aircraft would have remained unaffected in the event of the transfer, such a move would certainly have been a very beneficial solution to increase capacity for long-haul services, and would therefore have mitigated the bottleneck problem. According to our information, in the absence of a compulsory transfer scheme, airlines did not voluntarily surrender slots at the original long runway in exchange for slots at the new short runway. Because every slot is a valuable commodity in itself, airlines simply kept their portfolio on the longer runway and sought further slots for the new runway.

It is recalled that, in accordance with IATA guidelines, the normal practice is to allocate slots on an airport basis, and not on a particular runway. Splitting an airport introduces unnecessary rigidities, in contradiction with the universal objective of maximising capacity.

In conclusion, in the context of the Regulatory Reform Programme, which also aims at removing bottlenecks to development, the EU asks the Japanese government to reconsider this element of the new runway at Narita, with a view to avoiding rigidities and maximising the capacity of the airport.

Since transfers between runways were not promoted, European airlines faced and still face a second concern in relation to the capacity created by the new runway, which has been mentioned by the Association of European Airlines. If the Japanese authorities are granting permanent historical rights during the interim period, before the runway is extended to its full length in accordance with existing plans, and such rights will be preserved after such an extension then this will introduce an unnecessary rigidity detrimental to long-haul services and in conflict with the rational objective of ensuring the best use of all available capacity at Narita in the longer term. At the time when the second runway is finally extended to a length sufficient for long-haul services to land and take off, there may be very few new slots available for such new long-haul services. An explanation of Japan's policy in this respect would be greatly appreciated.

Furthermore, airlines having obtained, during the interim period, historical rights at the second runway to operate short-haul services might be in a position, once the full length is achieved, to switch some of their slots and start operating long-haul services instead. When last heard, the Ministry of Land, Infrastructure and Transport (MLIT) was still considering the point. Since our airlines are not in a position to undertake all operations on the new runway during the interim period, they perceive such a two-step approach as a potential cause of imbalance. In their view, the allocation of permanent historical rights during the interim period might risk distorting the purpose of a non-discriminatory and objective allocation process, by not taking fully into account all the capacity developments foreseen in the medium term.

Other ongoing issues

Further arguments which have already been raised in the past in the context of the reform exercise.

- Even though the approval, on 21 March 2002, of the transfer of slots from one carrier to another carrier of the same country is reported to have been approved by MLIT rather than by the slot co-ordinator, improvements to the transparency of slot allocation appear, nonetheless, to have been made. However, certain rules specific to MLIT, i.e. the hourly and daily limits on slot numbers, continue to restrict the freedom of the slot co-ordinator to meet demand. Overall, there is still considerable potential to simplify and enhance the transparency of regulations and to modify regulations to conform to the IATA guidelines that represent the international standards.

- Changes in both air traffic control procedures and the management of runway capacity could bring about an increase in the combined total of slots available on the old and new runways at Narita airport. Furthermore, this could be done within internationally recognised noise limits and without compromising safety. As previously indicated, the European Commission continues to be willing to sponsor exchanges of information and experience between Japanese and European air traffic control experts. Capacity restrictions at Narita are fundamentally a matter of sub-optimal regulation, as recognised in past discussions in the forum of the former Regulatory Reform Committee (RRC).

- Recent statements by Japanese airlines, as well as foreign airlines operating in Japan, have shown that issues relating to capacity and costs are beginning to impinge unduly on sound business decision-making. Although Japan has stated

that "The landing charges at Narita and Kansai have been set at the present levels after consultations with IATA", IATA in fact points out in its Press Statement N°21 of 24 September 2002 that it is "currently in negotiations with Narita Airport Authority in which it is seeking a reduction in Narita's landing fees - the world's highest." Clearly the first-mentioned consultations with IATA did not result in consensus. What is the objective of the charges currently levied? Is it exclusively to run the services provided, to cross-subsidise other airports or to make a profit ?

- The pricing of international air fares in Japan and the ways in which they may be publicised and settled in that country are all matters of deep concern to the airline industry as a whole. The fact that international air fares have received approval from the aeronautical authorities of Japan and other countries does not mean that they can not be liberalised so as to reflect the reality of the market.

- In Japan's last reply on the issue in respect of arrangements for the settlement of bills in Japan for international airfares no answer was given. Equally, the problem of a complex system of reimbursements to travel agents for tickets discounted beneath the government-approved prices remains and prevents airlines from selling discount fares directly to the customer. No answer has been given in respect of the ways in which these fares may be publicised.

- The same applies to the setting of fees for navigation in Japanese airspace and the setting of charges applied for the use of communal spaces at Japanese international airports. Japan will recall that the services specified are not normally expected to be major sources of profit-making revenue. What then is the economic relationship between the cost of providing the services and the charges levied for those services? Would Japan please detail the correlation between ICAO policies on all such charges, as set out in ICAO Document 9082/6 adopted on 22 June 1992 and amended on 8 December 2000, and the charges levied by Japan which are so much higher than those levied elsewhere?

Priority reform proposals:

a. In line with the objectives of the reform exercise, it is respectfully submitted that the Japanese authorities take the necessary steps to avoid any unnecessary rigidities or bottlenecks in the allocation of the runway capacity available at Narita, particularly after the opening of the second runway. This includes maximising the overall capacity by promoting the use of the longer runway by long-haul services, which cannot be transferred to the new runway. Transfers of short-haul services to the new runway should be further promoted, if necessary by mandatory schemes.

b. In the absence of active measures to promote such transfers, the Japanese authorities should consider the consequences of granting permanent slots at the new runway during the interim period before it reaches the full planned length. In that scenario, long-haul operators might in practice lose a chance to have fair access to the capacity created by the new runway even in the long term. This would be in contradiction with the expressed purpose of an objective and efficient slot allocation.

c. The allocation of slots at Japanese airports should be carried out in accordance with a transparent, fair and equitable slot allocation system, taking into consideration IATA guidelines. Allocation procedures at Japanese international airports should be subject to critical regulatory reform in order to give the slot co-ordinator the freedom to respond more readily to market demand.

d. In addition, in order to meet market demand for landing and take-off slots at Tokyo's Narita Airport, the current regulations which limit their numbers should be revised so as to permit an increase in the total available for general allocation.

e. By making optimum use of all facilities and reforming the systems currently applied in Japan, landing charges at Japanese international airports, fees for navigation in Japanese airspace, and charges applied for the use of communal spaces at Japanese international airports should be decreased to levels matching more closely those applied in major countries and which are in accordance with ICAO principles.

f. Arrangements for the setting of official prices in Japan for international air fares should be further liberalised so as to reflect the reality of the market. The ways in which these fares may be publicised should permit airlines to quote real market prices directly to the consumer. Arrangements for the settlement of bills in Japan for international air fares should be simplified into a single operation if that is what the parties involved desire.

2.7.2. Sea transport (International Shipping)

There has been progress in Japan in terms of operating hours at major ports. Since the labour–management agreement on 5 April 2001 relaxed operating hours, a further such agreement was concluded on 29 November 2001, which for the first time permitted 24-hour operation of stevedoring services, and the opening of container terminal gates between 8.30 – 20.00 every day except 1 January.

However, the main problems faced by the European shipping industry in Japan arise from restrictive working practices on the waterfront. These practices limit competition and operational flexibility and raise the costs of doing business. Charges at ports in Japan, among the highest in the world, undermine the competitive position of Japanese ports *vis-à-vis* other ports in East Asia. They form part of a broader picture of high costs for all those doing business with Japan and in Japan, and are keeping freight rates to and from Japan artificially high despite the prevailing situation of global overcapacity in liner shipping and the downward pressure this is placing on freight rates elsewhere.

Under the current Prior Consultation System the Japan Harbour Transportation Association (JHTA) has an agreement with relevant parties to hold consultations with shipping lines prior to any changes that might reduce employment or adversely affect working conditions. Shipping lines are therefore required to consult the JHTA for approval of certain changes to their operations, including even minor issues such as substitution of vessels. This situation remains unimproved despite the best efforts of MLIT.

It must be acknowledged that there are no serious difficulties being currently experienced with the Four-Party Agreement now in force. However, the large discretionary power of the JHTA and the *de facto* restraint this exercises on free competition in harbour service provision, are anomalous and the system continues to inhibit the development of competitive pressures which might push charges down. The current situation is based solely on good will, and good will may be ephemeral. Whether or not, as MLIT contends, the number of cases handled through the JHTA has dropped by 80%, the existence of the JHTA's powers in practice inhibits shipping lines from seeking out competitive bids for port services. It should be noted that the JHTA fulfils an obsolete regulatory function while also representing the interest of only one side of the regulatory equation – in this case the domestic port services industry. The EU takes a position of principle that regulatory functions, if indeed at all necessary, should be separated from promotional functions in order to ensure a level playing field for new entrants, promote competition, and avoid conflicts of interest.

The Three-Party Agreement remains, in addition, largely unimplemented. There remains considerable potential to rationalise and simplify regulations as well as to accelerate reform of regulatory procedures in the area of prior consultation. The EU in particular requests MLIT to address proposal (b) below, since it has remained unanswered since first presented.

Priority reform proposals:

a. Ensure that the prior consultation and alternative prior consultation procedures are transparent, equitable and swift.

b. Further review the role of the JHTA in dealing with applications for changes to shipping line operation, with a view to eliminating all vestiges of undue influence on the free play of competition in the provision of harbour transport services in Japan.