

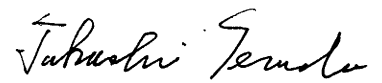
**EXTERNAL US PRESSURE ON JAPAN'S  
POLICY REFORM  
IN THE CASE OF LARGE-SCALE RETAIL STORE LAW**

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A sub-thesis submitted for the degree of Master of Arts in East Asian Studies, Graduate Program in East Asian Studies, the Australian National University.

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Except where otherwise indicated this  
thesis is entirely my own work

A handwritten signature in black ink, reading "Takashi Terada". The script is cursive and fluid, with the first name and last name clearly distinguishable.

Takashi Terada

September 1993

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## INTRODUCTION

The Structural Impediments Initiative (SII) talks held from September 1989 to July 1990 represented the first attempt by Japan and the United States to harmonise their domestic problems in international trade negotiations. These bilateral talks were also the first of their kind to delve into a comprehensive review of domestic laws and intrinsic business practices. In this sense, the SII talks may be seen as a preamble to mutual arrangements by domestic economies of their respective institutions and practices. This is likely to feature more prominently in the field of international relations, as seen recently in the European Community (EC) and the North American Free Trade Agreement (NAFTA). In this context, as the United States and Japan are the two largest and most technologically advanced economies in the world, accounting for more than 40 per cent of the world total gross national product, it is significant that they started harmonising their domestic rules through the SII talks, which are examined in this thesis.

Japan appears so far to have unilaterally accepted US demands to restrict its exports to the United States and, through Voluntary Export Restraints (VERs), to hold trade negotiations designed to open up its markets. Moreover, in the SII talks, Japan submitted to US pressure to transform its domestic structures, in what was generally regarded as domestic intervention. This thesis aims to clarify how external pressure (*gaiatsu*) from the United States affects Japan's decision-making process, focusing on the deregulation and review of the Large-Scale Retail Store Law (LSRSL), to which, of the more than 200 items on the SII agenda, the United States was most strongly opposed. Examination of this issue provides a good example of how Japan was forced by external

pressure to transform its domestic structures. The United States was successful in forcing Japan to revise, but not to abolish the LSRSL, seen as a non-tariff barrier preventing foreign products from entering the Japanese market. The Liberal Democratic Party (LDP) was reluctant to comply with the US demand to abolish, even to reform, the law, for it did not wish to risk alienating a key constituency, namely small and medium-scale retailers who benefited from the LSRSL in their competition with the large-scale retailers. The Ministry of International Trade and Industry (MITI) basically agreed to deregulation of the distribution industry, but was not in favour of radical reform and abolition of the law, since this would result in confusion in the industry. Nevertheless, the Japanese government decided to substantially revise the law, consequent to the SII talks. In the case of the LSRSL, close interactions within the so-called 'iron triangle' consisting of the LDP, MITI and the pressure groups for small and medium-scale retailers tended to slow down the speed of deregulation and was dismantled. The LDP expected small and medium-scale retailers to vote for it in elections, while the retailers hoped that the LDP would maintain the LSRSL. MITI, under pressure by LDP politicians and petitioned by small and medium-scale retailers, introduced regulations to the law. This thesis explores how the 'iron triangle' was dismantled and how reform of the LSRSL was accelerated due to US pressure.

The two-level games model advocated by Robert Putnam will be utilised in the discussion with a view to examining the decision-making process in the case of reform of the LSRSL. Putnam introduces a useful model based on the premise that, as national leaders must win ratification from their constituents on international agreements, their negotiating behaviour reflects the simultaneous imperatives of both a domestic political game and an international game. In fact, as interdependence deepens and domestic structural adjustments such as the SII talks arise, domestic politics and international relations are likely to

become more entangled. In such circumstances, an analysis of decision-making processes in which the international and domestic levels are dealt with simultaneously is used here since it appears to accommodate the type of international negotiations characterised by the SII talks.

Chapter 2 describes the background to the introduction of the LSRSL and explores its problems. The LSRSL, whose purpose is to protect small shops by requiring large stores to consult with local shop keepers before opening retail outlets, was introduced in 1974 and regulated more strictly several times afterwards. The LSRSL was strengthened under MITI's 'administrative guidance' (*gyosei-shido*), not through legal procedures. In addition, many local governments imposed their own restrictions on retail establishments with a view to protecting small retailers; thus, the issue of the LSRSL gave rise to legal and political problems within Japan.

Chapter 3 offers a general theoretical introduction to the two-level games model, which is employed to analyse the central question of how US pressure influenced Japan's decision-making processes with respect to reform of the LSRSL. This chapter discusses a key concept of the two-level games model, namely the win-set, which describes the latitude available in decision-making.

Chapter 4 discusses the origins and content of the SII talks in an effort to clarify the background to the emergence of the LSRSL issue. This chapter focuses on the US domestic political circumstances that gave rise to pressure on Japan, discussing how the US government initiated the SII talks in order to frustrate Congress's leaning towards protectionism.

Chapter 5 discusses why Japan has been so reactive to US pressure. This chapter also attempts to explain the Japanese reactive state in terms of

domestic factors, employing the 'reactive state model' developed by Kent Calder: 1) bureaucratic shortcomings; 2) the influence of pressure groups; and 3) a medium-scale election system.

Chapter 6 analyses Japan's decision-making process in reforming the LSRSL by employing the two-level games approach. The preferences and coalitions of domestic actors with respect to the LSRSL in Japan are explored first. Japanese political institutions and negotiation strategies in the SII talks are then examined. Explanation is provided of how Japan decided to reform the LSRSL rather than to abolish it.

Chapter 7 concludes the thesis by examining the implications derived from the preceding chapters concerning how the LSRSL was reformed after the SII talks and its significance with respect to the Japanese retail industry. The thesis concludes that although the considerable reform undertaken is unlikely to lead to a substantial improvement in the US-Japan trade imbalance, the reform itself has benefited Japanese consumers as a result of the pressure exerted by the United States.



## THE PROBLEMS OF LARGE-SCALE RETAIL STORE LAW

Upon arriving at the Osaka International Airport on 8 January 1992, President Bush went directly to Kashihara city in Nara prefecture in order to attend the opening ceremony of a *Toys 'R Us* store, a US chain of discount toy stores. This attendance at the opening ceremony of just one US toy store indicates how important the problem of market entry by large-scale stores in Japan was to the United States. The opening of large-scale retail stores in Japan was subject to the LSRSL, but the Japanese government had drastically reformed the law, as promised in the SII Interim Report. The establishment of a *Toys 'R Us* store with a floor space of 3,000 square metres in Kashihara city was in fact made possible through the SII talks.

During the talks, the US government had, as its most overriding demand, the abolition of the LSRSL, which it regarded as a non-tariff barrier preventing foreign products from penetrating the Japanese market. Even in Japan, many business persons, academics and bureaucrats argued that the law contained problems and should be abolished or drastically reformed. Reform of the law did not materialise, however, until the United States placed pressure on Japan to do so. This suggests that external political pressure for change, to domestic laws for instance, is more effective when supporting groups exist in the country concerned. The purpose of this chapter is to explicate the problems with the LSRSL which gave rise to an opposition group in Japan itself and led the United States to place pressure on Japan to abolish the law. This chapter seeks to provide some background to the LSRSL to prepare the ground for later chapters.

## The origins of the LSRL

Since many small and medium-scale retail stores are concentrated in small areas in Japan, competition with large-scale stores has been very intense, and dates back a long way. The Department Store Law (*hyakkaten-hou*) controlled business licensing of department stores in both pre- and post-war Japan; namely from 1937 to 1947 and from 1956 to 1973 respectively. The pre-war Department Store Law was created to protect small and medium-scale retailers in the economic disorder caused by the Great Depression as well as the wartime economic difficulties. It was abolished by General Headquarters (GHQ) after the Second World War, as being inconsistent with the newly enacted Anti-monopoly Law, but the restoration of the Japanese economy urged business owners of department stores to expand, leading to the law's revival. In both cases, this resulted from pressure placed on politicians by interest groups of small and medium-scale retail stores.<sup>1</sup>

The LSRL was enacted on 1 March 1974, superseding the Department Store Law, due mainly to the advent of supermarkets in large cities at the beginning of the 1960s and expanding into provincial cities in the early 1970s. The top twenty supermarket companies opened as many as 150 stores throughout Japan in 1972 alone.<sup>2</sup> In 1972 the sales returns of *Daiei*, the largest Japanese supermarket company, exceeded those of *Mitsukoshi*, the largest department store, which illustrates how rapidly the supermarkets grew.<sup>3</sup> Supermarkets began to participate competitively in the Japanese retail industry, which until that time was comprised of department stores and small and medium-scale retail stores.

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<sup>1</sup>Hosono, 1992, pp. 29-33.

<sup>2</sup>Kusano, 1992, p. 92.

<sup>3</sup>Kusano, op. cit. p. 91 and Tsuruta and Yahagi, 1991, p. 288.

Supermarkets, it may be argued, were able to advance rapidly by evading the clutches of the Department Store Law. A large-scale retail store such as a department store was made the target of regulation under the Department Store Law, whereby the floor space of a building run by a sole retailer (one company) was restricted to no more than 1,500 square metres.<sup>4</sup> By taking advantage of a loophole in the law, supermarkets, as 'quasi-department stores', could evade the application of the Department Store Law and increase in number. The quasi-department store system allowed supermarket enterprises to establish several affiliated store companies and put these in the one building in order to keep the floor space within the 1,500 square metres limit.<sup>5</sup>

In general, department stores deal with 'shopping goods' such as clothing or furniture, while supermarkets handle 'convenience goods' such as food, which is also the province of small-scale retail stores.<sup>6</sup> Furthermore, while department stores tend to be located in the centre of large cities or near train terminals due to agglomeration effects, supermarkets are generally found outside such areas.<sup>7</sup> Thus the business damage to small and medium-scale retailers inflicted by supermarkets appeared to be larger than that caused by department stores. Department stores believed it was unfair that supermarkets were not regulated by the Department Store Law. Together with small and medium-scale stores which were threatened by the rapid growth of supermarkets, they insisted on a new law that would also regulate supermarkets.<sup>8</sup> This argument led MITI to consult with the Distribution Division of the Council of Industrial Structure.

MITI's task was complicated by the separate interests of the department stores, supermarkets, and small and medium-scale retail stores, and thus it took more

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<sup>4</sup>Hosono, *op. cit.*, pp. 34-37 and Kusano, *op. cit.*, pp. 93-94.

<sup>5</sup>*Ibid.*

<sup>6</sup>Sugioka, 1990, p. 95.

<sup>7</sup>*Ibid.*

<sup>8</sup>Hosono, *op. cit.*, pp. 37-38.

than two years of consultations before the LSRS� bill was passed in the Diet to replace the old law.<sup>9</sup> Department stores sought to include supermarkets for regulation under the new law. The supermarkets argued, however, that this would work against modernisation of the Japanese retail industry, which MITI was seeking to promote. Small and medium-scale retail shops were against abolishing the regulation of only one kind of large-scale store. MITI was basically opposed to enforcing the regulation by establishing a new law, since it thought it important to consider consumer interests as well as the principle of competition in advancing industrial rationalisation.<sup>10</sup>

MITI eventually resolved these differences by introducing two items into the new law. First, large-scale stores would be regulated on a building basis, not on a company basis. If the floor space of a building exceeded 3,000 square metres (or 6,000 square metres in ordinance designated cities), the building would be deemed to be a large-scale store. This meant that supermarkets could also be regulated, precluding them from adopting the so-called 'quasi-department store strategy' because all the affiliated companies in such a building would become subject to regulation. Second, the Department Store Law's licensing system was repealed and replaced by the notification system. Under the licensing system, applicants had to obtain permission from MITI to open or add a store; the notification system, however, allowed applicants to automatically establish a store and start doing business in a certain period prescribed in the LSRS�, but only after they had notified the MITI minister.<sup>11</sup>

The second item, however, incurred strong objection and criticism from small and medium-scale retail stores when the intention to introduce the notification

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<sup>9</sup>Ibid.

<sup>10</sup>Kusano, *op.cit.*, pp. 95-98.

<sup>11</sup>Tsuruta and Yahagi, *op.cit.*, pp. 289-290.

system was revealed during the Council of Industrial Structure's deliberations.<sup>12</sup> Interest groups of small and medium-scale retail shops sought to frustrate the introduction of the notification system by appealing to politicians. As a consequence, MITI persuaded the politicians to add to the notification system the condition that the MITI minister inspect the contents of notification in consultation with the Chambers of Commerce and Industry (CCIs) concerned, and if necessary advise or order changes.<sup>13</sup> Since the MITI minister was authorised to investigate, advise or order changes, the LSRSL notification system could be interpreted much like the licence system of the Department Store Law. In short, it meant that even if large-scale retailers notified the MITI minister or local governor, they would not necessarily be able to set up stores. This system was to cause several problems, as argued in the latter part of this chapter.

These two items were incorporated in the LSRSL announced on 1 October 1973 and enacted on 1 March 1974. Small and medium-scale retailers were satisfied with continuation of regulation of large-scale stores. Department stores were happy, for their part, that the law would control supermarkets. Although supermarkets were regulated under the law, they regarded the LSRSL, with its introduction of a notification system to replace the licence system, as a step towards deregulation of the retail industry.<sup>14</sup> The LSRSL was likely to make it easier for large-scale retailers as a whole to establish stores.

## **The content of the LSRSL**

### *The aim of the law*

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<sup>12</sup>Kusano, op.cit., p. 95, and Tsuruta and Yahagi, op.cit., p.290.

<sup>13</sup>Ibid.

<sup>14</sup>Kusano, op.cit., pp. 108-109.

The aim of the LSRSL was the proper development of Japanese retail business.

This was to be accomplished through:

- 1) proper assurance of trading opportunities for small and medium-scale retailers;
- 2) while protecting consumer interests; and
- 3) adjusting the retail activities of large-scale stores in the area concerned.

#### *Floor space subject to regulation*

The first category of large-scale retail stores comprised those with a floor space of more than 1,500 square metres (more than 3,000 square metres in ordinance-designated cities). The second category denoted stores with a floor space of more than 500 square metres (this category was added to the 1978 reform). Applications by the first category were to be submitted to the MITI minister and the second category to the governor in the prefecture proposed as the store's location.

#### *Notification according to Article 3*

After the local governor or MITI minister accepts notification from the building's owner, the owner is required to make an official announcement of the notification. No one is allowed to open a large-scale store within seven months (reformed from six months in 1978) after the notification has been made.

#### *Notification according to Article 5*

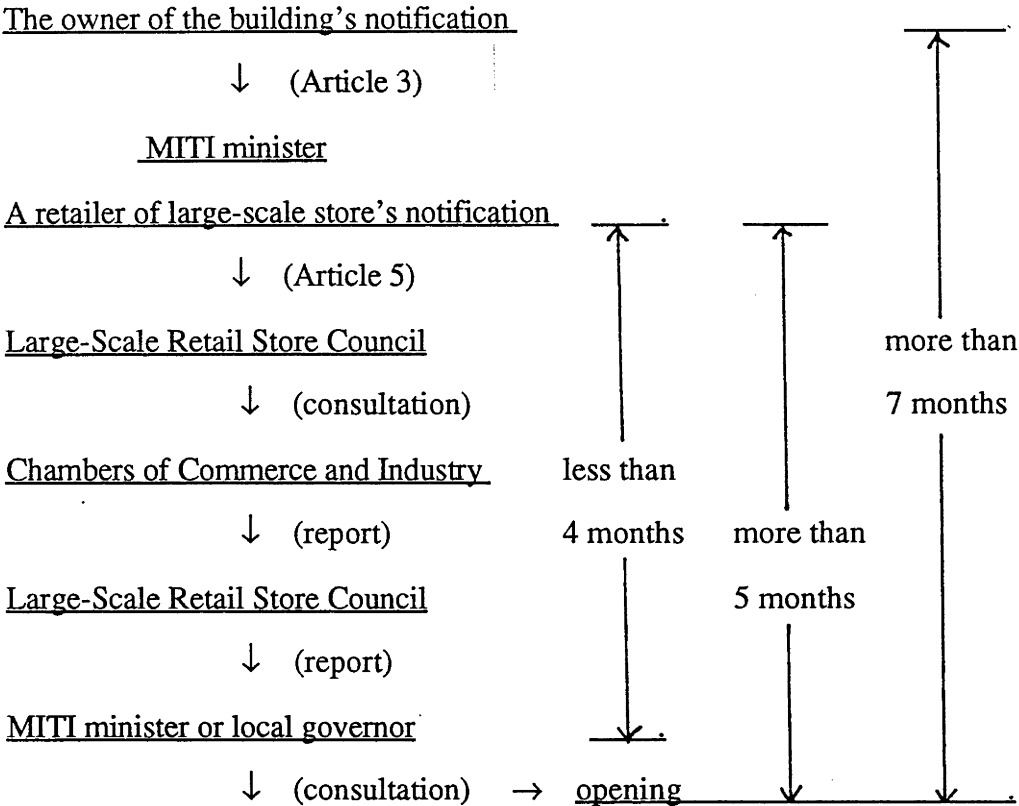
The retailer of the large-scale store must notify the local governor or MITI minister concerning 1) the name of the shop, 2) the address, 3) the opening

day, and 4) the floor space. This must be done five months (reformed from four in 1978) before the planned opening date.

### *Inspection and adjustment*

- 1) The minister or the governor must consult with the Large-Scale Retail Store Council (*daitenshin*) or the Prefectural Large-Scale Retail Store Council respectively about the degree to which the establishment of a large-scale retail store will influence retail activities of small and medium-scale stores in the proposed area.
- 2) The Large-Scale Retail Store Council must consult with the Chambers of Commerce and Industry (CCIs) on the city level, or the Commerce and Industry Associations (CIAs) on the town and village levels in the proposed area about the investigation.
- 3) The CIAs or the CCIs must then advise the Large-Scale Retail Store Council on the result of the investigation. In this case the CCIs or the CIAs require the CCCAs, set up within the CCIs or the CIAs, to collect local opinions. However, as argued later, the so-called Prenotification CCCAs, organised between the notifications of Article 3 and Article 5, in reality governed the adjustment from 1974 to 1979, before the so-called Prenotification Explanation (*jizen setsumei*) was instituted.
- 4) After obtaining feedback on the investigation, the MITI minister or the local governor, if necessary, can advise or order the planners of large-scale retail stores to reduce their floor space and postpone their opening day.

**Chart 2-1 Adjustment System of the LSRSL in the Case of Category 1**



*The transition of the LSRSL*

The LSRSL was revised in 1979, just five years after its enforcement in 1974. The point of the revision was, as mentioned before, to introduce a second category of large-scale stores, defined as those in which the floor space ranges from 500 to 3,000 square metres (500 to 6,000 square metres in ordinance-designated cities). Also, the adjustment was entrusted to local governors.

After the enforcement of the law, and as an increasing number of large-scale stores were established with a floor space of less than 1,500 or 3,000 square metres, small and medium-scale retailers experienced a sense of impending crisis. For instance, in some cities, the floor space of large-scale stores



crisis. For instance, in some cities, the floor space of large-scale stores exceeded that of retailers in 1976 by more than 50 percent (67.1 per cent in Musashino city and 56.4 per cent in Fujisawa city).<sup>15</sup> Also, economic difficulties caused by the first oil shock accelerated this sense of growing crisis among small and medium-scale retailers. In order to protect these retailers, local public authorities attempted to regulate an increasing number of large-scale stores with a floor space of less than 1,500 square metres (3,000 square metres in ordinance-designated cities),<sup>16</sup> by setting up local ordinances in their local assemblies, for instance. These factors contributed to the revision of the LSRL in 1979.

Despite the law's revision, the number of notifications to establish large-scale retail stores fell only slightly. For instance, those in the first category were 243, 567 and 371 in 1978, 1979 and 1980 respectively while those in the second category were 1,029 in 1979 and 424 in 1980, as indicated in Table 2-2. Due to an increasing number of notifications by large-scale stores, nearly 100 local authorities adopted a resolution in 1982 to freeze the establishment of large-scale stores.<sup>17</sup> In addition, small and medium-scale retail stores put pressure on LDP politicians to ensure greater regulation under the LSRL by

Table 2-2. The Number of Notification of Large-scale Stores

Year	78	79	80	81	82	83	84	85	86
Category 2		1029	424	308	270	276	288	349	369
Category 1	243	576	371	194	132	125	156	158	157

Source; Tsuruta and Yahagi, 1991, p.290.

<sup>15</sup>Kusano, op.cit., p.117.

<sup>16</sup>Kusano, op.cit., pp. 127-128, and Tsuruta and Yahagi, op.cit., p. 293.

<sup>17</sup>Kusano, op.cit., p. 138.

re-enacting the Department Store Law's licence system, and dismantling the notification system. However, MITI, which was basically against regulation of large-scale stores, resisted their attempts to adopt the licence system once more, choosing instead to employ a system of administrative guidance. MITI, in this sense, played a mitigating role between large-scale retailers and the LDP politicians who were being petitioned by small and medium-scale retailers.

As the problem of 'administrative guidance' (*gyosei shido*) will be expounded in more detail in the latter part of this chapter, only the content of administrative guidance conducted in 1982 is touched upon here. The following discusses two striking features of the 1982 system of administrative guidance.

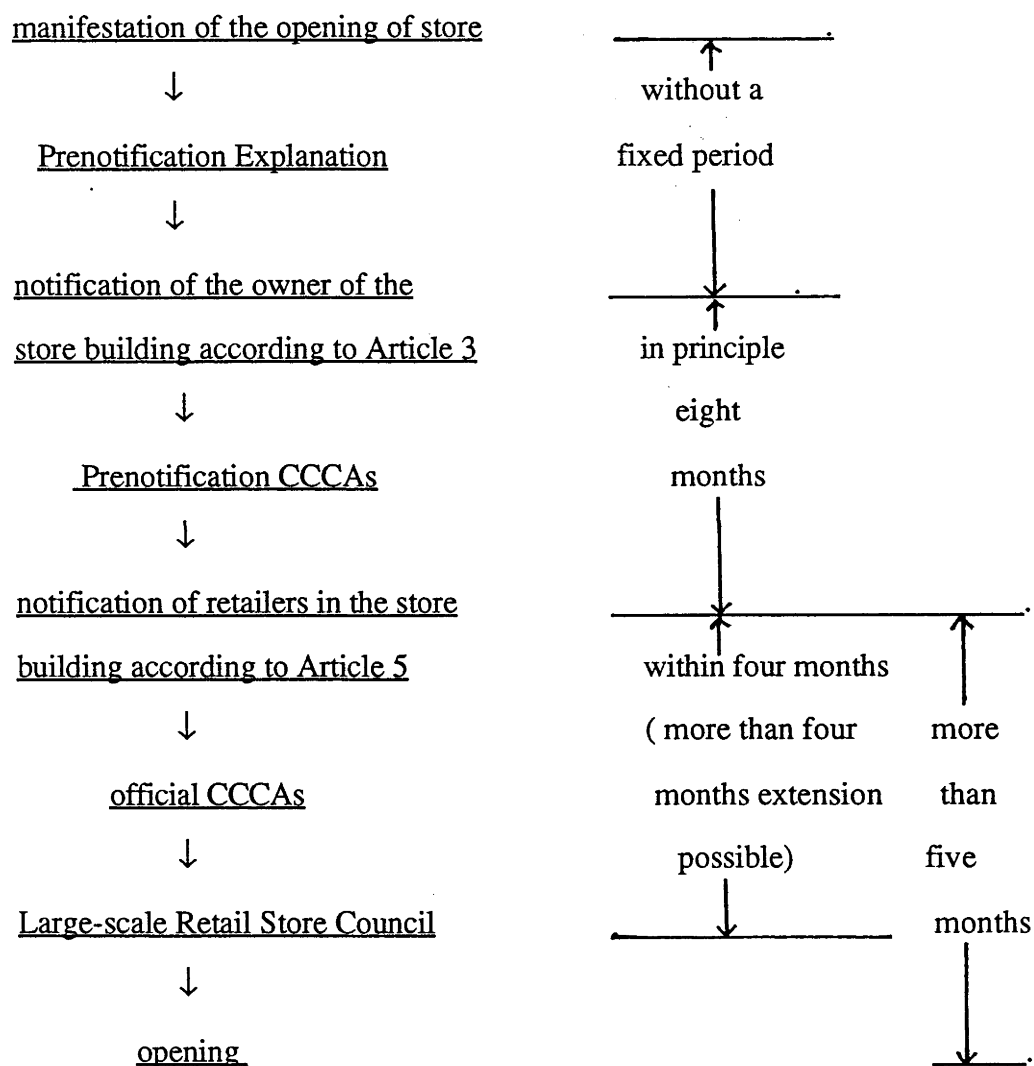
First of all, MITI required both the building's owner and the retailers in the building to explain their plans to the local authorities in the intended area before adjustment of the law officially started.<sup>18</sup> Although this was not stipulated in the LSRS�, the adjustment of the large-scale store was in reality conducted in the CCCAs set up in the CCIs. The LSRS� decreed, as mentioned earlier, that the MITI minister or the local governor should consult with the Large-Scale Retail Store Council in the areas pertaining to the investigation and the Council in turn should consult with the CCIs. The venue of adjustment in the CCIs was the CCCAs, which consisted of about twenty members comprised of consumers, retailers and people of academic standing in the planned area. However, there existed in reality the Prenotification CCCAs between Article 3 and Article 5 notifications prior to the 'official' CCCAs. In other words, the same adjustment system was formed in the Prenotification CCCAs, before the official adjustment on large-scale stores in the 'official'

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<sup>18</sup>Kusano, op.cit., pp. 138-140.

CCCA's was commenced. Both the 'official' CCCAs and the Prenotification CCCAs were recognised through MITI's administrative guidance.<sup>19</sup>

Chart 2-3. The Real Adjustment System of the LSRSL



<sup>19</sup>As for the prior Councils for the Coordination of Commercial Activities, see Suzumura , 1989, pp. 3-4, Kiyonari and Yahagi, 1991, pp. 24-27, Hosono, op.cit., pp. 53-55 , Kusano, op.cit., pp. 135-138 and Sugioka, op.cit., pp. 101-103.

Nonetheless, since the number of notifications for large-scale stores did not decline substantially, MITI resorted to administrative guidance in 1982 and established the Prenotification Explanation to avoid confusion in the Prenotification CCCAs. In fact, some municipalities made it a rule not to accept notification without agreement between the large-store and the small-scale store in the Prenotification Explanation - what was termed the 'additional regulation' (*uwanose-kisei*).<sup>20</sup>

The second striking feature of administrative guidance in 1982 was the restraint placed on the further establishment of large-scale stores in an area in which large-scale stores had already reached substantial numbers and in a small municipality whose population was less than 30,000.<sup>21</sup> As a result, the numbers of both notifications and openings of large-scale stores stabilised, as indicated in Table 2-2. Thus, although the system of administrative guidance launched in 1982 was supposed to terminate in 1984, it continued after the SII talks.

### **The problems of the LSRSL**

In theory, if retailers followed the procedure set forth in the LSRSL, they could expect to open stores thirteen months after notifying the MITI minister or the local governor. However, it often took more than a few years for them to do so. In fact, prior to adjustment of the law in 1992 to ensure it was implemented in a stricter fashion, there was not a single case of a large-scale store being opened within thirteen months.<sup>22</sup> Large-store operators had to wait for more than ten years in extreme cases. The United States thus regarded the

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<sup>20</sup>Kusano, op.cit., p. 25 and Tsuruta and Yahagi, op.cit., p. 304.

<sup>21</sup>Tsuruta and Yahagi, op.cit., p. 296.

<sup>22</sup>Tsuruta and Yahagi, op.cit., p. 285.

law as a structural impediment to entry into the Japanese market and demanded that Japan abolish or drastically reform it in the SII talks. To understand the US position, it is helpful to review certain problems with the LSRSL that explain why it tended to take large-store operators such a long time to open their outlets.

The first problem can be traced to inconsistencies with the law itself and the confusion this created.<sup>23</sup> The law aims to properly ensure trading opportunities for small and medium-scale retailers while striving to protect consumer interests and by adjusting the retail activities of large-scale stores in the area concerned. One of the difficulties lies in reconciling protection of consumer interests with ensuring business opportunities for small and medium-scale retailers. The purchasing behaviour of consumers depends mainly on the quality or price of goods,<sup>24</sup> and large-scale stores can generally sell cheaper goods and also provide better quality goods than small and medium-scale retailers. Thus protection of small and medium-scale retailers can, in some cases, prove detrimental to the interests of consumers. In sum, these two aims are inconsistent.

The second problem relates to the Prenotification Explanation system introduced through administrative guidance in 1982. In the Prenotification Explanation, unlike the 'Prenotification' and 'official' CCCAs, only representatives of the local small and medium-scale retailers and the planners of large-scale stores could participate in Prenotification discussions concerning adjustment of the large-scale stores. Excluded from these discussions were academic experts and the representatives of consumers allowed to attend the CCCAs. This led to favourable results for small and medium-scale retailers,

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<sup>23</sup>Hosono, *op. cit.*, p. 50-51, and Tsuruta and Yahagi, *op. cit.*, pp. 285-286.

<sup>24</sup>Kusano, *op. cit.*, pp. 17-18, and Tsuruta and Yahagi, *op. cit.*, p. 304.

allowing them for instance to narrow the original floor space or have the intended opening day pushed back. In this case, MITI did not engage itself in the adjustment process; 'it simply delegated its power to the retailers themselves'.<sup>25</sup>

In addition, it became customary for local municipalities to refuse notifications based on Article 3 without an agreement made in the Prenotification Explanation. According to a MITI survey, 15 prefectures and 105 cities, towns and villages required an agreement at the Prenotification Explanation stage in 1989.<sup>26</sup> For instance, in Shizuoka city, the largest tea trading city in Japan as well as the nation's manufacturing centre for plastic toys and mirror-stands, new large-scale stores were obliged to consult the local small and medium-scale retailers group of the Shizuoka Council for Commerce and Industry (in the Prenotification Explanation) and obtain agreement from them to open a store before submitting their notification as required by the LSRSL. Thus Shizuoka city had no supermarkets.<sup>27</sup> This additional regulation also contributed to pressure on large-scale stores to reach a compromise with small and medium-scale stores. In the end, the Prenotification Explanation system was likely to promote a favourable result only for small and medium-scale retailers. Yet, this was contrary to a stated purpose of the law: to protect the interests of consumers.

The third problem with the LSRSL was associated with administrative guidance. Administrative guidance can be defined as bureaucratic action to control certain activities in order to achieve a given administrative purpose without a legal basis.<sup>28</sup> Administrative guidance was apt to make it impossible

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<sup>25</sup>Upham, 1993, p.289.

<sup>26</sup>Tsuruta and Yahagi, op.cit., p. 307.

<sup>27</sup>*Mainichi Daily News*, 20 March 1990.

<sup>28</sup>Shindo, 1992, pp. 29-44.

for outsiders to know when and where the adjustment was to be made, who was to attend the discussions and how such an adjustment could be made given that it did not entail official legal statements.<sup>29</sup> The Prenotification CCCAs, the Prenotification Explanation, and even the official CCCAs, were actually set up by administrative guidance; these adjustment arrangements were not stipulated in the LSRL. That is, as there was no legal foundation, these venues enabled municipalities to employ additional regulation. Moreover, as discussions pertaining to adjustments were conducted behind closed doors this facilitated payoffs by large stores to small and medium-scale retailers.<sup>30</sup> But since participants in the Prenotification Explanation were not subject to legal constraints, these payoffs were not regarded as bribes and thus could not incur penalties. This eventually resulted in clouding of the law's transparency, which might have contributed also to opacity in the Japanese distribution system as a whole.

So why did MITI favour administrative guidance? In fact, the law's real adjustment mechanisms represented a substantial departure from the notification system. As mentioned earlier, since notifications were not accepted by local municipalities without an agreement in the Prenotification Explanation introduced through MITI's administrative guidance, this made it almost equivalent to the present licensing system, which MITI was opposed to. Explanation of this lies in the fact that MITI must ensure an amendment bill is passed in the Diet to reform laws, which takes a considerable amount of time and effort. Secondly, in the licence system, all responsibility for damage to small and medium-scale stores rests with MITI, since MITI serves as the sole authority for allowing large-scale stores to open.<sup>31</sup> In short, by introducing administrative guidance, MITI was able to sustain both types of systems - the

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<sup>29</sup>Tsuruta and Yahagi, *op.cit.*, p. 315.

<sup>30</sup>Oyama, 1988, p.69, and Tsuruta and Yahagi, *op.cit.*, p.305.

<sup>31</sup>Oyama, *op.cit.*, p.307.

notification system to deal with the legal side of things and the licence system to cope with the practical issues.

The fourth problem was that MITI entrusted adjustment to local government, which resulted in delays in the opening of large-scale stores. This 'regionalism' of the law led to the creation of an additional regulation over large-scale stores with a floor space of less than 500 square metres, called the 'expanding regulation' (*yokodashi-kisei*). These two 'extra' regulations were formulated in local assemblies as ordinances. For instance, 23 prefectures and 991 cities and towns engaged in regulating stores with less than 500 square metres floor space in 1989.<sup>32</sup> This type of deviation was due in the main to the fact that the small and medium-scale retailers themselves were the adjusters.

In the Prenotification Explanation, where consumer representatives and academic experts were excluded from involvement in the process of adjustment, the planners of large-scale stores and local small retailers were the only adjusters. There was also the additional regulation system. Thus the role of both the 'Prenotification' and the 'official' CCCAs was simply to recognise retroactively the contents of the agreement made in the Prenotification Explanation. In the end, small and medium-scale retailers, as interested parties, were able to prolong the adjustment time.

The four problems discussed above probably resulted from the intertwining of the formal and informal systems in the law, to which was added local ordinances. Owing to this complicated system of regulation, entry barriers to the Japanese retail industry were perceived to be unduly high. As well, this system functioned not only to protect small and medium-scale retailers but also the existing large-scale stores from competition with newcomers. While it is

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<sup>32</sup>Tsuruta and Yahagi, op.cit., p.307.



true that large-scale stores needed substantial time and had to engage in considerable compromise to open their outlets, they were able to do so once they had submitted a notification. Large-scale stores were thus reluctant to push for reform of the law. In fact, very few large-scale stores have ever filed lawsuits.<sup>33</sup> The above system was to continue until 1990 when the law was improved as a consequence of US pressure in the SII talks.

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<sup>33</sup>Kusano, *op.cit.*, p. 115 and Suzumura, *op.cit.*, p. 17.

## THE TWO-LEVEL GAMES MODEL

This chapter provides the theoretical framework for this thesis: the two-level games model developed by Robert Putnam. While the SII talks provided a forum for international negotiations between Japan and the United States, the issues discussed, such as the reform of the LSRSL, were in the main domestically oriented. As argued in chapter 2, the issue of the LSRSL was fairly complex and, politically, deeply-rooted. Understanding the interaction between both domestic and international levels of negotiations can help to clarify why the LSRSL was reformed in the SII talks, as a result of strong pressure by the US government.

### **The character of the two-level games model**

The premise of the two-level games model is that the state does not consist of a single actor but plural actors. Putnam insisted that one should not say 'the state, it..', but rather 'the state, they...because the central executives representing the state are directly exposed to both domestic and international levels'.<sup>34</sup> In the case of the SII talks, the Japanese negotiators were executive bureaucrats in MITI, the Ministry of Finance (MOF), and the Ministry of Foreign Affairs (MOFA), and consulted with, or were pressured or directed at home by, LDP politicians who were concerned that the consequences of the SII talks would prove critical in their constituencies. Their US counterparts were senior bureaucrats in the Department of State, the Department of Treasury, and the Office of the United States Trade Representatives (USTR), pushed by the

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<sup>34</sup>Putnam, 1988, p. 432.

Congress to gain concessions from the Japanese government during the SII talks. Furthermore, as politicians in both countries were exposed to several pressure groups in their constituencies, such groups can also be regarded as actors who comprised the state in terms of being able to influence the outcome of SII talks. Domestic politics can drive international negotiations and vice versa, which can lead to political struggle and conflict on both levels. In sum, the two-level games model is not a state-centric one and therefore is suitable for 'theorising about how domestic and international politics interact'.<sup>35</sup>

In fact, the outcome agreed on by the negotiators at the international table (Level 1) must be ratified with respect to its consequences on the domestic level (Level 2), in order to implement the agreement.<sup>36</sup> The actors on Level 2 who ratify the Level 1 agreement can be legislatures, ministries, interest groups or public opinion. Thus, Level 2 is certain to influence Level 1 bargaining and positions. Conversely, situations at Level 1 'may "reverberate" across Level 2 politics so as to alter the preferences of the relevant domestic players' in an attempt to obtain support on an agreement.<sup>37</sup> This may be achieved through benign or coercive methods: by providing benefits or side payments, or by threats, punishment or pressure.<sup>38</sup> The point of this argument is how to achieve an agreement on Level 1 which will be ratified by Level 2 constituents; in Putnam's terms, how to produce an overlapping 'win-set'. Putnam defines a win-set as 'the set of all possible Level 1 agreements that would "win"- that is, gain the necessary majority among the constituents - when simply voted up or down'.<sup>39</sup> Wider win-sets lead to overlap, and thus agreement is more likely: agreement would therefore be hampered if win-sets do not overlap.

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<sup>35</sup>Putnam, op.cit., p. 433.

<sup>36</sup>Putnam, op. cit., p. 436. Putnam defined Level 1 as a bargaining stage between the negotiators, leading to a tentative agreement, and Level 2 as separate discussions within each group of constituents about whether to ratify the agreement.

<sup>37</sup>George and Rapkin, 1992, p.6.

<sup>38</sup>Lehman and McCoy, 1992, p.604.

<sup>39</sup>Putnam, op.cit, p.437.

As well' Putnam emphasises that 'the relative size of the respective Level 2 win-sets will affect the distribution of the joint gains from international bargaining'.<sup>40</sup> If negotiators are perceived to hold the larger win-set, they could be pushed by the other Level 1 negotiators to the point where the country's gains from a ratifiable agreement would be minimised.<sup>41</sup> Conversely, negotiators with the smaller win-set can hold an advantageous bargaining stance by pleading that further concessions will lead to the agreement not being ratified. As well, negotiators with the larger win-set and the weaker or equal positions on Level 1 could gain concessions from their domestic constituents, which would increase the likelihood of reaching agreement on Level 1. For instance, Japan's position in the SII talks seemed weaker than that of the United States due to its huge trade surpluses with the latter, which partly caused Japan to accept US demands. In the end, the negotiators selected a bargaining position after concluding their calculation of their respective strengths compared with those of their counterparts and of their domestic constituents,<sup>42</sup> as was the case in the SII talks.

### **Determinants of the size of the win-sets**

The above observations indicate that the size of the win-sets, in the two-level games model, is critical. Putnam suggests that the determinants of the size of the win-sets are as follows: 1) Level 2 distribution of power, preferences and coalitions, 2) Level 2 institutions and 3) Level 1 negotiator's strategies.

#### *1) Level 2 distribution of power, preferences and coalitions*

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<sup>40</sup>Ibid.

<sup>41</sup>Ibid.

<sup>42</sup>Lehman and McCoy, op.cit., p.608.

The two-level games model depends on a theory of domestic politics because domestic groups, in the hope of realising their interests at Level 1, put pressure on their negotiators at the international level and the negotiators intensify their efforts to satisfy these domestic pressures. Thus, the size of the win-set is contingent on Level 2 distribution of power, preferences and coalitions. For instance, Putnam mentions that 'the lower the costs of "non-agreement" to constituents, the smaller the win-set':<sup>43</sup> that is, in this case, there is little room left for Level 1 negotiators to obtain concessions from Level 2. Thus, Putnam argues that 'the size of the win-set ( and thus the negotiating room of the level 1 negotiator) depends on the relative size of the "isolationist" forces (who oppose international cooperation in general) and the "internationalists" (who offer "all-purpose" support)'.<sup>44</sup> It may be safe to assert that the prospects for an agreement on Level 1 can be facilitated by domestic divisions on Level 2, which similarly means that a government with divisions on Level 2 is more likely to be able to strike a deal on Level 1 than a government which is firmly committed to a single policy. This means that a Level 1 negotiator (country A) can take advantage of Level 2 domestic divisions affecting his opponent (country B) by using factional resistance as a lever to gain country B's submission. Also, 'the composition of the active Level 2 constituency (and hence the character of the win-set) also varies with the politicisation of the issue', which encourages 'groups who are less worried about the costs of no-agreement, thus reducing the effective win-set'.<sup>45</sup>

## *2) Level 2 institutions*

The size of the win-set also depends on the political institutions on Level 2, which are mainly concerned with ratification procedures. For instance, in the

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<sup>43</sup>Putnam, op.cit., p.422.

<sup>44</sup>Putnam, op.cit., p.444.

<sup>45</sup>Putnam, op.cit., p.445.

US Senate, a two-thirds majority is necessary for ratification; on the other hand, the Japanese Diet has a simple majority requirement for ratification. In this case, the win-set of the United States will be smaller than that of Japan. Put simply, this US position heightens US bargaining power in negotiations. In other words, the US negotiators can appeal to their Japanese counterparts, arguing that they will not be able to gain the two-thirds majority needed on a certain agenda without further compromise by Japan. In this case, however, the possibility of international cooperation between the two is likely to decrease, because the negotiation could reach a deadlock if Japan is unwilling to compromise. That is, the United States has difficulty in reaching a compromise with Japan due to the necessity of a two-thirds majority to ratify a given agenda. As well, it is worth noting that 'the greater autonomy of central decision-makers from their Level 2 constituents, the larger their win-set and thus the greater the likelihood of achieving international agreement'.<sup>46</sup> That is, those with greater autonomy can be forced to make concessions to reach an agreement. This is because Level 1 negotiators will see little objection to a given agenda from Level 2. Yet, a state with stronger autonomy encountering Level 2 pressure may be weaker in terms of its relative bargaining position at Level 1, since this may be taken advantage of by the opposing negotiators seeking compromise from the state with stronger autonomy at Level 1.

### *3) Level 1 negotiator's strategies*

Putnam regards the different strategies of Level 1 negotiators as determinants of the size of the win-set. Each negotiator on Level 1 is keen to ensure the other side's win-set is as large as possible, but this tendency is not necessarily the case with respect to his own win-set, since he faces the dilemma that 'the larger his win-set, the more easily he can conclude an agreement, but also the

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<sup>46</sup>Putnam, op.cit., p.449.

weaker his bargaining position [will be] vis-a-vis the other negotiator'.<sup>47</sup> This situation is likely to incline each Level 1 negotiator to show a strong interest in the popularity of his opponent (Party A), because Party A's popularity increases the size of Party A's win-set, which leads to increasing the scope of success and the relative bargaining leverage of Party B. In other words, Party A is unlikely to encounter strong opposition on a certain agenda from Level 2 due to its popularity. Thus, a negotiator will seek to keep his win-set smaller than that of his counterpart. In short, 'negotiators should normally be expected to try to reinforce one another's standing with their respective constituents'.<sup>48</sup> In such a case, 'reverberation' may occur if an international negotiator offers benefits to his counterpart's domestic constituents or, conversely, makes threats in order to win support for an agreement. In sum, Level 1 negotiators may take a 'carrot' or 'stick' approach to influence conditions governing a potential agreement.<sup>49</sup>

The two-level games model sheds light not only on a negotiator's bargaining position, leverage or strategy, but also on the significance of each side's domestic situation in terms of its influence on international negotiations. This model also explains how a negotiator who is perceived as weaker can obtain a concession by switching his domestic weakness to an international strength and how the international negotiation reverberates across the domestic level, and vice versa. Thus, this model appears to be applicable in the case of the SII talks, particularly to the reform of the LSRSL, which was a domestic matter, in SII international negotiations.

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<sup>47</sup>Putnam, *op.cit.*, p.450.

<sup>48</sup>*Ibid.*

<sup>49</sup>Lehman and McCoy, *op.cit.*, p. 642.

## WHY AND HOW THE SII TALKS WERE INITIATED

This chapter discusses why and how the SII talks, which dealt with the domestic structures of both the United States and Japan, came about. The point worth emphasising is that the Bush Administration had to set up the SII talks in order to restrain Congress from resorting once more to the Super 301 in 1990, which would have meant moving against a free trade system. Although the SII talks were supposed to take place independently of the framework for the Super 301, which was incompatible with the GATT principle of multilateralism, the SII talks were actually undertaken to coincide with the schedule laid down for implementing the Super 301, and were watched by Congress. Also, the US government hoped to retain its independence on matters of trade, and the SII talks helped it demonstrate to Congress that the government could solve Japanese trade impediments without Congressional intervention.

These facts inevitably led the US government to seek through the process of the SII talks outcomes satisfactory to Congress by the Spring of 1990, when President Bush would have to decide whether the Super 301 would be applied to Japan once more. In sum, pressures appear to have existed on both levels; one on the US domestic level, stemming from pressure by the US Congress on the US administration, and the other on the international level, from the US government on the Japanese government. These two-levels of pressure appear to be significant in fixing the origins of the SII talks and thus confirm the applicability of Putnam's two-level game model as discussed in chapter 2.



## The Super 301

On 25 May 1989, the United States announced it would apply the Super 301 to Japan, India and Brazil as priority countries to dislodge their unfair trading practices, if necessary by retaliation. The Super 301 stipulated that the United States should retaliate with 100 per cent sanctions unless unfair trade practices were removed within eighteen months after negotiations. This decision gave rise to grave concern internationally, provoking debate and criticism about such an aggressive unilateral method.<sup>50</sup> It is believed that the chief target of the Super 301 was Japan,<sup>51</sup> and that the US government, in the hope of stabilising US-Japan relations and to evade responsibility for the breakdown of the free trade spirit was reluctant to utilise the Super 301 in Japan's case<sup>52</sup>. But this did not appease Congress, which was running out of patience with the US-Japan trade imbalance<sup>53</sup>, probably because 'the intensity of the US pressure (from the Congress) [was] highly correlated with the magnitude of the US-Japanese trade imbalance'.<sup>54</sup> On the other hand, Japanese government officers warned the United States that the use of the Super 301 would aggravate tensions between the two nations.<sup>55</sup>

The US government, in this sense, was forced to focus on a solution that could minimise the discontent of both Japan and Congress. In short, in order to

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<sup>50</sup>For criticism of the Super 301, see Bhagwati and Patrick, 1990.

<sup>51</sup>It is said that India and Brazil were selected so as not to give the impression that Japan was the only unfair trading country. This consideration was advanced by the Secretary of State James Baker and National Security Adviser Brent Scowcroft. Yet, both India and Brazil, in fact, were countries which were opposed to the US claim in the Uruguay Round that services and intellectual property should be included as negotiating items. In Sato, op. cit., pp, 166-167. Also, *Tokyo Business Today*, July 1989.

<sup>52</sup>Yet, there was some agreement with the claim of Congress that the Super 301 should be used for Japan even within the US government such as US Treasury Secretary N. F. Brady and USTR, C. Hills. In Sato *ibid*.

<sup>53</sup>Most of the members of Congress were pleased when Japan was included in the list as an unfair trader. In *Tokyo Business Today*, July 1989.

<sup>54</sup>George, 1991, p.6.

<sup>55</sup>Fukushima, 1991, pp. 200-201.

appease Congress, the US government, following the Super 301, specified Japan as a priority country, but as well, it chose items for negotiation with Japan that were relatively easy to solve: forest products (concerned with construction standards and product requirements), and satellites and super-computers (both of which were concerned with government procurement), all three items being very specific and defined products; under Japanese government control, unlike semi-conductors, and issues in the case of satellites and super-computers, such as government procurement and products requirement in the Uruguay Round. By choosing these items, the United States sought to avoid criticism by other countries that the Super 301 was against the GATT.<sup>56</sup> It was partly on account of this that both nations were able to successfully conclude negotiations over these three issues.

### **The origins of the SII talks**

Because Congress felt that the three products discussed above constituted too small an agenda and structural barriers were not included as a subject of negotiation, the US government thought it necessary to prepare another negotiating table with Japan. The US government regarded it as imperative that Congress be prevented from moving further towards protectionism, contributing to further deterioration in US-Japan relations. Managed or result-oriented trade, as an alternative to GATT-based multilateralism, had gathered support in the US Congress at that time.<sup>57</sup> And the US government viewed this tendency in the Congress as a threat to successful conclusion of the Uruguay Round, which was a 'top priority for the [Bush] Administration'<sup>58</sup>. It

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<sup>56</sup>Ibid.

<sup>57</sup>Mastanduno, 1992, p. 246.

<sup>58</sup>Mastanduno, op.cit. p. 241.

is highly likely that the US government initiated the SII talks in order to pacify Congress.

This decision appears to have been sustained by the following facts. First of all, a considerable rise in the exchange rate of the yen against the US dollar (from ¥260 a dollar in 1985 to ¥140 by late 1989) after the Plaza Accord in 1985 failed to improve the trade imbalance with Japan to any great extent. Secondly, Japan's average nominal tariffs and quotas had decreased by the early 1980s to become the lowest among the other advanced nations.<sup>59</sup> Thirdly the United States was successful in improving its trade balance with other trading countries, especially with the European Community (EC), but not with Japan.<sup>60</sup> These three factors probably urged the US government to target Japan's economic structural barriers and reduce its trade imbalance with Japan, and so calm the anger of Congress.<sup>61</sup> This suggestion is supported by a statement by Linn Williams, Deputy USTR:

The failure of the US and other foreign goods to gain greater access to the Japanese market despite their competitiveness of price and quality in other markets and despite macro economic adjustments and the relative lack of formal trade barriers, leads us to conclude that there are structural factors in the Japanese economy that hamper imports and distort the economy.<sup>62</sup>

The US government subsequently required the Japanese government to commence the SII talks employing a separate framework from the Super 301. It was no coincidence therefore that the initiation of the SII talks and the application of the Super 301 to Japan were announced on the same day.

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<sup>59</sup>See Cohen, 1985, pp. 141-142, Sato and Rizzo, 1988, pp. 1177-178, and El Agra 1988, pp. 57-58.

<sup>60</sup>Fukushima, *op. cit.*, 198-199.

<sup>61</sup>Fukushima, *op.cit.*, pp.202-203.

<sup>62</sup>Committee of Finance, United States Senate, 1989, p.24.

## The response of the Japanese government to the SII talks proposal

The Japanese government was reluctant to endorse the SII talks. First of all, items targeted for change by the United States in the SII talks were mainly concerned with domestic structures such as land policy, public investment and *keiretsu* transactions, which were not supposed to be subjects of international negotiation. Domestic laws are in general regarded as an internal affair, and pressure to change or abandon such laws is regarded as domestic intervention. In addition, the Japanese government connected the US trade deficit with macro-economic policy that affected savings and investment, believing that fewer Japanese trade barriers would 'mean both more US spending on exports and more imports',<sup>63</sup> unless the United States changed its spending habits<sup>64</sup>. Therefore, the Japanese government initially resisted US proposals, insisting that deregulation of domestic laws would not necessarily lead to correction of the trade imbalance between the two nations,<sup>65</sup> which was, in fact, the aim of the SII talks.

But since Japan thought it essential that it maintain friendly relations with the United States, the Japanese government found it difficult to reject the SII proposal. As a Japanese negotiator of the SII talks confessed, Japan's high economic dependence on the US market (in 1990, more than 30 per cent of Japan's total exports were to the United States and more than 20 per cent of its imports were from the United States) made it vulnerable to US demands to participate in the SII talks<sup>66</sup>. In addition, it seems that the Japanese government also thought it essential not to give impetus to US protectionism by breaking up trade negotiations with the United States.<sup>67</sup> The Japanese

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<sup>63</sup>Lawrence, 1990, p.108.

<sup>64</sup>Interview with an MITI officer who declined to be named.

<sup>65</sup>Nomura, 1990 and Yabunaka, 1991. Both were involved in the SII talks as negotiators.

<sup>66</sup>Nomura, op.cit., p.10.

<sup>67</sup>Yabunaka, op.cit., p.39.

government also sought to avoid nomination again in 1990 as a priority country in the Super 301. Consequently, the Japanese government officially agreed to the commencement of the SII talks, provided that they focused not only on Japanese structural impediments but also US structural impediments, and that they be conducted not as results-oriented negotiations, but rather as a series of talks only.<sup>68</sup>

### Features of the SII talks

The SII talks were conducted over five official rounds. The first round was held on 4-5 September 1989, the second on 6-7 November in 1989, the third on 22-23 February 1990, the fourth on 2-6 April 1990 (when the Interim Report was issued) and the fifth and final round on 25-28 June 1990 (which produced the Final Report). The venue alternated between Tokyo and Washington. The US government identified more than 200 individual items requiring change by the Japanese government. These can be group into six categories:

1. the price mechanism
2. the distribution system
3. savings and investment patterns
4. land policy
5. *keiretsu* (corporate affiliations)
6. exclusive business practices.

The Japanese government for its part identified seven problem areas requiring change by the United States:

1. savings and investments

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<sup>68</sup>Interview with a MITI officer who declined to be named.

2. industry investment
3. corporate behaviour
4. government regulations
5. research and development
6. promotion of exports
7. job training and educational reform.

The SII talks provided the first opportunity in fact for both nations to grapple with the above domestic issues in an international setting. Previous US-Japan trade negotiations had dealt with international arrangements such as export restrictions and import quotas. Linn Williams, Deputy USTR, exaggerated the facts and declared that 'as far as I know, no other sovereign state has ever agreed on such structural reforms as Japan promised in the SII'.<sup>69</sup> Despite concerns to protect their autonomy with respect to domestic politics and economic matters, the two largest economies in the world agreed to alter long-standing institutions and practices at each other's behest.

The SII talks can be also distinguished from other US-Japan trade negotiations such as the Orderly Market Agreement (OMA) and the Market-Oriented Sector Selective (MOSS) talks in that both countries agreed on the agenda for the talks, negotiating on matters that directly influenced people in everyday life, such as revision of Japanese collusive business practices and the US educational system. Previous trade negotiations concentrated exclusively on issues of concern to exporters and importers in the main. The SII talks were to involve social, economic and industrial reform structures in Japan. US demands in the SII talks were described as 'a third coming of the Black ship'.<sup>70</sup>

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<sup>69</sup>See Williams, 1990.

<sup>70</sup>The expression 'Black Ship' derives from Commodore Perry's black ships which sailed into Tokyo Bay in order to end Japan's isolationism in 1853. The 'Black Ship' became a symbol of great reforms delivered under pressure. The second 'Black Ship' referred to substantial reforms conducted by United States after the Second World War.

In reality, the US government sought to obtain concessions from the Japanese government by pointing out that agreements in the SII talks would lead to improved Japanese standards of living for Japanese consumers. The response was favourable, with 50 per cent of respondents in a *Nikkei* survey expressing basic agreement with the US demands.<sup>71</sup>

As well, Japan and the United States, for the first time, requested mutual removal of each other's structural impediments. The Japanese government insisted that the SII talks be a 'two-way street' negotiation. In practice, however, the two countries' structural impediments were rarely examined together when making trade-offs.<sup>72</sup> The talks in the SII talks were mostly conducted on separate tracks: 'the SII talks were, in effect, two negotiations rather than one'.<sup>73</sup> Before the first round of talks commenced, Michael Boskin, the Chairman of the US Council of Economic Advisers, suggested that Japan take advantage of this opportunity to speak its mind to the United States.<sup>74</sup> Previously, in US-Japan trade negotiations, the United States always required that trade negotiations be set up with Japan unilaterally and pressured Japan into making concessions. The SII talks, however, looked set to provide the United States with an opportunity to improve its domestic structure, decrease its financial debt, and enforce competitiveness of domestic industries.

The different nature and potential of the SII talks helps explain the statement made by Senator Baucus, one of the steadfast supporters of the Super 301, that the talks were 'the most important trade negotiations that the US [had] ever entered into'.<sup>75</sup> According to Baucus, 'only the SII talks [held] out the

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<sup>71</sup>This result is based on data in a *Nikkei* telephone survey conducted on 16-19 March 1990.

<sup>72</sup>Mastanduno, op.cit., p.249.

<sup>73</sup>Ibid.

<sup>74</sup>*Nihon Keizai Shimbun*, 30 August 1989.

<sup>75</sup>Mastanduno, op.cit., p.248.

prospect of significantly improving the overall bilateral trade deficit'.<sup>76</sup> He also believed that 'in the long run the SII talks were more important than the Super 301'.<sup>77</sup>

### **Domestic and international levels of US pressure**

The special features of the SII talks perhaps made them even more important than the Super 301. Of particular significance, from the political viewpoint, were the close links between the two. The Super 301 was applied twice, in 1989 and 1990, while the SII talks were carried out in the interim. This placed pressure on Japan to indicate outcomes in the Interim Report to Congress's satisfaction before President Bush would nominate Japan for Super 301 in 1990. In other words, the content of the Interim Report served as a litmus test to gauge the view of Congress towards Japan and, in the broader sense, to check Congress's propensity for protectionism. Thus, when the SII talks reached a deadlock after the third round, President Bush, who hoped to mitigate Congress's leaning towards protectionism by bringing the SII talks to a successful conclusion, urged Prime Minister Kaifu to have emergency meetings on 2-3 March 1990 in order to move the negotiations forward. The President's intervention probably stemmed from his strong belief that protectionism should be controlled, and that the Congress should be restrained on this issue for the purpose of maintaining a free trade system and bringing the Uruguay Round to a successful conclusion. It was thus in the US interest to conclude the SII talks successfully, since failure may have given Congress cause to strengthen protectionism, and thereby threaten GATT principles.

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<sup>76</sup>Ibid.

<sup>77</sup>Ibid.



So as to satisfy Congress but at the same time avoid application of the Super 301 to Japan, the talks, in the short term, were designed to obtain some concessions from Japan, rather than to encourage mutual efforts to remove their structural impediments, and lead to an improvement in the US balance of payments. This is suggested by a statement made by a US negotiator in the SII talks:

American negotiators were uncomfortable at the thought of changing domestic practices on the advice of Japan. To embrace Japan's agenda would be to acknowledge that the [Bush] Administration was not doing all it could to maximise American competitiveness - clearly a message it did not want to send to Congress.<sup>78</sup>

It can be argued that the aim of the SII talks was, in principle, to identify and solve structural problems in both nations, but the United States, in practice, expected Japan to remove as many of the impediments discussed in the SII talks as possible, but not to remove any of its own. But the United States had other goals in mind: to prevent the Congress from pursuing further protectionism and to maintain government authority over trade policy.

Congress had threatened the US government, especially the executive concerned with trade policy, that it would usurp authority over trade policy. Under the Super 301, Congress could require the USTR to set up an inventory of trade barriers in its trading partners, make a list of nations and unfair trade practices, and establish deadlines for the removal of the practices by the listed nations. It could also initiate retaliation by the United States in cases of non-compliance.<sup>79</sup> This indicates that by fixing USTR procedures under the Super 301, Congress could exert its influence on US trade policy and negotiations through such avenues as the USTR. The SII talks, however was free from

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<sup>78</sup>Mastanduno, op.cit., p.254.

<sup>79</sup>Bhagwati and Patrick, 1990, p.3.

such legal restrictions and gave Congress no room to officially intervene. Thus the US government had to obtain concessions from the Japanese government that would appease Congress in order to preserve its initiative on trade policy.

As a consequence, the SII talks contributed considerably to halting moves towards protectionism in Congress. The Interim Report issued on 5 April 1990 enabled President Bush to announce on 27 April that the Super 301 would not be applied to Japan in 1990. As well, the US government demonstrated to Congress by successfully compiling the Final Report that it had dealt thoroughly with Japanese trade barriers in the talks. This has succeeded thus far in precluding Congress from assuming full authority for trade policy and from passing any protectionist bills.<sup>80</sup> In this sense, at least, it is clear that the SII talks were successful.

Domestic-level pressure from Congress automatically led the US government to pressure the Japanese government in turn on an international level. And because the US government was preoccupied with appeasing Congress, this led to double standards in tackling issues on the SII agenda. The United States, on the one hand, demanded that the Japanese government relax regulations and decrease intervention, as in the case of the LSRS. On the issue of *keiretsu* transactions, however, the United States demanded that the Japanese government *increase* guidance and intervention. This in fact ended up promoting and abetting 'Japan-style' government intervention and regulation.<sup>81</sup> This suggests how willing the US government was to go to all kinds of lengths to attain its objectives, and also how strongly it pressured Japan to comply with those objectives.

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<sup>80</sup>Fukushima, op.cit., p.215, and Mastanduno, op.cit., pp.244-245.

<sup>81</sup>Ogura, 1992, p.9.

## THE JAPANESE NATURE AS A REACTIVE STATE

Chapter 4 argued that it was mainly domestic US factors which gave rise to pressures on Japan with respect to the SII talks. This chapter will discuss why Japan has been so vulnerable to US pressure, focusing on its domestic political aspects. In fact, the US negotiators put strong pressure on the Japanese to address the LSRSI during the SII talks, and it was this pressure that later contributed to materialisation of reform of the law. This thesis aims to explore how US external pressure affected Japan's decision-making process in relation to this issue. This chapter will begin by exploring the role of external pressure in changing policies in other countries in general, with particular reference to the US-Japan relationship. It will then discuss the Japanese domestic situation, highlighting the features that have made it vulnerable to US pressure.

### Features of US external pressure

External pressure can be defined as pressure exercised by a country that seeking to influence the affairs of another country. In exercising external pressure, it is of primary significance that actors exist in the country being subjected to pressure who welcome and support outside pressure for change: otherwise, such pressure produces antipathy towards the country doing the pressuring. In other words, the country applying the pressure can capitalise on 'silent allies' in the country being pressured that predispose the latter country to accept its demands. Also, external pressure is more effective when domestic conflict exists towards a certain policy over which the pressuring country itself hopes to exert its influence. Conversely, domestic actors also can take

advantage of this external pressure to realise their own demands on government. The issue of the LSRL is a case in point, in that a number of groups existed in Japan, such as some large-scale retail stores and consumers, that had wished to reform or abolish the law. This cleavage in opinion in Japan disposed US negotiators and policy-makers to declare often during the SII talks that reform or abolition of the LSRL would benefit Japanese consumers. In this way, the US negotiators sought to obtain support for change from within Japan itself.

It is also worth noting that external pressure carries two kinds of effects in terms of proceeding with policy reform by policy-makers in the pressured country: it shifts the responsibility of policy reform; and it advances the degree of reform.

In effect, policy-makers who realise the necessity of the policy change, consequent to being pressured, may find it difficult to implement the policy change due to strong domestic opposition. In persuading domestic groups opposing a policy change to accept it, policy-makers can say to such groups that although they are unwilling to reform the policy, the pressuring country will never be satisfied with the status-quo. That is, the policy-makers can then shift the responsibility of changing the policy to the pressuring country. A senior MITI officer in charge of the Japanese distribution industry aptly stated that:

we actually needed external pressure from the United States in rejecting persistent petitions of local groups to maintain the law. Such local groups seemed to understand, in the end, that strongly pressured by the United States, MITI would be

driven into a corner and would consequently have no choice but to change the law.<sup>82</sup>

That is, by capitalising on US external pressure MITI was able to ward off the likely petition or pressure from LDP politicians and such pressure groups. US external pressure could in fact help MITI proceed with reform of the LSRSL.

The second effect of external pressure is to bring about more far-reaching consequences. In the case of the reform of the LSRSL, MITI eventually rescinded the CCCAs. As pointed out in chapter 2, the CCCAs were the real adjustment venues (though not stipulated in the LSRSL) organised by local Chambers of Commerce and Industry. It is safe to assert, in this sense, that MITI's rescinding of the CCCAs, which led to a considerable transparency of the law, was equal to emasculation of the LSRSL. Thus, this decision represented a substantial concession to the United States. With regard to the rescinding of the CCCAs, the above-mentioned MITI officer supported the idea by stating:

MITI could not have abolished the CCCAs, and the reform itself would have been less regulated without external pressure from the United States. In fact, the political impact brought about by rescinding the CCCAs must have been substantial, because it led to depriving the Council for Commerce and Industry of their main task.<sup>83</sup>

The 'far-reaching' effect of external pressure was also evident in the shortening that occurred to the adjustment period. MITI initially volunteered to reduce the period of adjustment to the law from the current average at that time of about three years to two years in the first few rounds of the SII talks. The United States was not content with this proposal, however, and put pressure on

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<sup>82</sup> Interview with Takaya Imai, Deputy Director of Distribution Industry Division, Industry Policy Bureau, Ministry of International Trade and Industry.

<sup>83</sup> Interview with Takaya Imai.

Japan to shorten the period even further. MITI came up with a revised proposal of one and a half years. The United States again objected and MITI then promised to shorten the period to one year, despite strong opposition from Japanese interest groups of small and medium-scale retailers. This considerable concession would not have eventuated without external pressure, and illustrates how such pressure can serve to advance policy change.

Another conspicuous feature of the US pressure placed on Japan is that the United States tends to adopt a specific trade issue as a 'symbol' of Japanese market exclusiveness. Such 'symbolising' has often been observed in previous US-Japan trade negotiations. In fact, a Japanese negotiator confessed that his US counterparts often stated during US-Japan trade negotiations on commodities such as beef, oranges and the construction industry, that this issue symbolised the closed nature of Japanese markets.<sup>84</sup> This reference to issues symbolic of behaviour and outlook helps to draw the attention of politicians, citizens or the mass media in the United States to the issue being negotiated and thus to place greater pressure on Japan to make greater concessions. Used in this way, US policy-makers are able to amplify the impression that the Japanese market is considerably exclusive. Even if the issue being negotiated is unlikely to contribute to solving the trade imbalance between the two countries, Japan is often forced to counter such impressions and thus make concessions on the issue. In short, the issue can become increasingly tinged with political significance, regardless of the economic considerations, generally prolonging negotiation of the issue.

This was true with respect to treatment of the LSRS in the SII talks. The United States often stated that the conclusion of the SII talks was contingent

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<sup>84</sup> Yabunaka, *op.cit.*, p.213.

on successful settlement of the LSRSL.<sup>85</sup> In other words, the LSRSL was regarded as the preeminent symbol of the exclusiveness of the Japanese market. As a consequence, it took lengthy negotiations to conclude the Interim Report, for the US side continued to demand substantial concessions on the issue from the Japanese. The Japanese found this extremely difficult since the issue was a politically sensitive one in Japan.

As argued thus far, US external pressure on Japan has had three notable characteristics: shifting responsibility for a policy change; advancing the degree of the policy reform; and using issues to symbolise Japanese market behaviour. All three features were evident in the case of negotiations over the LSRSL. The following discussion employs the 'reactive state' model developed by Kent Calder to explain why Japan has remained so vulnerable to US pressure.

### **Japanese characteristics as a 'reactive state'**

A reactive state is a nation in which 'the impetus to policy change is typically supplied by outside pressure'.<sup>86</sup> This kind of state, according to Calder, is not capable of pursuing independent foreign policies. Calder discusses Japan's reactive nature in terms of its inability to launch into independent foreign economic policies. His comments are applicable also to the notion that Japan cannot easily revise domestic laws and reform its structures to ameliorate social conditions by itself, depending instead on external pressure for change, even if it 'has the power and national incentive to do so'.<sup>87</sup>

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<sup>85</sup> Yabunaka, *op.cit.*, p.174.

<sup>86</sup> Calder, 1988a, p 518.

<sup>87</sup> Calder, *op.cit.*, p.519.

Except for the United States and China, other countries have rarely utilised external pressure to influence Japanese policies and attitudes.<sup>88</sup> The United States and China differ, however, in terms of the areas in which they apply pressure on the Japanese. The Chinese have tended towards exercising vetos; and have done so effectively when attempting to thwart undesirable Japanese policies towards China such as the recent history textbook issue. But when China acts to persuade Japan to adopt desirable policies towards it, such undertakings have often met with failure.<sup>89</sup> The United States, on the other hand, has tended to use pressure on Japan in a more comprehensive and concrete manner, not only in economics and trading but also in political matters such as the allocation of ODA and burden sharing. The United States then is the only nation that exerts a strong influence on Japan to the extent that Japan will often implement more desirable policies. There are several reasons why Japan has so often succumbed to US pressure, the two major ones being Japan's heavy dependence on the United States and its indigenous political system.

As regards Japan's dependence on the United States, Japan was for a long time protected by the US nuclear umbrella during the Cold War era, namely US extended nuclear deterrence, which allowed Japan after the Second World War to allocate its economic resources to industrial development rather than to military expenditure.<sup>90</sup> Even after the Cold War, Japan and its neighbours have continued to rely on US military commitments to Japan. In sum, without the US military presence, Japan would need to increase its military expenditure and strengthen its military capability. This scenario would necessarily incur

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<sup>88</sup> Tanaka, 1989, pp.28-30.

<sup>89</sup> Chinese leaders have often complained that Japanese companies are unenthusiastic about direct investment in China, but it is unlikely that these pressing statements are themselves conducive to increasing Japan's direct investment in China. See Tanaka, *op.cit.*, pp.35-36.

<sup>90</sup> That the United States placed its military personnel in Japan was also due to its forward deployment strategy to contain the former Soviet Union.



resistance from neighbours that still harbour bitter memories of the war and might contribute to an escalation of the arms race in East Asia. Japan's wish to avoid this and ensure a continued US military presence tends to make it more compliant to US pressure.

Economic dependence on the United States also renders Japan vulnerable to US pressure. As argued before, the United States is Japan's largest market. In 1990, more than 30 per cent of Japanese exports went to the United States, and Japan imported more than 20 per cent of its total imports from the United States. If the United States should adopt a 'tit for tat' strategy by placing tariffs on Japanese products to make Japan bow to US pressure, Japanese exporters would face difficulties. Japan therefore strives not to give added impetus to US protectionism and break up trade negotiations with the United States. In the end, such political and economic dependence on the United States predisposes Japan to accede to US pressure.

### **Japanese domestic elements as a reactive state**

Having looked at Japan's dependence on the United States, the focus of this discussion will turn to the indigenous Japanese domestic factors that make domestic policy reform difficult. There are at least three political constraints preventing Japan from pro-actively undertaking reforms of its policies and laws: 1) bureaucratic shortcomings, 2) the influence of interest groups, and 3) a medium-scale election system.

Bureaucracy as a rule does not necessarily equal one monolithic entity, but an aggregation of several ministries. In Japanese bureaucracy, bureaucrats are traditionally employed through examinations, and then interviews, by each

ministry, inter-ministerial personal exchange is rare, and the bureaucracy provides a life-time employment system is conventional.

Japanese bureaucracy is split into self-contained, hierarchical organisations, each with their own ultimate authority.<sup>91</sup> Ministers generally represent the interests of their own ministries only and rarely intervene in the matters of another.<sup>92</sup> This tendency allows each ministry to clearly delineate its own concerns. Such a system is advantageous in making and implementing long-term policy and planning since it contributes to policy consistency and the nurturing of expertise.

Nevertheless, there is frequent competition and conflict between ministries regarding budgetary matters and matters of authority. Furthermore, it is difficult for the ministries to resolve such ministerial confrontations. Where 'bureaucratic responsibilities have yet to be defined, ministerial jurisdiction is unclear',<sup>93</sup> and policy adjustments by the Japanese bureaucracy tend not to function effectively. In such cases, ministries are apt to cling to their own interests and authority, and are unable to work together to produce a unified coherent policy. This makes Japan more dependent on external pressure for the purpose of settling such ministerial confrontations, which leads it to be reactive. This proclivity was also seen in the SII talks.<sup>94</sup> Since the issues discussed in the talks were wide-ranging, the five official talks were attended by vice ministers from MITI, the Ministry of Finance (MOF), the Economic Planning Agency (EPA) and the Ministry of Foreign Affairs (MOFA) as joint chairmen. In the hope of protecting their own interests as much as possible, these ministries failed to exchange information, before realising the Interim

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<sup>91</sup> Iwai, 1988, p.156.

<sup>92</sup> Miyazato, 1990, p.61.

<sup>93</sup> Calder, *op.cit.*, p.529.

<sup>94</sup> NHK, 1990, p.106.

Report, about, for instance, the extent to which they would concede to US demands on issues of concern. Even on the Japanese side, there were disagreements about the content of the report. For example, the MOF was reluctant to agree to a suggestion by the MOFA that Japan should specify an exact amount of money for public investment. As well, other ministries such as MOFA and MOF gave their assent to a review of the LSRSL, though the issue had nothing to do with them, but MITI refused to allow it. Such disagreements and confrontations among ministries tend to contribute to Japan's vulnerability to external pressure.

That domestic interest groups in Japan possess considerable political power also contributes to Japan's vulnerability to external pressure. Groups of farmers, merchants and constructors, focused on their own concerns, tend to 'resist foreign encroachments into the Japanese domestic market',<sup>95</sup> which creates more competition. This being so, interest groups have long been supporters of the LDP, assisting in electoral activities and donating substantial amounts of money to the party. The LDP therefore hesitates to implement or reform policies that threaten the interests of such pressure groups.

In the SII talks, the United States had demanded with respect to Japanese land policy that Japan review its taxation system for agricultural land within urbanisation promotion areas in the major metropolitan regions.<sup>96</sup> This would mean that taxation on agricultural land would be increased to a level equal to that of housing. The fixed assets tax of agricultural land is, at present, one-eighth as much as that of housing land, and inheritance tax on agricultural land is virtually exempt. In fact, the government sought to revise its taxation on agricultural land in major metropolitan areas, issuing two bills in 1971 and

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<sup>95</sup> Calder, *op.cit.*, p.530.

<sup>96</sup> See the SII Joint Report.

1982, but on both occasions it was confronted by strong resistance from agricultural organisations in metropolitan areas and by the LDP Dietmen supported by such groups. Consequently, such bills have had their teeth removed.<sup>97</sup> As these cases illustrate, interest groups tend to prevent Japan from actively implementing policies to improve social conditions, leaving Japan even more vulnerable to external pressure.

Thirdly, the medium-scale Japanese electoral system also contributes to Japan's reactive state. The LDP, in this system, has to have at least more than two candidates in the same electoral district to gain a majority in the Diet; thus, LDP candidates in the same district end up running against each other.<sup>98</sup> Owing to this, electoral activities are handled mainly by supporting societies (*koenkai*) for individual candidates, based on their electoral system, rather than by the LDP. This means that LDP Dietmen are apt to be sensitive to pressure exerted by their constituents and their constituents' interests. Candidates prove less attractive if they emphasise international or defence affairs as electoral issues, which have nothing directly to do with the everyday lives of voters. Accordingly, the policy area in which the LDP Dietmen possess strong points is a crucial issue, and this has produced so-called 'tribe Dietmen' (*zoku-giin*). In most cases, these candidates devote themselves to policy matters which meet the interests of their constituents, such as agriculture and construction. In sum, Dietmen who concentrate solely on their constituents' interests and not international policy tend to have found it difficult to participate in active international policy-making. As well, as touched upon earlier, because such Dietmen are vulnerable to pressure groups within their constituency, they are liable to display a negative attitude to transforming laws that impact adversely

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<sup>97</sup> Of the 43,000 ha which should be taxed in three of the largest metropolitan areas, 36,000 ha is exempted. In NHK, 1990, p.147. See also Calder, 1988b, p.409.

<sup>98</sup> This leads to the creation of factions within the LDP. Also, the system makes electoral competition harder, and produces 'money politics'.

on the interests of such pressure groups. In sum, owing to its medium-scale electoral system, Japan tends to rely on external pressure to launch policy reforms that go against the interests of constituents or powerful interest groups. This seems to predispose Japan towards being a reactive state.

This chapter has discussed two issues that render Japan vulnerable to external US pressure: its high dependence on the United States, and domestic factors such as pressure from interest groups. In the case of the SII talks, it seems that Japan actually capitalised on outside US pressure, with an eye to proceeding with difficult domestic-related problems, mentioned earlier, that it had been unable to otherwise redress. Support for reform of land policy, for instance as incorporated in the Maekawa Report, coincided with discussion of such reform in the SII talks. In this way, the United States actually assists Japan in making progress on difficult domestic reforms.

The following chapter will examine how the reform of the LSRSL, the most difficult issue on the SII agenda, was dealt with in the talks. It will then focus on this issue in relation to Japanese domestic politics by application of the two-level game model, as outlined in chapter 3.

## **THE TWO-LEVEL GAMES MODEL AND REFORM OF THE LARGE-SCALE RETAIL STORE LAW**

This chapter examines Japan's decision to drastically reform the LSRSL, despite the existence of opposition at home. Although Japan promised to drastically 'reform' the law, it rejected US pressure to completely abolish it. This chapter employs the two-level games model, emphasising factors influencing Japan's commitment to drastic reform of the law, such as its domestic preferences and coalitions, its ratification system, and US strategies during the SII talks.

### **Domestic and international pressure to reform the LSRSL**

Following world-wide deregulation in the 1980s through liberalisation and privatisation, Japan moved to create a 'smaller government'. As world economic growth as a whole had slowed due to the two oil shocks, the intention was to reinforce the supply-side, made unstable by the oil shocks, so as to restore steady economic growth. Since activation of the private sector seemed essential to this aim, governmental regulation needed to be reviewed. Japan deregulated its national railways and telecommunications, for instance. But, as touched upon in chapter 1, the retail industry, especially in relation to the LSRSL, ran counter to the trend of the times. The administrative guidance which was introduced in 1982 put a restraint on further establishment of large-scale retail stores.

Nevertheless, voices emerged within Japan to reform the LSRL. For instance, the Chairman of the *daitenshin* (Large Scale Retail Store Council) commented in June 1987 that while the basic framework of the law should be maintained, the coordination processing period should be shortened. The Economic Planning Agency (EPA) also gave affirmative support to reform of the law. In June 1988, the EPA issued a report entitled *Towards Establishing a Liberalised Distribution System* in which it insisted that the law needed to be properly implemented in accordance with its original purposes such as protection of the interests of consumers.<sup>82</sup> The 1988 *Economic White Paper* also suggested that the government eliminate or reduce intervention and restrictions on private sector activities including the LSRL. In other report, the EPA recommended in April 1989 that the LSRL be deregulated.<sup>83</sup> Changing consumer behaviour might have contributed to pressure to change the law, with small and medium-scale retailers unable to respond to the growing sophistication and diversification of consumer needs.<sup>84</sup>

Even on the international level, criticism mounted towards the LSRL as a major example of Japanese non-tariff barriers. The G7 Summit Conference held in Toronto in June 1988 focused on structural adjustment of its members. Japan promised to consider reform of its distribution industry, including the LSRL. The OECD also announced in an economic investigation of Japan in August 1988 that Japan reform its distribution industry, the LSRL being singled out as the factor restricting the activities of large-scale stores.

In its report published in June 1989, *Vision of the Japanese Distribution Industry in the 1990s*, MITI admitted the necessity of reform of the LSRL. Before the report was issued, MITI appeared to take the position that

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<sup>82</sup>See Economic Planning Agency, 1988.

<sup>83</sup>See Economic Planning Agency, 1989.

<sup>84</sup>Hosono, 1992, pp. 136-140.

deregulation of the law lagged only slightly behind other industrial deregulations.<sup>85</sup> Yet, pressured to reform the law on both domestic and international levels, MITI appeared more driven by the fact that more than 40 per cent of all local municipalities had placed their own restrictions on the activities of large-scale stores through ordinances. MITI's report recommended as follows: 1) the whole coordinating process period should be shortened to almost two years, 2) the adjustment system such as the Prenotification Explanation and the CCCAs should be made clearer, and 3) restrictions by local government should be rectified.<sup>86</sup>

Yet, since the report did not insist on rescinding the law as such, its basic framework was to be maintained. This was probably because the Report Committee included representatives of small and medium-scale retailers, as well as academics, consumers and large-scale retailers. The report, in that sense, issued a well-balanced recommendation. Before the SII talks were initiated, MITI appeared to believe that, by promising to implement the recommendations incorporated in the report, it could persuade the US government to ease off pressure on the law.<sup>87</sup>

### **Why the United States took up the LSRSL issue in the SII talks**

There were at least four reasons why the US government regarded the LSRSL as the important item on the SII agenda. First of all, the United States believed that large-scale stores were more likely to carry imported products, and that abolition or reform of the LSRSL would lead to an increase in imported US products. This would help redress Japan's trade imbalance with the United

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<sup>85</sup>Kusano, 1992, p.168.

<sup>86</sup>Ministry of International Trade and Industry, 1990, pp. 170-182.

<sup>87</sup>Kusano, 1992, pp. 176-178.



States. Secondly, since regulation of large-scale store activities was conducted by the Japanese government through the LSRSL, the United States hoped that US-Japan governmental-level negotiations would enable a quick resolution, unlike private-sector practices such as *keiretsu* transactions. Thirdly, Japanese large-scale stores could set up outlets in the United States with little difficulty, but US stores could not do so in Japan. The US government blamed the law for this. Fourthly, a US toy retailer, *Toys'R'Us*, planned to enter the Japanese market, but because of the LSRSL, the company had difficulty opening its outlets. Complaints by the Chairman of *Toys'R'Us*, Charles Lazarus, to the USTR, Carla Hills, provoked an interest by Hills in this issue.<sup>88</sup> In fact, prior to the commencement of the SII talks, no foreign large-scale store had managed to open an outlet in Japan under the LSRSL.<sup>89</sup> Thus it was that the issue of the LSRSL grew to be the most significant item on the SII agenda.

There was, in addition, a political reason why the LSRSL issue drew attention to itself. Small and medium-scale retailers has long been LDP supporters, and abolition or reform of the law would put that support at risk, leading to election losses for some LDP candidates. In effect, recommendations involved in the report, *Vision of the Japanese Distribution Industry in the 1990s*, were not implemented very quickly. The report, announced in June 1989, was scheduled to become effective in September 1989. Yet, MITI failed to officially notify the regional bureaus of international trade and industry about the report due to LDP pressure to postpone the implementation of the recommendations in the report until after the general election held in February 1990.<sup>90</sup> After the LDP lost control of the Upper House after the 1989 election, some LDP Dietmen become wary of advocating dramatic policy changes that might alienate traditional LDP supporters. In particular, they did not wish, by

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<sup>88</sup>*Nihon Keizai Shimbun*, 5 October 1989.

<sup>89</sup>Upham, 1993, p.288.

<sup>90</sup>Kusano, 1992, p. 176. also *Nihon Keizai Shimbun*, 22 February 1990.

reforming the law, to lose the support of small and medium-scale retailers, whose votes were necessary for re-election.

In addition to the above political reasons, regulations imposed by the municipalities made it difficult for MITI to officially notify them of the recommendations contained in its report. As pointed out in chapter 1, 991 local governments had their own regulations for stores smaller than 500 square metres (the expanding regulation) and 105 municipalities required large-scale retailers to reach agreements with local retailers before they submitted applications to the local government (the additional regulation).<sup>91</sup> MITI appeared to believe that given these kinds of local regulations, stipulated in ordinances, any notices it might issue to abide by the recommendations would have little impact.

In fact, changes to these local rules were likely to incur the wrath of the Ministry of Home Affairs (MOHA), because the recommendations contained in MITI's report ran counter to regional regulations and upset local autonomy. MITI was supposed to refrain from intervening in local affairs by forcing changes in local ordinances. MITI took some time to explain matters to MOHA, which delayed notification of the changes to local bureaus. These two factors spoiled MITI's hopes of avoiding prolonged negotiations on the law with the US government.

Within Japan itself, there was widespread opposition to rescinding or reforming the law. One argument was that restrictions on large-scale stores were necessary to protect small and medium-scale retailers, because elderly consumers who lived in downtown areas and could not drive might experience shopping difficulties due to the fact that large-scale stores were located in the

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<sup>91</sup>Tsuruta and Yahagi, *op.cit.*, p. 307.

main suburban areas.<sup>92</sup> While the United States initiated the SII talks for the purpose of reducing its trade deficit with Japan, the most competitive US imports were food products, many of which were already licensed to Japanese firms for local production. In regard to this, Toshio Tajima, vice president of the 50,000-member Federation of Specialty Store's Association, stated that 'even if the law is abolished, it probably will not make much difference in the scale of imports'.<sup>93</sup> As well, exorbitant land prices, Japan's labour shortage and rising construction costs would frustrate the expansion plans of large-scale retailers.

Despite the aforementioned opposition in Japan, the LSRSL was drastically reformed. The result of the SII talks regarding the LSRSL, as incorporated in the Final Report, concluded in June 1990, exceeded the recommendations of the MITI report on the distribution industry. The main points of the Final Report were as follows:

- 1) The coordination process period would be less than one and a half years (by May 1990) and all applications would be accepted.
- 2) In the next regular session of the Japanese Diet (in 1991), an amendment of the law would be submitted, including further shortening of the coordination processing period from two years to one year for opening large-scale stores.
- 3) The law would be reviewed further two years after the above-mentioned amendment to the law, including removal of regulations applying to specific geographical areas.<sup>94</sup>

The point, however, is that Japan did not bend to the initial request by the United States that the law be abolished. The United States compromised by

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<sup>92</sup>*Nihon Keizai Shimbun*, 14 April, 1990.

<sup>93</sup>*Ibid.*

<sup>94</sup>See the SII Final Report.

acceding to reform of the law; Japan, for its part, also made a concession, indicating that the law would be drastically reformed. The following analysis applies the two-level games model to show why and how Japan decided to reform the law and not comply with the US request to rescind it.

## **Level II preferences and coalitions concerning abolition of the LSRSL**

Putnam points out that 'the size of the win-set (and thus negotiating room for the Level 1 negotiator) depends on the relative size of the "isolationist" force (opposed to international cooperation in general) and the "internationalists" (offering 'all purpose support')'.<sup>95</sup> In the case of discussion of the LSRSL in the SII talks, the first force meant disagreeing to abolish, or even to reforming the law; the latter meant agreeing to abolish or reform the law so as to ensure sound relations with the United States. The following discussion will analyse the preferences of Japan's domestic actors concerning the LSRSL.

### *The Ministry of International Trade and Industry*

Since the LSRSL is a commercial law, MITI's Bureau of Industrial Policy is responsible for it. Also, the Retail Commerce Division of the Small and Medium Enterprise Agency attached to MITI has been concerned with the law in relation to the development of small and medium-scale retailers. MITI is able therefore to exercise an influence on the law, through administrative guidance, for instance. MITI's stance on the law was ambivalent, however. While MITI understands that large-scale retailers are necessary in the light of consumer interests and price stability, it also needs to consider the interests of small and medium-scale stores. This has placed it in a dilemma. MITI's basic

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<sup>95</sup>Putnam, 1988, pp. 442-443.

priority is industrial rationalisation in relation to the principle of competitiveness. Thus MITI was, in general, against regulating large-scale stores opening under the LSRS. <sup>96</sup> Quite a few MITI officers are reported to have agreed to abolition of the law. <sup>97</sup> A former Vice Secretary of MITI, Naohiro Amaya, mentioned that 'personally speaking, I was opposed to the introduction of the law, because I thought the law would not liberalise the distribution industry'. <sup>98</sup> MITI had in effect continued to regulate the law, due to pressures from LDP politicians petitioned by small and medium-scale retailers. Politics dominated development of the law. Amaya, in this sense, said that 'as politicians could decide the law's direction, administrators had no choice but follow them'. <sup>99</sup> LDP politicians had pressured MITI to regulate the law further; for instance, by reviving the licence system of the Department Store Law. MITI, instead of legislating regulation of the law, chose to regulate it through administrative guidance. This also enabled it to resolve the dilemma of how to protect the interests of both consumers and small retailers. If MITI had chosen legislation instead of administrative guidance, this might have encouraged large-scale retailers to initiate a lawsuit claiming that legislation was opposed to freedom of business as contained in the Constitution. This scenario would have retarded the adjustment process for opening large-scale stores.

In the case of the SII negotiations, MITI's opposition to abolishing the law was clear. MITI had issued its report, *Vision of the Distribution Industry in the 1990s* prior to the SII talks, recommending that the basic framework of the law be maintained, but that the adjustment processing period be limited. MITI

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<sup>96</sup>Hosono, 1992, pp.38-40.

<sup>97</sup>*Asahi Shimbun*, 26 March 1990.

<sup>98</sup>Kusano, 1992, p.114.

<sup>99</sup>*Ibid.*

regarded these recommendations as adequate and US pressure to abolish the law as too radical. One MITI officer remarked that:

MITI prefers the soft-landing, because rescinding of the law would promote confusion among small and medium-scale retailers. As well, abolition of the law would contribute to the municipalities' additional regulations being overlooked, which might lead to stronger regulations.<sup>100</sup>

In short, restrictions on large-scale stores were needed until small and medium-scale retailers were able to adjust to the changing industrial structure caused by reform of the law. Another reason why MITI was reluctant to rescind the law was that after abolition of the law, wrong adjustment by municipalities as to whether or not a large-scale store could open in a certain area might retard development of retail trading in that area. Also, MITI was concerned that abolition of the law would lead to excessive competition among large-scale stores, along with substantial damage to small and medium-scale retail business. The LSRSL served to introduce order into the retail industry, and MITI employed it to maintain that order. To conclude, it is safe to assert that MITI's win-set from deregulating the law would increase, but to abolish the law would reduce that win-set.

### *Liberal Democratic Party*

The LDP, as explained, protected small and medium-scale retailers, since they had long been LDP supporters. This probably contributed to stabilising the number of such retailers in Japan more than in other developed countries.<sup>101</sup> For instance, immediately after the Lower House election in 1972 when the LDP lost some seats, the Tanaka Administration enacted the Small and

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<sup>100</sup>Interview with Takaya Imai, Deputy Director of Division of Distribution Industry, MITI.

<sup>101</sup>Inoguchi and Iwai, 1987, p.17.

Medium-scale Retail Business Promotion Law, which enabled small retailers to borrow loans at low rates of interest and to receive some tax privileges. The same measures were taken after the 1973 oil shock when small retailers faced financial difficulties.<sup>102</sup> The LDP shored up its traditional support in this way. As well, small retailers helped with the politicians' electoral activities in their constituencies. Without their cooperation, politicians would have found it difficult to conduct their electoral campaigns. Thus, the LDP was generally opposed to abolishing, even reforming, the LSRL, since this might damage the small retailers, and lose it votes.

Among LDP politicians, the so-called commercial and industrial trade Dietmen (*shoko-zoku*) have vested interests in small and medium-scale retailers. These Dietmen, 'who identify strongly with a particular policy area, develop technical expertise therein, and form policy and patronage networks with relevant bureaucrats and private sectors',<sup>103</sup> had continued to pressure MITI to regulate the law further after its inception. Yet, compared with their agricultural counterparts, discussed earlier, *shoko-zoku* was not as consistent or monolithic, for while these Dietmen represented small and medium-scale retailers or corporations, they also had vested interests in large-scale retailers, who helped them secure political funds. Before administrative guidance was introduced in 1982, certain *shoko-zoku* pressured MITI to stop the opening of a particular large-scale store, while also demanding that it allow another large-scale store to open.<sup>104</sup> *Shoko-zoku* have thus been petitioned by both small and large-scale retailers. *Shoko-zoku*, petitioned by small retailers, had no objection to MITI's *Vision of the Distribution Industry in the 1990s* and the SII Interim Report, probably because they thought it unwise to support only one side

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<sup>102</sup>Ibid.

<sup>103</sup>George and Rapkin, 1992, p.10.

<sup>104</sup>Kusano, 1992, p.210.

(small retailers) and hence took advantage of the US pressure to shift responsibility.

The influence of politicians who had exclusively supported small and medium-scale retailers in the 1970s and 1980s, and thus were not numbered among *shoko-zoku*, was therefore limited. For instance, Jun Shiozaki, Kazuo Shioya and Gentaro Nakajima, all of them inclined to protection of small and medium-scale retailers, were not invited to become Chairmen of either the Commerce and Industry Division of the LDP's Policy Affairs Research Council (PARC) or the Commerce and Industry Committee in the Lower House.<sup>105</sup> Takeshi Noda, Hideo Watanabe, Takashi Tawara and Kaoru Yosano, all who chaired the Commerce and Industry Division of PARC at different times, had a mediating role to play between small and large retailers. This suggests that the interests of small retailers were not reflected in the LDP's commercial policy. However, as the LSRSL became an important item on the SII agenda, and an international issue, LDP leaders rather than the *shoko-zoku* emerged as the main actors in SII discussion of the issue.

Within the LDP, a Special Research Committee on Economic Adjustment, under the President of the LDP (Prime Minister), was established with a view to tackling reform of Japan's economic structure. The LDP's Executive Council (*somu-kai*), the party's final decision-making organisation, was excluded from the process, and the Committee's bills were regarded as official LDP policy. The Committee's role appeared significant in determining whether the law was to be abolished or not. The Chairman of the Committee, Toshio Yamaguchi, thought it necessary that Japan make substantial concessions to the United States, and even allowed for abolishing the law.<sup>106</sup> However, at a

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<sup>105</sup>Kusano, op.cit., pp.219-222.

<sup>106</sup>*Nihon Keizai Shimbun*, 16 March 1990.



Committee meeting on 27 March 1990, just before the fourth session of the SII talks in Washington, almost all its members expressed their objections to abolition of the law,<sup>107</sup> for it appears they were anxious about losing support from small and medium-scale-retailers.

LDP politicians were reluctant in general to involve themselves in the decision-making process on the law, partly because they wished to avoid giving the impression that they were not especially interested in the interests of consumers and partly because they did not want to alienate large-scale retailers, and thus lose their financial support.<sup>108</sup> The politicians did not want to be left accountable should the issue meet a bad end, and thereby lose the votes of some small retailers.<sup>109</sup> Thus it was that they chose the safe option, and entrusted LDP leaders such as the Prime Minister with the decision-making authority.

Prime Minister Kaifu was a strong supporter of the law's abolition. Kaifu was initially regarded as an interim Prime Minister, because most of the Prime Ministerial candidates were then involved in the 'Recruit Scandal' and could not run for Presidential election in the LDP. In fact, Kaifu had never held a top cabinet or party post and lacked a substantial personal following. He appeared to be a figurehead only, controlled by party leaders in the largest factions. In order to overcome his political weak points, Kaifu sought, successfully, to incorporate Japanese consumers into his support coalition, in the process, contributing towards 'a greater consumer consciousness and awareness in Japan'.<sup>110</sup> In adopting such a stance, Kaifu kept pace with US demands in the SII talks. This situation created a coalition between a 'weak Prime Minister'

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<sup>107</sup>*Nihon Keizai Shimbun*, 30 March 1990.

<sup>108</sup>*Asahi Shimbun*, 29 March 1990.

<sup>109</sup>*Ibid.*

<sup>110</sup>George, 1991, p.19.

(Kaifu) and the US negotiators with their ostensible support of Japanese consumers.

In relation to the SII talks, Kaifu's purpose was to maintain power; the aim of the United States was to reach agreement on the SII. Kaifu was reluctant to abolish the LSRL in February 1990 for fear of resistance from an LDP majority, but after talks with President Bush in March 1990, in which he was required to make an effort to conclude the SII Interim Report, Kaifu showed a strong willingness to abolish the law and tried to exert his leadership to this end.<sup>111</sup> In the summit conference with President Bush, Kaifu seemed convinced that without the law's abolition, the US side would not be content. This change in approach to abolition of the law was due to confidence in his ability to resist opposition from the LDP majority, derived from strong US support for his position, along with the LDP's victory in the Lower House election held in February that year. Kaifu sought to capitalise on US pressure to increase his influence and sweep away opposition to elimination of the law. In this sense, the United States became 'an alternative power base for [Kaifu] seeking to overcome shortfalls in [his] own factional strength and domestic resistance to change'.<sup>112</sup> Kaifu appeared to cling to abolition of the law to ensure ongoing support from the United States and to strengthen his political base.

Another LDP leader, Ichiro Ozawa, the Party's secretary-general, mediated between Kaifu and the LDP majority. Ozawa thought that although Japan had to concede to the US demands, opposition to abolition of the law by LDP politicians should be taken into consideration. Ozawa, who belonged to the Takeshita faction, the largest faction in the LDP, consulted with Shin

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<sup>111</sup>Mabuchi, 1990, p.16.

<sup>112</sup>George, 1991, p.18.

Kanemaru, the faction's president, as to whether the law should be abolished or not. Kanemaru, the party's most powerful decision-maker, agreed with Ozawa, noting that Japan could not live without the United States, and that it had helped create modern Japan.<sup>113</sup> Kanemaru was also consulted by the MITI minister, Kabun Muto, who was opposed to abolishing the law. This provides an indication of Kanemaru's power in the LDP's policy-making process. After all, Kanemaru and Ozawa occupied the middle position with respect to the law's abolition.

While Kaifu and a few LDP cabinet members agreed to the law's abolition, a majority of LDP members opposed it, with LDP leaders such as Ozawa and Kanemaru positioned between them. The win-set of the LDP to abolish the law was considerable, because Kaifu supported the US demands. But since most of the LDP politicians were opposed to the law's abolition, and Ozawa and Kanemaru regarded such a move as too radical, the United States was unlikely to increase the LDP's win-set to a level where the law would be abolished.

### *Interest groups*

Interest groups within the retail industry can be divided into two groups: large-scale retailers, and small and medium-scale retailers. Interest groups behind the large-scale retailers mostly preferred to abolish the law, except for some old large-scale retailers such as *Daiei* and *Nichii*, as discussed in chapter 1, because an existing large-scale retailer benefited from a law that made it difficult for other large-scale retailers to establish outlets in the same area. In any case, old large-scale retailers had already established business networks throughout the nation, and so newcomers such as *Life Store* had great difficulty establishing

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<sup>113</sup>*Asahi Shimbun*, 6 April 1990.

themselves. This is partly why the Japan Chain-store Association, the main interest group for the large-scale retailers, has never taken steps to appeal for abolition of the law.<sup>114</sup> As well, supermarkets attempt individually to exert their political influence, since there exists considerable competition among them.<sup>115</sup> In short, the interest groups behind large-scale retailers lack coherence. This means that although political funds from individual large-scale retailers are attractive to the LDP, the influence of these interest groups has been relatively small. In terms of modernising the retail industry, however, MITI and these interest groups for large-scale retailers have been able to work together.

Small retailer interest groups petitioned LDP politicians, especially the *shoko-zoku*, to regulate the law further. Their block vote of approximately 1,500,000 votes made the LDP politicians hesitate to support deregulation of the LSRSL even if this ran counter to the current trend. Small and medium-scale retailers tend to close down or sell their businesses rather than to pass them along as a family business. Thus, they rarely invest in equipment or seek to modernise their management, unlike the large-scale stores. They prefer therefore to prevent large-scale stores from opening rather than engaging in management modernisation.<sup>116</sup>

Nevertheless, differences of opinion also exist among the small retailers, with some seeking to coexist with large-scale stores and enjoy mutual prosperity. Some argue, for instance, that a large-scale store in the centre of a shopping district is often helpful in attracting customers to the district. Owing to differences of view among small retailers, the Association of National Shopping District Promotion had difficulty in achieving a unanimous view on reform of

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<sup>114</sup>Kusano, 1992, p.150.

<sup>115</sup>Oyama, 1988, p.57.

<sup>116</sup>Oyama, 1988, p.58.

the LSRL.<sup>117</sup> The Association's Chairman, Katsuichi Yamamoto, pronounced approval of the decision to radically reform the law after the contents of the SII Interim Report were released, although he withdrew this statement two days later due to protest by some members of the Association.<sup>118</sup> What distinguished the interest groups of large-scale retailers and small-scale retailers was probably the fact that MITI backed the former in deregulation of the retail industry, although it was against abolition of the law. It is true that LDP politicians generally supported small retailer interest groups, but not necessarily right across the board, as discussed earlier. The political influence of small retailer interest groups appeared strong in the 1970s and 1980s in relation to regulating the law, but declined somewhat as differences of opinion emerged among the small retailers themselves.

The Japan Chamber of Commerce and Industry persisted in its opposition to any kind of deregulation of the law, since this might force many of Japan's 1,620,000 small retailers into bankruptcy.<sup>119</sup> Rokuro Ishikawa, then President of the Japan CCI, stated that 'the law's abolition could lead to a distorted rush of large-scale store opening, creating great uncertainty and confusion among small retailers and "mama-and-papa" stores.<sup>120</sup> The CCCAs, through which adjustment of large-scale stores was conducted, were housed in 473 local CCIs. In this way, the CCIs, which are specially licensed corporations, served as public bodies for adjusting negotiations between local small and large-scale retailers. On the other hand, the CCIs tended to function on behalf of small and medium-scale retailers since these retailers collected votes for the LDP at election time.<sup>121</sup> In fact, 50 per cent of the CCIs' management funds derived from local small and medium-scale retailers. Senior officials in certain local

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<sup>117</sup>Kusano, 1992, p.238.

<sup>118</sup>*Nihon Keizai Shimbun*, 7 April 1990.

<sup>119</sup>*Nihon Keizai Shimbun*, 6 April 1990.

<sup>120</sup>*Ibid.*

<sup>121</sup>Oyama, 1988, p.70.

CCIs were indeed the local small retailers. If the law were abolished and the CCCAs were disbanded, the *raison d'être* or authority of the CCIs would be diminished. Thus, the Japan CCI was opposed to eliminating the law, though its influence was limited after the CCCAs were abolished in accordance with an agreement contained in the SII Interim Report.

### *Consumers*

Consumers attitudes towards abolishing the law were quite positive. According to a 1991 Nikkei survey of 1,091 Japanese consumers, 76.7 per cent of respondents who knew the LSRL believed that abolition of the law would have positive effects on their daily lives. Also, 41.9 per cent of the respondents expected the price of goods to be reduced, and 24.4 per cent of these expected the number of goods to increase.<sup>122</sup> The high percentage of consumers in favour of abolition of the law seemingly relates to the US ploy, admitted by Linn Williams, then Deputy USTR, of appealing to Japanese consumers, who the United States claimed would benefit from reform of the distribution system.<sup>123</sup> The United States in effect played the role of 'an interest group representing the voice of Japanese consumers',<sup>124</sup> a voice that the Japanese government was obliged to consider in the SII talks.

However, the influence of consumer groups on politics was arguably smaller than that of other interest groups. For instance, consumer groups that support the Japan Communist Party make contact with the LDP less often than other groups do and are less frequently consulted with in turn.<sup>125</sup> The fact that there is no nation-wide organisation uniting small Japanese consumer groups 'leaves

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<sup>122</sup>*Nihon Keizai Shimbun*, 26 April 1990.

<sup>123</sup>See Williams, 1990.

<sup>124</sup>George, *op.cit.*, p.18.

<sup>125</sup>Mabuchi, *op.cit.*, p.16.

each movement to promote its own goals and policies'<sup>126</sup> and thus they exert a limited influence on politics. External pressure from the United States tended to compensate for the shortcomings of consumer groups in Japan. In other words, it was because the United States put the issue of the law on the SII agenda that Japanese consumers began to pay attention to the issue.

The pro-abolition coalition ultimately comprised Prime Minister Kaifu, the Japan CCIs, consumers and some intermediate large-scale retailers. MITI, the LDP majority, small and medium-scale retailers, and some 'existing' large-scale retailers formed the anti-abolition coalition. However, Kaifu failed to sweep away opposition within the LDP. And the other actors in the pro-abolition coalition failed to create a powerful political campaign to achieve their aim.

However, MITI, who thought it necessary to deregulate the distribution industry, and the LDP leaders such as Ozawa and Kanemaru, who put a priority on relations with the United States, admitted that deregulation of the LSRSI was necessary. The majority of LDP leaders who did not support abolition of the law, since they did not wish to lose the support of the small retailers, failed to mount a strong campaign, however. This was probably because small retailers were not their sole group of supporters and thus the loss of some small retailers would not prove serious. In addition, not all small retailers were against abolition or reform of the law since, as already mentioned, they felt that large-scale stores in their shopping districts helped to attract customers to the district.

These observations help to explain why Japan decided to compromise with the United States and, if not to abolish the law, then to substantially reform it beyond the recommendations issued by MITI before the SII talks commenced.

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<sup>126</sup>*Tokyo Business Today*, March 1990.

To clarify how Japan formulated its compromise, the next section focuses on the Japanese decision-making process with reference to, in Putnam's terms, Level II political institutions.

## Level II political institutions

Before the LDP was replaced by the coalition administration in July 1993, ratification of any policy required approval by the LDP, Cabinet and Diet. Since this thesis is interested in Japan's decision to reform the LSRL in the SII talks, only the LDP's involvement will be examined here, specifically how the LDP decided on reform of the law, as opposed to its abolition, or leaving it unchanged.

Normally, a draft of a policy proposed by bureaucrats had to be examined by LDP Dietmen before it went to the Diet. There were four stages in the LDP part of the legislation process: 1) a division of the Policy Affairs Research Council (PARC); 2) adjustments by the *zoku-giin*; 3) PARC; and 4) the *somukai* (Executive Council, EC).<sup>127</sup> The first two were the important venues. In short, policy approved in a division of PARC was important in that after it passed through that division, the draft was recognised as official policy assuming that the other divisions did not oppose it.<sup>128</sup> In PARC's divisions, as already argued, the *zoku-giin*, who had a close relationship with the ministry in charge, played a significant role in mediating between Dietmen with different opinions so as to achieve unanimity. In other words, a *zoku-giin* was a LDP Dietman who had 'a special relationship with the bureaucracy and act[ed] as

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<sup>127</sup>Iwai, 1992, pp.177-179.

<sup>128</sup>Matsuzaki, 1989, p.117. PARC and the EC were in general ritualised, except where a dispute over policy is not solved on a division level.



the bureaucracy's spokesman'<sup>129</sup> and represented a pressure group within the LDP.

In reality, the *zoku-giin* participated in policy-making from the initial stage (bureaucracy level) through informal meetings with the bureaucrats in charge, since the bureaucrats needed the *zoku-giin*'s cooperation to ensure the bill they submitted passed smoothly through the LDP level. This process allowed the *zoku-giin* to incorporate their interests in a bill. In the meantime, targeted by interests groups, the *zoku-giin* could acquire political funds through these groups, expand their areas of support and maintain a close relationship with the ministry associated with those interest groups.<sup>130</sup> Therefore, it was crucial that LDP Dietmen as the *zoku-giin* identified their special areas. In other words, a symbiotic relationship existed among *zoku-giin*, bureaucrats and interest groups. This relationship was sustained by a system in which the structural divisions of PARC were organised vertically in accordance with their associated ministry. The existence of *zoku-giin* in a PARC division, their allegiance to particular pressure groups in return for political funds and votes, and their close relationships with bureaucrats captured the nature of LDP input into policy-making. The history of the LSRL shows the strong influence of *shoko-zoku* in regulation of the law and the decision-making process in the Division of Commerce and Industry of PARC. These decisions became what were generally regarded as official LDP policy.

Given the above observation, Putnam's notion may be true that 'the Japanese propensity for seeking the broadest possible domestic consensus before acting constricts the Japanese win-set, as contrasted with majoritarian political cultures.'<sup>131</sup> However, this mode of decision-making takes considerable time.

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<sup>129</sup>Kanazashi, 1984, p.131.

<sup>130</sup>Inoguchi and Iwai, 1987, pp.21-24.

<sup>131</sup>Putnam, op.cit., p.449.

In the case of the SII talks, the United States had to decide whether Japan would be nominated at the end of April 1990 as a priority country under the Super 301. Since Japan sought to resolve the LSRSL issue prior to this, consensus politics could not be employed in this instance. Also, as the LSRSL issue had become an international issue by virtue of its selection on the SII's main agenda, consensus-style or *zoku-giin*-oriented decision-making was not suitable in this case.

Thus, the number of LDP politicians involved in the decision was limited to Prime Minister Kaifu, Secretary-General Ozawa and Kanemaru, President of the largest LDP faction. Kaifu was perhaps the only Japanese 'negotiator' in the SII talks with decision-making authority. Negotiators from both nations had to gain approval from political authorities at home concerning their agendas at the SII talks. Kaifu, who met with President Bush in March 1990 in order to get the SII talks moving along again after they became bogged down, was convinced that the United States would not budge from its desire to see the LSRSL abolished and thus he continued to support its abolition. Putnam notes that 'the greater the autonomy of central decision-makers from their Level II constituents, the larger their win-set and thus the greater the likelihood of achieving international agreement'.<sup>132</sup> In Kaifu's case, his weak political support within the LDP reduced his autonomy and meant it was unlikely that Japan's win-set with respect to abolition of the law would widen.

Before the fourth round of the SII talks, held 2-5 on April 1990, the LDP coordinated its final plan, after considering the opposition of both LDP politicians and MITI to abolition of the law. Kanemaru decided on MITI's compromise proposal; namely, that the coordination processing period be less than one and a half years (to be conducted during May 1990) and that the law

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<sup>132</sup>Putnam, 1988, p.449.

be reviewed in 1994 with a removal of regulations applying to specific geographical areas. However, this decision represented a considerable concession, since it exceeded MITI's recommendations in the *Vision of the Japanese Distribution Industry in the 1990s*, a report issued before the SII talks were initiated. Also, as the specific geographical areas included large cities like Tokyo and Osaka, LDP politicians from these large cities were extremely upset, with Ken Harada, Chairman of the Dietmen Association of Metropolitan Areas, declaring that they had been made scapegoats.<sup>133</sup> Thus, the LDP had been obliged in the end to make some sacrifices.

### **Level I strategies and the United States**

The United States employed three strategies to encourage Japan to abolish the LSRL and to widen Japan's win-set. It sought to: 1) win Japanese consumers over to the US side, 2) focus pressure on LDP leaders, and 3) intensify the pressure by limiting the time allocated to negotiation.

The United States consistently emphasised the benefits that would accrue to Japanese consumers if the SII agendas supported by the United States in Level I negotiations were realised. The implicit message to the Japanese consumers was that its government should be pressured to accede to US demands for the sake of its consumers. Partly because of this, the response by consumers to fulfilment of the US requirements in the SII talks was a positive one. Satoko Tanaka, Secretary-General of the Association of Tokyo Regional Ladies Organisations, said at the time that 'the US requirements in the SII talks are all proper and just'.<sup>134</sup> The US strategy to appeal to the Japanese consumers was

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<sup>133</sup>*Nihon Keizai Shimbun*, 7 April 1990.

<sup>134</sup>*Asahi Shimbun*, 27 March 1990.

a clear one, since it promoted in Japan a widening win-set to abolish the LSRSL.

Putnam argues that 'each Level I negotiator has a strong interest in the popularity of his opposite member since Party A's popularity increases the size of his win-set, and thus increases both the odds of success and the relative bargaining leverage of Party B'.<sup>135</sup> Prime Minister Kaifu expounded a platform of 'politics for consumers', often referring to 'benefits for consumers' and 'reforms for consumers' in his speeches in the Diet.<sup>136</sup> His political stance is also evident in his comments at the conclusion of the SII Joint Report: 'I am confident that the SII talks will greatly contribute to...enhancing consumer interests'.<sup>137</sup> The US support for Japanese consumers, albeit to gain concessions during the SII talks, stimulated support for Kaifu, whose position within the LDP was weak and thus in need of consumer support, and also heightened his popularity to some degree. By appealing to Japanese consumers, the United States was able to win Kaifu over to its side, all of which was supposed to result in a widening of the Japanese win-set.

The second strategy employed by the United States to widen the Japanese win-set was to bring Kaifu into the front-line of the talks. As Putnam notes, 'foreigners prefer to negotiate with a head of government than with a lower official'.<sup>138</sup> This is probably because a head of government is in general the ultimate decision-maker and is more likely to fulfil any promises made than are mere negotiators. A head of government, in Putnam's words, provides 'the only formal link between Level I and Level II'.<sup>139</sup> In order to advance the SII talks when they became bogged down, President Bush sought a summit

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<sup>135</sup>Putnam, op.cit., p.451.

<sup>136</sup>Mabuchi, op.cit., p.16.

<sup>137</sup>See the Joint Report of the SII.

<sup>138</sup>Putnam, op.cit., p.452.

<sup>139</sup>Putnam, op.cit., P.456.

meeting with Kaifu alone. This meeting provided Kaifu with added incentive to see the talks reach a successful conclusion and to exercise his leadership to achieve this. Kaifu in fact became the most powerful supporter of the US demand to abolish the LSRL. By focusing on Kaifu, the United States was probably hoping to circumvent Japan's conventional *zoku-giin*-oriented decision-making process, with its tendency to lead to long drawn-out discussion and parochial viewpoints. The Bush-Kaifu summit meeting had the effect of predisposing Kaifu to take the lead in deciding Japan's stance on the law.

As part of this second strategy, the United States met with former Prime Minister, Noboru Takeshita, on 11-12 March 1990. Takeshita, along with Kanemaru, was a leader of the largest and most powerful LDP faction and able perhaps to iron out differences of opinion among party politicians. US appeals to both Kaifu and Takeshita, it was hoped, would contribute to widening Japan's win-set to abolish the law.

The third strategy employed by the United States was to place a time limit on the SII negotiations and its production of its Interim Report. To avoid being nominated as a priority country under the Super 301, which was scheduled to be decided at the end of April 1990, the Japanese government was obliged to conclude its Interim Report with the United States in a way that was satisfactory to Congress. Given the limited time for negotiations, the United States was able to put pressure Japan to make concessions much more easily, hopefully widening the Japanese win-set to abolish the law. As Putnam notes, 'a small domestic win-set can be a bargaining advantage'.<sup>140</sup> As discussed in chapter four, Congress's propensity to pursue protectionism and its tough stance on Japan due to the huge trade imbalance between them made it much

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<sup>140</sup>Putnam, op.cit., p.440.

more difficult to widen the US win-set to abandon its proposal to abolish the law. In fact, the US side often stated during negotiations that without substantial concessions from Japan, Congress would not be dissuaded from citing Japan under the Super 301. Thus, since it appeared impossible to widen the US win-set, the US negotiators attempted to enlarge the Japanese win-set.

The above analysis suggests that, from the viewpoint of the Japanese win-set, Japan was unlikely to abolish the law. With respect to reform of the law, however, Japan's win-set would be increased, given the existence of supporters within Japan to deregulate the retail industry and the three strategies adopted by the United States discussed above. In reality, the Japanese proposal that the coordination processing period be less than one and a half years (from May 1990) and that the law be reviewed in 1994, including removal of regulations over specific geographical areas, represented a huge concession. The United States managed, at the very least, to force Japan to incorporate the word 'removal' in the Final Report. The Japanese claim that removal of the law in certain municipalities would encourage them to create their own restrictions on opening large-scale stores might also have helped persuade the United States to abandon its proposal that the LSRL be abolished. Japan was asked to hold follow-up talks with the United States in order to check whether or not the contents of the Final Report were still to be carried out. In this sense, Japan paid a price for not abolishing the law, although in the end both countries' win-sets overlapped.

## CONCLUSION

The preceding chapters have thus far explored the following issues: 1) why and in what ways the LSRS� generated problems in Japan; 2) why the SII talks were initiated and how the issue of the law was dealt with in the talks; 3) the implications of external US pressure on the SII talks and why Japan was so reactive to this pressure; and 4) how Japan decided to substantially reform the law, as illustrated through application of Putnam's two-level games model.

These investigations have shown that external US pressure was effective in forcing Japan to embark on domestic reforms made difficult otherwise due mainly to vested interests. Although Japan did not actually abolish the LSRS�, its reform of the law was substantial. Without US pressure, such drastic reform would not have been accomplished. This concluding chapter draws out the implications of the law's reform for the establishment of large-scale stores following the SII talks and provides an overall interpretation of the reformed law.

### **The appropriate implementation of the law**

The SII Final Report set out the Japanese proposal to reform the law in three stages: 1) the appropriate implementation of the law, on 30 May 1990 prior to the conclusion of the Final Report; 2) amendment of the law, on 8 May 1991; and 3) review of the law in 1994 to include the removal of regulations in specific geographical areas.<sup>141</sup>

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<sup>141</sup>See the SII Final Report.

The main points of the reform at the first stage were: 1) the coordination processing period would be less than one and a half years, 2) all applications would be accepted, and 3) the Japanese government would notify each prefectural governor to take the necessary corrective measures.

The first point represented a great improvement on the average period of 35 months required previously to open a large-scale retail store.<sup>142</sup> The second point represented a substantial improvement also in that previously a number of items were left uncoordinated and thus not accepted for a long time. To fix the period and accept all applications represented a 'revolutionary' improvement for the large-scale retailers.

With respect to the third point, considerable time was required to allow local governments to respond to the notification, but this was a crucial point nevertheless, since local regulations completely deviated from the degree of regulation under the LSRL. Adequate implementation of the law contributed to increased numbers of large-scale stores, with announcements of store openings in the order of 1,210 in the ten months from 30 May 1990, when the deregulation measures for appropriate implementation of the law were introduced, to 31 March 1991. This represented a substantial increase over average figures for previous years.<sup>143</sup>

What is interesting, however, is that of the 1,359 applications to open large-scale stores at the end of May 1990 as the law took hold, 374 of these were cancelled of the holders' own accord one year later.<sup>144</sup> Prior to reform of the law, large-scale retailers were unable to predict opening their times and thus tended to hand applications in regardless of whether they even had the finance

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<sup>142</sup>Kiyonari and Yasaku, 1991, p. 39.

<sup>143</sup>Nikkei Research Institute of Industry and Market, 1992, p. 260.

<sup>144</sup>*Ibid.*



to open stores. What they wanted was simply the chance to be ahead of the other large-scale retailers. As adequate implementation of the law enabled all large-scale retailers to open their stores after the fixed period, however, unnecessary or non-urgent applications, which had previously promoted excessive competition among large-scale retailers, were withdrawn. Major large-scale retailers, such as *Daiei* and *Jasco* for instance, formerly attempted to open outlets up to one day earlier than other large-scale retailers, and were satisfied if they could open outlets of only one square metre larger than their competitors' outlets. This type of practice gave rise to competition not only on a management level but also in relation to shares. One positive effect of adequately implementing the law was to reduce this unhealthy competition.<sup>145</sup>

### **Amendment and review of the law**

Following implementation of the reform, MITI submitted bills to amend the law. Introduced in the regular session of the Diet on 18 February 1991, the amendment was passed on 8 May 1991. The key points of this second stage of reform were as follows: 1) the coordination processing period for opening stores would be further shortened to approximately one year, 2) the CCCAs would be abolished and replaced by the Large-scale Retail Store Council (LSRSC), 3) the boundary line between the first and the second category of large-scale stores would be raised from 1,500 to 3,000 square metres (3,000 to 6,000 square metres in ordinance-designated cities), and 4) in order to restrain separate regulations by local municipalities, certain legal measures would be introduced.<sup>146</sup>

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<sup>145</sup>Interview with Mr Imai. According to Imai, it was not the LSRSL that made it difficult for large-scale retailers to open their stores but partly the excessive competition that existed among large-scale stores themselves.

<sup>146</sup>See the SII Annual Report, Follow-up, compiled on 22 May 1991.

With reference to the first point, it was important to clarify the starting day for coordination. Previously, under administrative guidance, large-scale retailers were required by MITI to give Prenotification Explanation to local small retailers, who capitalised on this to delay the opening day of the large-scale stores. Yet after the second stage of the reform, the starting day for coordination was set as the day when notification, according to Article 3, was effected. In other words, the Prenotification Explanation, which was previously exercised before the Article 3 notification was required, would be abolished and the 'official' explanation made to suffice. The period for this 'official' explanation was fixed as less than 4 months. This kind of reform aimed to shorten the time taken for large-scale retailers to open their outlets.

The second point was also important in that the coordination procedure became much more transparent. Both the Prenotification and official CCCAs as well as the Prenotification Explanation were not stipulated in the LSRSL itself: nevertheless, the CCCAs played a practical coordination role. After the law's reform, the CCCAs were to be disbanded and the Large-Scale Retail Store Councils were to become the official legal coordinating centres. Members of Large-Scale Retail Store Council were to become quasi-public servants and acceptance by them of payoffs from large-scale retailers, as in the pre-reform system, would be penalised. This reform contributed to simplification of the law coordination procedure.

As regards to the third point, the second category of large-scale stores were designated as stores with a floor space of 500-3,000 square metres. Legal authority was to be transferred to the local governor. The MITI minister was in charge of coordination of the first category of stores, making the local governor responsible for coordination of the second category. Supermarkets whose commercial sphere was relatively small were to be coordinated under

the local authority (the local governor), rather than the national authority (the MITI minister).<sup>147</sup> In fact, it was almost impossible for MITI to check small retailers' commercial activities in all prefectures, cities and towns. National Large-Scale Retail Store Councils were placed in charge of coordination of department stores and comprehensive supermarkets, while prefectural Large-Scale Retail Store Councils assumed responsibility for coordinating food supermarkets or specialty stores.

With regard to the fourth point, it was difficult to abolish the two types of regulations imposed by local governments: the additional and the expanded regulations. The reformed LSRL stipulates in Article 15 that when a certain municipality determines that the opening of a large-scale store will inflict substantial damage on small and medium-scale retailers in the planned area, and thus decides to impose a regulation on the store, it must respect the law's intent.<sup>148</sup> Owing to this new stipulation, it became more difficult to implement the additional regulation. The additional regulation meant that without an agreement between large-scale retailers and local small retailers, the local authority would not accept the application, since the Prenotification Explanation via which agreement between both large and small retailers in the planned area was reached, was rescinded.

On the other hand, the expanded regulation over the opening of large-scale stores with a floor space of less than 500 square metres proved more difficult to remove. According to the above stipulation, the law can be interpreted as approving the expanded regulation. Local authority has the discretion to judge whether or not the damage caused by the opening of a particular large-scale store will prove substantial. Nonetheless, local authority may hesitate to

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<sup>147</sup>Kiyonari and Yasaku, 1991, p.44.

<sup>148</sup>Kiyonari and Yasaku, *op.cit.*, p. 250.

exercise the expanded regulation since the above stipulation on implementation of the expanded regulation was incorporated into the law.

The third stage of reform, promised in the SII Final Report, involved a review of the law, including removal of regulations applying to specific geographical areas. Since this review will not take place until 1994, it is difficult to predict whether or not regulation of the opening of large-scale stores in specific areas will be abolished. It is not clear first of all what 'specific geographical areas' means, although large cities such as Tokyo and Osaka would certainly be included. If the term denotes large cities only, excluding suburbs around these cities, the removal of regulation would have no significance, since land prices are expensive and labour is scarce in such cities, and thus an increase in numbers of new large-scale stores would be unlikely. Also, as many large-scale stores already exist in large cities, newcomers are likely to avoid such competition, preferring to open outlets elsewhere.

### **The impact of the reform on US-Japan trade**

The original purpose of the SII talks was to help redress the trade imbalance between Japan and the United States. The reformed law was supposed to allow more US large-scale stores to open in Japan and to increase the number of large-scale stores carrying imported goods. The United States hoped this would contribute to reducing its US trade deficit with Japan. But this did not eventuate, one reason being that Japan's land prices are extremely high compared with those in other countries. Thus US retailers hesitated to enter the Japanese market. Some Japanese retailers were themselves hesitant. As one Japanese retailer commented, 'land prices for large-scale stores should be 350,000 yen per 3.3 square metres; in fact, they are more than 800,000 yen.

So we are unable to open more than 10 outlets one year under our present budget'.<sup>149</sup> This is an important factor, since without sufficient parking and shopping variety, large-scale stores cannot attract consumers. In addition, since reform of the law, the demise of the so-called bubble economy has depressed their financial situation and made it more difficult for them to expand.

The United States has claimed, conversely, that large-scale stores have sold more imported products than small and medium-scale stores in terms of quantity of imported goods per store. Japanese large-scale stores have explored various routes to procure foreign goods and have proven superior to small-scale retailers in terms of their know-how. Yet Japan has recently increased its imports from East Asian and European countries as well as the United States for electronic parts and automobiles. This has hampered the sales of US products in Japanese markets. The most competitive products from the United States are said to be food products, many of which have already been licensed to Japanese firms, ensuring local protection.<sup>150</sup>

Manufacturers of top brand foreign products such as clothes, perfume and bags have placed their goods exclusively in the first-class department stores, not wishing to risk their reputations by placing their products in supermarkets. Japanese department stores have not been driven to increase their outlets, however, thus the reformed law would not contribute to department stores selling such top brand foreign products well. These factors have prevented US products from selling well in Japanese markets. Thus it is doubtful whether abolition of the LSRL would have helped increase the sale of US products in

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<sup>149</sup>*Nihon Keizai Shimbun*, 14 April 1990.

<sup>150</sup>*Ibid.*

Japan. This also invalidates the notion that abolition of the law would help solve the trade imbalance between the two countries.

### **Implications of the SII talks for US-Japan relations**

This thesis concludes that what the United States required of Japan in the SII talks was that they harmonise their institutions. Faced by their growing economic interdependence, the SII talks were to provide the first step towards integration of the two economies, facilitated in part by reform of the LSRSL. While reform of domestic laws is basically a domestic matter, it is nevertheless imperative that the same standards or rules be established in countries that conduct substantial volumes of trade with each other.

Where such deep interdependence exists between countries, domestic intervention may become normal,<sup>151</sup> since interdependence presupposes mutual influence on each other's affairs. When the domestic institutions and politics of countries impact on the international arena, cooperation and coordination of domestic policy becomes necessary. In the case of the SII talks, Japan and the United States agreed to hold 'follow-up' meetings to ensure that the promises incorporated in the SII Final Report would be carried out. Such an undertaking represents the institutionalisation and regularisation of policy harmonisation through domestic intervention. It was in this sense, then, that the SII talks were truly an historic event.<sup>152</sup> But if the new Hosokawa administration, and other Japanese administrations that follow it, fail to address the structural factors which caused Japan to be reactive, as discussed in this thesis, the United States will continue to place pressure on Japan.

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<sup>151</sup>Kojima, 1990, p. 158.

<sup>152</sup>Kojima, *op.cit.*, pp. 162-163.

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