

PACIFIC ECONOMIC PAPERS NO. 302

APRIL 2000

Implications of Recent Japanese Legal Reforms

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The Australia–Japan Research Centre is part of the Asia Pacific School of Economics and Management, The Australian National University, Canberra.

ISSN 0 728 8409

ISBN 0 86413 260 3

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Edited by: Jennifer Amyx and Sarah Leeming

Typeset by: Minni Reis

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PREFACE

The three papers in this volume explore changes in Japan's legal framework in the areas of finance, competition policy and public administration. The papers were first presented at an international conference entitled 'Beyond Japan Inc.: Reform and Transparency in Japanese Governance', which was held at The Australian National University on 20 September 1999. The conference drew together Australian, Japanese, American and British experts from industry and academia and was generously supported by the Japan Foundation.

Each paper in this volume focuses on developments in Japan's legal framework and suggests that significant changes have taken place. In 'After the Big Bang: heading for a transparent financial system', Akiyoshi Horiuchi analyses the background of the Big Bang financial reforms, the progress with these reforms and the issues that remain to be faced. He argues that the Big Bang represents the breakdown of the old financial regime governing the Japanese economy and the beginning of regime change. In 'Re-regulating Japanese Transactions: the competition law dimension', Veronica Taylor examines the introduction of a new political initiative, the 'legal system reform agenda', and the institutional shift that seems to be occurring in competition law and enforcement. She argues that within both the systemic legal reform agenda and the competition regulation sphere, the balance in the regulatory mix leans toward more legalism and 'juridification'. In 'Private Governance of Public Rights in Japan: revisiting the Japanese governance debate', Leon Wolff identifies a legal trend in Japan that has implications for the debate over the nature of Japanese governance: the private governance of public rights. Using a case study of changes in sexual harassment law, he argues that Japanese corporations are key players in the Japanese administrative state.

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**After the Big Bang: Heading for a
Transparent Financial System**

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AFTER THE BIG BANG: HEADING FOR A TRANSPARENT FINANCIAL SYSTEM

Introduction

Japan's financial system has been heavily burdened with non-performing loans since the beginning of the 1990s – longer than half a decade. Because the government failed to act quickly, the situation progressively worsened and emergency injections of public funds were needed to recapitalise banks and stabilise the financial system.

The financial system is not a mere mechanism for transferring funds from savers to users. It constitutes a core part of the corporate governance system of a market economy. Financial intermediaries such as banks directly monitor and discipline corporate managers, and suppliers of funds to financial and capital markets act to supervise and evaluate the managerial capacity of firms. A malfunctioning financial system disturbs the mechanisms of corporate governance and reduces the efficiency of the corporate sector. Because the banking sector dominates Japan's financial system, the banking crisis has been particularly serious for the Japanese economy (Horiuchi 1999; Hoshi and Kashyap 1999; and Milhaupt 1999). The seriousness of the crisis forced the Japanese government to take emergency measures in 1998 to recapitalise ailing banks.

The crisis also forced the Hashimoto government to seriously reconsider its program of financial reforms and in November 1996 a comprehensive package of reforms was announced – the 'Big Bang' – which aimed at making the Japanese financial system more efficient, transparent and globally competitive. Piecemeal reforms had been underway since the early 1980s – the period when financial liberalisation began worldwide. In a world of connected capital markets, deregulation became contagious, compelling other governments to follow along the same path. Japan was not exceptional in this regard. The Japanese government's program of financial reform began in 1980, with the 1949 Foreign Exchange Control Law amended to deregulate foreign exchange markets. The number of areas in the financial system that were heavily regulated either by statute or by administrative guidance have been gradually narrowed. This gradual liberalisation is why some analysts view the Big Bang as the culmination rather than the beginning of Japan's financial deregulation.

There were, however, some major discontinuities in the Big Bang reforms. Most importantly, the control the Ministry of Finance (MOF) has had over the reform program has lessened as the Big Bang plan has materialised. The Ministry's loss of power reflects its failure to cope effectively with the financial crisis caused by the non-performing loan problem. For better or worse, the decline of MOF's influence marks the disappearance of a regime that unified Japan's segmented financial system.

This paper explains how the Big Bang reforms have aided the breakdown of the financial regime that has governed Japan's economy during the past half century. The old regime, formed after the financial crisis of the late 1920s, was strengthened by wartime controls during the first half of the 1940s and by the reconstruction package implemented immediately after World War II. This regime dominated corporate finance during the high-growth era from the early 1950s to the early 1970s. Japan is now constructing a new financial regime more suited to the 21st century, and the Big Bang marks the beginning of this change. This paper investigates what the new regime is likely to be and how it is likely to influence the Japanese economy.

This paper explains how the old regime was perpetuated by the safety net set up by the Ministry of Finance, which aimed to shelter existing institutions from competition and prevent company failures. It looks at how delayed financial deregulation led to inefficiency in Japan's financial system and how MOF's influence over the Big Bang plan has lessened as a result of its policy mistakes. The first financial reforms to come out of the plan are examined, and the paper asks what issues remain before the goals of the Big Bang can be realised. Finally, there is a discussion of how the Big Bang can be expected to influence the Japanese economy.

What is the Big Bang?

In November 1996 then Prime Minister Ryutaro Hashimoto proposed a package of reforms called the Big Bang. The plan was to totally reform Japan's financial system according to the principles of (1) a free market; (2) fair trade secured by transparent and reliable rules; and (3) an institutional framework satisfying international standards in such areas as law, accountancy and banking supervision. The plan came in response to the recognition that the blame for Japan's inefficient financial system and the prolonged bank crisis lay in MOF's opaque administration and the lack of competition in the sector.

Delayed financial deregulation

The banking crises experienced by many countries during the 1980s and 1990s are conventionally explained by a combination of financial deregulation and a lack of effective prudential regulation (Keeley 1990; Lindgren et al. 1996). According to this view, financial deregulation reduced the profitability of traditional providers of financial services, inducing banks and other financial institutions to take high risks while knowing the government would not allow them to fail. The absence of prudential regulation made it possible for banks to increase their risk, and a surge in non-performing loans pushed these countries' financial sectors into crisis.

It is doubtful that the conventional thinking holds true for Japan. The seriousness of Japan's banking crisis is explained by the absence of competition, not excessively fierce competition (Hanazaki and Horiuchi 1998). The postponement of full-scale financial deregulation produced the banking crisis in the early 1990s, which forced the Japanese government using the shock therapy of the Big Bang to make the financial system more competitive and transparent.

Some deregulation of financial and capital markets had occurred prior to 1996. For example, Takeda and Turner (1992) place the start of the reforms at around the beginning of the 1980s. However, the policy of the government (particularly the Ministry of Finance) was one of 'gradualism' in order to maintain the status quo in the financial system as long as possible. The Ministry believed gradual reforms were needed to prevent a surge in market competition that could damage existing financial intermediaries. The government saw a stable financial system as synonymous with the absence of exit (through either liquidation or bankruptcy), and the pace of deregulation was kept gradual to protect inefficiently managed institutions. This was sometimes called the convoy policy.² For example, in 1979 the Ministry of Finance introduced the negotiable certificate of deposits (NCD) as the first step in the deregulation of interest rates on fixed-term deposits. NCD issues were heavily restricted, however, and full liberalisation was accomplished only in 1994, 15 years after deregulation began.

Japan's financial system was established immediately after World War II and the government has restricted entry into the financial service industry and prohibited financial institutions from expanding into other areas within the industry. This segmentation protected the vested interests in each sector and made the financial system as a whole less contestable.³ The lack of competition has meant that inefficiently managed financial

institutions were tolerated. The non-performing loan problem and the other difficulties that surfaced in the early 1990s immediately after the bubble economy burst revealed the poor management of Japanese financial institutions. The complaints from consumers about inefficient financial services were an important catalyst in promoting the Big Bang reforms.

MOF's comprehensive safety net

A by-product of gradual deregulation was that the government was unable to quickly dispose of distressed banks. The government did not want to recognise the need for exit and therefore maintained stability by securing small-scale depositors and also investors in bank-issued debts against bank failures. The Ministry of Finance guided (or more precisely ordered) the relatively strong (larger) banks to absorb those at the brink of bankruptcy.

The most conspicuous example has been the 1986 rescue of Heiwa Sogo Bank, one of Japan's largest cooperative regional banks and a poor performer mainly due to inefficient management. The Ministry of Finance persuaded Sumitomo Bank to absorb Heiwa Sogo. Sumitomo bore all the costs associated with the bail-out. The rescue operation protected not only all Heiwa Sogo's depositors and investors, but also its shareholders. Moreover, some Heiwa Sogo managers kept their positions on the board. In return Sumitomo obtained Heiwa Sogo's branches in the important Tokyo Metropolitan area. Because Japan's deposit interest rates were heavily regulated, banks used their network of branches as a tool of non-price competition. The Ministry of Finance controlled the number and location of bank branches, and manipulated the distribution of rents among banks. This restriction of competition was part of MOF's wide safety net. The Ministry conferred rents on banks and financial institutions, particularly large-scale ones, who in turn collaborated with MOF to support the safety net. The policy seemed efficient in that it did not require explicit financial support from the public: the end-users of financial services bore the costs, paying high prices for low-quality services.

The financial reforms have highlighted the unviability of this safety net. Financial deregulation has been gradual but steady, making it more and more difficult for the Ministry of Finance to persuade banks and financial institutions to collaborate in maintaining the system. In addition, the opaqueness of MOF's control over the banking system undermined the safety net as it prevented any examination into whether or not it was being implemented cost effectively. As Kane (1995) points out, a lack of effective monitoring of the regulator can

result in agency problems: the regulator does not necessarily pursue the roles the public has delegated to it. There is a danger that the regulator and the regulated financial institutions will transfer the costs of imprudent management to end-users of financial services and then ultimately to the public. Japan experienced just this problem in the 1980s and in the 1990s. Thus, the establishment of a competitive financial system through the Big Bang reforms is closely related to the issue of how to rebuild the safety net.

Who promoted the Big Bang?

After the end of World War II, the Ministry of Finance took all important decisions regarding the financial system. But MOF's repeated policy errors meant that from the mid-1980s its role in drawing up the Big Bang reform program was not influential.

The Ministry's decision to continue gradual reforms of the financial system in the face of a rapidly changing economic and technological environment was a significant mistake. In 1992 the Laws Related to Financial Reformation (*Kinyu-Seido Kaikaku Kanren Hou*) were passed, allowing subsidiaries of firms operating in various financial sectors to cross over to other sectors. The Ministry of Finance, however, reduced the impact of the legislation by restricting the scope of business that newly established subsidiaries could undertake. For example, securities subsidiaries of banks were not allowed to undertake stock brokerage because this was considered an important source of revenue for existing small securities companies. The trust-bank subsidiaries of commercial banks, long-term credit banks and securities companies were not permitted to develop full-scale trust businesses because MOF was worried about the damage to existing trust banks. Therefore, despite this new legislation, the Japanese financial system remained far from contestable.

The serious problem with non-performing bank loans revealed the flaws associated with MOF's opaque administration and traditional procedures. MOF's failure to quickly dispose of problem banks encouraged the moral-hazard behaviour of banks and financial institutions, undermined the viability of the safety net and placed a huge burden on taxpayers.⁴ There is much evidence that MOF's opaque administration produced the policy of forbearance, which only worsened the non-performing loan problem.

In June 1998 the Laws for Financial System Reformation were passed, achieving an important part of the Big Bang. These laws amended the Banking Law (*Ginko Ho*), the Securities Exchange Law (*Shoken Torihiki Ho*) and the Law for the Insurance Industry

(*Hokengyo Ho*), with a view to promoting market competition and protecting end-users (particularly individual investors) from undue risk. Formally, these amendments were based on reports submitted a year earlier by MOF's prestigious advisory councils.⁵ In this respect the Big Bang appears to have followed the usual pattern of emanating from MOF, but the reality has been quite different. By the mid-1990s it was clear that the Ministry's claims that its administrative intervention had made the Japanese financial system more efficient and stable were mistaken. The Big Bang began outside MOF and was a direct response to criticisms of the administration and of MOF's financial reforms.

In April 1995 the Deregulation Subcommittee (*Kiseikanwa Sho-iinkai*) of the Administrative Reform Committee (*Gyosei Kaikaku Iinkai*) drew up a list of desirable reforms in various areas and asked the relevant administrative offices to take specific measures to realise these goals. The subcommittee's list included several items related to the financial sector, reflecting the strong dissatisfaction of end-users (particularly non-financial firms) of financial services. Directly responsible to the Cabinet, the subcommittee wielded significant influence and the Ministry of Finance was forced to respond to its demands.⁶ The subcommittee's agenda contributed to MOF's policy shift from conservative gradualism to positive financial deregulation. In addition, in the late 1990s Diet members increased their influence over legislation to deal with financial crises, which is remarkable considering the overwhelming influence of the bureaucracy in Japanese politics.

The decline of MOF's influence over financial policy will contribute to making the Japanese financial system more transparent. However, it may not lead to more efficient policy management of financial matters. Because legislators lack information and analytical capacity, it is uncertain whether they will be able to efficiently lead the bureaucracy's decision-making regarding financial matters. Moreover, politicians tend to be short-sighted in policymaking, as has been proven by the government's recent decision to postpone paying off the insured deposits of failed banks.

Specific reforms

Since the announcement of the Big Bang in November 1996, many areas of the financial system have undergone reform. The 1998 Laws for Financial System Reformation were particularly important because they provided a blueprint of the Big Bang reforms. Further financial reforms have also been introduced during the past few years.

Improvements to asset-management markets

One aim of the Big Bang is to improve the asset-management industry. Although Japanese households have accumulated huge financial wealth, they have not enjoyed high-quality services for managing their assets – traditional banking practices have dominated.⁷ From 1965 to 1996, personal financial assets increased nearly fourfold from 32 trillion yen to 1,200 trillion yen. The relative share of securities decreased from 23 per cent to 12 per cent over the same period, while the relative share of deposits (bank deposits plus postal savings) remained at a little higher than 50 per cent. Over the same period, the personal sector's holdings of insurance significantly increased. The reliance on the banking system suggests that the efficiency of the entire financial system has crucially hinged on the risk management of the banks and that the ups and down in the banking sector are likely to influence the whole economy.

While bank credit is a very important way of sharing risk, other methods of financing should be gaining importance in Japan. Other authors have argued that bank credit is less effective in promoting venture businesses than the capital market mechanisms supported by venture capitalists (Black and Gilson 1998; Milhaupt 1997). These authors recommend a direct flow of funds from savers to fund users (i.e. venture businesses), but asset-management services need to be substantially improved if this is to occur.

Trust banks and life insurance companies have dominated asset management in Japan. These intermediaries have tended to adopt investment strategies inconsistent with the interests of investors – that is, households. Insurance companies, for example, have reportedly held blocks of the shares of non-financial companies to ward off capital market pressures. In return for shareholding, the companies become faithful clients of the insurance companies and offer jobs to the companies' employees. The system has not benefited policyholders. It is also noteworthy that Japanese insurance companies have been deeply involved in MOF's ad hoc practice of bailing out distressed banks by providing banks with capital without, at least from hindsight, reasonable returns. In the past, insurance companies have been required to purchase junior debt or preferred stocks issued by banks in order to strengthen their capital bases. Since these purchases have usually experienced capital or default losses, this investment policy is not justifiable.⁸

The rules regarding the establishment of asset-management companies have been liberalised, fostering greater competition in the asset-management industry. Many Japanese

financial institutions have been forced to improve their management of assets either through establishing joint ventures or collaborations with foreign institutions.

The government has also started to reform the market for investment trusts. Amendments to the Investment Trust Act in June 1998 allowed private trusts to be set up and for banks and insurance companies to directly sell investment trusts to customers.⁹ Aimed at vitalising the market for investment trusts, the reforms should make asset-management markets more comprehensive and competitive and will increase the presence of individual investors. Because intermediaries will no longer be able to neglect the interests of individual investors, the influence investors have over Japan's corporate governance may increase.¹⁰

Reforms in corporate finance

The financial reforms that followed the announcement of the Big Bang plan contain various policies to liberalise the corporate finance system. For example, new financing tools such as perpetual bonds and medium-term notes (MTNs) have been introduced. The unique characteristic of MTNs is that they are continuously offered to investors over a period of maturity bands: nine months to one year, more than one year to 18 months and two years up to 30 years. MTNs are registered under the shelf-registration rule, which gives the issuer maximum flexibility for issuing securities on a continuous basis. The government also initiated the development of an over-the-counter market for stocks and began to promote unlisted stock markets with a view to helping small firms raise funds from capital markets. In May 1999 non-bank finance companies were permitted to issue bonds and commercial paper to finance their loans, making the market for personal and small-businesses loans more competitive.

These reforms do have merits, but in reality some merely ratified the market-driven development of corporate finance in Japan. Many blue-chip companies have been active in international capital markets such as the Euro-bond market to avoid domestic restrictions on raising funds. If the government is to prevent the hollowing out of Japanese capital markets, it must liberalise domestic markets. As Horiuchi (1999) explains, the major companies had already started to reduce their reliance on borrowing before the 1980s when the government began a campaign of financial deregulation, turning instead to internal funds (mainly from depreciation and retained profits). While financial deregulation increased bond and equity financing in corporate finance during the 1980s, the increases were at most marginal. The overwhelming importance of internal funds during the past two decades

suggests that the impact of financial deregulation on the financing decisions of major companies was not as significant as many analysts believed.

The most important policy change has been the promotion of capital markets for small businesses. Small Japanese businesses have traditionally relied heavily on bank credit and bank relationships, although the use of bank credit was relatively small during the high-growth period from the early 1950s to the early 1970s. In 1980 bank loans to small businesses accounted for only a third of the total amount of bank credit, but the share rapidly increased to around 70 per cent in the late 1980s, and has remained at this level since. This suggests that small businesses have found it difficult to branch out from bank credit to other forms of financing, primarily because of asymmetric information problems. Small companies have had a greater reliance on their relationships with banks than have large companies (Petersen and Rajan 1995), which find it easier to attract other sources of finance.

The banking crisis has shaken bank–firm relationships. Smaller companies have been harder hit by the shrinkage of lending caused by the non-performing loan problem because they have not disclosed their business in a reliable form. Lacking information, the capital market has been reluctant to take the place of banks in supplying funds to small firms. Small businesses need alternative sources of funds in order to maintain liquidity.¹¹ The heavy reliance on bank financing has also not been constructive for high-risk venture businesses, which require more comprehensive mechanisms of risk sharing and technical evaluation. Venture businesses have relied heavily on the capital market for financing but, despite its large scale, the Japanese capital market has only just started to take an interest in venture businesses. Japan could learn much from the United States' experience with developing venture capital (Black and Gilson 1998).

Reforms of the capital market

Since the liberalisation of foreign exchange transactions and international capital movements in the early 1980s, Japan's capital market has had a far greater involvement with international markets than other sections of Japan's financial system. Because capital market intermediaries have been more vulnerable to competition from abroad, their push for liberalisation has been stronger than that of other domestically oriented intermediaries. Deregulation of domestic securities markets has made good progress, with the government committing to totally liberalise brokerage fees on stock trading by the end of 1999. The

liberalisation of brokerage fees will greatly improve the efficiency of the stock market in Japan by forcing securities companies that have relied on profits from controlled brokerage fees to be more competitive and making it possible for innovative companies to offer investors various means to cut the costs of stock trading.

Although not directly related to the Big Bang, the 1993 amendment to the Commercial Code, which substantially lowered the cost to shareholders of initiating derivative actions, seems to have been changing the landscape of corporate governance in Japan (Milhaupt 1996: 55–7). Shareholders previously needed a huge amount of money to file a derivative suit, but the amendment fixed this fee at 8,200 yen. The many scandals involving incumbent managers that surfaced in the early 1990s destroyed the credibility of the traditional system of bank-centred management monitoring (the main bank relationship).¹² The amendment to the Commercial Code will strengthen the ability of the capital market to monitor corporate managers. From 1950 to 1990 only 27 derivative suits were filed, but the number jumped up to 23 in the three years from 1991 to 1994, mainly because of the amendment to the Commercial Code.

The Big Bang in the accounting system

Efficiency in the capital market relies on transparent accounting methods in the business sector. The lack of a reliable accounting system has been the Achilles' heel of the Japanese financial system. Even in recent years, cases were observed of firms going bankrupt even though their balance sheets seemed sound and had been certified by auditors immediately before the bankruptcy. These cases have increased public distrust of the accounting system in Japan. Foreign investors do not fully believe in the accounting information disseminated by Japanese firms. Drastic reforms are necessary to bring Japanese accounting standards up to global standards if the system is to be credible.

The Council of Business Accounting (*Kigyō Kaikei Shingikai*), one MOF's important advisory committees, has been notoriously slow in responding to the increasing demand for transparent accounting in the Japanese capital market. The council has belatedly submitted several recommendations since 1997 to remedy Japanese accounting standards. These recommendations are preceding the Big Bang reforms in the accounting system. The system has been reformed along three fronts: consolidated accounting rules have been rationalised; the principle of marking-to-market accounting of financial commodities has been introduced;

and companies are now required to disclose pension liabilities. These reforms are strengthening the transparency of company activities.

Consolidated accounting rules. Since March 1999 Japan has been shifting to a new rule of consolidated accounting. The old standard of consolidation, effective until the 1997 fiscal year, allowed companies to manipulate their balance sheets by transferring losses or bad assets from their own accounts to those of their subsidiaries. This loophole was possible because of the definition of a subsidiary in terms of the relative amount of shares held by the parent company. A company was able to transfer bad assets to de facto subsidiaries (whose shares the company did not heavily hold) because it was not required to consolidate its own accounting with those of its subsidiaries.

The new standard maintains the criteria of de facto influence in stipulating that those companies that are substantially influenced by their parent company in terms of managerial decision-making are to be regarded as subsidiaries even if the parent company does not hold substantial shares. This more stringent standard of consolidated accounting began in March 1999 (the 1998 fiscal year) for banks and financial companies. The standard will be applied to non-financial companies in April 2000.¹³

The marking-to-market principle. Under the current accounting rule, only financial institutions are required to record market values of those financial assets that they hold with the intention of selling in the future. Thus, the marking-to-market principle has not applied to stocks that financial institutions hold for the purpose of cross-shareholding. Non-financial companies need not to record the market value of financial assets at all. The new rule, which takes effect in March 2001, requires both financial and non-financial companies to adopt the marking-to-market principle for recording marketable financial assets, including some derivatives, in their balance sheets. Under the current accounting rule, the existence of hidden profits (i.e. the accumulated capital gains of financial assets) does not give a true picture of the assets of individual firms. Under the new rule, window dressing by manipulating hidden profits will not be possible, thereby contributing to greater transparency in corporate management.

Pension liabilities. Under the current accounting rule, Japanese firms do not have to be explicit about their pension liabilities, which has allegedly allowed employers to be indifferent about these liabilities and made it difficult for outsiders to grasp the true shape of a firm's balance sheet. However, a new rule will be introduced in March 2001 that will require firms to explicitly disclose their pension liabilities.

Reforms for greater market competition

If the performance of Japan's financial service industry is to improve, new entry needs to be allowed into every section of the industry to make it more contestable. Market competition provides a discipline on financial institutions by forcing inefficiently managed firms to exit. The Japanese government's attitude toward reducing barriers to new entry has, however, been timid.

The most likely candidates for new entry are financial institutions active in closely related areas. For example, entry into the securities business would be easier for banks than for non-financial firms. This explains why in 1993 the first step in promoting contestable financial markets was to allow existing financial intermediaries to establish subsidiaries in other specialties within the industry.¹⁴

However, the government has protected existing companies competing with the new entrants by limiting the services that the newcomers can offer. For example, securities subsidiaries established by banks have not been allowed to undertake stock brokerage because this is the most lucrative area for existing securities companies, particularly small firms. These subsidiaries have also been restricted in their underwriting businesses because their parent banks were believed to be unduly influential in the fundraising decisions of client companies. The 1992 Laws Related to Financial Reformation permitted commercial banks and securities companies to establish trust banks as subsidiaries. However, the subsidiaries were not allowed to develop full-scale trust businesses in consideration of existing trust banks.

The government's policy of gradualism has been criticised for keeping the Japanese financial system far from contestable. The Big Bang reforms responded to this criticism by lifting some restrictions on new entrants, as did the 1998 Laws for Financial System Reformation by abolishing most of the remaining restrictions on crossover entry in the financial sector.¹⁵

The Antitrust Law had prohibited so-called pure holding companies, defined as companies that have other companies' shares as more than half their assets. In June 1997 the Antitrust Law was amended to permit pure holding companies to be set up, including in the financial service industry. So while the 1992 Laws Related to Financial Reformation permitted the subsidiaries of banks and other financial institutions to engage in financial services outside their own specialty, the amendment to the Antitrust Law allowed firms to

set up holding companies to restructure their business. In order to make the 1997 amendment of Antitrust Law workable, the Commercial Code was amended to allow the easier establishment of a “parent-child relationship” between two companies where the parent company holds all the shares of the other company.¹⁶ These changes are expected to promote restructuring and reduce compartmentalisation and should bring about greater competition and flexibility in the financial sector.

The decrease in the intermediation capacity of the banking sector and rapid advances in electronic technology have induced non-financial companies into the banking sector. At the end of 1999, Ito-Yokado, one of the largest supermarket chains, and Sony, a multinational electronics company, announced plans to start offering banking services. While Ito-Yokado will focus on providing settlement services to the retailing sector, Sony wants to specialise in offering Internet banking to the public. The Banking Law does not prohibit non-financial companies from engaging in banking services, leaving the decision up to the financial authority, the Financial Supervisory Agency (FSA), which is also responsible for regulating those companies that do enter. The FSA has already determined the guidelines for non-financial companies to enter the banking business. This development will increase the pressure for a more contestable banking sector in Japan.

Strengthening prudential regulation

The current financial crisis has forced the Japanese government to belatedly recognise the importance of prudential regulation of banks and other financial institutions. The crisis has also forced the government to take emergency measures to reconstruct the financial system’s safety net. A complete discussion of the emergency measures is beyond the scope of this paper, but important developments in prudential regulation are highlighted below (for full explanations, see Horiuchi 1999; and Milhaupt 1999).

Several important reforms of prudential regulations were implemented after the announcement of the Big Bang in 1996. The establishment of the FSA in June 1998 was the most important as it saw the responsibility for monitoring financial markets and institutions shift from MOF to the FSA. The FSA is independent of MOF and directly responsible to the prime minister. From July 2000 the FSA will be called the Finance Agency (*Kinyu Cho*) and will take on even wider responsibilities, while the Ministry of Finance will be renamed the Treasury Ministry (*Zaimu Sho*) and will concentrate on budgetary and taxation matters.¹⁷

This regulatory reform is commendable. The FSA will be more able to accumulate information from the financial sector than MOF, which had amassed a wide array of responsibilities over the financial sector, public finance, taxation and the budget. The FSA has maintained an arm's-length relationship with individual banks and financial institutions, which should strengthen the supervision of managerial activities and prevent moral-hazard behaviour.

In 1996 the Banking Law was amended to require banks to periodically take prompt corrective actions (PCAs) to self-assess their own capital adequacy subject to external audit. After April 1998 banks with capital below certain specified levels are required to restructure or even cease operations to avoid transferring excessive risk to the deposit insurance fund. By introducing transparent rules of intervention into bank management, the prompt corrective action scheme aims to: (1) prevent the government's forbearance policy by promoting the timely settlement of distressed banks; and (2) motivate banks with low capital to restructure their balance sheets as soon as possible.

The scheme should quickly be able to identify troubled banks and therefore protect the banking sector from widespread bank failures. However, because it was introduced at the time when the banking sector was fragile and places strong pressures on bank managers by forcing them to be conservative with credit, the policy seems to have worsened Japan's economic woes.¹⁸

Remaining issues

This paper has sketched out the recent financial reforms instituted under the Big Bang plan. These reforms aim to vitalise the Japanese financial system by improving managerial efficiency and strengthening supervisory mechanisms. However, many issues still need to be resolved to achieve the broader goal of the Big Bang.

Is free exit possible?

A competitive financial system requires not only free entry, but also free exit of inefficient intermediaries. However, the recent mix-up over the procedure for dealing with distressed banks shows that Japan's financial system is not well prepared for the exit of inefficient financial institutions. Falling asset values and overly generous long-term liabilities of insurance companies, reflecting poor risk management, are likely to lead to another crisis.

Explicit rules allowing those institutions to fail while limiting the impact on ultimate users and clients need to be established.

During the late 1990s, the Japanese government coped with the banking crisis with a view to shrinking the traditional safety net. The government's commitment to start paying off the insured deposits of failed financial institutions in April 2001 implies that holders of non-insured deposits and other bank debts will have to bear at least some of the costs associated with bank failures (Horiuchi 2000). This shrinkage of safety net will give depositors and other investors greater incentives to monitor bank management, thereby increasing the market discipline for prudent management (Calomiris 1999).

Despite the government's commitment, the current legal framework makes it practically impossible to meet the pay-off schedule. The FSA has the authority to initiate bank reorganisation or bankruptcy procedures on behalf of depositors. However, unlike in the United States, Japanese law does not differentiate between bank failures and those of other companies. Moreover, there exists no legal principle of giving priority to deposit liabilities over other debts in the case of bank failures. Under the current legal system, Japan's pay-off cannot be finished within a few days, as is possible in the United States. A prolonged pay-off would further reduce confidence in the financial system. Thus, to meet its commitment, the government will have to substantially amend the laws concerning bank failures.

The government could overcome the difficulties associated with the pay-off procedure to make a quick settlement possible, particularly for small banks. In Japan the political pressure for protecting small banks is a more serious hindrance to starting the pay off. Many small banks such as *shinkin* banks, credit cooperatives and some regional banks are resisting the stronger market discipline the start of the pay off would bring. Because these banks have financed small and medium-sized enterprises (SMEs) in local areas, politicians do not want to see those banks disappear, even if they are inefficiently managed, when many SMEs are suffering from the credit crunch. Thus, at the end of 1999, yielding to strong pressure exerted by politicians, the Japanese government postponed starting the pay off until April 2002. This decision endangers the credibility of the financial reforms.

Is the new financial agency efficient?

The Big Bang plan assumes that financial markets will work efficiently. However, it does not eliminate the role of the government in the financial system. In particular, the government

must be responsible for preserving a fair and stable financial system by supervising market transactions and financial prudence. These functions have been integrated into the FSA, which collects information from banks and other financial intermediaries while keeping its relationships with them at an arm's-length. Because the agency needs to increase its number of knowledgeable staff, the administrative costs of implementing effective supervision may be large.

On the other hand, as we have learnt from the recent MOF scandals, it is difficult to provide the supervisory agency with appropriate incentives to accomplish the role delegated to it by the taxpayers (Kane 1995; Horiuchi and Shimizu forthcoming). The separation of the supervisory authority from MOF, which now concentrates on fiscal matters, was necessary but the issue remains of how to motivate the FSA to work efficiently. It is probably necessary for the agency to disclose its activities according to a specific format, as this would prevent deviation from its designated role.

In July this year, the Financial Supervisory Agency and the Financial Division of MOF will be integrated into a new government agency – the Financial Services Agency (*Kinyu-Cho*). This new agency will specialise in comprehensive matters related to the Japanese financial system.¹⁹ The agency will utilise information collected during supervisory activities, improving the efficiency of financial administration. In order to economise on supervisory costs, the government should transfer some tasks to the market. If given access to relevant information, investors will have strong incentives to monitor the management of banks and other intermediaries. A well-balanced division of labour between the government and the market is badly needed in Japan.

Should the public financial institutions be retained?

One of the mysteries of the Big Bang plan is that public financial institutions were not explicitly included. Public financial institutions, particularly the Postal Savings and Postal Life Insurance (*kan'i hoken*) Services, are a major part of the Japanese financial system. It will be difficult to achieve the ideals of the Big Bang when these huge market players are insulated from market discipline. The main reason for the silence on the issue of the public financial institutions was, of course, political.

The Postal Savings Service forms the backbone of public finance. Postal savings and life insurance are under the jurisdiction of the Ministry of Posts and Telecommunications (MPT).

The Ministry is politically very influential because of the indirect support the postal network has given to many politicians by providing a convenient tool for distributing subsidies to specific areas or industries. Sectionalism in the Japanese bureaucracy and the reluctance of politicians to abandon the public financial institutions has prevented the inclusion of the public financial institutions in the plan.

The public financial institutions have perpetuated Japan's old-fashioned financial system. The government has reportedly used funds from the public financial system to intervene in stock trading with the intention of sustaining stock prices above the market level. These price-keeping operations have been regarded as an important tool to help banks and financial institutions avoid decreases in their equity capital. Although it is unclear, both theoretically and empirically, whether or not this practice has been effective, policymakers believe it has been and that it would be unwise to abolish this very convenient institution.

There has been an expectation that the public financial institutions will be used to mitigate the credit crunch. Public financial institutions could provide emergency funds but it is important not to let emergency measures prevent the structural reform that is necessary to construct an efficient financial system. The involvement of the public financial institutions in an emergency package holds the danger of transferring risk from private agents to the public sector, which would hurt the financial system as a whole. The public financial institutions are at odds with the new financial regime the Big Bang plan is constructing, but when and how this contradiction will be settled remains to be answered.

Can the infrastructure adapt to financial reforms?

Financial markets rely on infrastructure such as clearing systems to achieve efficient transactions in financial markets, but some infrastructural problems remain. For example, the clearing systems in Japan's securities markets have been technologically separated. The clearing systems for government bonds, stocks, corporate bonds and commercial paper have functioned almost totally independently from each other. This situation is inconvenient for investors and needs to be rectified if securities markets are to be efficient and competitive.

It will not be as easy as foreigners may expect to establish a unified clearing system covering the entire Japanese securities market. The equilibrium among interest groups that the compartmentalism of the financial system has produced has meant it has been difficult to introduce financial reforms. When attempts were made to introduce a unified clearing

system, each interest group tried to build up a clearing system specific to its group, and the current system of narrowly subdivided sections resulted. The Japanese government has been unable to resolve this issue. Japanese traditions of consensus building and unanimity have prevented a more comprehensive clearing system from being introduced. It is likely to take a long time to resolve this coordination failure.

Is the taxation system market friendly?

The taxation of financial transactions is very complex in Japan: the taxation on securities trading is very comprehensive and the exchange tax is widely regarded as having prevented the development of a derivatives market in Japan.

The complex taxation system is not only a problem for the financial services industry, but it is one that needs to be reformed as soon as possible. Although the distortions created by the present taxation system have been widely recognised in Japan, MOF, which is responsible for managing the system, does not seem to be enthusiastic in addressing the problem. The Ministry seems to be more interested in collecting taxes than developing an efficient financial system free from tax distortion.

Conclusion

The Big Bang plan has forced Japan's financial system to face a regime change. The crisis in the old financial regime compelled the government to hammer out a new policy of financial deregulation and therefore the Big Bang is more than merely a continuation of the gradual liberalisation policy followed until the mid-1990s. Significant reforms have already been enacted, although many issues need to be settled before the larger aims of the plan will be fully realised.

Although it was motivated by the financial crisis caused by the non-performing loan problem, the Big Bang is fundamentally about long-term deregulation of the financial system, particularly of the traditional safety net managed by MOF. The Big Bang has been restructuring the safety net and the regulatory mechanism.

The Big Bang plan emphasises the importance of market competition and transparent rules of supervision in financial services, and therefore should improve the governance of financial institutions in the long run. Drastic changes in the structure of the financial services

industry are still required before this goal can be realised. For example, increased competition will force a reduction in the number of banks and their employees.

The plan has tended to promote the development of securities markets rather than banks and this should change the system of corporate governance in Japan. Banks have played a overwhelmingly important role in corporate governance in Japan (e.g. Hoshi, Kashyap and Scharfstein 1990, 1991; and Aoki and Patrick 1994) and the development of securities markets will decrease the importance of banks and increase the disciplinary role of capital markets. In this sense, the Big Bang will move the Japanese system toward the Anglo-American system where the capital market plays an essential role in corporate management, and may force managers to adapt to environmental changes. However, it is uncertain whether the system change will contribute to efficient management in the corporate sector in the long term.

Notes

- 1 I appreciate the constructive comments and suggestions of Peter Drysdale and Chris Becker on the original version of this paper. They greatly improved its quality.
- 2 MOF's view that the most important objective of financial administration is to prevent bank failures induced it to take various opaque measures to bail out distressed banks and, somewhat ironically, hindered it from introducing explicit rules to deal with bank failures. This led to the notorious policy of forbearance, which allowed banks to hold non-performing loans in the hope of eventual economic recovery.
- 3 The breakdown of the system of long-term credit banks provides the most conspicuous evidence of the failure of the compartmentalisation policy. This system was effective immediately after World War II when firms needed long-term credit but savers (households) wanted highly liquid short-term stores of value. The system lost its *raison d'être* as the economy grew, but the government has continued to protect the system by suppressing the development of securities markets that would compete with these banks. The maintenance of the policy despite the rapid reduction of major companies' reliance on bank borrowing indulged the long-term credit banks. If the government had abandoned the policy at the beginning of the 1980s, long-term credit banks would have faced the need to restructure much earlier. The fact that two of the three long-term credit banks are now under state control because of extremely poor performance illustrates the failure of the policy.
- 4 The Law on Emergency Measures to Revitalise the Functions of the Financial System and the Law on Emergency Measures to Promptly Restore the Functions of the Financial System, both of which were enacted in late 1998, established two special accounts within the Deposit Insurance Corporation (DIC). The Account for Prompt

Financial Restructuring provides financial support for strengthening banks' capital bases, while the Financial Revitalisation Account provides funds to liquidate, temporarily nationalise or transfer failed banks to bridge banks temporarily. These accounts are publicly supported by 53 trillion yen in the form of government guarantees. The DIC also has a special account, supported by 7 trillion yen of government bonds, that protects depositors from bank failures.

- 5 These are the Council for the Financial System (*Kinyu Seido Chosa-kai*), the Council for Securities Transactions (*Shoken Torihiki Shingi-kai*) and the Council for the Insurance Industry (*Hoken Shingi-kai*). It is believed that MOF has almost completely controlled the topics to be investigated in those councils and what their reports propose. The councils' reports can be regarded as MOF's policy agenda.
- 6 The Administrative Reform Committee was formed by the Murayama Cabinet, which consisted of a coalition of anti-LDP groups. In spite of the change of the government to the LDP-dominated Hashimoto Cabinet, the Deregulation Subcommittee continued its activities. This implies that the subcommittee's deregulation campaign was independent of the ruling political party.
- 7 According to the flow-of-funds account reported by the Bank of Japan, the personal sector's financial assets totalled 1,200 trillion yen in December 1996.
- 8 The insurance industry has faced abnormally low returns in financial markets as a result of the crisis. Since most of their liabilities were issued during the asset bubble of the late 1980s, promising high returns to policyholders, insurers have been hurt by the BOJ-led abnormally low interest rates. By July 1999 two life insurance companies had gone bankrupt.
- 9 According a *Kinzai* survey, as of May 1999 the outstanding amount of investment trusts sold by banks and insurance companies was 1.1 trillion yen, only 2.2 per cent of the total sold. Although the share is small, it is expected to increase in the future (*Kinyu Zaisei Jijo*, 23 June 1999, pp. 38–9).
- 10 The development of the asset-management industry is expected to increase the influence institutional investors have on corporate managers, forcing them to become more orientated toward shareholders. Some scholars expect these changes in corporate governance to improve managerial efficiency in Japan (see, for example, Gibson 1998).
- 11 During the crisis, many firms were cornered because their banks refused to supply liquidity. The banks' attitude was a natural response to the need for recapitalisation, but it damaged the trust firms had placed in the banks. It may take a long time for these relationships to be rebuilt.
- 12 Reportedly, it was the United States' Structural Impediments Initiative that forced a substantial amendment of the Commercial Code. The amendment also lowered the threshold percentage of stock ownership required to inspect corporate books from 10 per cent to 3 per cent.
- 13 The number of subsidiaries reported by banks increased in March 1999 because of this change to the consolidating rules. The new system showed the non-performing loans of city banks to be 139 billion yen (1 per cent) higher as a result (Nikkei Shimbun, 22 May 1999).

- 14 The insurance industry was excluded from this deregulation. Even after 1993 the insurance industry has been segregated from other financial services.
- 15 There has been some new entry into the financial industry. For example, from March 1999 Orix Trust Bank made telephone and Internet banking facilities available to investors. In April 1999 Mitsubishi Trading Company entered into the securities and investment advisory businesses, and in November 1999 Ito-Yokado, one of Japan's largest supermarket chains, announced its plan to establish a bank to offer settlement services to the retailing sector.
- 16 The Japanese banking industry has began metamorphosing through the establishment of holding companies. Daiwa Securities Company has already become a holding company. In August 1999 Dai-ichi Kangyo Bank, Fuji Bank and Industrial Bank of Japan announced a plan to establish a holding company to integrate and restructure their businesses by autumn 2000. In October 1999 Tokai Bank and Asahi Bank announced a plan to establish a holding company in October 2000.
- 17 The Ministry of Finance has been proud of its name, which it has held for more than 1,300 years, but the recent scandals and policy failures have cost the ministry its venerated name.
- 18 The PCA has been applied by the FSA to five banks by June 1999 and is clearly of practical use. An emergency policy is needed to force drastic structural changes on existing banks and other financial institutions. This would require the government to take over the management of several banks to recapitalize them quickly. The fact that this goes against the ideals of the Big Bang complicates the process of financial reform in Japan.
- 19 Not all the administrative tasks related to the financial system have been removed from MOF, which is still responsible for dealing with financial crises and with supervising the Deposit Insurance Corporation in collaboration with the Financial Services Agency.

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**Re-Regulating Japanese Transactions:
The Competition Law Dimension**

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RE-REGULATING JAPANESE TRANSACTIONS: THE COMPETITION LAW DIMENSION

Introduction: regime shift in Japan's competition law?

In the wake of Japan's recession during the 1990s and its diminished prospects for recovery, political scientists, economists and lawyers have been forced to revise their views of how the Japanese economy operates. An early casualty has been the characterisation of Japan as a developmental state, or what has been called the Japan Inc. model (Johnson 1995; Carlile and Tilton 1998: 1–15). Pempel has argued (1997, 1998, 1999) that Japan is in fact experiencing a 'regime shift', in which its operating rules and dominant institutions are undergoing fundamental change. However, we still have a very incomplete picture of the targets, scope and forms of such change. By focusing on the catalysts and outcomes of institutional change in particular instances, we are likely to be better equipped both to analyse a changed Japanese economy, and to formulate predictive and comparative models (Aoki forthcoming)

This paper discusses some apparently new elements in the restructuring of Japanese regulatory institutions. The first is the introduction of a new political initiative: the 'legal system reform agenda' (*shihoseido kaikaku*) and a loosely related set of legal policy changes identified with it (MITI 2000: 202). The second focus of the paper is an institutional shift that seems to be occurring in competition law and enforcement. This latter development seems to run counter to much of the accepted wisdom about the deliberate non-enforcement of competition policy in Japan. Although the changes to competition law and policy described below predate the announcement of a 'legal reform agenda' in 1999, I suggest that the two sets of developments are interrelated and to some extent mutually reinforcing. The changes that I describe below are still unfolding and so this paper does not aim for definitive predictions. One tentative conclusion, however, is that within both the systemic legal reform agenda and the competition regulation sphere, the balance in the regulatory mix seems to be tilting toward more legalism and 'juridification', with interesting implications for future work on Japanese institutions.

The paper proceeds in a reverse chronology. First, it describes the new legal reform agenda and its relationship to deregulation in Japan. Second, it focuses on competition law

and the way that this has functioned as a 'litmus test' of economic reform agendas of the previous decade. In particular, the institutional capacities of Japan's Fair Trade Commission (JFTC) have been the focus of sustained domestic and international criticism. These critiques define an institution as an organisational entity – in this case an (ostensibly) independent regulator. By contrast, following Aoki (forthcoming), this paper uses a wider definition of an institution. Aoki views institutions as a domain of transactions participated in by a set of agents – endogenously created through the agents' repeated interactions and thus self-enforcing. He acknowledges, though, that institutions are constructed socially and that once established they become objectified and 'taken for granted', and begin to govern the agents' choices. At a second level, institutions therefore also function as the rules of the game (Aoki forthcoming). Using this wider institutional lens, I give roughly equal emphasis to a range of institutional 'players' in Japanese competition law: the JFTC as a regulatory agency, the courts, the companies that are the focus of enforcement, and academic commentators and the media as contributors to the regulatory climate.

The third part of the paper discusses developments in competition law reform and case-law results since 1995. This is not a quantitative study of reported cases or non-prosecutions between 1995 and 2000, nor are competitive conditions in particular industries examined (Tilton 1996). Rather, it focuses on a small number of cases that were litigated, atypically, to the highest levels in Japan, and the 'ripple effect' of these on players outside the direct ambit of the court proceedings. One of these was the Fair Trade Commission, which appears to have gained a stronger political and legal profile since 1995. At the same time, I point to some indications that attitudes to compliance with competition regulations are changing within Japanese corporations. Compliance norms, in turn, are both promoted by (and at times subverted) in policy forums, in industry forums, in the media and through conventional legal channels. What this means is that nuanced evaluations of competition law and policy in Japan require us to look at the total institutional picture, rather than simply focus on a particular enforcement agency or on reported court cases.

Competition law and the legal system reform agenda

Many business and political commentators still routinely describe Japan as a 'non-legalistic' country, but this is an increasingly moot proposition. One of the indicators of a policy-level climate change was the August 1998 announcement by Japan's then prime minister, Keizo Obuchi, which promised a complete overhaul of the Japanese legal system:

We will pursue complete reform of the [legal] system in order to make it easier for citizens to use and to ensure that the legal system functions as the basis for a secure life for the populace and for equitable economic activity. (Fujikawa 2000: 18; Taylor trans.)

The former prime minister underlined his commitment to the legal reform agenda by appointing a Legal System Reform Commission (*Shihokaikaku Shingikai*) in July 1999 with a mandate to report within two years. The commission published its key issues for debate in December 1999 and a preliminary report in April 2000 (Shihokaikaku Shingikai 2000).¹

Although Obuchi's successor, Prime Minister Mori, has not as yet declared support for the agenda itself (Fujikawa 2000: 18), it seems unlikely to be abandoned. In the short term it will continue simply because budget allocations have already been made for some related items (Homusho 2000). A more significant factor is that Obuchi was simply declaring a widely shared consensus that both substantive and procedural legal reforms were overdue in Japan. The desire for legal reform cuts across numerous institutions and interest groups in Japan. The actors involved, their agendas and the pressure points for legal reform in Japan are diverse. The diversity is not immediately apparent when looking at the (abbreviated) list of topics for debate under the legal system reform agenda (MITI 2000: 201):

(1) Systemic Elements

(a) Realisation of a more user-friendly legal system

- Increasing access to lawyers
- Addressing depletion of numbers of lawyers
- Lawyers' relationship to adjacent legal professions
- Increasing legal aid
- Alternative dispute resolution outside court settings
- Publication and access to information relating to legal proceedings and the legal system

(b) A civil procedure system that responds to people's expectations

- Improving access to the courts
- Comprehensiveness and speed in civil proceedings
- Meeting the need for expert opinions in specialist cases
- Reforming civil execution procedures
- Strengthening the capacity for effective checks on the judicial system

(2) Human Resources

- (a) A criminal procedure system that responds to people's expectations
- Investigative and inquisitorial procedures suited for the present day
 - Comprehensiveness and speed in criminal proceedings
 - Reviewing a public defender system for accused and defendants in proceedings
 - Participation of citizens in judicial proceedings
 - The jury system/lay participation in adjudication
 - Review of participation under the existing judicial system
- (b) The number of and training for legal professionals
- Appropriate increases in numbers of legal professionals
 - The stage of training for legal professionals
 - The national bar examination and Supreme Court Training Institute
 - The role of legal education in universities
 - Legal ethics
 - The unification of the branches of the legal profession
 - Strengthening human resources for courts and the public prosecutor's office
 - The internationalisation of the legal system
 - Allocating a budget for the legal system

As a shopping list of reform topics, the legal system reform agenda looks fairly innocuous. However, embedded in each of the 'topics' are sundry debates, the viewpoints of lobby groups and subsidiary agendas. By way of example, large Japanese corporations have been voicing dissatisfaction with the availability, cost and quality of legal services in Japan for some time. Part of the public face of that lobbying can be read in a long-running *Nikkei* editorial series reflecting a mix of investigative journalism and 'trashing' of legal institutions such as the Supreme Court and the Japan Federation of Bar Associations (e.g. *Nikkei* 2000b). The series sets out to expose inefficiencies in legal procedures, disparity in access to legal advice across Japan and the anti-competitive effects of Japan being unable to match US legal skills in areas such as biotechnology and industrial property. Those themes are taken up in a more measured way in the most recent White Paper from the Ministry of International Trade and Industry (MITI 2000).² This latter treatment, however, is in a sense more controversial, because the 11 pages of statistical analysis and commentary simply treat Japan's legal services as an inefficient services industry that is now a drag on economic growth

and industrial innovation. Although MITI stops short of prejudging the outcomes of the legal system reform debates, the level of detail in the topics traversed leaves the reader in no doubt about the Ministry's stance. The topics include legal profession remuneration, the breaking of *bengoshi* (barrister) monopolies on legal practice, electronic publishing of court decisions and greater transparency in patent examinations.

In fact, a wave of important legal reforms affecting commercial interests in Japan has been passed or is pending. Beginning in the mid-1990s, a new Code of Civil Procedure (passed in 1996, effective in 1998) has intended to improve access to the courts, rationalise the carriage of cases, create a small claims jurisdiction and make the law more transparent by translating it into contemporary language (Kamiya, forthcoming). Although the Code reforms predate the legal reform agenda, they can be seen as the symbolic downpayment on the creation of a more 'user-friendly' legal system. A second wave of reforms relates to the Corporations Code, which enabled easier corporate break-ups and acquisitions (*Nikkei* 2000a).

Another key area has been the introduction of bankruptcy and insolvency law reforms. In this area we can see a significant shift in the procedures for law reform in Japan. Where traditionally the role of the Legislative Advisory Council (*Hosei Shingikai*) was central to the preparation of new legislation, the pace and volume of new legislation presented to the Diet has increased and the Council's role, although not abolished, has in substance been devolved to more specialist groups.³ Circumvention of the Legislative Advisory Council is usually explained as being necessary because the legislation is complex, urgent and highly specific. In many cases the old pattern of introducing broad umbrella legislation that is subsequently fleshed out by special laws and regulations has been abandoned in favour of much more exhaustive drafting at the outset. Much of this new legislation is being drafted against the backdrop of the reform of the agenda for the legal system, and so carries with it implicit promises of procedural efficiencies and improved legal infrastructure and personnel.

This is the point at which the commercial and consumer strands in the reform agenda intersect. Implicit in the agenda for legal reform is a series of amorphous, tacit promises to 'citizens' (*shimin*) that the reformed system will be more efficient and responsive to their needs. Citizens seem to break down into corporate citizens on the one hand and 'consumers' on the other. As a number of scholars have observed, however, identifying the interests of Japanese 'consumers' (*shoshisha*) is problematic (e.g. Vogel 1999). In Western capitalist systems, law is often the frontline for conflict between the interests of consumers and those

of corporations. In Japan, by contrast, consumer lobby groups in many cases identify with the interests of producers. Recent attempts to flesh out consumer protection law in Japan, for example, have met with intense opposition from the business lobby (Kitagawa 2000; Ochiai et al. 2000). As a result the Consumer Contract Law of 2000, promoted by the Economic Planning Agency (EPA) as a regulatory bookend to the 1996 Product Liability Law, was largely neutered. The EPA adroitly characterises its constituents as ‘consumers’ and ‘businesses’ who can and should interact without the distorting effect of law (Taylor 1997). This stance is consistent with the rebadging of consumers as *seikatsusha* (literally those with lives) in Japan, ‘which fuses the notion of consumer with that of worker and citizen’ (Vogel 1999: 196) It should not surprise us, then, that the ‘consumer needs’ being highlighted at present in the legal reform agenda seem to be projections by other interested parties, notably government agencies and the Bar, rather than being genuine reflections of public demand.

Lawyers, not surprisingly, have embraced the legal reform groundswell, despite bitter debate within the wider legal profession about preferred outcomes. Some have described the new agenda as the pivot (*kaname*) for both the administrative reform and deregulation processes. This may reflect their genuine delight of being able to dust off and implement long-cherished plans for change, or it may be polite way of saying that legal system reform represents Japan’s last change to revisit a stalled set of economic policy initiatives.

For some political and economic commentators, then, the 1990s represent ‘the lost decade’ of infinitesimally slow deregulation and policy reform in Japan. For lawyers, however, the 1990s stand as a historic turning point, the implications of which are only beginning to emerge. Much could be said here about the political attempt to elevate law and legal institutions to the status of circuit breakers within a system that has traditionally downplayed the need for law. There is more than a visible shadow here of the kind of legal formalism that is resurgent in US law and policy debates and is now a feature of multilateral organisations such as the World Trade Organisation (WTO), the Organisation for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF) and the World Bank. What is significant for the present discussion, however, is that the agenda for legal reform is unfolding without visible opposition, and seems likely to legitimate and strengthen the use of formal juridical controls on business and government in Japan.

Rethinking the institutional critiques of Japanese competition law

Competition law and policy is implicit in the reform agenda. A telling phrase is MITI's use of the phrase 'legal services industry', rather than the nomenclature preferred by that industry – 'the legal profession'. The two labels do not correspond. MITI's 'competition perspective' is focussed on the global number of legal professionals in Japan, including specialists such as patent attorneys, judicial scriveners (*shihoshoshi*) and sundry para-legals and lawyer-substitutes. The Japan Federation of Bar Associations, by contrast, defines legal professionals as those who have passed the national Bar Examination – lawyers (*bengoshi*), judges and prosecutors. Both the Bar Examination and the Lawyers Law (*Bengoshi ho*; Law No. 205 of 1949) are thus under review as major impediments to the fuller provision of service and competition in this sector.

Competition law seems to offer a solution precisely because it is both an economic and a legal policy tool (*NBL Henshubu* 2000).⁴ It seems to simultaneously offer a technique for supporting deregulation and a way of making the market much less congenial for entrenched players. Viewing competition law as a litmus test of Japan's deregulatory reform, of course, is consistent with the way in which multilateral institutions such as the WTO, the OECD, the IMF, the World Bank and the Asia Pacific Economic Cooperation (APEC) forum now elevate competition regulation as an important tool of microeconomic reform, market restructuring (e.g. Ullrich 1998) and, ultimately, legal system modernisation.

The experience of deregulating economies over the last two decades has been that, for every removal of industry-specific regulation or legislation, there is usually a counterbalancing application of law. Typically, restrictive licensing schemes and bars to market entry have been displaced by 're-regulation', either directly through legislation, or indirectly through other modes of governance.⁵ In markets such as Australia, New Zealand and the United States, much of the re-regulatory work has been entrusted to competition and consumer protection laws and their enforcing agencies. Almost without exception, however, foreign commentators have remained profoundly sceptical about whether Japan's competition law would be given sufficient 'teeth' to entrench institutional or market change (e.g. Tilton 1998). This, then, is a useful point at which to re-evaluate the character of Japan's competition law regime.

Japanese competition law scholars do not disagree with the proposition that, until recently, the formal enforcement of Japan's competition law was routinely overshadowed by

the intervention of government and industry (e.g. Murakami 2000: 6). However, they speak of the 1980s and 1990s as being like the ‘night and day’ of domestic competition regulation (Shiraishi 2000). That is, from the standpoint of legal theory and practice, the latter half of the 1990s has seen an unprecedented change in both the qualitative and quantitative significance of competition law in Japan. This paper suggests some areas of change that may furnish a basis for this kind of perception.

Let us focus first on the ‘formal’ side of competition regulation. Japan’s Fair Trade Commission was unique in being the only independent regulatory agency created in Japan by postwar legal reforms. This partially explains criticisms couched in tones of, ‘Why can’t Japan’s FTC be more like the United States FTC, its conceptual model?’. Certainly, for decades the differences between the two agencies were stark. The JFTC was captured by the Ministry of Finance and eviscerated through understaffing and legislative changes designed to undermine its mandate and its capacity to rule against government-sanctioned courses of action. Its present level of 560 staff (a third of the US FTC) represents an increase on its historical size, albeit an insufficient number of staff to exhaustively investigate and prosecute all breaches of the Antimonopoly Law.

The text of Japan’s Antimonopoly Law reads as substantively similar to US antitrust law or Australian competition law statutes (Shitekidokusen no kinshi oyobi koseitorihiki no kakuho ni kansuru horitsu 1947, Law No. 54, as amended). The problem has been that its application in the postwar period was largely curtailed by a political preference for market stability and security for domestic industry over market competition and consumer welfare (Tilton 1998: 184). Japan’s FTC itself possibly shared that preference for stability over untrammelled market competition (Haley 1997: 147). So, for example, the JFTC cooperated with MITI dictates, supporting the cartelisation of selected industries in the postwar period (Haley 1997: 147). Similarly, the JFTC did not provide a bulwark against the prevalence of administrative guidance by MITI and other agencies. Not surprisingly, few foreign companies in the Japanese market, or seeking to enter it, were prepared to test the agency’s complaint process, although this was a route open to them. The complaint brought by Kodak against Fuji in the Japanese photographic film market in the 1990s was the exception proving the rule. By the time that the Kodak–Fuji dispute had exhausted its formal channels, however, there were indications that the behaviour of Japan’s FTC was beginning to change.

Institutional change in the 1990s

The mid-1990s seems to represent a turning point in competition law enforcement in Japan. By March 1996 the JFTC had pursued complaints against the largest number of enterprises since its inception and had ordered fines in the largest number of infringement cases to that point (*NBL Henshubu* 1996).⁶ Those figures have subsequently risen again. Following the passage of revisions to the Antimonopoly Law in June 1996, the JFTC itself was restructured and its enforcement capacity strengthened. The changes included the appointment of a former prosecutor as director of the agency (rather than the traditional secondment from the Ministry of Finance) and the creation of an Administrative Office to coordinate the Commission's administrative functions. A new Economic Transactions Office, Transactions Division, Office of Investigations and Special Investigations Division were also established.

From 1996 onward the JFTC identified its two priority activities as: (1) comprehensive investigations in cases of deliberate contravention of the law, such as price cartels, collusive tendering and import systems; and (2) the direct use of the market mechanism to enhance deregulation. The latter priority mandated a review of exceptions to and exclusions within the Antimonopoly Law, 'in order to promote the openness and transparency of markets and (engagement in) pre-emptive action to prevent administrative guidance by government agencies that have the effect of limiting competition' (*NBL Henshubu* 1996). In theory this amounted to a 180-degree change in the agency's stance and a formal embrace of the (then) government's deregulation agenda. In practice it prefaced a line of well-publicised enforcement moves by the JFTC from the mid-1990s onwards.⁷

This period also saw a fundamental shift in the JFTC's enforcement stance. Many studies of this agency to date have suggested that it generally favoured administrative processes over criminal prosecution as the major enforcement route for breaches of the Antimonopoly Law. US trade commentators commonly present this as a flawed choice. It can be more accurately characterised as what Gerber (1998) calls 'the administrative model' of competition typical of Japan and the European Union. The distinguishing characteristic is discretionary policy decisions by bureaucrats who often seek 'voluntary' compliance from business. In contrast, 'the juridical model' of US competition law treats competition as 'normal law' to be applied in the same form, language and modes of thought as other kinds of private or criminal law. Australian competition law and enforcement is an interesting hybrid of these two approaches (Tamblyn 1992).

What we see in the JFTC's enforcement of the Antimonopoly Law in Japan in the 1990s is not a diminution of the administrative model of enforcement, but the addition of court support for JFTC investigations, and prosecution of both private sector players and their public sector collaborators. An illustrative case was the Tokyo High Court decision (31 May 1996) upholding a JFTC finding that major electrical contractors had engaged in collusive tendering (a *dango* arrangement) for government contracts. *Dango* practices themselves were old news in Japan, but the case was given front-page coverage because 17 senior managers of major electrical manufacturing companies including Hitachi, Toshiba and Mitsubishi were found guilty of contravening the Antimonopoly Law and were given criminal sentences. The managers responsible were given suspended prison sentences of 10 months each and their companies fined between A\$400,000 and A\$600,000 each.

The High Court found that between 1989 and 1990, electrical manufacturers had formalised a system for subdividing tenders for government sewerage projects, and that this was done with the active cooperation of the relevant agency, the Japan Sewerage Corporation. This contravened article 3 of the Antimonopoly Law, which prohibits any unreasonable restraint of trade. In evidence, a number of managers stated that they had misgivings about the scheme because it was not a competitive tendering process, but felt unable to object to such a formal structure. They were furthermore unwilling to jeopardise their company's status with a public corporation that so clearly supported the status quo. The court was explicit and scathing about the active role played by the public corporation in prereleasing the specifications and budget for projects:

At a time when the level of fines under the Antimonopoly Law had just been increased' the court said, 'This represented serious criminal behaviour by our country's leading heavy electrical manufacturers' and 'criminal cooperation by a public corporation ... in an area affecting citizens' daily lives'. (*Nikkei*, 31 May 1996: 1)

This is strong language for a Japanese judge, and we can hypothesise that this kind of judicial support strengthened the JFTC's hand. By the time that the High Court rendered this decision, some the effects of the deregulatory push and the US–Japan Structural Impediments Initiative (SII) negotiations were visible in the public contracting sector, as public corporations and agencies reportedly began to replace tender-by-invitation processes with open competitive bidding. The decision may have strengthened this transition, although we

have no direct evidence of this. Further pressure for compliance with the Antimonopoly Law and public tendering processes could also emerge from shareholder representative actions. Corporate law reforms in the early 1990s relaxed the procedural barriers to shareholder actions, but to date most of the resulting actions have been against financial institutions for causing shareholder loss through illegal or negligent corporate decision-making. Although few, if any, shareholder actions to date have cited competition law breaches, this remains a possibility for the future.

A study by Morita (1998) of judicial decisions in the 1990s has found that the courts uniformly adopted and followed the JFTC's analysis of anticompetitive behaviour. In other cases, including the Shiseido decision discussed below, it is not uncommon for court judgments to include passages from the agency's guideline documents, generally without attribution or acknowledgment, as is standard drafting practice for judicial decisions in Japan.

The significance of this is threefold. First, it points to strong judicial support for the JFTC as an agency (or at least judicial confirmation of the agency's predictions about those cases that it chooses to prosecute). Second, it maps a wider range of enforcement techniques for the JFTC than were generally acknowledged prior to the 1990s. Third, it begins to alter the fundamental regulatory balance. That is, the courts are now 'written into' the enforcement of the Antimonopoly Law. This change in turn raises questions about the institutional capacity of the courts. Within legal policy circles, the shift is significant because it overturns the traditional separation of 'public' and 'private' law that held that freedom of contract should be inviolate and should be able to insulate parties from 'public law' interventions such as the Antimonopoly Law.

New competition regimes and old contracts

Whether Japanese competition law actually gained traction in the 1990s is a matter of debate. Tilton, for example, argues that the 'gains' are largely illusory (1998: 180). One of his criticisms is that from the mid-1990s, Japan's FTC expended considerable energy on pursuing complaints about resale price maintenance (RPM) in vertical distribution channels, ultimately with little real impact on the practices themselves. He uses the Shiseido Case (Shiseido Tokyo Hanbai KK v. Fujiki Honten KK 1994), appealed to Supreme Court level, as the paradigm for this proposition: a case ultimately won resoundingly by a manufacturer who

appeared to exert extremely tight control over every facet of its distribution channels, including pricing.

Certainly the Shiseido and related cosmetics distribution cases from the 1990s form an important tranche of competition law, but I draw somewhat different conclusions from them. First, it is not clear that the JFTC concentrated resources on policing vertical pricing arrangements in the 1990s. This is not the perception of franchising lawyers in Japan during the period (Kawagoe 1996). More data is needed here to support Tilton's assertion. Outside Japan, it is apparent that vertical pricing arrangements in distribution chains, whether franchised or not, were increasingly been 'left to the market' by competition regulators in the 1990s. The basis for doing so was that vertical chains can deliver price efficiencies and that consumer interests are protected by competition in the retail market itself (Fels 1996). This presumes competitive markets, an issue that goes to the heart of the assessment of Japan's political and economic structures (Haley 1998).

What seems more likely is that the JFTC had conflicting priorities – the need to police horizontal pricing arrangements and the need to respond to complaints from disgruntled distributors in vertical arrangements that were no longer viable in a restructuring market. Complaints about RPM were congruent with dramatic changes in distribution markets in Japan during the 1990s, and also with a wave of litigation commenced within franchised distribution chains during the same period. Tilton (1998: 180) cites First (1995) for the proposition that RPM ultimately benefits smaller, inefficient distributors and that manufacturers benefit from prohibitions on RPM because it allows them to cut margins and supply more efficient distributors. Both of First's observations are illustrated in the cosmetics distribution cases.

The 'cosmetics cases' were a series of suits brought against famous brand-name cosmetics manufacturers in the 1990s. The brand names were important because it has been routinely argued in the past that familiar corporate names are missing from reported cases in Japan. Shiseido is arguably the most prestigious of Japan's domestic cosmetics and toiletries manufacturers, although it does not have absolute dominance in market share. Like most manufacturers, Shiseido had developed a web of affiliated distributors and retailers (in this case 25,000 – both exclusive and non-exclusive). The conditions for membership in the Shiseido retail distribution chain were prescribed in a tightly drawn standard-form contract that covered, among other things, the mode of sale, promotion strategies and obligations to participate in corporate training (Shiseido Tokyo Hanbai KK v. Fujiki Honten KK 1994; Taylor 1995).

Product distribution in this case was through a wholly owned subsidiary of Shiseido. In 1991 the subsidiary terminated its 28-year continuing contract with retailer Fujiki Honten. The reason given for termination was that Fujiki Honten had breached the prescribed sales method. In this case, this meant a failure to sell Shiseido products over the counter ('face-to-face') to consumers. Instead, Fujiki had embarked on discounting in faxed catalogues and order forms to customers. Fujiki counterclaimed against the Shiseido wholesaler, initially on the basis that the contract termination was unfair.

The Shiseido Case attracted widespread interest from the outset because it pitted a well-known company against a long-term business partner, and required the courts to apply emergent case law on terminating continuing contracts. A key issue was that the contract prescribed one month's notice for termination, whereas case law indicated that a 28-year contract would require notice of between six months and one year, depending on the proportion of the distributor's business accounted for by the terminating manufacturer's product (Taylor 1993). The first decision, in favour of Shiseido, also coincided with a wave of consumer product discounting, dubbed *kakaku hakai* (price destruction), which marked the rise of discount bulk retailers in Japan and attempts by smaller retailers to remain competitive and break free from resale price maintenance dictated by manufacturers.

Shiseido argued successfully in court for the validity of the contract clause allowing termination for breach of a serious condition of the contract, since the breach under question went to the heart of the contract. Fujiki argued, initially unsuccessfully, that Shiseido's termination was wrongful for two reasons. First, Fujiki did not regard itself as being in breach. Second, Shiseido's refusal to supply the product was unconscionable, being tantamount to the destruction of Fujiki's business (that is, that it amounted to breach of good faith, or alternatively, an abuse of right). On appeal, Fujiki Honten prevailed on this latter point and the Tokyo High Court awarded a significant figure in damages (Shiseido Tokyo Hanbai KK v. Fujiki Honten KK 1994; Taylor 1995).

At this point Fujiki also added the claim that the structure of the contract was in breach of the Antimonopoly Law because face-to-face product consultations were simply a device to suppress large-volume sales and discounting and to ensure resale price maintenance. The High Court accepted this analysis, in what became a highly controversial decision. What had begun as an acrimonious contract termination was rapidly transformed into an attack on the vertical contract controls imposed by cosmetics makers and an equally determined attempt by Shiseido to prevent a retailer from breaking step. For his part, the Fujiki Honten

respondent had begun to see himself as the Robin Hood of Japanese retailing – the person who would break Shiseido’s oppressive stranglehold on its distributors (Shiseido Tokyo Hanbai KK v. Fujiki Honten KK 1994).

The High Court appeared to have been influenced by an investigation by the JFTC of Shiseido’s sales methods, which seemed to show a link between the sales method, resale price maintenance and anticompetitive outcomes. The JFTC drew headlines for the search of the premises carried out at such a high-profile company. Nevertheless, the JFTC declined to mount a full prosecution against Shiseido.

At this time, there was no provision in the Antimonopoly Law allowing private actions. Thus, Fujiki Honten was dependent upon the JFTC exercising its judgment to press forward under the Antimonopoly Law. The agency’s refusal to do so explains why Fujiki Honten’s counterclaim is grounded in contract, with the competition law breach added in as a subsidiary issue.

A practical side effect of both the litigation and the JFTC investigation was that Shiseido and other manufacturers admitted to later radically changing the distribution patterns they had sought to preserve in the court action. Shiseido did not deny, for example, that it was already supplying chain stores and bulk discount stores with stock that could be discounted, and that they would seek a stronger differentiation between luxury lines and everyday toiletries. There is anecdotal evidence that the luxury lines were only made available to retailers who were prepared to comply with Shiseido’s directives on sales methods and promotion, as is the case in the cosmetics industry outside Japan.

Many commentators doubted, however, that the High Court had adequately understood the competition dimensions of the dispute. On appeal to the Supreme Court, Shiseido forced a re-examination of the competition question. Shiseido maintained throughout that face-to-face sales was a legitimate sales strategy, with demonstrable benefits to consumers. In particular they argued that guidance from trained consultants was a crucial element of the product because consumers were ‘not only buying the product; they were buying the chance to be beautiful’. Shiseido also stated explicitly that such guidance pre-empted mistakes by consumers that could result in skin allergies or the like. Fujiki argued unsuccessfully on this point that if the product were really potentially harmful, it would contravene the Pharmaceuticals Law and the Product Liability Law.

In its 1998 decision, the Supreme Court reversed the High Court decision and held that the limits placed on the mode of sale were genuine components of the products themselves,

rather than anticompetitive devices (Supreme Court, 18 December 1998). The judges accepted that resale price maintenance might be a by-product of the face-to-face sales method. They were prepared to allow this, however, on the basis that it could be justified with a 'rational reason'. In doing so, the Court implicitly accepted Shiseido's claims about brand safety and 'brand image'.

The decision can be read a number of ways. First, one should note that the final appeal in the Shiseido Case was the first competition law case heard by Japan's Supreme Court in nine years. In a system in which appeals to the Supreme Court were automatic until 1998, this is also an indicator of the relative scarcity of competition litigation to this point. This may explain why, on one reading, the Supreme Court seemed to be swerving around the allegations of anticompetitive behaviour. Nowhere in the judgement, except in Fujiki's affidavit as respondent in the case, was there any attempt to quantify market share, to analyse product lines and market differentiation or to balance the indirect ban on discounting with an estimation of lost consumer welfare. In short, there was no economic or competition law analysis of the kind that we might find in a comparable US or Australian case, although the court implicitly seemed to be following a European stance in relation to controls on the distribution of luxury goods. I return to this point below.

On the other hand, the Supreme Court's reported decision closely followed the reasoning in prior cases once it accepted Shiseido's argument that its products were not simply self-serve generic products. That is, once Shiseido was able to show that its luxury cosmetics comprised a package of product and service, then there was a 'rational reason' why the service component had to be delivered in a stipulated way. As any consumer will testify, prices for these kinds of cosmetics remain considerably higher in Japan than in other markets as a result.

What the Shiseido Case did do, arguably, was to centre competition law in public and corporate debates about the nature of deregulating markets and the potential for judicial and agency intervention.

The shadow of competition law reform

The Shiseido decision is less surprising if we consider the role of corporate self-regulation. The evidence from the case reveals that the distribution contracts in question were drawn up very carefully. There was no prohibition on discounting per se; only the requirement that products

had to be sold across the counter, with the agreed form of promotion and staff training. Strictly speaking, Fujiki Honten was not terminated merely for discounting. This is consistent with interviews carried out with Shiseido's Legal Affairs Department, where it was clear that the company was well aware of the need to comply with the Antimonopoly Law (Uchida 2000).

Self-regulatory compliance with the Antimonopoly Law, even where it is formalistic, is arguably an important element in the Japanese regulatory landscape. The internal Shiseido stance reported above is not an isolated one. It is consistent with the results of 10 interviews conducted by the author with Japanese companies between 1996 and the present, in which legal compliance – in particular with the Antimonopoly Law – is nominated as the fastest growing area of corporate legal affairs. Compare this, however with the figures from a Tokyo Foundation study cited by MITI, in which only 50 per cent of 484 randomly selected large corporations (those with over 300 employees) surveyed had an established legal affairs department. The figure dropped to less than 10 per cent for small and medium-sized corporations (MITI 2000: 204). Recently, the head of Toyota's Legal Affairs Division publicly called for an increase in Japanese judges and lawyers conversant with competition law (Makino 2000). These companies have not suddenly embraced the religion of rigorous competition. Rather, the indications are simply that some Japanese companies have a growing, grudging acknowledgment that Japanese Antimonopoly Law enforcement is a new feature of their business environment.

We see some indications, too, of a broadening of the meaning of 'self-regulation' in Japan. As Tilton (1998) points out, 'self-regulation' in Japan has often been understood as industry rules and codes of conduct designed to prevent new entrants from coming into the industry. Schaeede's recent and important study of industry self-regulation also highlights the role that industry associations play in stabilising the industry and its profits by adopting pricing or quality regulations that preserve the status quo, and through information exchange (2000: 10). Promoting member companies' compliance with law per se does not rate highly as a self-regulatory objective in Schaeede's study; rather industry associations interact dynamically with regulators to shape – or soften – the impact of law and to regulate members beyond the strict letter of legal regulations (2000: 9). These kinds of self-regulations are illustrated in the May 1996 decision by Japan's non-life insurance companies to abolish 'self-regulation'. In fact these were industry-wide fee-setting arrangements – the practice of paying identical fees to insurance agents selling non-life company products. Although this did not amount to price setting per se, in practice it meant identical pricing of premiums for corporate insurance

policies in areas such as product liability, fire and marine, and plant and machinery. These kinds of corporate policies account for 44 per cent of the casualty insurance market, where annual income from premiums totals 4,400 billion yen (A\$55 billion). The industry decision anticipated the extension of the Antimonopoly Law and was an attempt to deflect the attention of the JFTC following its on-the-spot investigations of plant and machinery insurance policy pricing earlier that year (*Nikkei* 1996).

The impulse toward self-regulation that complies with, rather than circumvents, the Antimonopoly Law may be strengthened by the introduction of reforms that will make it easier to bring private actions under the Law. Revisions to the Antimonopoly Law in 2000 introduced two main changes. The first was the formal abolition of the natural monopolies accorded to industries such as electricity and gas. The second was the provision of strengthened remedies for both consumers and corporations who suffer loss as the result of anticompetitive behaviour contravening article 8(1) 5 or article 19 of the current law. The significance of the latter change is that it introduces, for the first time, injunctive relief. Until now, an alleged victim of anticompetitive behaviour had to wait for confirmation of a JFTC finding against the target company and then apply for damages under article 25 of the Antimonopoly Law. Alternatively the complainant could claim tort damages using article 709 of the Civil Code, and expect the traditionally low payout from a Japanese court, but long after the actions complained of had been taken. The pending reforms would make it possible to apply for an injunction before a JFTC finding has been formalised, ideally enabling the plaintiff to secure quick relief that is not dependent on JFTC resources. Other changes (new article 83(3)) allow the courts to formally request an opinion from the JFTC and for the agency, in turn – with the permission of the court – to tender an opinion regarding a particular case (*NBL Henshubu* 2000).

We can see in the new reforms a new and formally enhanced role for the JFTC vis-à-vis the courts. This new structure, however, raises doubts about the judicial system's capacity to fulfil its jurisdictional mandate in competition law. In theory there is no bar to this, but in practice the bench has very few judges with either experience in competition law or formal training in economics. As tacit recognition of this problem, the proposed reforms allow petitions for injunctive relief to be brought in district courts that have high courts attached to them. This convoluted formula is a compromise response to an earlier draft that sought to limit these kinds of cases to the Tokyo District Court. The underlying rationale is to assign judges to competition cases in a way that will build up judicial experience while limiting the

scope for divergence in decisions (Shiraishi 2000). On the other hand, Murakami (2000) is more optimistic, pointing to the scope for Japanese judges to draw on established jurisprudence in the area from the European Union and the United States. It remains to be seen what the practical effect of this jurisdictional definition will be. Perhaps more pressing than the problem of judicial inexperience is the question of access to suitably qualified lawyers. There are currently almost no commercial practitioners in Japan who specialise in competition law or trade practices. The severe shortage of lawyers in regional areas – and particular shortage of those with international business experience outside the Tokyo and Osaka areas – also means that legal resources for these kinds of cases are spread very thinly beyond the Tokyo–Osaka corridor (e.g. MITI 2000: 204). Again, the impact this will have on litigation patterns, if any, is open to investigation.

This enhancement of the roles of the JFTC and the courts in enforcing the legislation coincides with the changing nature of the JFTC's jurisdiction. Its next challenge will be how to deal effectively with intellectual property, particularly in the context of distribution chains (*Nikkei* 1999).

Under the current Antimonopoly Law, article 23 is interpreted literally by most legal practitioners as exempting the exercise of patent, trademark or design rights from the operation of the Law. In practice, this means that licensing agreements concerning intellectual property rights may contain restrictive provisions toward the licensee that cannot be challenged by invoking the Antimonopoly Law. The most recent example of this has been disputes between petrol stations and petrol wholesalers. As the price of petrol has fallen, petrol retailers have sought to sell 'no-brand' petrol in tandem with brand-name products. The major oil companies opposed this practice on the basis that it would infringe the trademark restrictions in the retail distribution agreement, which designate the premises as the unit of 'trademark management'. In 1999 the Petroleum Council, within the Agency of National Resources and Energy, designated separate pumps and underground tanks as the units of trademark management, thus supporting, in theory, the dealers' position. However, petrol wholesalers remain able to simply prohibit the sale of no-name petrol on the basis of trademark infringement, at least until the JFTC's 1999 Guidelines on Patent and Know-How Licensing Agreements are tested (Kozuka 1999; JFTC, no date).

The point here is that value in distribution chains is increasingly generated by intellectual property, rather than by the commodity itself. If intellectual property rights continue to be manipulated for anticompetitive purposes, the ripple effect on the economy will

be significant. There has been a related recognition of the importance of this issue in the reforms to Japan's Code of Civil Procedure, effective in 1998. Japan's constitutional structure does not permit the creation of specialist courts per se, with the exception of family courts. Instead, petitioners in intellectual property disputes are 'permitted' to bring their claims to district courts in Tokyo, Osaka and Nagoya in addition to the court that would usually have jurisdiction, if the latter is not one of the nominated district courts. The aim is to provide speedier and more expert disposition of a growing number of cases in Japan concerning intellectual property.

Conclusion

Economists, political scientists and trade negotiators have been inclined to dismiss competition law as a dysfunctional area of regulation in Japan. The 1990s witnessed lengthy debates about whether formally and informally sanctioned cartels would be dissolved, whether price fixing would be policed effectively, whether the letter of the Antimonopoly Law would be enforced, and whether Japan's Fair Trade Commission would be adequately resourced. The answers to some of these questions are now emerging.

Many commentators would concur that the results so far have been 'feeble' (Tilton 1998: 180). However, the 'shopping list' style of critique of Japanese competition law and policy has some serious limitations. It remains grounded, for example, in a 'top-down' view of law and its operation, which typically focuses on the institutional capacity of the JFTC and calls for vigorous prosecution and judicial sanctions of the maximum number of cases. Within trade circles, this view often takes the form of preoccupation with finding legal 'levers' to pull in order to open the Japanese market.

This view of how law and its enforcing agencies work is superficially attractive, but ultimately unrealistic. Socio-legal research of the past 40 years tends to show, rather, that the factors motivating or reinforcing good corporate citizenship and legal compliance are multifaceted, and not limited to 'black-letter' law. It follows that policymakers in the 21st century need to position formal law and the courts to one side of a governance matrix.

On the formal, legal, side of the governance matrix, we need to take into account the systemic characteristics of the target jurisdiction. In the case of Japan, this means factoring in data about the limits of civil procedure enforcement powers such as discovery; the serious lack of lawyers and judges trained in either economics or in competition law; and a civilian

legal system's preference for administrative, rather than criminal, regulation. The other side of the governance matrix comprises a host of non-court 'agents' whose interactions define and enforce the institutional rules for competition. These include the transaction parties (their employees, institutional and interpersonal relationships, and relative economic leverage); the structure of the industry (schemes of self regulation, bureaucratic directives and guidance); cultural mores and ideology; perceptions of legal rules and court generated norms (the so-called shadow of the law); and intervention by third parties such as government inspectors, bankers and lawyers (Macaulay 1991).

Historically the legal/non-legal and formal/informal dichotomies of governance have been recognised as commonplace. So, for example, direct legal controls on business have been supplemented by (and often subordinated to) informal social or commercial controls exercised by communities outside formal legal forums. Tilton observes this kind of self-regulation in Japan as a form of market closure (1998).

The new insight visible in governance literature (e.g. Grabowsky and Braithwaite 1992), in legal theory (e.g. Habermas 1996) and in economic thinking (e.g. Aoki forthcoming) is that regulatory 'institutions' draw from both sides of the equation. The formality of legal rules and processes are not insulated from the apparent autonomy of industry bodies, professional groupings and corporate compliance behaviour. It follows that changes in one element are likely to have flow-on effects to other parts of the regulatory sphere, and that this porousness means that industry bodies, professional groupings and corporate behaviour have the potential to be harnessed to change legal policy goals in a range of ways. Schaede (2000) is right to call attention to industry and trade associations as key regulatory players in Japan, presenting persuasive evidence of their regulatory influence, particularly in the interstices of formal law. We may find over time, however, that Schaede's study, at least to the extent that it relies on data prior to the mid-1990s, may overstate the scope of industry associations' regulatory influence and understate the impact of formal law in the regulatory mix.

In the case of competition law and policy, we should be looking for the ripple effect from changes to law and policy in the interplay between state intervention; induced industry 'voluntarism'; inculcation and absorption of the desired norms by key players – (individually and collectively); reinforcement of competition rules through formal and informal government channels; and interventions by change agents, such as insurers, banks, legal professionals, and the professional managers who design and approve the transactions.

I have argued above that the formal legal elements in the governance matrix for competition law and policy in Japan seem to be becoming more prominent. What we would expect to see then, is responsive change from the courts, from corporations and in the views of policy commentators in the media and academe. If we follow Aoki's dualist description of institutions, what we then expect is that the change to the law or the change in enforcement stance affects other players. At the same time, however, these players' perceptions of the changes and their responses to them start to reconstitute the institution, or 'the rules of the game'. This area deserves greater research. What is less likely to emerge in Japan is a wholesale embrace of a foreign model or a sudden switch to a putative 'global standard' of competition law enforcement. Indeed, the examples discussed in this paper do not illustrate such a trend. This fact suggests, among other things, that legal responses to economic expansion and restructuring in Japan are not uniformly 'global', but are local and culturally specific.

Notes

- 1 Just weeks before Prime Minister Obuchi's stroke and departure from public life in 2000, he appointed the outspoken former president of the Federation of Japanese Bar Associations, Mr Nakabo, as a special policy advisor. Nakabo had already declared his support for a non-LDP politician and it is likely that this appointment was a way of preventing him from campaigning against the government in the 2000 general election.
- 2 In January 2001 MITI will be renamed the Ministry of Economy, Trade and Industry (METI).
- 3 In the case of insolvency law reform, the government set up a Committee on Insolvency Law Reform (*Tosan ho bukai*) within the Legislative Advisory Council of the Civil Affairs Bureau of the Ministry of Justice (Steele 2000). Japan's new Civil Rehabilitation Law (*Minji saisei ho*, Law No. 225, 1999) is the first component in a comprehensive reform of its insolvency law regime. The law was passed by the Diet on 14 December 1999 and came into effect on 1 April 2000. It will replace the Composition Law (*Wagi ho*, Law No. 72, 1922).
- 4 See, for example, the Cabinet Decision of 20 March 1999, taken as part of the government's 'Three Year Deregulation Plan' to introduce legislative amendments to abolish cartels for the gas and electricity industries and to introduce new civil remedies under the Antimonopoly Law (*NBL Henshubu* 2000)
- 5 Examples of direct legislative intervention can be found in corporate law, environmental protection, consumer protection, insolvency, civil dispute resolution and competition regulation. Indirect forms of governance, by contrast, are modes of political and legal control that go beyond legislation enacted by government. Exam-

ples include industry codes or self-regulation; the privatisation of government utilities so that corporate governance and contracts replace industry-specific licensing and direct government supervision; and the monitoring of companies and transactions through third parties such as financial institutions, insurers and legal advisors (e.g. Macaulay 1996).

- 6 The total of the fines levied were the second-highest total for fines reported since the agency's inception: during 1995, 6.4 billion yen (A\$80 million) was collected from 741 enterprises in 24 infringement cases.
- 7 Announcements and investigations by the JFTC were well-publicised in the sense of being front-page news in major daily newspapers such as the *Nikkei Shimbun*. This pattern seems to have continued, although I have not undertaken a formal analysis of the length and placement of the reportage.

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Private Governance of Public Rights in Japan: Revisiting the Japanese Governance Debate

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PRIVATE GOVERNANCE OF PUBLIC RIGHTS IN JAPAN: REVISITING THE JAPANESE GOVERNANCE DEBATE

Introduction

Dramatic growth in the Japanese economy in the postwar period – and its meltdown in the 1990s – has attracted sustained interest in the power dynamics underlying the management of Japan’s administrative state. For a long time, scholars and commentators have debated about who wields power in Japan. The question has been asked in different ways. In the 1970s and 1980s, the question was usually posed as: who orchestrated Japan’s economic miracle in the 1960s and 1970s? Today, the question is usually reframed to: who is accountable for the policy failures that plunged Japan into financial crisis and recession during the 1990s? Yet the core issue remains the same – who governs Japan? (Johnson 1995).

Scholars are divided in their responses. Some, for example, maintain that Japan’s bureaucracies dominate the policymaking process and exert an all-powerful influence over the economic management of the nation (Kaplan 1972; Campbell 1977; Johnson 1982; Zysman 1983; Anchordoguy 1989; van Wolferen 1989; Kato 1994; Keehn 1997). The best-known proponent of this view is Chalmers Johnson who, in his pathbreaking study of MITI (Johnson 1982), paints a picture of an omnipotent Japanese developmental state that planned, engineered and effected Japan’s postwar economic success by exercising control over industry. Others, such as Ramseyer and Rosenbluth (1993), rely on a rational choice paradigm of the interaction between politicians and bureaucrats to submit that bureaucrats regulate according to a political script. They suggest that because the Liberal Democratic Party has formal veto power and control over civil servant promotions and salaries, the bureaucracy in reality implements policies in the shadow of its political leaders.

This paper argues that this bifurcation overlooks an important actor in Japan’s power politics – the Japanese corporation. My thesis is that Japanese corporations exert significant public policymaking powers in Japan. In fields as diverse as environmental management and gender equity, Japanese corporations are devising and implementing their own public policy agendas. The paper suggests that the current formulation of the governance debate in Japan – whether it is politicians or bureaucrats who run Japan – rests on a conceptual oversimpli-

fication of law. This oversimplification derives from the traditional categorisation of law into ‘public’ (e.g. administrative) and ‘private’ (e.g. corporate) law. Such a categorisation implies a rigid demarcation of power boundaries – public versus private – despite growing evidence of interaction and overlap. Thus, under this style of legal thinking, corporations have no independent place in the arena of public policymaking.

Traditional legal thinking is too limited to properly appreciate how power is exercised in a modern state such as Japan. As part of a search for a replacement, I find that recent innovations in regulatory theory – innovations that emphasise the interactive nature of governance and control – provide a more satisfying conceptual starting point for understanding power relationships in Japan. New-style regulatory theory expressly includes the corporation as part of the matrix of power and, therefore, allows a more nuanced understanding of how public policy is created and implemented. This has immediate relevance for understanding Japan. As Japan continues its major program of public law reform, current regulatory theory offers an alternative platform to reinterpret recent administrative law developments and to critically re-evaluate whether emerging standards of accountability and transparency in public law will necessarily lead to more open governance in Japan.

The paper revisits the debate on Japanese governance and demonstrates how the debate has neglected the Japanese corporation as a player in the power stakes. It highlights how scholars either:

- 1) exclude the corporation altogether from the debate’s terms of references; or
- 2) subsume the corporation within one of the two dominant positions in the debate – (that is, by arguing either that corporate preferences inform political choices or influence bureaucratic practices) – and thereby fail to ascribe to the corporation a more independent policymaking role.

The empirical evidence that suggests that corporations are important players in the power game is then explored. In particular, recent legal and regulatory developments in gender equity and environmental policy are used as examples to illustrate the relevance of corporations in the Japanese administrative state. It is then suggested that a rigid reliance on traditional models of law – which divide power into public and private – is to blame for why the Japanese governance debate has downplayed the corporation as a site of policymaking. A

new theoretical approach is needed to understand the governance role of Japanese corporations, and the paper charts the path of regulatory theory – from traditional command-and-control regulation to more recent ideas centred on corporate self-regulation – to highlight how newer-style approaches can aid understanding of how Japanese corporations actively participate in public policymaking.

The Japanese governance debate: the ‘invisibility’ of the Japanese corporation

Bureaucrats versus politicians

According to Carlile and Tilton (1998: 199), law is the key to understanding Japanese-style public administration. With the inability of the Japanese legal system to provide firms and individuals with proper channels to challenge informal government policy, a ‘developmentist ideology’ – in which bureaucrats are entrusted with responsibility to manage the nation’s development and security – can prevail unchecked. This means, writes Henderson (1973: 195), that ‘[r]ather than a rule of law, a rule of bureaucrats prevails’ in Japan.

Ramseyer and Nakazato (1999: 191–219) agree that law is the starting point for analysing Japanese governance. But they come to a radically different conclusion. The Japanese legal system, they submit, is a rational system of rules operating under the umbrella of a parliamentary democracy. Bureaucrats rule according to the whim of Japan’s political leaders. They do so because their career destinations and salaries are controlled by the Liberal Democratic Party (LDP). If they do not act within the ambit allowed by the LDP, the judiciary – also under the control of the LDP (Ramseyer 1994) – will step in to enforce the LDP’s policy preferences through judicial review. Therefore, they conclude, Japanese law allows the LDP a stranglehold over public administration because the essential dynamic underscoring Japanese administrative law ensures an executive and judiciary loyal to LDP policy objectives.

Not all commentators, however, subscribe to one of these two positions. Some, for example, see Japanese law in transition (Oda 1992). They argue that Japanese governance is undergoing a metamorphosis – from administrative fiat to rule by law (Hollerman 1988). As Milhaupt and Miller (1997) contend, the slow economic growth, financial instability and political transition mean that informal regulation based on consensus and cooperation is breaking down. In its place, legalism – represented by the growth of formal legal rules

and procedures – is emerging. The reigns of power, in short, are being handed over from the bureaucracy to the legislature.

The forgotten corporation

The Japanese governance debate, therefore, reflects a basic tension between bureaucratic and political power. Thus, some find the weight of power in Japan rests with the ruling LDP party; others, with the bureaucracy; still others, somewhere in between. In all these myriad positions, however, the role of Japanese corporations has been overlooked.

Usually, commentators dismiss the role of corporations in public administration on the implicit basis that corporations are the *regulated*, never the *regulators*. Thus, Spaeth (1994) argues that Japanese corporations comply passively with agency directives. This is because of a cultural deference to governmental authority, a fear that non-compliance will result in a loss of future privileges, and the procedural difficulties in obtaining judicial review. Haley (1991: 139–68) applies an institutional history of Japan to conclude that the Japanese civil service regulates the private sector by negotiation and encouragement (because it has the authority to command respect and compliance) and never by force or compulsion (because it does not have the legal powers to do so). Haley's view differs from Spaeth in that he acknowledges that the corporation is accommodated as part of Japanese regulatory design; but he does not go so far as to suggest that it is an active and independent actor. Ramseyer and Nakazato (1999: 190–219) use neo-classical economic theory to reach a similar perspective. Ramseyer and Nakazato believe that the Japanese corporation is regulated according to a wider LDP political script. The bureaucracy, as an agent of the LDP, enforces LDP preferences against those of businesses. The judiciary, also as an agent of the LDP, refuses judicial review when the bureaucracy correctly enforces orthodox LDP policy, but grants judicial review – and upholds private property rights – when the bureaucracy departs from the LDP position. The corporation, in short, can never buck the system as masterminded by the LDP. This is not to suggest that commentators completely discount the power wielded by the Japanese corporation. Some, such as Patrick and Rosovsky (1976: 47), make a clear case that corporations act despite the prevailing regulatory environment:

While the government has certainly provided a favorable environment, the main impetus of growth has been private – business investment demand, private saving, and industries and skilled labour operating in a market-oriented environment of relative prices.

Friedman (1988: 5–25) agrees. Japanese corporations, he argues, derive their own ideas about justice, fairness and propriety as a result of market behaviour; they are not driven by bureaucratic or political imperatives. Others, such as Tilton (1990) and Uriu (1996), go further and suggest that corporations are active participants in the policymaking process. Tilton (1990), for example, points to trade associations – private institutions with the status of quasi-states – as important players in governing the political economy. Uriu (1996: 8) is even more blunt:

I find that firms and labor have been direct participants in all phases of industrial policy-making. In many cases, they have actually driven the policy-making process and have heavily influenced policy decisions. I also find that MITI bureaucrats have not been able to make and implement policy free from specific industry or political pressures. Rather, bureaucrats have been subject to strong constraints and pressure from industry and their political allies.

Even so, these ideas on corporate power still do not perceive the corporation as an independent source of public policymaking in Japan. They are more limited in their claims. They see the corporation either as driven by the logic of the market, not the imperatives of political or bureaucratic policy, or as active lobbyists in both the formulation of policy by politicians and its implementation by bureaucrats. The first conception, if anything, sees virtually no link at all – or, at least, a very weak link – between public governance and private behaviour. The second brings corporations firmly within the push and pull of the politicians-vs-bureaucrats debate on Japanese governance. This is because corporations are assumed to bear only a degree of influence on the government and/or the civil service in the arena of public administration. Ultimate responsibility for creating and enforcing policy still rests with either one (or both) of these institutions. The corporation is not regarded as having any independent role to play in developing and implementing public policy.

The Japanese corporation, therefore, remains subsumed within the prevailing parameters of the Japanese governance debate – a debate over whether politicians or bureaucrats rule. Positions vary widely, of course. Do politicians govern? Or do bureaucrats reign supreme? Or is the true position somewhere in between? In this debate the corporation is regulated by either – or a combination – of these arms of government. Variations on this theme do exist, including that corporations are ruled by the market and not governmental institutions, and that corporations are active lobbyists in existing policy processes and not mere passive

subjects of regulation. However, corporations are never seen as independent forums for public policymaking.

Corporate compliance in Japan: the ‘visibility’ of the Japanese corporation

Including the corporation: ‘offer’ and ‘acceptance’ of power

Recent legal and regulatory developments, coupled with empirical evidence of Japanese corporate behaviour, suggests that the parameters of the governance debate need to be adjusted to more fully embrace corporate actors. In fields as diverse as environmental regulation and gender equity policy, Japanese corporations are finding increasing scope to devise – and implement – public policies themselves. This is not to surmise that Japanese corporations share power equally with the bureaucracy and the ruling elite. The available evidence does not – cannot – back this conclusion. However, the evidence does suggest that public policymaking in Japan is a more complex whirlpool of interacting agents than the existing terms of the governance debate permit.

Nor, of course, is evidence of private power in the public sector unique to Japan. With a shift to privatisation across the globe, corporations worldwide enjoy greater freedom in the power they may exercise. Some are alarmed by this prospect – witness the popular demonstrations in Seattle against the World Trade Organisation in December 1999, against the International Monetary Fund in Washington DC in April 2000 and, most recently, against the World Economic Forum in Melbourne in September 2000. In response, academics and public officials have called for a fresh debate on corporate social responsibility (Cornell Club 1999). Once again, even though corporate power is a global phenomenon, this does not reduce its significance in the Japanese context. If anything, it confirms that Japan is not ‘uniquely unique’ (Dale 1986; Sugimoto and Mouer 1984) and that debates on modern Japanese law, society and the political economy – such as the governance debate – can draw on international and comparative trends. As Woodiwiss (1992: 6) powerfully explains:

The reasons why the uniqueness assumption [about Japan] should be rejected are twofold; first, it owes its existence to the intellectual dominance of a pernicious, quasi-academic discourse which ... we have learnt to call ‘orientalism’. Second, and as a consequence, it calls into question, for no good reason, the applicability of the social sciences to the Japanese

case. According to this discourse, Japan, like all the other societies of what in the eighteenth and nineteenth centuries was constructed as ‘the east’, is not simply different or even opposite to ‘the west’, but also its ‘other’ and usually its inferior.

Two interlocking forces have been chiefly responsible for propelling corporations in Japan (and elsewhere) onto the public policymaking stage. Applying a contract-based analogy of ‘offer’ and ‘acceptance’, these forces consist of an ‘offer’ of power by legislative grant to corporations to self-regulate on an issue of public policy, and the ‘acceptance’ of this power by corporations through the proactive adoption of compliance programs.

The offer

In Japan’s case the offer of power to corporations is invariably by means of legislative grant, usually packaged in broad statutory language and coupled with a duty – non-actionable in law – that the corporation must exercise this power responsibly and in good faith. The terms of the offer involve the legislature setting targets and goals for the corporation to achieve. Although these may be further clarified by the bureaucracy, responsibility for designing and implementing a program for meeting the targets and goals rests solely on the shoulders of the corporation. This delegation of public policymaking functions seems to run across constitutional contours within which Japanese parliamentary democracy nestles. According to Japan’s Constitution, ultimate power rests in the Diet. As article 41 unambiguously proclaims, ‘The Diet shall be the highest organ of state power, and shall be the sole law-making organ of the State’. By article 76, executive power rests in the Cabinet, which must administer the law ‘faithfully’ and oversee the civil service ‘in accordance with the standards set by law’. The Constitution thereby creates a governmental structure in which enacting policy rests in the legislature and implementing policy rests with the bureaucracy. Although parliamentary democracy is far from dead in Japan, the flow of power to the Japanese corporation has arguably complicated this neat constitutional framework.

The acceptance

The acceptance of this offer manifests itself in the emerging ‘culture of compliance’ enveloping corporate Japan. Although compliance is not new in Japan, it is becoming more widespread following the banking crisis in the 1990s (Nomura 1999). ‘Compliance’ describes a proactive corporate management program of self-regulation on a wide variety of public policy issues. The

program usually involves redefining corporate goals to specifically incorporate social and environmental responsibilities, even though these invariably fall outside the original charter of the corporation. In this way, the phenomenon of corporate compliance exceeds traditional approaches to corporate governance under which directors are required only to exercise their business judgment to maximise shareholder wealth. As the Supreme Court held in *Ikenaka v. Tabushi* (Judgment of the Tokyo District Court, 16 September 1993, 1469 *Hanrei Jiho* 25 at 25):

Corporations are *entities that pursue profits* by entrusting their operations to directors elected at the general meetings of shareholders. Thus, in principle, the decision of legally elected directors shall be respected where such decision was made within their authority and *in the best interests of the company*, so that *the directors may concentrate on management without being inhibited*. In this way, corporations can expect to make *profits*. (Emphasis added by the author)

The shift to corporate compliance in Japan, therefore, is not a natural outcome of the corporate endeavour. What, then, is driving corporations to ‘accept’ the power ‘offered’ to them by the legislature? Very broadly, the answer lies in the expanding array of legal techniques for incorporating social responsibilities into the duties of corporate management as well as the growing rigour of social activism and the increasingly searching public scrutiny of corporate scandals.

The key legal mechanism for broadening directors’ duties lies in article 266–3 of the Commercial Code. This article provides that directors are personally liable to third parties for losses sustained as a result of intentional or grossly negligent dereliction of duties. In the 1969 case of *Muto v. Izuo Kokai KK* (Judgment of the Supreme Court, 26 November 1969, 23 *Minshu* 2150), the Supreme Court held that article 266–3 was a special provision designed to protect third parties (especially creditors). The Court also held that it operated in addition to, not in combination with, any civil law tort requirements. The voluminous case law on article 255–3 has focused on balancing directors’ responsibilities to protect third parties with their broader discretion to take business risks. However, at least in theory, the courts would not allow discretion to act if a business decision amounted to a violation of a law or the Articles of Incorporation. In such a case, an injured third party could invoke article 266–3 to seek compensation directly from the directors. This possibility throws open personal liability for

directors of Japanese companies if a breach of a law or regulation – including those relating to anti-discrimination, environmental management and product safety – eventuates in insolvency. Following the collapse of the bubble economy in the early 1990s and the banking crisis in the mid-1990s to late 1990s, many corporations are becoming increasingly sensitive to such a risk. As a result, since about 1998, a number of Japanese corporations and financial institutions have begun establishing internal compliance policies and systems to meet their responsibilities under the Civil Code, Commercial Code, banking and finance laws, environmental statutes and labour legislation (Nomura 1999).

Another potential legal technique by which Japanese directors and managers may be held accountable for social responsibilities in the future is via strict vicarious liability for regulatory offences, coupled with the availability of ‘due diligence’ defences or damages discounts for having in place a system to prevent breaches. Due diligence defences allow directors and top management to escape personal liability for a regulatory offence committed by an agent of the corporation if they can show they had in place an effective internal control or compliance system to prevent the breach occurring. Unlike in Australia, the concept of ‘due diligence’ has yet to be entrenched in legislation, but its potential is currently of great interest to legal scholars. For example, some scholars forecast that Japanese corporate governance law will soon move in the direction taken by US law and embrace ‘due diligence’ as the tool for testing directors’ liability for regulatory breaches (Nomura 1999: 47).

A corporate compliance culture is also being fostered by scrutiny of corporate activities by media outlets and activist groups. Public disclosure of corporate scandals has been especially important in driving this development (Risuku Defensu Kenkyukai 1995; Risuku Defensu Kenkyukai 1997). Negative publicity has made top managements of targeted companies see social responsibility as a priority for practical reasons of public relations and brand image, even if liability is not technically a legal issue. In the post-bubble recession that has gripped the Japanese economy for most of the 1990s, a series of corporate failures and banking scandals have severely tarnished the image of many Japanese businesses, both domestically and internationally. The financial sector’s inability to contain bad debt, culminating in the collapse in November 1997 of Japan’s tenth largest bank, Hokkaido Takushoku Bank, and fourth largest broking firm, Yamaichi Securities Corporation, led to a widespread loss of confidence in the Japanese financial system. Multi-billion dollar bailouts of financial institutions, such as Cosmo and Kizu Credit Unions and Hyogo Bank, and a string of insolvencies involving major corporations fuelled further public outcry. Reports of corporate

excesses quickly filled the pages of newspapers: corporations spending lavish sums ‘entertaining’ public officials; securities brokers unlawfully covering the financial losses of their clients; company directors paying the mafia (*sokaiya*) to control annual general meetings of shareholders. With Japan still struggling to escape its longest recession since the war, corporations are looking to embrace ‘compliance’ programs to restore the public’s faith in their businesses (Nomura 1999: 45).

Case studies: environmental management and sexual harassment

Two brief case studies – one on environmental management, the other on gender equity in the workplace – serve to demonstrate the growing importance of corporations in devising and implementing public policy in Japan. In both case studies, the ‘offer’ of power to the corporations is made in recent amendments to environmental and equal employment opportunity statutes.

In environmental management, the relevant statute is the 1993 Fundamental Act on the Environment (Law No. 91 of 1993). This act merges principles of pollution control and natural environment preservation into the one legislative framework (Kawashima 1995: 248). By section 4, one of the key purposes of the Act is to encourage corporations to engage in sustainable development with as little ‘burden on the environment’ as possible. Although the Act specifically acknowledges that national and local governments must take suitable measures to preserve the environment, the statute imposes an express duty on corporations to seek production methods and business activities that are less taxing on the environment. Thus, section 8(1) imposes an ‘obligation’ on corporations ‘to take necessary steps’ to contain pollution and preserve the natural environment. Specifically, corporations must adjust manufacturing and production processes to ease the burden on the environment; use, as far as possible, recyclable and environmentally friendly raw materials; and dispose of waste and byproducts ‘appropriately’ (sections 8(2), 8(3)).

New legislative provisions in the Equal Employment Opportunity Act (Law No. 45 of 1985) set up a similar scheme in regulating sexual harassment in the workplace. In June 1997 the Diet responded to demands by labour lawyers and feminist activists to legislate against sexual harassment by enacting new section 21 of the revised Equal Employment Opportunity Act. Section 21, which came into effect in April 1999, provides that employers owe a duty to prevent sexual harassment occurring in the workplace. More specifically, employers are

obliged to ensure that their female employees do not endure 'any sexual words or conduct' which lead to unfavourable working conditions for them (so-called *quid pro quo* harassment) or create a hostile working environment (so-called environmental harassment).

The Fundamental Act on the Environment and the Equal Employment Opportunity Act share common traits. First, both statutes use broad and expansive language to invest corporations with policymaking responsibilities in their respective areas. Second, the statutes do not establish any system of sanctions should corporations neglect their statutory responsibilities. Third, the acts encourage corporations to work with government (national and local) and the civil service in exercising their legislative duties, although corporations still retain a large degree of autonomous discretion in how they do so. Thus, section 8(4) of the Fundamental Act on the Environment requires corporations to 'cooperate' with national and local governments as part of a 'coordinated' approach to environmental management, but does not reduce the considerable scope corporations have in devising and implementing their own in-house environmental policies (Nemoto 1999: 5). Similarly, section 21 of the Equal Employment Opportunity Act provides that the Ministry of Labour is authorised to issue guidelines clarifying the substantive duty on corporations to regulate on sexual harassment. When, in March 1998, the Ministry of Labour issued its first set of guidelines, the Ministry did little to direct corporations on how they should handle their legislative role. Rather, it merely confirmed that corporations were required to draft a corporate sexual harassment policy, distribute it to all employees and educate their workforce as to its purport. It also mandated that corporations should set up internal systems to provide counselling services and to handle complaints of alleged harassment 'appropriately and flexibly'.

Both statutes, therefore, entrench a system of *private* governance of *public* rights – that is, a system of intra-corporate regulation of environmentalism and sexual harassment respectively. Under the legislative schemes, private 'governments' (corporations) must handle the public rights of environmentalism and gender equity in accordance with their relevant policies. In both of these public issues, the discretion to customise policy – in terms of designing measures to combat environmental degradation and implementing procedures to resolve individual sexual harassment disputes – is, although not total, very wide.

Recent empirical evidence demonstrates that corporations have not been reluctant in engaging with these policymaking powers. This is especially so in environmental management (Nemoto 1999). A survey of 500 publicly listed corporations by the Science and Technology Policy Research Institute in May 1994 revealed that 98 per cent of the 263 companies that had

responded to the survey had developed internal environmental policies (Nemoto 1999: 1–2). According to the survey, the motivating factors behind the uptake of environmental policies by corporations included: the desire to fulfil corporate social responsibilities (98.0 per cent); the wish to improve the corporation's image in the community (82.1 per cent); and the need to obey social regulations (60.3 per cent).

The latest statistics from Japan on corporate compliance with sexual harassment law, although less dramatic, are similarly compelling. The evidence clearly points to a steady increase in corporate policymaking concerning sexual harassment over the last decade. In November 1989, when sexual harassment was still a relatively new topic of public debate, a survey by Asahi Television showed that 78 out of 80 companies had not given much thought to introducing policies on sexual harassment (Moronaga 1989: 11). By the late 1990s, little had changed. In 1997 a survey of 2,254 companies and 6,762 employees indicated that only 5.5 per cent of companies had implemented systems to prevent sexual harassment, with another 14.5 per cent planning to do so in the near future (Shokuba in Okeru Sekushuaru Harasumento ni Kansuru Kenkyukai 1998). In 1999, with the new sexual harassment provisions in the Equal Employment Opportunity Act taking effect from April, a survey of 322 corporations revealed 28.1 per cent had established an internal grievance-handling unit, with a further 23.5 per cent preparing to do so. According to this same survey, however, 80 per cent of companies self-reported that they had at least taken some steps to respond to the issue of sexual harassment in the workplace. These steps included incorporating new rules in the employees' code of conduct (55 per cent), amending the internal manual to add information about sexual harassment (34.8 per cent), establishing awareness and training programs (27 per cent), preparing and distributing information pamphlets (24.2 per cent) and developing an internal sexual harassment policy (14.6 per cent). Larger corporations are leading the way on dealing with the issue of sexual harassment: 100 per cent of companies with over 3,000 employees self-reported that they had taken action on combating sexual harassment, compared to 88.5 per cent for companies with between 1,000 and 2,999 employees and 70.7 per cent for companies with less than 1,000 employees (Rosei Kenkyujo Henshubu 1999: 6–7).

Beyond traditional legal thinking: new conceptual 'glasses' to render the invisible Japanese corporation visible

This evidence of corporate engagement with public policymaking in Japan immediately questions the characterisation of Japanese governance as rule by either politicians or

bureaucrats. With policy powers invested by law and embraced by management, corporate Japan can no longer be ignored as a power-wielding agent in the public policy arena. But how do we refocus the debate so that it includes the corporation?

The answer lies in developing new theoretical 'glasses' to render the invisible corporation visible. This involves two steps. The first is to deconstruct the underlying conceptual model that has allowed the prevailing orthodoxy about Japanese governance to ignore the function of the corporation in favour of the bureaucrat-vs-politician dualism. The second step is to replace this conceptualisation with new theoretical tools to achieve a more nuanced understanding of the interactive nature of power generally and policymaking in the private domain specifically.

The private/public divide

A conceptual oversimplification of law explains the current invisibility of the corporation from the Japanese governance debate. The oversimplification rests on the categorisation of law into 'public' (e.g. administrative) law and 'private' (e.g. corporate) law. This two-fold classification artificially assumes that the 'public' and the 'private' are two separate circles in a Venn diagram with no points of intersection and no areas of overlap. According to this logic, any discussion of public policymaking means interrogating the roles of public institutions - the legislative, executive and judicial arms of government. Private actors, such as corporations, are excluded from this conceptual picture.

The evidence of this conceptual reasoning is ubiquitous in the Japanese governance debate. This is because the competing perspectives on the respective roles of the legislative and executive arms of government in governance in Japan are premised on the relative importance scholars attach to the phenomenon of administrative guidance. Put simply, administrative guidance refers to the practice of informal implementation of policy, including taking actions that an agency may not have legal authority to institute. Since administrative guidance is assumed to play a similar role to compulsory regulation in other capitalist systems, 'it is easy then to conclude, if one begins with the assumption of the ministries' power, that administrative guidance is remarkable because it achieves results that are impossible in other systems without binding legal power. Conversely, if one assumes bureaucratic impotence, it is easy to dismiss administrative guidance as toothless rhetoric' (Upham 1997: 399).

For example, those who argue that Japanese ministries exert an all-powerful influence on Japan's political economy usually invoke the reasoning that administrative guidance effectively precludes judicial review (Ramseyer and Nakazato 1999: 205). Thus, van Wolferen (1990: 215) contends that lack of judicial review of administrative decisions in Japan 'had had the effect of totally insulating bureaucratic activity from judicial review'. According to Saunders (1996: 373), 'informal decisions are not reviewable, because most of what MITI and other agencies do is informal and a matter of 'guidance', not a legal 'disposition', and therefore is not reviewable'. And, according to Johnson (1995: 79), 'administrative guidance by Japan's powerful state bureaucracy can often result in rampant lawlessness in favor of those enterprises and interests that enjoy privileged access to the bureaucracy'.

This line of reasoning is invariably accepted uncritically by scholars of corporate law who conclude that Japanese corporations are passive recipients of administrative guidance (Bottomley 1999: 42):

Regulation of corporate law in Japan is the responsibility of the Ministry of Justice, acting through its Local Legal Affairs Bureau. The Ministry of Finance, via the Securities and Exchange Law, has jurisdiction over takeovers, stock exchange listings, supervision of securities businesses, securities market surveillance and, together with the Bank of Japan, foreign corporations.

In carrying out their regulatory functions, Japanese administrative agencies rely to a considerable degree on unofficial administrative guidance (*gyosei shido*) in addition to legislation and subordinate regulations. The practice of administrative guidance has been described as a regulatory technique that – although generally non-binding – seeks to conform the behaviour of regulated parties to broad administrative goals. For example, the Ministry of Finance might impose restrictions on certain securities trading activity by administrative guidance rather than relying on statute.

The opposite viewpoint, by contrast, maintains that administrative guidance is merely part of a richer fabric of formal administrative law. According to this argument, administrative guidance *is* subject to administrative review, especially if the guidance contradicts the pro-capitalist preferences of the LDP (Ramseyer and Nakazato 1999: 205–6):

[C]laims of virtual non-reviewability [of administrative guidance] are wrong – and wrong because they both miss the obvious and misstate the law. They miss the obvious because to obtain judicial review of administrative guidance, a firm need simply flout it. The agency will then either roll over and play dead or it will sue. If it takes the first tack, the firm wins. If it takes the second, the firm obtains its review.

[A]ccounts of [non-reviewability] misstate the law because they miss what courts actually do.

Toward a theory of interactive governance

The division of law into ‘public’ and ‘private’, which undercuts the debate over Japanese governance, borrows conceptually from the theory of command-and-control regulation. Command-and-control regulation assumes a style of regulation in which standards are imposed on corporations and backed by criminal or civil sanctions (Ogus 1994: 5). The private/public dichotomy accommodates the design of command-and-control theory wherein regulation is divided hierarchically into ‘top’ (the commander) and ‘bottom’ (the controlled), for the private/public dichotomy splits law spatially into ‘left’ and ‘right’. Here public law is assigned to the domain of the commander and private law is assigned to the domain of the controlled. In this way, the governance debate excludes the Japanese corporation because of two dovetailing conceptual assumptions: first, *public* law cannot recognise an autonomous role for *private* policymaking actors; and, second, *public* institutions are the ‘commanders’ and *private* firms are the ‘controlled’.

Since the early 1980s, however, scholars and policy analysts have criticised command and control regulation from two main perspectives: an economic analysis that sees the costs of assessing, understanding and complying with command-and-control regulation as unacceptably high; and a socio-political analysis of the ineffectiveness of this type of regulation to produce compliance with regulatory objectives. The experience of command-and-control regulation shows that it is neither reasonable, practical nor effective for external legislatures and regulators to be solely responsible for determining how organisations should manage social issues (Bardach and Kagan 1982). The design and enforcement of regulations to govern every potential social dilemma facing business is simply not achievable. And even if it were achievable, it would not make businesses better citizens, since citizenship implies an internal capacity to respond with integrity to external values (Selznick 1992).

John Braithwaite (Grabosky and Braithwaite 1986; Ayers and Braithwaite 1992; Braithwaite and Makki 1993; Braithwaite 2000) has led calls for a new model to replace command-and-control regulation. As the foremost scholar on empirical and theoretical accounts of corporate accountability, he has analysed how scrutiny by regulators and public interest groups – combined with the background threat of ‘big stick’ legal sanctions and negative publicity – can maximise the potential for corporate self-regulation. For example, Ayres and Braithwaite’s (1992) theory of responsive regulation suggests that, in general, it is better to maximise the possibility that regulatees will comply with regulatory objectives voluntarily than to constantly rely on heavy sanctions or coercive regulatory regimes. They found empirically that when regulators use strategies of ‘dialogue, communal judgment, reciprocal wooing, and persuasion, which is minimally coerced by power relations’, they can negotiate more constructive regulatory outcomes (Ayers and Braithwaite 1993: 97). By contrast, when regulators use coercive strategies, they often break down the goodwill and motivation of actors who might otherwise have been responsive. However, they also found that persuasive and self-regulatory regulation is more likely to be effective when backed up by the possibility of more severe sanctions: regulatees, then, will know there is a certainty of punishment if they defect and that other regulatees will not get away with breaking the rules.

This reconceptualisation of regulation as an interactive dynamic between regulator and regulatee immediately exposes the public/private dichotomy as a false divide. This has important implications for redefining the Japanese governance debate. By rejecting *public* governance as the sole province of the *public* sector, the parameters of the Japanese governance debate may be widened to reflect growing empirical evidence of private sector participation.

Upham (1997) takes the first step forward in this direction. Upham criticises the emphasis scholars have placed on administrative guidance in the governance debate, questioning whether the attention on administrative guidance provides any meaningful clues on how Japan governs itself (1997: 399):

The problem is that the structure within which regulation operates often makes the debate on administrative guidance irrelevant. In fields as distinct as land use planning and broadcast licensing, Japanese bureaucrats delegate their public power to private parties and function not as direct overseers of regulatory policy, but, at most, as overseers of its private implementation. This pattern frequently extends to the formation of policy as well as its implementation, and the bureau-

cratic role diminishes to intervention at moments of political crisis. At other times, the agency plays an active monitoring and enforcement role, but seldom does a Japanese agency play the role that one would expect from the classic models of economic regulation.

Upham's response is to formulate a new theory on Japanese public administration – the delegation of public policy issues to private citizens. Under this theory, Japanese regulators delegate part or most of their power to private parties. In many cases, regulated parties can make their own decisions without any principled bureaucratic oversight. 'The administrative agency may intervene during times of political crisis, but rarely does so in the ordinary course of regulation, instead choosing the cheap and safe course of delegation' (1997: 401–2). Upham refers to this as the privatised model of regulation (1997: 399–404). This often occurs with policy issues which are chiefly economic or commercial in character. An example is the administration of the Large Scale Retail Stores Act (Law No. 109 of 1973) by the Ministry of Trade and Industry (MITI). According to the Act, MITI is required to make an independent determination as to whether or not to permit development of a large-scale retail store (sections 5, 7–14). Thus, the statutory procedure formally requires MITI, upon receipt of a notification from the developer of its intention to build a large-scale department store (section 5), to send the plans of the proposed store to two deliberative councils for more detailed consideration. Once the councils report back to MITI with their recommendations (sections 7–14), MITI must then reach an independent judgment based on the interests of consumers and the retailing industry (section 11). In practice, however, MITI requires developers to consult directly with local merchants and to reach a negotiated agreement on the conditions under which both would agree to the opening of a new store (Upham 1997: 409).

The empirical evidence from environmental management and sexual harassment policy suggests a trend in administrative practice that goes even further than Upham's model. Unlike in Upham's model, the Basic Act on the Environment and the Equal Employment Opportunity Act do not delegate regulatory authority to those who are being regulated; it shifts entirely the decision-making forum to a completely private domain – the corporation. Policymaking is relegated (to corporations) rather than delegated (to private parties). This style of regulation may be described as a corporatised model of regulation. It appears to be more common with social and environmental policy issues. For example, concerning sexual harassment in the workplace, the Ministry of Labour has not provided a 'regulatory space' within which female

victims of sexual harassment and their employers can ‘create their own decision-making structure’ (Upham 1997: 401). Instead, the Ministry charges corporations with full responsibility to implement and operationalise their own compliance programs on sexual harassment.

Conclusion

These developments mean that we should aim to elevate the debate over who governs Japan to a more sophisticated level by applying recent advances in regulatory theory to reinterpret recent empirical evidence of corporate engagement with public policymaking in Japan. This paper has argued that the Japanese governance debate to date has neglected the role of the Japanese corporation because of a conceptual oversimplification of law into ‘public’ and ‘private’. Accordingly, the debate has lacked the conceptual tools to accommodate empirical evidence of policymaking by private firms. This evidence reveals that, in areas of environmental and anti-discrimination policy, corporations have played a significant role in defining and articulating standards of public policy.

Recent innovations in regulatory theory – in which governance and power are perceived as an interactive encounter between regulator and regulatee – provide a more satisfying theoretical springboard from which to relaunch a discussion on governance in Japan. By applying these newer theoretical ideas, we may see alternative models of regulatory behaviour in Japan – such as delegated regulation in the case of economic policy and relegated regulation in the case of environmental and social policy – which have been ignored in the debate over the past 30 years.

But resetting the parameters of the debate and providing answers to the paradox of power in Japan are distinct tasks. The analysis developed in this paper probably raises more questions than it answers. For example, is the trend of private governance of public rights a long-standing development – or is it a recent aberration? Is it a good thing? And how autonomous is corporate policymaking – or is there scope for it to be manipulated by political leaders, contaminated by bureaucratic interference and/or constrained by judicial oversight? These are future problems for Japanese studies scholars.

A more pressing question is whether or not evidence of corporate policymaking negates recent administrative reform efforts to make Japan more transparent by shrouding some

public decision-making processes beneath the corporate veil. This question is of particular relevance in light of the latest swathe of legislative reforms aimed at promoting greater transparency in public decision-making processes.

The reform process kicked off on 1 October 1994 when the new Administrative Procedures Act (Law No. 88 of 1993) took effect. The Act requires administrative agencies to publish criteria necessary for determining administrative applications, to make their determinations within a reasonable period of time, and to supply reasons for denying applications (sections 12–37). The objective behind these requirements is to protect citizens' rights by providing general and uniform rules for administrative actions such as dispositions, administrative guidance and notifications, thereby advancing 'a guarantee of fairness and progress towards transparency' (section 1). More recently, on 14 May 1999, the Diet passed the Information Disclosure Act (Law No. 42 of 1999), a broad-based freedom of information statute that allows citizens to access information held by government agencies (section 1). The Act is premised on promoting 'fair and democratic' public administration under which agencies owe a duty to 'explain' their functions, provide citizens with access to relevant government information and encourage more informed debate about governmental activities and services (section 1). Finally, on 8 July 1999, the Diet passed two packages of bills that seek to trim the number of government ministries from 23 to 13 by 2001 (Central Ministries and Agencies (Reform) Act, Law No. 103 of 1998, sections 5 and 7). Ostensibly an attempt to cut the bureaucracy – and thereby curb its power – the packages will also grant more authority to local governments (section 32) and strengthen the role of the Cabinet in policymaking (sections 6–10). The stated rationale behind this legislative reform is to replace a corpulent, rigid and top-down system of public administration with a more streamlined, efficient and transparent model.

In contrast to the goals of these public law initiatives, corporate governance is a system of private and potentially unprincipled decision-making that takes place within the four walls of the corporation. This raises a potential conflict between the stated goals in public law of transparency and the reality in private law of (at least some) public decision-making in fields such as sexual harassment and environmental management. Applying self-regulation theory, the clue to the future of the push to transparency in Japan might be the extent to which the policies of corporate 'governments' are subject to scrutiny by the public, the media, social movement activists and the government.

Note

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