

# OECD Reviews of Regulatory Reform

## JAPAN

### PROGRESS IN IMPLEMENTING REGULATORY REFORM



OECD Browse\_it Edition  
• Read Only  
• Lecture seule

#### **About OECD Browse\_it editions**

In a traditional bookshop you can browse the display copies from cover-to-cover, free of charge. Wouldn't it be good to be able to do the same online? Now you can. OECD's Browse\_it editions allow you to browse our books, online, from cover-to-cover. But, just as in a real bookshop where you can't take or copy pages from the books on display, we've disabled the print and copy functions in our Browse-it editions - they're read-only. And, just as in a real bookshop, you may choose to buy or borrow from a library some titles you've browsed, so we hope you'll buy or borrow our books when they meet your needs. Tell us what you think about our Browse-it service, write to us at [sales@oecd.org](mailto:sales@oecd.org).

#### **Buying OECD Publications**

You can purchase OECD books and e-books from our Online Bookshop - [www.oecd.org/bookshop](http://www.oecd.org/bookshop) where, if you purchase printed editions you can download the e-book edition free of charge. Our books are also available from a network of distributors, click the 'Distributors' button on this website: [www.oecd.org/publications/distributors](http://www.oecd.org/publications/distributors) to find your nearest OECD publications stockist.

#### **OECD Publications in Libraries**

You'll find OECD publications in many institutional libraries around the world, especially at universities and in government libraries. Many subscribe to the OECD's own e-library, SourceOECD. SourceOECD provides online access to our books, periodicals and statistical databases. If your institutional library does not yet subscribe to SourceOECD, tell your librarian about our free three-month trial offer. For more details about SourceOECD visit <http://new.SourceOECD.org> or email [sourceoecd@oecd.org](mailto:sourceoecd@oecd.org). OECD has a network of Depository Libraries in each Member country where all OECD printed publications are available for consultation - [www.oecd.org/depositorylibraries](http://www.oecd.org/depositorylibraries) for a list.

## OECD Reviews of Regulatory Reform

# Japan

### Progress in Implementing Regulatory Reform



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

## ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996), Korea (12th December 1996) and the Slovak Republic (14th December 2000). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

Publié en français sous le titre :

Examens de l'OCDE de la réforme de la réglementation

**Japon**

Progrès dans la mise en œuvre de la réforme de la réglementation

## Foreword

**P**rogress implementing regulatory reform in Japan is the subject of the first in a series of monitoring exercises carried out under the OECD's Regulatory Reform Programme. At its inaugurating meeting on 27-28 March 2003, OECD's Special Group on Regulatory Policy approved an activity to monitor the implementation of policy recommendations of the country reviews carried out under the Regulatory Reform Programme since 1998. Japan and Mexico are the first countries to initiate such an assessment.

The 20 country reviews completed between 1998 and 2004 include more than 1 000 specific policy recommendations and approximately 120 chapters each focussing on regulatory reforms in selected areas. Taken as a whole, the reviews demonstrate that a well-structured and implemented programme of regulatory reform contributes to better economic performance and enhanced social welfare. Economic growth, job creation, innovation, investment, and new industries benefit from regulatory reform, which also helps to bring lower prices and more choices for consumers. Linkages among competition, market openness and regulatory policies are mutually reinforcing. Comprehensive regulatory reforms produce results more quickly than piece-meal approaches; and they help countries to adjust more quickly and easily to changing circumstances and external shocks. At the same time, a balanced programme must take social concerns into account. An effort must be made however to pursue medium-term goals in the face of short-term obstacles. Sustained and consistent political leadership is an essential element of successful reform. A monitoring exercise can help renew an action plan, and drawing on useful practices from other countries, can inform public dialogue on the benefits of reform.

The monitoring exercise offers insights on the follow-up of the suggested policy-options within a country's economic and institutional context, providing an important opportunity to benchmark status, progress and further challenges on the domestic reform agendas. The pressures for reform often respond to a crisis or shock. Although the circumstances leading to a decision to give regulatory reform higher priority will vary from country to country, experience shows that governance systems should be more flexible and adaptive. The monitoring exercise also, and importantly, contributes to a better understanding of the problems facing all countries when implementing policies to improve the quality of regulation and the regulatory environment, including when and how to introduce new units, the process of building constituencies and communicating the results of reform, the use of regulatory impact analysis, and other techniques to achieve a "whole of government" approach.

Each report consists of an assessment of the progress made to implement the recommendations of past reviews, complemented by ongoing cross-country analytical work of best practices and regulatory performance. The report on Japan includes country-specific assessments of progress in the areas covered by the thematic studies in all past reviews: regulatory performance (macroeconomic context, strengths, successes and main results of regulatory reform); regulatory governance (tool, institutions and management structures to promote regulatory quality); competition policy; and market openness. The regulatory reform review of Japan published in 1999 included covering of electricity and telecommunications, but an assessment of these sectors was not retained for this

monitoring exercise. The exercise is supported by a self-assessment based on a questionnaire completed by the country, and mission of a Secretariat team to collect further information and to discuss with policy makers. The report, including options and recommendations based on the success achieved to date and on Japan's current context and challenges was presented to and discussed by the SGRP on 14 June 2004.

**Acknowledgements.** The horizontal Programme on Regulatory Reform is headed by the Deputy Secretary-General Richard Hecklinger. The country reviews and monitoring exercises are co-ordinated by the Directorate for Public Governance and Territorial Development.

The monitoring exercise of Japan reflects contributions from the government of Japan, the Working Party on Regulatory Management and Reform of the Public Governance Committee, the Competition Law and Policy Committee and its Working Party, the Working Party of the Trade Committee, and representatives of member governments.

In the OECD Secretariat, Odile Sallard, Rolf Alter, Josef Konvitz, Peter Ladegaard, Randall Jones, Anthony Kleitz, Charles Tsai, Masahiro Fujita and Michael Wise contributed substantially to the monitoring exercise of Japan. The documentation was prepared by Jennifer Stein.

## Table of Contents

<b>Summary .....</b>	<b>7</b>
<b>Chapter 1. Japan Monitoring Exercise: Synthesis .....</b>	<b>13</b>
The review of regulatory reform in 1998 .....	14
<b>Chapter 2. Government Capacity to Assure High Quality Regulation .....</b>	<b>35</b>
2.1 Introduction .....	36
2.2 Regulatory policies .....	37
2.3 Regulatory institutions .....	43
2.4 Regulatory tools and procedures .....	47
Bibliography .....	57
Annex 2.1. Implementation of the 1999 recommendations .....	58
<b>Chapter 3. Competition Policy.....</b>	<b>61</b>
3.1 Substantive law and applications .....	63
3.2 Institutions and processes .....	66
3.3 Coverage of competition law and policy .....	74
3.4 Policy studies and advocacy .....	78
3.5 Conclusions and recommendations .....	79
Bibliography .....	83
<b>Chapter 4. Market Openness .....</b>	<b>85</b>
4.1 Transparency and openness of decision-making .....	87
4.2 Non-discrimination .....	90
4.3 Avoidance of unnecessary trade restrictiveness .....	95
4.4 Use of internationally harmonised measures .....	99
4.5 Streamlining conformity assessment processes .....	102
4.6 Application of competition principles .....	103
4.7 Making progress in implementing the recommendations from the 1999 Report .....	105
Bibliography .....	107
Annex 4.1. Implementation of the 1999 recommendations .....	109

**List of Boxes**

2.1. The Japanese notions of regulatory reform .....	38
2.2. Key initiatives under the March 2004 Three-Year Programme for Regulatory Reform .....	39
2.3. Establishing Special Zones .....	41
2.4. RIA best practices .....	52
3.1. Transparency.....	65
3.2. Consumer-competition policy link .....	66
3.3. FTC status .....	67
3.4. FTC resources .....	68
3.5. International co-operation agreements .....	69
3.6. Private litigation .....	74
3.7. Administrative guidance .....	75
3.8. Exemptions .....	76
3.9. Wider responsibility for competition policy.....	77
3.10. Supply-demand balancing .....	78
4.1. Reform of the judicial system in Japan .....	92
4.2. Customs clearance: trade facilitation, technology and labour.....	100

**List of Tables**

2.1. Proposed and implemented deregulatory measures under the Special Zones initiative .....	42
2.2. Number of approved Special Zones.....	42
2.3. Number of permissions/authorisations required at national level in Japan.....	54
3.1. Implementation of 1999 Recommendations .....	81
3.2. Exemptions from AMA.....	82
4.1. Current progress by METI under the action plan for putting administrative processes online.....	98

**List of Figures**

1.1. Per capita income in Japan is falling relative to other OECD countries	25
1.2. Projected social security spending.....	26
1.3. Budget balance and public debt .....	27
1.4. Potential growth .....	28
1.5. Indicators of market openness.....	29
1.6. Inward FDI positions in OECD countries.....	30

## Summary

In the years since 1999, when the OECD regulatory reform review of Japan was published, the Japanese government has introduced a number of measures to enhance regulatory quality and promote regulatory reform, competition policy and market openness. This monitoring exercise was initiated to assess the progress made, to identify some of the lessons that can be learned about the process of implementation and to indicate what more can be done in the light of current challenges. The monitoring exercise covers the core issues of capacity for regulatory quality, competition and market openness, each presented in a chapter of its own.

Efforts to improve regulatory quality have the objective of enhancing the environment for competition, innovation and growth, while ensuring that regulations efficiently serve important social obligations. Although regulatory reform is clearly part of the domestic agenda, it has international ramifications, not least because regulatory systems can help promote market openness, and regulatory co-operation can help promote harmonisation and recognition of foreign conformity. Regulatory systems contribute to the overall profile for competitiveness and the quality of public governance.

Regulatory reform has helped Japan cope with its low rate of economic growth in recent years, which has been symptomatic of its need to address structural problems. There is further scope to improve regulatory quality in the service sector, particularly to encourage inward investment. This would strengthen competition, with positive effects on growth. Better use of regional assets, which the special zones programme encourages, should strengthen innovation and resiliency in the Japanese economy. Further reform now may make it easier to cope with problems in the future related to the size of the public debt and the demographic transition related to the ageing of the population.

In the recent past, the emphasis in Japan has been on deregulation. The goal in 1998, when Japan was reviewed, was to complete the move from a model of state-led growth to a model of market-led growth characterised by a more efficient and flexible economy. In Japan as in other countries, this transition shifts attention away from the quantity of regulation to its quality. As policy objectives become more diverse and respond to social and economic change, to new problems and to technological innovation, regulation itself is becoming more complex. This calls for further efforts to improve regulatory tools and institutions, to reassess existing regulations in the light of current economic and social developments, and to assess the impact of new regulations when they are drafted. Sustained, comprehensive action is needed to ensure the thorough implementation of measures already taken, to broaden the constituencies in and out of government supporting the regulatory reform agenda, reinforcing procedures and institutional capacities to ensure that good regulatory practices become integral to the culture of the public administration. A whole-of-government approach is one of the main challenges for Japan's next three-year Program for Regulatory Reform.

Much has been accomplished since the end of the 1990s as a foundation for the future. A pragmatic and incremental approach toward implementation, and strong political

leadership at the highest level have been important factors. The competition authority has been strengthened, the Council on Regulatory Reform (CRR) has helped to consolidate support for the government's agenda, and the special zones programme, which is also part of the Prime Minister's office, has promoted significant local initiatives and accelerated the process of revising existing regulations. In its recent reports, the CRR has taken up reform in areas of social regulation such as medical care, social services and education. On 19 March 2004, the Cabinet decided on the next Three-Year Programme for Promoting Regulatory Reform, and a three-year mandate for the CRR (renamed the Council for the Promotion of Regulatory Reform). The highlights include establishment of a ministerial committee to serve as a headquarters for regulatory reform, continuation of the CRR based in the cabinet office as a private-sector advisory body, introduction of Regulatory Impact Analysis, promotion of reform through the programme for special zones for structural reforms, and a focus on reform in 17 priority areas. These measures could further strengthen the horizontal co-ordination of regulatory reform. Although regulatory reform depends on the political support of the prime minister, the priorities of any prime minister will change over time, with the result that the agenda for regulatory reform may not be given the attention it deserves, consistently and for a long enough period, to sustain a change of administrative culture.

The review of existing regulations and administrative simplification measures is underway but the process is incomplete. Japan's e-government policy aims to make all existing administrative procedures and transactions possible through the Internet. By April 2004, 97% of all procedures handled by the national government (around 13 000) were available on-line. Most OECD countries have considerable stocks of regulation and administrative formalities that have accumulated without adequate review and revision. Yet regulations may soon be outdated due to technological innovation or social or economic change. The elimination of regulations to balance supply and demand, and the conversion of *ex ante* permits and licenses to *ex post* notifications, have been key objectives of regulatory review programmes since 1999. Despite success in eliminating most supply-and-demand regulations in many sectors, surveys show that the number of *ex ante* permits and licenses has not been significantly reduced. Numbers do not reveal qualitative improvements, of course; and new authorisations may be needed to meet new health, safety, environmental and business laws. But the steady flow of new *ex ante* permits indicates the progress still to be made to reduce administrative burdens, and promote alternatives to regulation.

Japan has made substantial progress in the most important competition policy areas highlighted in the 1999 Report. Key issues identified at that time included the scope of exemptions from competition law and non-competitive tendencies in regulation, including the penchant for "supply-demand" balancing controlling entry, and administrative guidance countenancing co-ordination. Progress in the reform of economic regulation is demonstrated by the removal from most sectors of supply-demand balancing as a consideration for controlling entry. Removing the exemption for "inherent monopoly" has permitted the FTC to take more enforcement actions in regulated network industries. The has a new economic unit and substantially more resources. A new law which gives the FTC new powers to deal with official involvement in bid-rigging takes some steps against administrative tolerance of collusion. Private suits are now authorised to seek orders as well as damages, and many have been attempted. Increasing the financial charges against

violators will bring Japan's competition enforcement more into line with levels of deterrence in many other OECD countries.

As traditional barriers to trade and investment have declined over recent years, the impact of domestic regulatory frameworks on market openness has become increasingly apparent. In general terms, progress in improving the economic efficiency and competitiveness of national economies is determined less by new measures liberalising border treatment for trade and investment, and more by behind the border regulatory reform in areas such as standards, sanitary and phyto-sanitary measures, markets for services, investment, etc. The role of market openness within the regulatory reform process is to support the attainment of regulatory objectives, including safety, health and environmental quality, in a manner that minimises negative impacts on domestic competition and efficiency. The integration of market openness considerations within regulatory systems becomes important. A big step forward was taken in 2001 when two government bodies dealing specifically with issues raised by both domestic and foreign businesses regarding regulations that impede access to the Japanese market were moved to the Cabinet Office: the Office of Trade and Investment Ombudsman (OTO) and the Office for Government Procurement Challenge System (CHANS). Progress made in recent years highlights the positive linkages and mutually reinforcing patterns between domestic regulatory reform and targeted efforts to facilitate market openness.

An analysis of concrete results in terms of better integrating market openness within the Japanese regulatory system has yielded inconsistent results to date, but the overall trend appears to be positive. A clear framework has been put into place which could support further progress. Improvements in customs administration have been significant in recent years. In the medium term, judicial reforms will help domestic and foreign producers by enhancing the transparency and predictability of an economic system traditionally less reliant on the open application of rules than on discretion and custom as a means of resolving disputes. Although some progress has been made in various fields, it is clear that better integration of the need to avoid trade restrictiveness into the regulatory system would enhance the business environment and help avoid disputes with trading partners.

One recommendation of the 1999 Report encouraged the Japanese Government to promote public understanding of the benefits of regulatory reform. Active efforts have been made in this regard, in particular with respect to inward FDI. In a context of generally improving conditions for FDI since 1999, particular impetus was given by Prime Minister Koizumi's decisive efforts to overcome suspicion of foreign ownership as part of his goal to double the amount of inward FDI into Japan over 5 years. Negative misperceptions of foreign investment must be challenged in a conscious effort to improve the image of FDI. Inward FDI is normally long term, brings technology and can be a key element for revitalising the Japanese economy.

Transparency-related measures are common to concerns about competition policy, measures to improve market openness, and regulatory quality. The Administrative Procedure Law adopted in 1993 has played an important role in improving administrative transparency and predictability by requiring government agencies to specify and make public the standards used to evaluate applications, and to specify standard processing periods for issuing licenses, permissions and approvals. The provisions of the law could be strengthened to monitor compliance. The government is committed to review the Administrative Procedure Law of 1993 as part of its new Three-Year Plan for Regulatory Reform.

The Public Comment Procedure of 1999 sets out regulations for the implementation of a system for public comments within the rulemaking process. The “No Action Letter” (NAL) system enables firms to seek prior clarifications on how regulations will be applied in certain situations. Both measures are positive steps, but their effectiveness could be improved. For example, the Public Comment Procedure is not applied to government procurement.

In accordance with the new Three-year Plan and Programme for Regulatory Reform of March 2004, RIAs are to be conducted by Ministries and Administrative Agencies on planned and existing regulations, beginning in 2004, as appropriate. The text of the Plan however does not indicate the criteria to be employed. The plan implies rather that formal, binding obligations regarding RIA will emerge from an experimental, introductory phase. Training programmes will be needed, and some consideration could be given to establishing a centre-of-government unit which could monitor the progress being made in ministries to introduce and diffuse RIAs. This is especially important insofar as RIAs should consider the effects of foreign trade and investment or of competition, when such criteria may not be the primary concern of a ministry or agency.

The programme for deregulation by establishing so-called special zones is a unique example of a place-based approach to regulatory reform. Thanks to the Special Zones programme based in legislation approved in 2002, certain regulations can be eased or lifted in geographically limited areas as a testing ground and first step for reforms to be implemented at the national level. Given the large degree of independence of national ministries, nationwide reform can be difficult to co-ordinate. In Japan, therefore, an area-based approach which combines regulatory reform with elements of decentralisation can lead to initiatives which might otherwise take longer, due to resistance by special interest groups. The system of prior screening of applications for the programme however raises questions about criteria for accepting or rejecting a project. Although it is too soon to assess this initiative definitively – the first zones were not approved until April 2003 – it has succeeded in generating hundreds of proposals, many of which have been implemented locally, and eventually nationally. However, the procedures which require an evaluation committee which meets only once a year to assess whether regulatory exemptions allowed for a particular special zone should be implemented nationally, discontinued, or maintained only in a special zone, limits the impact of this programme on the stock of regulations.

Three issues need attention if Japan’s ambitious agenda for regulatory reform is to be realised:

- Commitment in the bureaucracy. Reform takes time and energy, and may not be rewarded. Sectoral ministries may be close to businesses in their sector.
- Public-private co-operation. An important driver for reform, but difficult to promote insofar as the constituency outside the government is diffuse, and may adopt a sectoral approach favouring reform on some issues but not on others.
- Multi-level co-ordination. The Special Zones programme highlights the importance of innovation at the local level, to design rules that are better adapted to local needs and opportunities. But decentralisation can pose new challenges related to co-ordination between central, regional and local governments.

The policy environment for reform is better now than it was a few years ago, but this is not the time to relax the effort. In many OECD countries, a crisis created the opportunity to pursue regulatory reform aggressively. The weak performance of the Japanese economy since the bubble burst in 1992 constitutes a crisis of sorts, insofar as it precipitated a debate

about the need for structural reforms, and coincided with other changes in the economic environment, such as the emerging economy of China, the ageing of the population and the rise of the Internet, which call for a more adaptive economy. The association of regulatory reform with deregulation reflects the objectives of the recent past. Implicitly, regulatory reform embodies a vision of the future. However important the technical and legal dimensions of regulatory reform may be, they will only be implemented thoroughly insofar as people see them as progressive, forward-looking measures in keeping with changes already underway in Japan. A high quality regulatory regime requires a proactive role for government in the creation and enforcement of regulations.

## *Chapter 1*

# **Japan Monitoring Exercise: Synthesis**

**J**apan was among the first of a series of in-depth country reviews on regulatory reform. The objective of the reviews is to help governments improve regulatory quality as a means of enhancing the environment for competition, innovation and growth, whilst ensuring that regulations efficiently serve important social obligations.

In the years since 1999 when the review of Japan was published, the Japanese government has introduced a number of measures to enhance regulatory quality and promote regulatory reform, competition policy and market openness. This monitoring exercise was initiated to assess the progress made, to identify some of the lessons that can be learned about the process of implementation and to indicate what more can be done in the light of current challenges. The monitoring exercise covers the core issues of capacity for regulatory quality, competition and market-openness, each presented in a chapter of its own.

Although regulatory reform is clearly part of the domestic agenda, it has international ramifications, not least because regulatory systems can help promote market openness, and regulatory co-operation can help promote harmonisation and recognition of foreign conformity. Cross-country studies can foster a better understanding of the cost of regulatory barriers and the measures needed to overcome them. Each country's regulatory systems reflect its values, history, constitution and institutional development, but in an international context shaped by an awareness of innovation and good practice in other countries and by the competitive pressures to increase investment and reap the benefits of international trade and technological innovation. Regulatory systems contribute to the overall profile for competitiveness and the quality of public governance.

What began in the 1990s as an effort to remove regulatory barriers is now a movement to recognize regulatory policy as a field in its own right. Regulatory reform is not something achieved once and for all, but an ongoing process to improve regulatory tools and institutions, to reassess existing regulations in the light of current economic and social developments, and to assess the impact of new regulations when they are drafted. These tasks call for a whole-of-government approach, which is one of the main challenges for Japan's next three-year Program for Regulatory Reform.

## The review of regulatory reform in 1998

When Japan was reviewed in 1998, regulatory reform had already been on the political agenda for several years. The goals at that time were ambitious: to complete the move from a model of state-led growth – in which interventionist styles of regulation were used to promote economic growth, carry out deep structural reform, and promote producer interests – to a model of *market-led* growth characterised by a more efficient and flexible economy. Regulatory reform thus embodied a vision of a society favouring greater personal choice and initiative, one in which consumer interests take higher priority, structural change is driven by market pressures, and domestic markets are more open to international competition. Policy objectives were right then and remain valid today. The lessons of implementation however are instructive about the rate of change, the level of

understanding about the benefits of reform and the institutional frameworks likely to carry reform forward.

What made regulatory reform so necessary? The poor performance of the Japanese economy in the 1990s which has contributed to the growth in the public sector deficit highlighted structural rigidities in the existing institutional and regulatory framework. The administration enjoyed discretion to regulate while at the same time monopolising information about regulation, a situation which insulated ministries from pressures to reform. Using pricing regulation and licensing requirements, ministries controlled supply in order to balance it with demand. A consensus-based decision-making process has traditionally relied upon informal mechanisms of consultations. The review argued that a sharp break with past regulatory practices was needed as part of a larger strategy including appropriate fiscal and monetary policies. Small-scale, incremental changes were too modest, and worked too slowly, to contribute significantly to economic recovery. Government-wide reforms to improve framework conditions such as administrative transparency, accountability and adaptability, and competition policy and enforcement would improve the capacity of the public administration to respond more quickly to economic change, technological innovation, and the demands of society.

The 1999 Review argued that “the key to successful regulatory reform lies partly in eliminating some fraction of Japan’s current regulatory stock...” This would require sustained, complementary measures away from economic intervention, and toward creating markets to provide social services, and to change the style of regulation in cases where regulation is justified from anti- to pro-competitive (p. 147). Deregulation as such, meaning the elimination of unnecessary regulations and a reduction in administrative burdens, while necessary, should be carried out as one part of a larger programme. In particular, the review called for robust competition institutions that protected public interests in a cost-effective way, reduced administrative measures for firms to enter or leave a market, and introduced more flexible regulations on land use, construction and design so as to promote urban development and the construction of more efficient and competitive distribution and retail facilities. The government was urged to improve the adaptability of the regulatory system, making change easier, and to enhance transparency and accountability. Japan was urged to strengthen the institutions promoting and carrying out reform, accelerate the review of existing regulations, and introduce regulatory impact analysis (RIA), and to do so within a comprehensive approach.

Specifically, Japan was urged to:

- Establish a central registry of regulatory requirements.
- Improve procedures for opening advisory council deliberations, and for public comment.
- Extend transparency requirements to non-governmental bodies with delegated regulatory authority.
- Define the limits of ministry action more clearly in foundation laws.
- Strengthen the Deregulation Committee.
- Improve the resources of the Fair Trade Commission, and its visibility and impact in decision-making.
- Strengthen rights of private action that could lead to legal challenges against restraints on competition.
- Train regulatory officials to promote market openness.

- Make support for competition principles and enforcement a mandate of all sectoral ministries and regulators.
- Establish a clear, effective relationship between consumer protection policy and competition policy.
- Eliminate all “supply-demand balancing” aspects of licensing, permitting and other formal or informal types of intervention.

Much has been accomplished since the end of the 1990s, in part due to a pragmatic approach and incremental toward implementation, and in part due to strong political leadership at the highest level. The competition authority has been strengthened, the Council on Regulatory Reform (CRR) has helped to consolidate support for the government's agenda, and the special zones programme has promoted significant local initiatives and accelerated the process of revising existing regulations. These and other achievements however reflect a concept of regulatory reform that still seems to be based too narrowly on deregulation, rather than more broadly on promoting high quality regulation. The 1999 Report noted that many accountability, transparency and competition problems in sectoral regulation result from lack of institutional clarity about the source, powers and purpose of regulation. Consecutive three-year programmes have gradually become more far-reaching and ambitious, focusing on cross-sectoral issues as well as social regulation (i.e., health and education). But there is still a gap between what the CRR proposes and what is included in the government's programme. Sustained, comprehensive action is needed to ensure the thorough implementation of measures already taken, to broaden the constituencies in and out of government supporting the regulatory reform agenda, reinforcing procedures and institutional capacities to ensure that good regulatory practices become integral to the culture of the public administration.

Regulatory reform has helped Japan cope with its low rate of economic growth in recent years which has been symptomatic of its need to address structural problems. The labour market has become more flexible, financial supervision has been strengthened and in the product market entry barriers have been eased. There is further scope to improve regulatory quality in the service sector, particularly to encourage inward investment. This would strengthen competition, with positive effects on growth. Given the limited scope for macro-economic policy measures, sustaining the expansion already underway and addressing the key challenges of rising public debt and population ageing will depend on structural reform policies to enhance Japan's growth potential. Reform in many key utility sectors has already contributed to reductions in prices to consumers but the results of reform in retail, business services and other parts of the service sector are likely to be more diffuse, and hence more difficult to measure. Better use of regional assets, which the special zones programme encourages, should strengthen innovation and resiliency in the Japanese economy. More effective regulatory tools and institutions take on greater significance when placed in this wider, more strategic medium-term perspective.

### **Regulatory capacity**

Created in 2001 on a three-year mandate, the Council for Regulatory Reform (CRR) has been driving regulatory reform in Japan. The 1999 Report had recommended that the independent advisory Deregulation Committee be strengthened and put under the control of the Prime Minister to drive reform in the ministries, which are equals. The establishment of the CRR has achieved this. The council consists of 15 private-sector

experts, supported by a staff of about 30 recruited from the private sector and ministries. It produces an annual report, leading to recommendations for the Prime Minister's Three-Year Plan for Promoting Regulatory Reform, which is updated yearly. Members of the Council can negotiate directly with ministries about regulatory reform. In its recent reports, the Council has taken up reform in areas of social regulation such as medical care, social services and education. The Council's report has also addressed cross-sectoral issues such as a review of the Administrative Procedure Act and No-Action Letters, and the introduction of a system for regulatory impact analysis (RIA).

Based on elaborate reports and action plans from the advisory Council for Regulatory Reform (CRR), Japan's regulatory reform policies since 2001 have been put forward in a Three-Year Programme, revised annually. Placed within the Cabinet Office, a Minister of State for Regulatory Reform is responsible for supervising implementation of the Three Year Plans by ministries and agencies. The headquarters for the Promotion of Special Zones for Structural Reform, a programme described in a later section of this chapter, is supported by an office in the Cabinet Office staffed with people recruited from ministries, local authorities and the private sector. The Prime Minister chairs the Headquarters. These bodies are concentrating on improving the stock of existing regulations. But there is no single unit whose function is to assess the quality of new regulations based on clear criteria, on a "whole-of-government" approach, raising questions about how the culture of government can become more sensitive to the importance of regulatory quality.

The review of existing regulations and administrative simplification measures is underway but the process is incomplete. Japan's e-government policy aims to make all existing administrative procedures and transactions possible through the Internet. By April 2004, 97% of all procedures handled by the national government (around 13 000) were available on-line. Most OECD countries have considerable stocks of regulation and administrative formalities that have accumulated without adequate review and revision. Yet regulations may soon be outdated due to technological innovation or social or economic change. The elimination of regulations to balance supply and demand, and the conversion of *ex ante* permits and licenses to *ex post* notifications, have been key objectives of regulatory review programmes since 1999. Despite success in eliminating most supply-and-demand regulations in many sectors, surveys show that the number of *ex ante* permits and licenses has not been significantly reduced. Numbers do not reveal qualitative improvements, of course; and new authorisations may be needed to meet new health, safety, environmental and business laws. But the steady flow of new *ex ante* permits indicates the progress still to be made to reduce administrative burdens, and promote alternatives to regulation.

On 19 March 2004, the Cabinet decided on the next Three-Year Programme for Promoting Regulatory Reform, and a three-year mandate for the CRR (renamed the Council for the Promotion of Regulatory Reform). (See Chapter 2, Box 2.1 for details). The highlights include establishment of a ministerial committee to serve as a headquarters for regulatory reform, continuation of the CRR based in the cabinet office as a private-sector advisory body, introduction of Regulatory Impact Analysis, promotion of reform through the programme for special zones for structural reforms, and a focus on reform in 17 priority areas. These measures could further strengthen the horizontal co-ordination of regulatory reform.

Japan is unusual among OECD Countries by keeping regulatory and policy-making functions together in relevant line ministries. Since 1999 there have been no significant

changes in the organisation of regulatory functions in telecoms, electricity, gas, postal services and transportation. Both regulatory policy and enforcement functions for these sectors remain under the control of a line ministry. The current separation of regulatory policy and enforcement functions within the same ministry may not be sufficient to ensure regulatory independence, especially in sectors with state-owned enterprises. An assessment based on economic outcomes suggests that further structural reforms supported by appropriate regulatory frameworks could strengthen competition, leading to lower prices and increased consumer benefits.

### **Competition policy**

Japan has made substantial progress in the most important competition policy areas highlighted in the 1999 Report. Key issues identified at that time included the scope of exemptions from competition law and non-competitive tendencies in regulation, including the penchant for "supply-demand" balancing controlling entry, and administrative guidance countenancing co-ordination. The Report recommended that regulators and sectoral ministries be given a mandate to support competition, including those in traditional monopolies such as telecoms, electric power, and transport. The Report called for increasing the independent policy stature and improving the resources of the Fair Trade Commission (FTC), more transparency in its decisions, and expanded co-operation with other enforcers. Stronger private enforcement would be supported by ending the quota limiting the size of the legal profession. Finally, the Report called attention to the undeveloped linkage between competition policy and consumer issues. A stronger competition policy would be particularly valuable for market openness in the distribution sector; and better communication efforts were recommended to demonstrate how the FTC protects the public interest.

Progress in the reform of economic regulation is demonstrated by the removal from most sectors of supply-demand balancing as a consideration for controlling entry. Removing the exemption for "inherent monopoly" has permitted the FTC to take more enforcement actions in regulated network industries. The FTC was moved to the Cabinet Office in 2003, thus underlining its independence. (Formerly an external organ of the Ministry of Public Management, Home Affairs, Posts and Telecommunications, the FTC would have been in the position of taking action in industries regulated by this ministry.) It has a new economic unit and substantially more resources. A new law which gives the FTC new powers to deal with official involvement in bid-rigging takes some steps against administrative tolerance of collusion. Private suits are now authorised to seek orders as well as damages, and many have been attempted.

Further reforms are under consideration. A study group of about 50 people which included academics, journalists, and some business and consumer representatives was set up by the FTC, following a recommendation of the Committee on Regulatory Reform to strengthen competition law and enforcement. It issued a report in October 2003 proposing a revision of the system of financial charges imposed in the administrative process, to make it more effective in deterring anti-competitive conduct. This is an important point. Although the maximum criminal fines were raised five-fold at the end of June 2002, deterrence is still insufficient because administrative charges are comparatively low. In December 2003 and April 2004, FTC releases outlined its plans based on the study group's proposals and giving consideration to public opinion. Increasing the financial charges

against violators will bring Japan's competition enforcement more into line with levels of deterrence in many other OECD countries.

Mergers are a matter of particular interest. In 2002, to enhance transparency and develop public understanding, the FTC clarified its policies about informal consultations. The FTC set a timetable for consultation and advice about whether a merger would require further investigation and possibly, relief. Some parties contemplating a merger who may wish to avoid publicity may be reluctant to use this more formal consultation process. New merger guidelines were issued for comment in March 2004 which would, among other things, set out safe-harbour rules based on market share and structure that would apply to all kinds of mergers. The process of eliminating and narrowing exemptions, already underway in 1999, has been substantially completed: the list of systems of exemption from the Anti Monopoly Act had been reduced from 57 in 1999 to 21 at the end of 2003. This reduction represents a substantial reform of competition policy. The most important remaining limitation on the scope of the AMA is the system of exemptions for co-operative organisations of small and medium sized businesses. Legislation about agriculture exempts co-ops in that sector from the AMA by cross-reference to the exemption for SME co-operatives.

The benefits of reform would be expected to show up in lower prices and efficiency gains to the benefit of firms and consumers, thereby also improving the competitiveness of exporting sectors. By lowering barriers to the creation of new firms, products and services, regulatory reform can help increase Japan's long-term potential growth rate. How competition policy should apply to social issues is becoming important in Japan. Greater attention to alternatives to regulation would yield more flexible and efficient instruments to maintain and increase protection in such areas as health and safety, the environment and consumer interests. The precise linkages within an economy that connect regulatory reform to innovation, employment and productivity are difficult to trace. Nevertheless, based on the experience of other countries, regulatory reform should raise potential and actual growth rates by stimulating supply-side gains in efficiency and technology while increasing consumer demand.

A Cabinet Office study of the economic impact of regulatory reform covering long-term trends since the 1980s showed that price reductions to consumers in energy, beverages and food, transport, finance, telecoms and selected retail operations amounted to JPY 8.8 trillion in 1998, and JPY 15 trillion in 2000. Trucking deregulation was responsible for JPY 3.9 trillion alone, power for JPY 2.5 trillion, and mobile telecoms for JPY 1.7 trillion, thus calling attention to the economic benefits of regulatory reform in key sectors that link different parts of the economy together through network services and utilities. A further analytical effort is needed to identify sectors where regulatory reform can have an impact.

The benefits of reform today are likely to be of the same magnitude as in the late 1990s. The gains achieved through sectoral de-regulation however must now be consolidated and broadened through cross-sectoral measures that could have a transforming effect on both government and the private sector. Although much progress has been realised through a pragmatic, incremental approach, there is scope for a comprehensive approach, already explicit in the 1999 recommendations, to build on what has been achieved, taking regulatory reform further.

### **Market openness**

As traditional barriers to trade and investment have declined over recent years, the impact of domestic regulatory frameworks on market openness has become increasingly apparent. In general terms, progress in improving the economic efficiency and competitiveness of national economies is determined less by new measures liberalising border treatment for trade and investment, and more by *behind the border* regulatory reform in areas such as standards, sanitary and phyto-sanitary measures, markets for services, investment, etc. The role of market openness within the regulatory reform process is to support the attainment of regulatory objectives, including safety, health and environmental quality, in a manner that minimises negative impacts on domestic competition and efficiency. Integrating market openness considerations within regulatory systems can alleviate situations in which regulations designed to attain specified objectives unintentionally and unnecessarily undermine the ability of trade and investment liberalization to enhance the competitiveness of national industries and benefit domestic consumers through greater selection and lower prices. A big step forward was taken in 2001 when two government bodies dealing specifically with issues raised by both domestic and foreign businesses regarding regulations that impede access to the Japanese market were moved to the Cabinet Office: the Office of Trade and Investment Ombudsman (OTO) and the Office for Government Procurement Challenge System (CHANS).

The 1999 OECD review of “Regulatory Reform in Japan” explored the theme of market openness within the Japanese regulatory system and made broad recommendations regarding how market openness could be more consistently interwoven throughout it. The six core principles of market openness forming the foundation of the Illustrative Best Practices in the synthesis report “Integrating Market Openness into the Regulatory Process: Emerging Patterns in OECD Countries” have seen minor improvements since the time of the 1999 Report, and include: transparency, non-discrimination, avoidance of unnecessary trade restrictiveness, harmonisation towards international standards, streamlining of conformity assessment and competition. These principles thus represent a tested methodology to consider the market openness of regulatory systems, as well as an instrument for integrating market openness within the process of regulatory reform. These are reflected in progress made in recent years, highlighting the positive linkages and mutually reinforcing patterns between domestic regulatory reform and targeted efforts to facilitate market openness.

An analysis of concrete results in terms of better integrating market openness within the Japanese regulatory system has yielded inconsistent results to date, but the overall trend appears to be positive. A clear framework has been put into place which could support further progress. In the medium term, for example, judicial reforms will help domestic and foreign producers by enhancing the transparency and predictability of an economic system traditionally less reliant on the open application of rules than on discretion and custom as a means of resolving disputes. The role of foreign suppliers in Japanese government procurement declined in value from 13.4 to 12.0% between 1999 and 2001. Although progress has been made with respect to freedom of association and equality of treatment between Japanese and foreign lawyers, gaps remain in terms of the requirements for qualifying as a foreign lawyer in Japan, becoming a partner of a law firm, and enabling the provision of cross-border legal advice. Further reforms will particularly enable foreign producers and potential market entrants to contribute to the reform process. Consideration of alternative types of regulation is another example. The

1999 Report pointed out several areas in which existing design-based criteria were more trade-restrictive than would have been necessary to achieve the same objectives by other means. Although some progress has been made in various fields, it is clear that better integration of the need to avoid trade restrictiveness into the regulatory system would enhance the business environment and help avoid disputes with trading partners.

Improvements in customs administration have been significant in recent years, including a single-window system for import/export and port procedures implemented in July 2003 (which now covers over 22% of customs clearances for ocean trade), a policy for customs offices to remain open 24 hours a day and 7 days a week, reductions in clearance-related fees, and pre-arrival inspections and simplified declarations for imported air shipments. Japan's efforts in the international field are reflected domestically in efforts to reference international standards as the basis for national standards and domestic regulation. In terms of voluntary standards for industrial products, whereas approximately 21% of 8 000 Japan Industrial Standards (JIS) were aligned to international standards at the time of the 1999 Report, the level has increased dramatically to 90% by early 2002. The MAFF has been making efforts continuously to align voluntary Japan Agricultural Standards (JAS), including recently revised standards on margarine and processed tomato products, to international standards, notwithstanding the special attributes of agricultural products as compared with most industrial products, namely their regional characteristics influenced by climate, geography or cultural traditions. The percent of voluntary JAS aligned internationally reached 38% by May 2002. METI has accredited foreign organisations as JIS certification bodies, making an important gain for the reduction of duplicative conformity assessment procedures. The number of foreign factories able to append the JIS mark rose by 50 between 1999 and 2002, to cover 400 factories in 21 countries. A similar exercise is underway for foreign grading and certification of agricultural products corresponding to the JAS system. The JAS Law revised in 1999 enabled foreign certification bodies to be registered. Subsequently their number has increased: MAFF has accredited 21 foreign certification bodies on organic products with 730 certified foreign operators to apply the JAS mark in 38 countries, and has accredited 10 foreign certification bodies on forestry products.

### **Transparency and administrative simplification**

Transparency-related measures are common to concerns about competition policy, measures to improve market openness, and regulatory quality. The Administrative Procedure Law adopted in 1993 has played an important role in improving administrative transparency and predictability by requiring government agencies to specify and make public the standards used to evaluate applications, and to specify standard processing periods for issuing licenses, permissions and approvals. Government authorities are to put their guidance in written form if so requested (and as long as no extraordinary administrative inconvenience arises), and to explain the legal basis for it. The provisions of the law could be strengthened to monitor compliance. The government is committed to review the Law as part of its new Three-Year Plan for Regulatory Reform.

The Public Comment Procedure, initiated in April 1999, sets out regulations for the implementation of a system for public comments within the rulemaking process. The "No Action Letter" (NAL) system enables firms to seek prior clarifications on how regulations will be applied in certain situations. Both measures are positive steps, but their effectiveness could be improved.

The Public Comment Procedure makes consultations mandatory for the establishment of Cabinet and Ministerial Orders, except in “... circumstances [...] in need of prompt implementation, in case of emergency or insignificant matters”.<sup>1</sup> However, its impact is diluted by the fact that it is applicable only on a discretionary basis to Internal Orders, Communication Notes, Administrative Guidance and negotiations for international agreements. Under the Public Comment Procedure, consultations may be conducted with the general public (i.e. by post, fax and Internet) or through public hearings (*kochokai*). The Public Comment Procedure is not applied to government procurement.

For the 399 Cabinet and Ministerial Orders subject to the Public Comments Procedure in FY 2002, only six did not actually undergo a public comments process due to invocation of the exceptions indicated above.<sup>2</sup> Between FY 1999 and FY 2002, the number of public consultations steadily increased from 265 to 399, and the ratio of consultations leading to amendments of prior texts stood at 14.5% for FY 2002. In keeping with the recommendation of the Public Consultation Procedure, 51.4% of consultations in 2002 were for periods of a month or longer, or an increase of roughly 10% above the ratio for 1999; the shorter the period, the more difficult it is for foreign firms to participate, and the less likelihood that well-substantiated comments can be properly taken into account.

### ***Innovation in regulatory policy and reform and the lessons of implementation***

The programme for deregulation by establishing so-called special zones is a unique example of a place-based approach to regulatory reform that deserves wider attention. Thanks to the Special Zones programme based in legislation approved in 2002, certain regulations can be eased or lifted in geographically limited areas as a testing ground and first step for reforms to be implemented at the national level. Given the large degree of independence of national ministries, nationwide reform can be difficult to co-ordinate. In Japan, therefore, an area-based approach which combines regulatory reform with elements of decentralisation can lead to initiatives which might otherwise take longer, due to resistance by special interest groups. The Special Zones initiative was intended to promote innovative proposals by municipalities striving to promote investment and growth. Implicitly, the programme exploits the creativity and knowledge of local authorities and the private sector to remove barriers to development. The system of prior screening of applications for the programme however raises questions about criteria for accepting or rejecting a project. Although it is too soon to assess this initiative definitively – the first zones were not approved until April 2003 – it has succeeded in generating hundreds of proposals, many of which have been implemented locally, and eventually nationally. However, the procedures which require an evaluation committee to assess whether regulatory exemptions allowed for a particular special zone should be implemented nationally, discontinued, or maintained only in a special zone, limits the impact of this programme on the stock of regulations.

The Special Zones programme are a tool for progress that will help Japan reduce regulatory barriers. Many of the reforms introduced through this programme would hardly be radical in other countries. For example, because only individual farmers can own land, the expansion of firms into the agricultural sector has not been possible. One of the most popular of the first wave of proposals for special zones is to allow firms to engage in agriculture by leasing land. To generalise this practice nationally, the evaluation committee would have to agree to let firms lease land throughout the country. But the evaluation committee meets only once a year, and could well justify delaying the national diffusion of

a local reform on the grounds that it is too soon to assess it. On the one hand, thorough evaluation is desirable; but on the other hand, the system for review limits the impact and potential of the Special Zones programme as a tool for national regulatory reform.

As in the case of some of the measures taken specifically to strengthen openness to FDI, the Special Zones programme reflects the principle of non-discrimination by applying to foreign as well as non-incumbent domestic firms, in the context of both policy development and implementation. Recommendations for the provisional relaxation of regulations by local governments under this programme can be proposed by foreign entities, but the local authorities decide what is recommended to the headquarters. An example of relaxation of discriminatory regulations can be seen in a zone in which English language education for primary through high school is provided by foreign instructors. In the health care sector it was decided in 2003 to accept more foreign medical practitioners as a nationwide measure without regard for reciprocity, but on the condition that they provide services only to the nationals of their home countries and to pass the Japanese medical examination in English. As a result, the number of foreign medical practitioners allowed to practice in Japan should increase. The formal decision made in March 2004 to allow private institutions to operate health care institutions is also being implemented on a non-discriminatory basis under the Special Zones programme. The design and implementation of the Special Zones programme reflects input from foreign investors and individuals not only in the development of regulatory reforms, but also as key participants within the broader process of structural adjustment which the reforms are designed to stimulate.

From the perspective of regional development, the special zones programme offers a way to exploit the competitive advantages of rural and urban areas, especially those affected by structural change. For example, the special zones programme could reinforce the programme for Urban Renaissance, another of the Prime Minister's initiatives. Regulatory reform could thus help improve public services, environmental quality, land use and housing; strengthen the links for diffusing research between universities and the private sector; and attract foreign investment and the presence of foreign firms.

Regulatory reform advances more quickly and its impact is deeper when there is political support at the highest level. The success of the CRR and of the Special Zones programme are due in part to the co-ordinating role played by the Cabinet Office and the priority given to this agenda by Prime Minister Koizumi. But this approach, while pragmatic, has targeted reform in areas where progress there is a consensus for reform. A comprehensive approach would need to rely on broad support across a government structure which however remains divided into sectoral ministries that can feel threatened by reforms which reduce their influence on the economy and make decision-making more transparent. An incremental approach which tries to preserve some of the strengths of a broadly consensual culture has been pragmatic, and to that extent, it has been successful, by-passing opposition. This has been the case in Japan, thanks to the efforts of Prime Minister Koizumi. But there are advantages and disadvantages to a strategy which relies so much on the office of the Prime Minister. Although regulatory reform depends on the political support of the prime minister, the priorities of any prime minister will change over time, with the result that the agenda for regulatory reform may not be given the attention it deserves, consistently and for a long enough period, to sustain a change of administrative culture.

Three issues need attention if the ambitious agenda for regulatory reform is to be realised:

- Commitment in the bureaucracy. Reform takes time and energy, and may not be rewarded. Sectoral ministries may be close to businesses in their sector.
- Public-private co-operation. An important driver for reform, but difficult to promote insofar as the constituency outside the government is diffuse, and may adopt a sectoral approach favouring reform on some issues but not on others.
- Multi-level co-ordination. The Special Zones programme highlights the importance of innovation at the local level, to design rules that are better adapted to local needs and opportunities. But decentralisation can pose new challenges related to co-ordination between central, regional and local governments.

One recommendation of the 1999 Report encouraged the Japanese Government to promote public understanding of the benefits of regulatory reform. Active efforts have been made in this regard, in particular with respect to inward FDI. In a context of generally improving conditions for FDI since 1999, particular impetus was given by Prime Minister Koizumi's decisive efforts to overcome suspicion of foreign ownership as part of his goal to double the amount of inward FDI into Japan over 5 years. Prominent Japanese academics, challenging misperceptions that foreign investment is predominantly composed of destabilising short-term capital flows or vulture (*hagetaka*) capital seeking to purchase distressed companies for rapid re-sale, have emphasized that inward FDI is normally long term, brings technology and can be a key element for revitalising the Japanese economy. A conscious effort to improve the image of inward FDI is suggestive of a change in government attitudes.

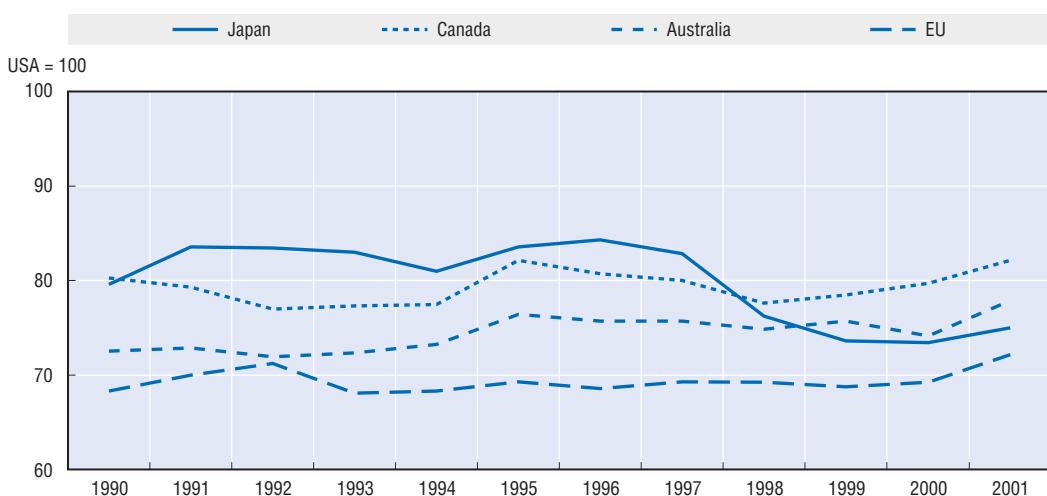
There is an implicit tension between the need to develop public awareness, and the effectiveness of intra-government discussions "behind the scenes". The more open the debate about regulatory reform, the greater the likelihood that special interest groups will focus on parts of the programme at the expense of the whole. Rhetorically powerful phrases about foreign investment, the closure of factories or offices, or health and safety considerations may overwhelm a more subtle discussion of the benefits of such regulatory tools as the No-Action Letter, or Regulatory Impact Analysis, that foster transparency and accountability, and subject the costs and benefits of regulations to critical scrutiny.

The OECD recognizes how vital it is to manage transition periods. "Fears about the effect of regulatory reform on employment, on small businesses, on local economies, and on traditional producers have necessitated government transitional initiatives during periods of adjustment. The current issue is how to ensure that transition is not a means of delaying reform, but of supporting timely change" (1999, p. 146). This counsel, which was appropriate in 1999, is all the more so in 2004, now that an economic recovery should reduce the costs of adjustment. Further reform now may make it easier to cope with problems in the future related to the size of the public debt and the demographic transition related to the ageing of the population.

### ***Bringing an end to the lost decade***

The strength of the current expansion has raised hopes of an end to a disappointing decade, during which economic growth averaged only 1% a year. Japan's weak growth is symptomatic of its failure to adequately address structural problems, as well as macroeconomic policy mistakes. The poor performance reduced Japan's output per capita,

Figure 1.1. Per capita income in Japan is falling relative to other OECD countries



Note: Based on current purchasing power parities.

Source: OECD.

measured in purchasing power parity terms, from 83% of the US level in the mid-1990s to under 75% at present (Figure 1.1). Japan has thus gone from being one of the richest countries in the OECD area to around the average. Extrapolating this trend would reduce Japan's per capita income to half of the US average – the level of Portugal and Greece today in relative terms – by 2030.

The recovery that started in early 2002 gained momentum at the end of 2003 and is expected to continue through 2005, which would make it the longest expansion since the collapse of the bubble. In contrast to the two previous upturns, the current expansion is being driven by private demand, without a large contribution from fiscal stimulus. The strength and durability of the upturn can be attributed to:

- *Buoyant overseas demand for Japanese products:* exports grew at a double-digit pace in 2003, with China accounting for two-thirds of the rise.
- *Progress in restructuring the corporate sector:* firms have substantially reduced their excess capacity, debt and labour. For example, corporate debt has been reduced from about 150% of GDP in the mid-1990s to 130% in 2003. These efforts have boosted corporate profitability and supported the sharp surge in business investment, which rose more than 9% in 2003.
- *Regulatory reforms implemented in recent years:* progress has been made in the labour, product and financial markets. In particular, the labour market has become more flexible while financial supervision has been upgraded. In the product market, entry barriers have been eased, allowing strengthened competition.

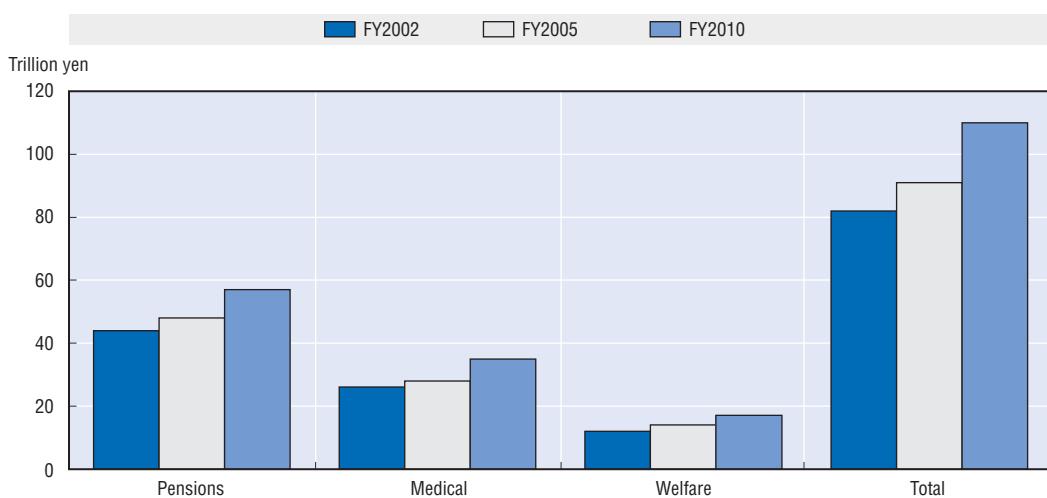
While the strength of the current expansion is encouraging, output growth at a 3½% annual rate since early 2002 has not been sufficient thus far to resolve persistent weaknesses in the Japanese economy. First, the underlying rate of deflation has remained rather stable. Excluding special factors, such as a hike in medical costs and a higher price for rice, consumer prices appear to be still falling at a ½% year-on-year rate. Moreover, the

deflator for private consumption continues to decline at a 1½% year-on-year rate. Second, land prices are still falling. In January 2004, they were 6% below a year earlier – the 13th consecutive annual decline – despite smaller falls in central Tokyo. However, the pace of decline accelerated outside the three major urban areas. Third, falling land prices have a negative impact on bank balance sheets since loans are often backed by real estate as collateral. Bank lending, excluding loan write-offs, fell 5% in 2003 – the sixth consecutive annual decline – even though loans to local governments and individuals increased. These negative factors act as significant headwinds, slowing the pace of economic growth.

A sustained economic recovery is required to resolve these problems, as well as to address long-term challenges, notably population ageing and the high level of public debt. Public pension spending has doubled from 6% of national income in FY 1992 to 12% a decade later. Outlays were boosted by rapid growth in the number of people over 65 and by the maturation of the state pension scheme that took its existing structure in 1966. With the working-age population already falling, and the elderly population continuing to rise, public-sector pension spending is likely to absorb a growing share of national income. Indeed, total social security spending – including pensions, medical care and welfare – is projected to increase by one-third between FY 2002 and FY 2010 (Figure 1.2). For the pension system alone, the gross liability is estimated to be 145% of GDP, taking into account the assets held by the social security system and assuming that contribution rates remain unchanged. The public pension system is thus unsustainable under existing rules in the face of an ageing population. To address this problem, the authorities plan to hike the contribution rate, which was 13.5% in 2003, each year from 2004 to 2016. Another option would be to cap the pension contribution rate at 20% of earnings, although this would reduce the replacement rate (pension benefit as a share of average salaries) by 10 percentage points to 42% of overall pay. However, even with a 20% cap, the higher contribution rate would tend to reduce the saving rate and labour force participation, thus slowing economic growth.

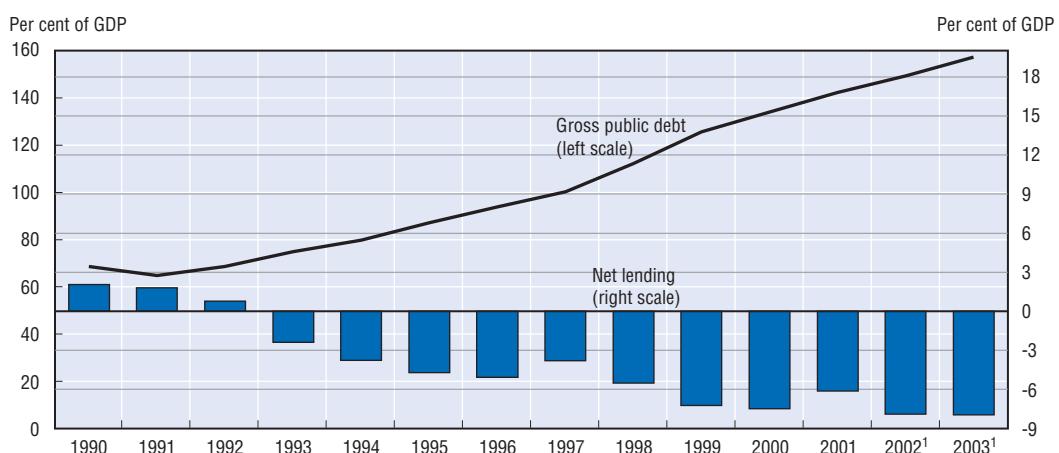
The rapid increase in social security spending, combined with the continued decline in tax revenues, is contributing to the deterioration in the fiscal situation. Indeed, the general

**Figure 1.2. Projected social security spending**



Source: Ministry of Finance.

Figure 1.3. Budget balance and public debt



1. OECD estimates for 2002 and 2003.

Source: OECD.

government deficit was about 8% of GDP in 2003, with public debt nearing 160%, the highest level in the OECD area (Figure 1.3). Moreover, this does not include the contingent liabilities of government corporations, which might significantly boost public spending. These developments make fiscal policy a serious concern. Debt dynamics will lead to a sharp run-up in public debt in the context of a nominal interest rate that exceeds the growth rate of nominal GDP, making the fiscal position unsustainable. One of the biggest challenges facing the authorities, therefore, is to ensure fiscal sustainability while avoiding measures that would undermine the economic expansion. According to OECD calculations, a primary budget surplus of around 1¾% of GDP would be necessary to stabilise public debt, albeit at a substantially higher level than at present. With the primary budget (i.e. excluding interest payments) currently running a deficit of 6% of GDP, a swing of nearly 8 percentage points is thus necessary to stop the snowballing of public debt. The scope for achieving such an improvement though expenditure cuts is limited by spending pressures related to ageing, making an increase in revenue unavoidable. However, as noted above, higher tax rates will tend to slow economic growth by weakening incentives to save and to work.

Faster economic growth would significantly help Japan meet the challenges of population ageing and rising public debt. However, Japan's growth prospects over the medium term appear mediocre as its rate of potential growth has slowed from 4% in the second half of the 1980s to around 1¼% at present (Figure 1.4). One key factor in the slowdown was the shift of labour inputs from a positive to a negative contribution since 1991. This reflects a reduction in hours worked and a fall in employment since 1998, which resulted in a higher unemployment rate, despite a declining working-age population. A second, more important factor has been a deceleration in labour productivity growth from a peak of almost 4% to around 1½% in recent years. Looking ahead, there is unlikely to be any significant pick-up in labour input that would boost the rate of potential growth over the medium term. Indeed, the working-age population is projected to continue falling, at a rate of 0.4% annually. This may be largely offset by a continued trend rise in labour force participation, even though Japan's rate is already somewhat above the OECD

Figure 1.4. Potential growth



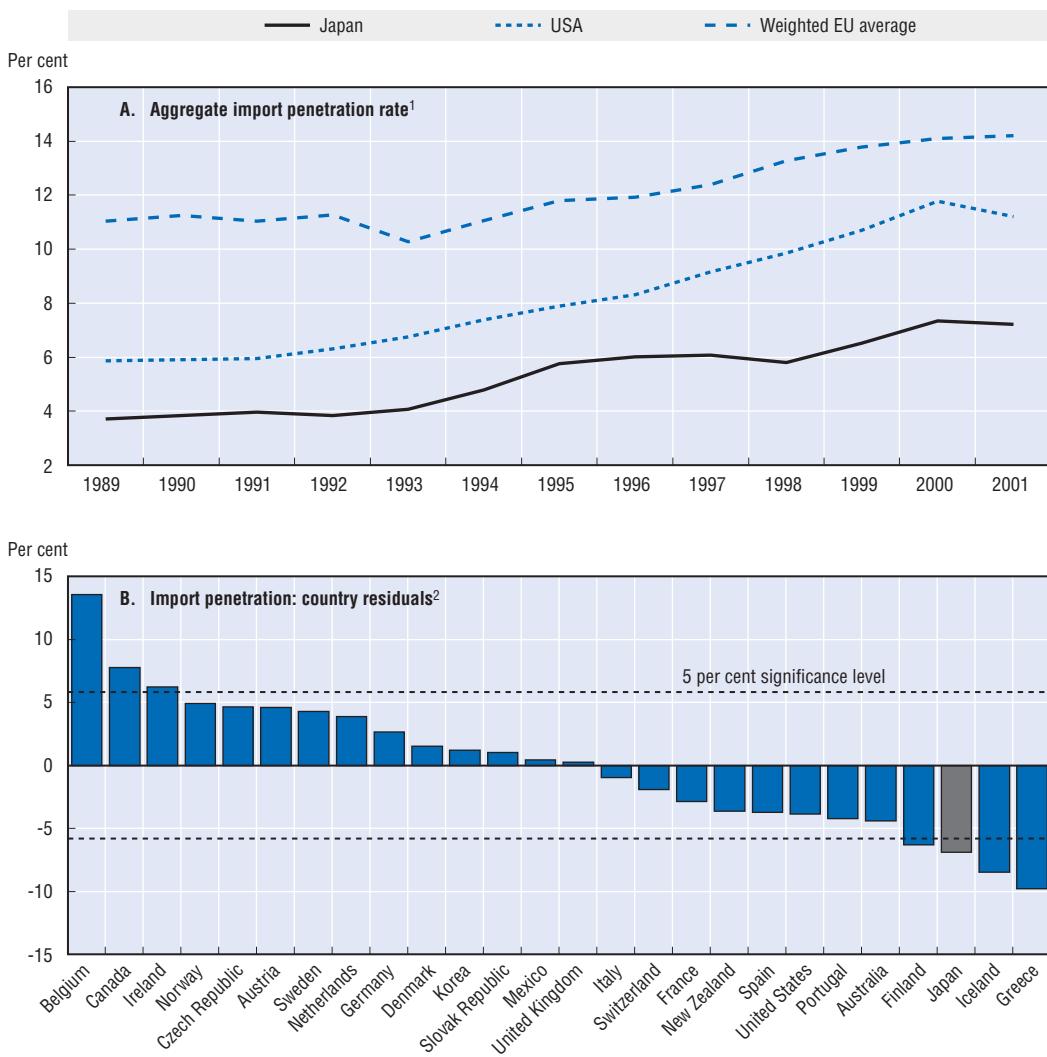
Source: OECD.

average. However, working hours, which remain 10% higher than the OECD average, are likely to decline further. The net effect is a negative contribution of 0.3 percentage point to output growth during the period 2003 to 2008. If labour productivity continues to rise at its current pace of around 1½% a year, Japan's potential growth would remain the lowest in the OECD area at 1.2% over the next five years.

One key to raising potential growth is to strengthen competition, in part by increasing openness to trade and investment. However, the Japanese economy is surprisingly closed to imports, even when controlling for transportation costs and per capita income (Figure 1.5). The increase in the overall import-to-GDP ratio in volume terms during the 1990s was smaller than in many other OECD countries. Moreover, the import share for the manufacturing industry is well below that of all other OECD countries. A further breakdown by industry type reveals a particularly low import penetration ratio for industries with high R&D intensities, as well as for some low R&D spending sectors.

The scope for foreign rivalry is also limited by the low level of FDI inflows: Indeed, Japan has the lowest inward FDI position in the OECD area (Figure 1.6). This reflects, in part, the past decade's poor growth performance, but also by explicit restrictions, such as ownership requirements, which remain relatively strict, although they are gradually declining. In addition, other features of the Japanese economy contribute to limiting inward FDI flows, including relatively high effective marginal and average taxation of inward FDI and the remaining restrictions against using foreign shares as compensation when purchasing Japanese shares. Administrative regulation tends to be concentrated in non-manufacturing industries, such as public utilities, telecommunication, financial intermediation, business services and the retail sector. Measures have recently been taken to encourage inward FDI as part of the government's goal to double the cumulative total over five years. A government committee proposed in its spring 2003 report specific measures to raise the attractiveness of Japan for foreign companies, such as the establishment of a streamlined support organisation for inward FDI with, for example,

Figure 1.5. Indicators of market openness



1. Manufacturing imports relative to manufacturing imports plus GDP, excluding intra-EU trade.

2. Residuals after controlling for effects of country size, GDP per capita and transportation costs.

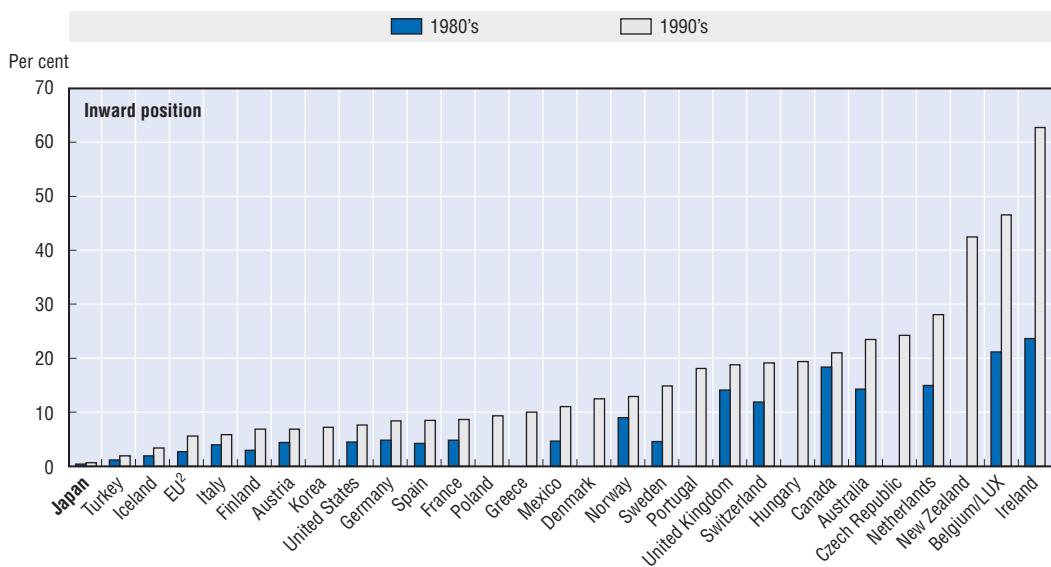
Source: OECD, *Monthly Trade Statistics*.

one-stop service centres to improve information flows. Other measures include better meeting foreigners' educational and medical needs, as well as improving conditions to develop growth clusters. As a pilot project, five local areas have been selected to promote inward FDI mainly through public relation campaigns.

In sum, the current economic upturn does not diminish the urgency of continuing with fundamental reforms to lay the foundation for a robust and sustainable expansion strong enough to reverse the downward trend in Japanese living standards relative to other OECD countries. The scope for further use of macroeconomic policies appears limited. The introduction of 13 fiscal packages since 1992 in an attempt to stimulate the economy has left Japan with an extraordinarily high level of public debt as noted above. Consequently,

Figure 1.6. Inward FDI positions in OECD countries<sup>1</sup>

Per cent of GDP



1. Average values over the two periods. For countries where the FDI position data are not available, values of bilateral stocks reported by their OECD partners were summed to obtain an approximate measure of multilateral FDI stocks.
2. Excluding intra-EU investment.

Source: OECD.

maintaining confidence in the long-term sustainability of public finances requires embarking on fiscal consolidation based on a credible programme. Likewise, monetary policy has been extensively loosened with short-term interest rates kept close to zero and the target for quantitative easing raised to 6½% of GDP. Given the limited scope for macroeconomic policy measures, sustaining the expansion and addressing the key challenges of rising public debt and population ageing will depend on largely on structural reform policies aimed at enhancing Japan's growth potential.

### Current challenges and options

The policy environment for reform is better now than it was a few years ago, but this is not the time to relax the effort. In many OECD countries, a crisis created the opportunity to pursue regulatory reform aggressively. The weak performance of the Japanese economy since the bubble burst in 1992 constitutes a crisis of sorts, insofar as it precipitated a debate about the need for structural reforms, and coincided with other changes in the economic environment, such as the emerging economy of China, the ageing of the population and the rise of the Internet, which call for a more adaptive economy. The association of regulatory reform with deregulation reflects the objectives of the recent past. Implicitly, regulatory reform embodies a vision of the future. However important the technical and legal dimensions of regulatory reform may be, they will only be implemented thoroughly insofar as people see them as progressive, forward-looking measures in keeping with changes already underway in Japan. A high quality regulatory regime requires a proactive role for government in the creation and enforcement of regulations.

## Regulatory tools

Japan started a process of regulatory reform later than many OECD countries, and even if its reform efforts have gained momentum, the state of the art in this field has continued to advance worldwide. This can be seen, for example, in the area of regulatory impact analysis (RIA). A RIA system is only now being introduced in Japan whereas other countries such as Mexico which, like Japan, lacked a RIA system a few years ago, have not only put one in place, but are now in a position to evaluate its performance.

In accordance with the new Three-year Plan and Programme for Regulatory Reform of March 2004, RIAs are to be conducted by Ministries and Administrative Agencies on planned and existing regulations, beginning in 2004, as appropriate. The text of the Plan however does not indicate the criteria to be employed. The plan implies rather that formal, binding obligations regarding RIA will emerge from an experimental, introductory phase. Training programmes will be needed, and some consideration could be given to establishing a centre-of-government unit which could monitor the progress being made in ministries to introduce and diffuse RIAs. This is especially important insofar as RIAs should consider the effects of foreign trade and investment or of competition, when such criteria may not be the primary concern of a ministry or agency.

To implement and make the requirements for RIA operational, Japan should consider:

- Ensuring ministerial accountability by requiring ministers to “sign off” on all RIAs in their portfolio.
- Targeting RIA efforts on regulations with significant economic and social impacts.
- Assessing all relevant regulatory effects, including competition policy and market openness.
- Monitoring compliance to carry out RIA.
- Evaluating RIA, to improve the design and implementation of the regulatory policy.

To enhance transparency and to monitor the use of the consultation process by ministries and agencies, and building on the progress made since the previous report to improve access to information:

- Provision of information over the Internet should also be mandatory for Internal Orders, Communication Notes, Administrative Guidance and negotiations for international agreements, with English versions wherever possible.
- The public comment procedure could be incorporated into the Administrative Procedure Act.
- Application of the Public Comment Procedures with a minimum comment period of 30 days should be made mandatory for Internal Orders, Communication Notes, Administrative Guidance and negotiations for international agreements; in exceptional cases where fewer than 30 days are provided, government departments should make public their reasons.
- The scope of eligible topics for a No-Action Letter should be expanded to cover existing business activities, and to local as well as central government regulations.
- Government guidelines for how administrative agencies handle requests for a No-Action Letter should be harmonised.

## **Regulatory Institutions**

Government capacity for regulatory reform, with benefits for both competition policy and efforts to promote market openness, could be strengthened through:

- The implementation of measures guaranteeing the permanence of the administrative agencies under the Cabinet Office in the event of a change in Prime Minister, which would be a useful in enhancing the persuasiveness and durability of the measures made by them.
- Increased co-ordination among the administrative agencies under the Cabinet Office, thus fortifying the capacity, coherence and effectiveness of efforts to improve the Japanese regulatory system.
- Merging the Headquarters for the Promotion of Special Zones Regulatory Reform and the soon to be established Headquarters for Promoting Regulatory Reform as a means to facilitate policy coherence between two bodies that are both involved in the creation and implementation of regulatory reform.

Increased dialogue with partner administrative agencies in Cabinet Office should serve to strengthen the role of competition policy within the larger programme of regulatory reform, thereby enhancing the market openness of Japanese regulatory reform.

- The new regulatory reform structure should be linked to the FTC. As part of the Cabinet Office, the FTC is now institutionally closer to market openness administrative agencies including the OTO, CHANS and JIC. One proposal under consideration is to make the chairman of the FTC a member of the government “headquarters” unit for promoting regulatory reform.
- The introduction of increased economic analytical abilities will further enhance the ability of the FTC to handle competition issues particularly in the public utilities sector which are important market openness implications.
- Placement of the OTO, CHANS and the JIC within the Cabinet Office could be a means to draw on synergies while unifying and better articulating the market openness perspective within the Japanese regulatory system.

## **Regulatory policies**

Strengthen further laws and institutions protecting consumers in Japan. Giving that responsibility to the FTC would help to focus competition law enforcement on consumer interests. Measures to increase the size of the legal profession would make the application of competition policy and regulatory policy more robust.

Complete the process of eliminating unnecessary controls on competitive entry; monitor the remaining exemptions from the AMA, particularly those related to SMEs; and step up enforcement to deter hard-core violations, with higher surcharges more in line with emerging international consensus.

Establish a systematic approach to cope with recurring themes in the trade debate, such as lack of openness procedures, unnecessary trade restrictiveness as well as harmonisation of standards and recognition of foreign conformity assessment. Anti-competitive practices reduce inward FDI. Steps to make progress in implementing the recommendation would include:

- Specific mention of relevant market openness themes under the new heading “Regulatory reforms designed to increase international appeal of Japan” in the March 2004

revision of the Three-Year Plan for Regulatory Reform, thereby formalising areas for progress that would be subject to review in subsequent reports of the CRR.

- Establishment of clearly-defined criteria for ascertaining equivalence and clearly-defined avenues for demonstrating such equivalence, as means to underpin progress toward increasing the scope of action for accredited foreign conformity assessment bodies.
- Regulatory co-operation with other countries. Co-operation with the American Chamber of Commerce and European Business Community in Japan demonstrates an area of co-operative effort with other economies that could serve as a template for substantive progress in co-operation within other economic fields. Dialogue with economies receiving high rates of inward FDI regarding the design of mergers and acquisitions should be continued.
- Supplement efforts to facilitate harmonisation toward international standards by engaging in co-operation and capacity building in the area conformity assessment with a view to increasing the number of Japanese accredited foreign conformity assessment bodies.

Probably the most substantive efforts in this area have aimed to improve the image of foreign participation of economic actors in the Japanese regulatory reform process. Success in this area could have a dramatic impact on a regulatory system which continues to provide a high degree of discretion to public officials. Further efforts to shape domestic public perceptions could involve:

- Promoting and disseminating studies of success stories in Japanese regulatory reform beyond the area of inward FDI, such as under the Special Zones programme.
- Increasing the visibility of regulatory reform success stories in other economies.

The Special Zones programme, which addresses issues related to competition, market-openness and regulatory quality, reflects a break from the past. High-level political support has been a critical ingredient for success. The process is both top-down and bottom-up, however, as it enables local and regional actors to propose initiatives, thereby increasing the awareness of and commitment to reform on the part of the public and not just the government. Promising innovations should be evaluated quickly, and diffused nationally.

In conclusion, there is a need for a clearer and more comprehensive set of principles to guide reform measures, covering both economic and social regulations. Many of the proposed measures to improve regulatory tools and institutions have the potential to improve policy coherence and the relations between the administration and the private sector. Consideration could be given to a systematic overview of regulations in force. A permanent unit in the Cabinet Office could help monitor the quality of new regulations and co-ordinate the introduction of RIA. Political leadership at high levels needs to be matched with responsibility and initiative across government, in ministries and agencies.

Regulation is about what needs to be regulated. The 1997 Recommendations recognise the importance of consideration of alternatives to regulation, of a whole-of-government approach, of political leadership. In recent years a dynamic approach has been encouraged by greater attention to evaluation of the impact of regulations as a means to improve policies. This monitoring exercise of Japan shows the relevance of the 1999 Recommendations as well as their applicability to Japan's economic conjuncture and institutional settings. As policy objectives become more diverse and respond to social and economic change, new problems, and technological innovation, regulation is itself

becoming more complex. Efforts to improve the quality of regulation should help the government enhance its capacity to adapt, thereby meeting the needs of citizens and businesses better, contributing to a climate of confidence and trust. As the role of the state in the economy changes, it does not become less important, but more strategic. An understanding of what has been achieved in recent years in regulatory reform, and of the impact of reform on both the workings of the administration and the activity of the private sector, provide the basis for setting objectives that can realise the full potential of the Japanese economy and meet the expectations of citizens.

### Notes

1. Section I of the Public Comments Procedure.
2. MPHPT (2004).

## *Chapter 2*

# **Government Capacity to Assure High Quality Regulation**

## 2.1. Introduction

This report is part of the monitoring of developments on regulatory reform since the 1999 OECD review of Japan. The report looks at developments in the Japanese government's capacities to assure high quality regulation with particular attention to the implementation of the 1999 Report's recommendations. Japan has made significant progress in many of the areas identified in the Report. This includes strengthening of the capacities and mandate of independent advisory councils promoting regulatory reform; elimination of most "supply-and-demand adjustment regulations"; and a series of measures to improve regulatory accountability. New initiatives such as the launching of a comprehensive Policy Evaluation System in 2002 and the introduction of Special Zones for Structural Reform in 2003 demonstrate the evidence-based and innovative drive in Japan's regulatory policies. The Japanese Government's new Three-Year Programme for Regulatory Reform (2004-2006) endorsed in March 2004 bear witness to a strong and continued political commitment to an ambitious regulatory reform agenda.

But important challenges persist. Results of many of the newly introduced transparency enhancing mechanisms have been mixed, at best. Regulatory Impact Analysis is by and large non-existent. There are no capacities at the centre of government to ensure a coherent and consistent quality of new regulation. Moreover the concept of regulatory reform still seems to be too narrowly based in ideas of deregulation. However there is a clear consciousness of the need for further adaptation and improvement. Most of the challenges mentioned above are already being addressed as part of the government's Regulatory Reform Programme.

To improve public sector capacities for good regulation, three major challenges face reformers today. First, bold and comprehensive action is needed to ensure the implementation of measures already taken. This includes corrections and fine-tuning of a number of regulatory quality initiatives that have not met their intended objectives. It also includes clarifying or developing guidelines for key obligations in the regulatory process, in particular to support the establishment of a RIA system. And it includes re-enforcing the procedures and institutional support to ensure a credible quality control of the regulatory process. Second, a sustained and multifaceted effort is needed to embed good regulatory practices not only in procedural guidelines but also into the culture of the public administration. The strong understanding at the highest political level, in some sections in key ministries, and among other key drivers of regulatory reform needs to be extended to regulators in all departments and at all levels. Third, and related to the above, the dominant perception of regulatory reform as synonymous with deregulation needs to be balanced with the notion that a high quality regulatory regime also requires a proactive role in the creation and reinforcement of regulations.

The outline of this report is based on the three pillars of regulatory quality – regulatory policies, regulatory institutions, and regulatory tools.<sup>1</sup> The recommendations of the 1999 Report are dealt with under each of these sections and summarised in annex 2.1.

## 2.2. Regulatory policies

The advantage of an explicit regulatory policy is that it can provide a platform for a comprehensive and co-ordinated approach to the use of regulatory tools and institutions. An explicit regulatory policy may also facilitate the integration and co-ordination of regulatory policies with other policy areas. Adopted at the highest political level, a regulatory policy should contain explicit and measurable regulatory quality standards and provide for a continuing regulatory management capacity.<sup>2</sup>

In Japan, the power of the civil service and the high independence of ministries necessitate a strong role of the prime minister in order to force powerful and sometimes reluctant ministries to reform. Since the 1980s a series of prime ministers, most recently Junichiro Koizumi, has played a prominent personal role in promoting regulatory reform. The strong support by prime ministers is a strength relative to many other OECD countries, but the fact that progress depends on personal support also explains why progress is sometimes slow and in selected areas. Political support may have suffered from the tendency to support reform in general but not in specifics.

The 1999 OECD Report commended Japan on the strong and persistent political support for regulatory reform. However it voiced concern that the regulatory policy was excessively focussed on deregulation and based on an item-by-item rather than comprehensive approach, see Box 2.1 below, and that existing regulatory reform principles were not clear enough to guide ministries in their reform efforts. The Report recommended that Japan adopt principles of good regulation based on those accepted by Ministers in the 1997 OECD Report on Regulatory Reform, and that all "supply and demand adjustment regulations" be eliminated by a specified date. It also recommended that regulatory reform should be expanded and accelerated through development of comprehensive sectoral plans, and that regulatory reform decisions be better co-ordinated with and reflected in subsequent budget and organisational decisions.

This section considers whether these recommendations have been implemented. The conclusion is that the Three-Year Programmes for Regulatory Reform remain a visible and dynamic platform for addressing Japan's regulatory reform challenges. The establishment of Special Zones for Regulatory Reform has added new and promising bottom-up dynamics to deregulatory measures in support of opening markets and creating consumer benefits. Furthermore, the Policy Evaluation System introduced in 2002 has the potential to improve the reflection of regulatory measures in budgetary and organisational consequences. However there is still significant scope for improvements. Although there is an increasing recognition that reform and regulatory reviews must be based on a set of concrete and consistently applied criteria, reforms remain primarily activity- and item-by-item driven, focussing on deregulatory measures. The adoption of concrete review and reform criteria may facilitate more comprehensive reviews and reduce the possibilities of vested interests to water down reform proposals. Moreover, reform commitments set out in the Government's Regulatory Reform Programmes have often been markedly less ambitious than reform recommendations put forward by the government – appointed advisory Council for Regulatory Reform (CRR).

### **Three-Year Programmes for Regulatory Reform**

Based on elaborate reports and action plans from the advisory Council for Regulatory Reform (CRR), Japan's regulatory reform policies have since 2001 been presented in

**Box 2.1. The Japanese notions of regulatory reform**

The Japanese debate on regulatory reform has been dominated by two notions of regulatory reform. First, regulatory reform has been more or less synonymous with deregulation. Second, the debate has been marked by a strong distinction between economic regulation (price and entry regulation) and social regulation (regulation of civil life and the distribution of publicly guaranteed goods such as health and education).

Deregulation is an inadequate principle to guide regulatory reform. Institutional, procedural and personnel capacities for high-quality regulatory reform are equally necessary elements in a regulatory policy. Regulatory capacities are needed not only to review the stock of existing regulations, but also to ensure a coherent and comprehensive assessment of the flow of new regulations.

In the context of regulatory reform as deregulation, the distinction between reform of economic and social regulation has come to draw a line between “necessary” reforms of economic regulation, and politically more controversial reforms (i.e. deregulation) of social regulation. The predominant reform context of deregulation often prevents a discussion of regulatory quality and reregulation – i.e. new and better regulation – as a supplement or alternative to deregulation. As a consequence, social regulation was long regarded as untouchable for regulatory reviews, although the strict differentiation between economic and social regulation is to large extent artificial. “Economic” regulation often has “social” effects, and vice-versa, as seen in the case of the reforms of agriculture (subject to “social regulation”) and liquor shop licensing (“economic regulation”). The notion of regulatory reform as deregulation, and the controversy associated with reform of social regulation has hampered debate and experiments with how to carry out efficient reform of “social regulation” without citizens experiencing loss of quality and quantity of publicly guaranteed services.

However there are indications that past notions of regulatory reform are now giving way to a more comprehensive approach. The Fair Trade Commission in a report from November 2002 called “Promotion of Competition in the Social Regulation Sector” argues that social regulation should be reviewed by employing the same approaches as those used in the reform of economic regulation. Similar views were voiced by Keidanren in its 2003 Annual Report. Moreover, short of applying specific review criteria, the CRR and the Government’s regulatory reform programmes are increasingly addressing reforms of social regulations.

annually revised Three-Year Programmes for Regulatory Reform. Reflecting progress in reducing economic regulations as well as broadening of the mandate of the CRR (see also Section 3.1), the three-year programmes have become gradually more far reaching and ambitious, focussing on cross-sectoral issues as well as social regulation. On 19 March 2004 the Cabinet decided on a new Regulatory Reform Programme. The overall theme of the programme is “the creation of a vibrant Japanese economy”, supported by a 762 items action plan. Key initiatives are summarised in Box 2.2 below.

The 1999 Report noted that Japan’s reform programmes tended to be based on the accumulation of many individual reform “items”, some of which are very significant in economic terms and others which are trivial and recommendations for more study. This is still the case. It is important to note, though, that the item-by-item approach can claim credit for almost all of the regulatory reforms that have occurred in Japan, and it has

**Box 2.2. Key initiatives under the March 2004 Three-Year Programme for Regulatory Reform**

- Establishment of a Ministerial Committee (“Headquarters”) for Regulatory Reform.
- Continuation of the private sector advisory Regulatory Reform Council based in the Cabinet Office (renamed the Council for Promotion of Regulatory Reform).
- Commitment to implement the CRR’s Action Plan for Regulatory Reform containing 762 specific reform and review proposal.
- Focus on reform in 17 priority areas with a view to facilitating private sector access and competition in sectors such as medical care, social services, education, agriculture, management of government property and services, automobile inspection, and the rental residence system.
- Commitment to gradually introduce Regulatory Impact Analysis, starting in 2004.
- Commitment to continue the promotion of reform through the use of special zones for structural reforms.
- Commitment to design regulatory reforms to increase the international appeal of Japan and to attract foreign direct investment.
- Commitment to review and revise transparency enhancing mechanisms such as the public comment procedure, the No Action Letter scheme, and the Administrative Procedure Law.

Source: Government of Japan.

proven operational in an administrative and political culture geared for informality, consensus and absence of open conflict. Moreover, although not comprehensive and sufficiently concrete, the reviews of demand-and-supply adjusting regulation (see Section 2.2 below) have been guided by a number of general reform principles.

However the item-by-item approach is not an adequate basis for coherent, consistent and sustained reform programmes. To improve the coherence of the item-by-item approach and to ensure that reform principles are applied equally to new and old regulations, the Japanese government should develop more explicit and measurable government-wide criteria for making decisions on how to review and produce regulations, and support those principles with written guidance to ministries. One source for inspiration could be the OECD principles accepted by Ministers in 1997 (to be updated in 2004-2005). The principles provide an internationally accepted set of principles which could be useful in guiding regulatory review and reform.<sup>3</sup> Keidanren, the Business Federation of Japan, has also suggested the making of a Basic Regulatory Reform Law setting out key principles to guide regulatory review and reform efforts particularly based on principles of free market access and competition.<sup>4</sup>

**Elimination of demand and supply adjustment regulations**

Market demand and supply adjusting regulations have been identified as one of the most anti-competitive features of the Japanese regulatory system. The elimination of supply and demand adjusting regulations has been a key objective in Japanese reform

programmes since 1999. The reviews of demand-supply adjusting regulations have been guided by three general reform principles:

- Elimination of economic regulations (market entry barriers), to the extent possible.
- Keeping social regulation at a minimum. And
- Transition from “strong” (*ex ante* licensing) to “weak” (*ex post* control) regulations.

According to the Japanese government supply-demand adjusting regulations have now been eliminated in most sectors. There are no data for the total number of supply and demand adjusting regulations eliminated. Although not directly mirroring the effects of the reduction of supply-and-demand adjusting regulations, the Cabinet Office in 2004 published estimates of recent years’ efforts to reduce entry regulation and deregulate in a number of economic sectors (mobile telephony, trucking, domestic airlines, car inspections, electric power, gas, oil, securities commissions, insurance, beverages and food, and products where resale prices had been designated such as cosmetics and pharmaceuticals). In total, the Cabinet Office estimated that these reforms increased consumer surplus by JPY 13.4 trillion per annum, or YEN 112 000 per capita. This amounts to about 4% of GDP.

### **Special Zones for Structural Reform**

The launching of Special Zones for Structural Reform in June 2002 introduced a fundamentally new and possibly significant component in Japan’s regulatory reform policies. The Special Zones concept – geographically limited areas where certain regulations can be eased or lifted – were launched to stimulate local economies and to act as a testing ground and first step for reforms to be implemented at the national level. It is also intended that the Special Zones initiative will trigger innovative endeavours of “regulatory competition” among municipalities striving to attract domestic and foreign companies.<sup>5</sup> An implicit yet clear motivation behind the local level approach to reform was to use the creativity and knowledge of local authorities and private sector actors to remove obstacles to go growth and subvert vested interests assumed to be less capable of stalling or blocking reforms implemented and tested at the local level. Box 2.3 summarises the procedures for establishing Special Zones.

Tables 2.1 and 2.2 provides an overview of the proposed and implemented deregulatory measures under the initiative, and the number of approved special zones. To date, a total of 250 deregulatory measures have been implemented nationwide, and another 176 deregulatory measures in one or several special zones. A total of 325 special zones have been approved.<sup>6</sup>

The Special Zones initiative is a new innovative approach to deregulation and structural reform. It is still too early to pass any judgements on the potential scope and effect of the initiative. Issues still remain in areas such as health, education and agriculture, where the Special Zones Initiative was intended to play a strong role in driving reform. There seems to be a tendency that special interests opposing reform stall and constrain the implementation of special measures on a national basis by referring to the need for “thorough testing and evaluation” of the reform measures at the local level. Strong political and institutional support should ensure that successful measures in the zones can be applied on a national basis as expeditiously as possible. It is important that the establishment and evaluation of special zones continue to be carried out in a transparent

### Box 2.3. Establishing Special Zones

The mechanisms in place to establish Special Zones include a mix of local initiative, informal consultations, and central approval and evaluation. As a first step, for a period of four to six weeks several times every year the Office for Promotion of Special Zones (located in the Cabinet Office) solicits regulatory proposals from all interested parties: local governments, private firms, citizens and foreign companies. Next, during a two-week period, the Office accepts petitions (from local governments only) for special zone designation. Approval of local governments' application requires the approval by a committee of cabinet ministers ("the Headquarters for the Promotion of Special Zones") chaired by the Prime Minister as well as the consent of the responsible minister. Most of the officially tabled applications are approved, following a process of screening and informal consultations between local governments, involved central ministries and the Office for Promotion of Special Zones. Proposals for reform as well as responses by ministries and agencies are made public on the Internet.

The Office for Promotion of Special Zones regularly publishes a list of the type of regulations for which special measures can be established. The idea is to have local governments choose from among these measures when formulating special zones plans and proposals. The list is expanded and updated as new special measures are approved by the Headquarters. An Evaluation Committee established in July 2003 composed of academics, representatives from the private-sector, and people selected among applying institutions and local government must assess whether regulatory exemptions allowed for a particular special zone should be either: i) implemented nationwide; ii) continue in the Special Zone only; or iii) discontinued. There is no fixed trial period of the special measures before they are assessed by the Evaluation Committee. Once a year the Cabinet submits a bill to the Diet in which it adds new special measures into a revised version of the law on Special Zones for Structural Reform.

There are no clear criteria for which deregulatory measures can and cannot be taken under the Special Zones initiative. The official government policy allows for "exceptions to regulations in a manner that is in line with respective special local characteristics", which, "through thorough assessments [...] will be extended to nationwide structural reform." Exemptions are essentially granted on a discretionary basis subject to negotiations between line ministries and the Cabinet Office of the local governments' proposal.

manner. A clear and minimum time length of special measures in special zones would also reduce any distortive effects stemming from uneven application of regulations.

#### **Policy evaluation**

In April 2002 the Japanese government introduced a new government-wide Policy Evaluation System (PES). MPHPT's "Standard Guidelines for Policy Evaluation" describes the main objectives of the PES as: 1) to clarify the administrative organisation's accountability to the general public; 2) to realize efficient and quality administrative activities for the benefit of the general public; and 3) to convert current administrative activities to outcome-oriented ones. The PES obliges each ministry and agency to conduct self-assessment-based evaluations of their policies applying one or several of the following criteria: necessity, efficiency, effectiveness, equity and priority. Ministries are encouraged to carry out the evaluations with the assistance of external experts. MPHPT is responsible

**Table 2.1. Proposed and implemented deregulatory measures under the Special Zones initiative**

	Application period	Total no of proposals	Realised in special zones	Realised nationwide
Round 1	August 2002	426	93	111
Round 2	January 2003	651	47	77
Round 3	June 2003	280	19	29
Round 4	November 2003	338	17	33
Total		1 695	176	250

Source: Government of Japan.

**Table 2.2. Number of approved Special Zones**

	Approval	No of Special Zones
Round 1	April 21 and May 23, 2002	117
Round 2	August 29, 2003	47
Round 3	November 28, 2003	72
Round 4	March 24, 2003	88
Total		325

Source: Government of Japan.

for reviewing and synthesising the evaluations, and to ensure the “comprehensiveness and strict objectivity” of the evaluations, as well as to make recommendations to ministries with the aim of improving policies. MPHPT’s Administrative Evaluation Bureau can carry out additional evaluations in order to ensure coherence or comprehensiveness of the evaluations. A Commission of independent experts has been established to ensure that MPHPT’s evaluations are conducted in a fair and neutral manner.

The Policy Evaluation System is linked to Japan’s regulatory policies by providing an evaluation framework that can be used for *ex ante* as well as *ex post* evaluations of regulatory performance. Since the introduction of the PES ministries have decided on a voluntary basis which projects (including regulations) they want to evaluate under the PES. MPHPT’s guidelines suggest that ministries, in selecting regulations for review, “take into account the intent of the [...] Three Year Plan to Promote Deregulation [...] and begin evaluation, starting with those that are ready to be evaluated.”<sup>7</sup>

So far, the item-by-item approach has made it difficult for observers to keep track of progress on the large number of reform projects and proposals. In this context, the PES is an important step in establishing comprehensive and consistent assessments of government policies and activities. A comprehensive evaluation system would allow a snapshot or “freeze” of regulatory policy commitments, and the possibility to follow progress and performance.

However there are indications that there is still some way to go before Japan’s Policy Evaluation System can reap the potential benefits. Firstly, the activities evaluated under the Policy Evaluation System have almost exclusively been spending activities. Although the System in principle is open to include regulatory programmes and performance, this has so far not been the case. Stronger co-ordination or integration with *ex ante* and *ex post* evaluations of regulatory performance – based on clear and transparent review criteria – is recommendable. The Government’s recent commitment to include RIA obligations under the PES is an important step in that direction. Similar formal obligations for ministries to

report on ex post regulatory reviews via the PES would further improve the comprehensiveness of the PES.<sup>8</sup> Second, the existing administrative systems may not be sufficiently supportive to the PES. As opposed to many other countries where New Public Management (NPM) performance tools were adapted at the same time as administrative systems were reformed, the PES and other NPM elements were introduced in Japan while existing systems were left largely untouched.<sup>9</sup> This observation suggests that the full potential of the PES may not be fully realised or only gradually as the supporting administrative culture and systems change. Third, stronger elements of third party evaluation and/or review may be necessary in order to ensure the credibility of evaluations. Ministries have wide discretion in choosing projects subjected to evaluation, and third parties participating in the evaluation. Moreover, it is the ministries' own responsibility to come up with suggestions for budgetary consequences of the evaluation.<sup>10</sup> Combined with the weak position of the MPHPT in scrutinising the evaluations there are limits to the possibilities for using the PES as a tool for revising funding levels and regulatory regimes.

### 2.3. Regulatory institutions

The right set of regulatory institutions is needed to ensure coherent regulatory implementation and to promote regulatory quality. Successful reform requires the allocation of specific responsibilities and powers to agencies at the centre of government to encourage, monitor and oversee progress across the whole of the public administration. Institutions also play an important role in ensuring regulatory accountability and transparency by separating regulatory policy functions from regulatory implementation and enforcement. As in all OECD countries, Japan emphasizes the responsibility of individual ministries for reform within their areas of responsibility. Establishing central drivers of reform has been more difficult in Japan than in most other countries, due to the traditional strong independence of the ministries and the relatively weak centre. In this environment, regulatory management in the form of day-to-day oversight of regulatory activities has not developed as a routine function independent of the ministries.

The 1999 Report praised Japan for the efforts undertaken by the independent advisory Deregulation Committee, and it noted the progress made on separating policy and regulatory enforcement functions by creating the Financial Supervisory Body. However the Report recommended a continued strengthening of these efforts, among others by expanding the capacities of the Deregulation Committee, and by taking a more comprehensive approach to separate regulatory from industry and policy promotion functions in key infrastructure sectors. This section looks at the implementation of these recommendations and other developments in the institutional support for regulatory reform in Japan.

In 1999 the Diet passed a series of bills, implemented in 2001, to reorganise the central ministries and strengthen control over policymaking by the Diet and Cabinet. As part of the reforms, the number of ministries was reduced from 22 to 12 and the horizontal responsibilities of the Cabinet Office were significantly strengthened.<sup>11</sup> Furthermore, Japan's elaborate system of *shingikai* or deliberation councils providing private-sector input to official decision-making was reformed.<sup>12</sup> These changes have also led to a strengthening of institutional drivers for regulatory reform. The conclusion of this section is that the Deregulation Committee's successor, the CRR, has been significantly strengthened along the lines recommended in the 1999 Report. A series of initiatives have strengthened the possibilities for horizontal policy-making and enforcement. However there has been only limited progress in credibly separating policy and regulatory enforcement functions.

## Councils

The 1999 Report recommended that the independent advisory Deregulation Committee be strengthened by an expansion of its resources, broadening of its mandate, by putting it under the direct control of the Prime Minister, and by strengthening the capacities of the Secretariat of the Committee. Actions accommodating the bulk part of these recommendations have been implemented.

Succeeding the Deregulation Committee (renamed the Regulatory Reform Committee in 1999) the Council for Regulatory Reform (CRR) is the most important driver of regulatory reform in Japan. Created in 2001 on a three year mandate, the Council consists of 15 private sector experts, organised into 13 Working Groups. Once a year, the Council – supported by a 30 persons staff recruited from the private sector and the ministries – produces a Report on Regulatory Reform with analysis and recommendations for the Prime Minister's annually revised Three-Year Plan for Promoting Regulatory Reform. Members of the Council can negotiate directly with the responsible ministries about regulatory reforms. Reflecting the gradual elimination of most entry and "economic" regulation in key economic sectors, the Council in its recent reports has taken up reform and deregulation of "social regulation", i.e. areas such as medical care, social services, and education. The Council's reports have also addressed a number of cross-sectoral issues of general importance for regulatory quality, such as reviews of the Administrative Procedure Act, the No Action Letters system, and the introduction of a RIA system. The influence of the CRR on regulatory reforms has been significant and gradually enhanced, also compared to other OECD Countries who have made use of independent, advisory and politically unaccountable bodies promoting regulatory reform.

On 19 March 2004, the Japanese Government renewed the three year mandate of the CRR [and renamed it the Council of the Promotion of Regulatory Reform (CPRR)] as part of the launching of a new Three-Year Regulatory Reform programme. New Council members appointed by Prime Ministers were announced in April 2004. Some observers have recommended a further strengthening of the Council's mandate in order to provide it with a stronger position in negotiations with ministries about further reforms. Although such strengthening is conceivable, additional powers to the CRR could raise questions about the political accountability for reforms.

## Centre-of-government agencies and committees

Most of the government agencies and committees charged with the promotion of regulatory quality are located in or associated to the Cabinet Office.

Placed within the Cabinet Office, a *Minister of State for Regulatory Reform* is responsible for supervising ministries' and agencies' implementation of the Three Year Plans for Regulatory Reform. The Minister for Regulatory Reform is supported by staff of the *Office for the Promotion of Regulatory Reform*, which also acts as the Secretariat for the Council for the Promotion of Regulatory Reform.

*The Headquarters for the Promotion of Regulatory Reform* composed of cabinet ministers was established in May 2004. The establishment of this ministerial committee could mark a further strengthening of the horizontal drive and co-ordination of regulatory reform in Japan. Main members of the CPRR will be able to attend the Headquarters' meetings in order to keep close co-ordination between both organisations. The Headquarters will be supported by the Office of the Promotion of Regulatory Reform in the Cabinet Office.

Another recent driver of regulatory reform is the Headquarters for the Promotion of Special Zones for Structural Reform established on 18 December 2002, based on the Law on Special Zones for Structural Reform. The Headquarters are composed of cabinet ministers and chaired by the Prime Minister. The Headquarter is supported by the Office for the Promotion of Special Zones located in the Cabinet Office and staffed with people recruited from ministries, the private sector and local authorities. The Office is in charge of the application process and the communication with the responsible ministries and agencies.

The Administrative Evaluation Bureau in the MPHPT is responsible for monitoring compliance with the obligations in the Government Policy Evaluation Act, including *ex ante* and *ex post* evaluations of regulatory performance. As per April 2004 this would also include providing guidance to ministries on how to prepare RIAs. The Administrative Management Bureau, also in the MPHPT, monitors compliance with public comment procedures and no action letters. In line with the strong independence and equality of Japanese ministries, the MPHPT has no powers to sanction non-compliance with the above procedures.

The Fair Trade Commission (FTC) is mainly charged with enforcing the Anti-Monopoly Act (AMA). The FTC has been playing an increasingly active role in promoting regulatory quality, among others by formulating guidelines to ministries and agencies to control anti-competitive abuse of administrative guidance. Reorganizing the FTC as an external organ to the Cabinet Office has had a positive effect on its visibility and its policy role. Inter-institutional contacts with other regulatory institutions, such as the Council of Regulatory Reform, are good but remain nevertheless under-developed with regard to formal consultation or information agreements (see Chapter 3 of this report on Competition Policy).

All significant agencies connected with the promotion of regulatory reform to enhance market openness are also located within the Cabinet Office (see Chapter 4 or this report on Market Openness).

The location within the Cabinet office of many of the important government agencies and committees charged with the promotion of regulatory reform is necessary to ensure co-ordination and high-level political support for reform in a context of highly independent and sometimes reluctant ministries.

Reflecting the predominant focus of regulatory reform in Japan on deregulation, the bodies above have functions relating primarily to improving the stock of existing regulation. So far, however, there is no centre-of-government unit tasked with vetting the quality of new regulations based on a set of criteria for regulatory quality. The RIA system to be gradually established from April 2004 will oblige ministries to prepare assessments of the expected impact of new regulations (*i.e.* the flow of regulations). In addition to ministries' responsibility to prepare RIAs, it is equally important to establish clear responsibilities for functions such as advising, monitoring and possibly challenging ministries' RIAs. Each ministry – in co-operation with the MPHPT and the CPRR – is envisaged to be charged with preparing the RIA guidelines. No decision has yet been taken concerning by whom and how compliance with RIA requirements should be monitored and enforced. It is important that this issue be addressed as part of the implementation of the government's new Regulatory Reform Programme.

Experience from OECD Countries suggests that the relationship between an effective, comprehensive regulatory policy and the existence of a central government oversight body appears to be strong. They are mutually supportive, and where one exists, the other is usually also present. New central bodies which go beyond improved co-ordination between existing bodies are probably essential in some shape or form. Experience suggests that central units are

best placed in, or reporting to, the centre of government, rather than in a line ministry which is likely to be too closely linked to specific policy and regulatory functions.

### **Independent regulatory authorities**

Japan is unusual among OECD Countries by not having any independent regulatory agencies at arms' length of central government, charged with the implementation and enforcement of regulation of economic sectors such energy and transport. The 1999 Report noted that many accountability, transparency, and competition problems in sectoral regulation result from lack of institutional clarity about the source, powers, and purpose of regulation. The report recommended separating regulatory from industry and policy promotion functions in key infrastructure sectors. Similar concerns have been voiced by many international observers and trade partners, as well as influential voices in the domestic debate. Although not necessarily calling for an independent regulator, the CRR in its July 2002 interim report expressed concern that a dedicated model of regulatory oversight is required for, among others, network sectors. The general concern from some observers and stakeholders is that regulators in many areas of economic activity lack independence, and that they have difficulties in separating policy functions from ownership, and enforcement functions, and in particular shielding the regulatory decision-making process from partisan influences.

The adversarial positions between proponents and opponents of independent regulators in Japan sometimes seem to be due to different perceptions of the concept. "Independent regulators"<sup>13</sup> as used in most OECD countries are often "enforcers" rather than regulators, and, although at arm's length, responsive to government policies, rather than "independent" from them. The policy question, therefore, is rarely about removing policy-making functions from elected and accountable ministers, but about establishing a regulatory framework that ensures a coherent, comprehensive and transparent implementation of such policies. The Japanese government has pointed out that the concept of independent regulators is unclear. Japan endorses the notion of independent regulators as in "independence from operators" and recognises the necessity to separate regulatory functions from ownership functions in sectors such as telecommunications and postal services. But it rejects the notion of "independence from politics" and "independence from regulatory policy-making", the former because it is seen as "impossible and inappropriate that regulatory authorities should be completely independent of Cabinet and thus enabled to make decisions without any public control."<sup>14</sup> The latter – independence from regulatory policy-making – is rejected because it is seen as "appropriate for [a] national strategy to be formulated by an organisation that have both policy-making and regulatory functions".<sup>15</sup> A separation is not viewed as necessarily leading to coherent, comprehensive and transparent regulation.

Since 1999 there have been no significant changes in the organisation of regulatory functions in key sectors such as telecoms, electricity, gas, postal services and transportation. Both regulatory policy and regulatory enforcement functions for these sectors remain under the control of the relevant line ministries (METI for gas and electricity, MPHPT for postal services and telecoms, and the Ministry of Land, Infrastructure, and Transport (MLIT) for transport), although carried out by different units within the respective ministries. The Fair Trade Commission (FTC) has strengthened its monitoring of violations under the Anti-Monopoly law by establishing an IT-utility task force in April 2001, and by formulating guidelines to ministries and agencies to prevent

further Anti-Monopoly Law violations.<sup>16</sup> METI, MPHPT and MLIT intend to remain the supervisory agencies for telecoms, electricity, gas, postal services and transportation. However on energy, METI plans to study alternative administrative setups designed for monitoring of markets, settling disputes and network regulation.<sup>17</sup>

The economic performance in regulated sectors such as energy, telecommunications, post and transportation suggests that further structural reforms supported by appropriate regulatory frameworks could lead to lower prices and increased consumer benefits.<sup>18</sup> Energy prices in Japan are higher than in any other OECD country. In the natural gas sector prices for both industry and households remain approximately twice as high as the OECD average. In the telecommunications sector charges for DSL Internet access are among the lowest in the OECD area, and very low priced Internet Protocol (IP) telephony prices are rapidly emerging, but traditional telephony prices and mobile phone services for both the business sector and residential users are among the highest in the OECD area (when using current exchange rates). For postal services prices for non-competitive standard letters are about one third higher than the average of other large OECD countries. Costs for using Japanese harbours are among the highest in the world.

The current separation of regulatory policy and enforcement functions within the same ministries seems to be insufficient to ensure regulatory independence. As noted in the OECD's 1999 Report, the financial sector supervisory board set up alongside the Ministry of Finance is a good example of how Japanese institutions can evolve in the direction of international best practices. Similar institutional measures, however, have not been taken in other sectors. A more general approach is needed to provoke change across a broader front, and to ensure that institutions are designed on consistent principles of competition, transparency, and accountability for results. Japan's acknowledgment of the need to ensure "independence from operators" has implications where operators are still substantially owned by the State. In these cases, measures must be in place to ensure that government agencies responsible for regulatory oversight in sectors with State owned enterprises are fully independent from the operator.

## 2.4. Regulatory tools and procedures

Well-functioning regulatory tools and procedures are needed to ensure the efficiency, transparency and accountability of the regulatory process. The 1999 Report expressed concerns about the lack of transparency and accountability in regulatory and administrative processes in Japan, and it noted the absence of a central overview of regulatory requirements and the absence of requirements for regulatory impact analysis. The Report recommended revisions of the Administrative Procedure Act in order to improve judicial reviews of administrative actions, to clarify what are permissible administrative actions, and to reduce the use of administrative guidance.<sup>19</sup> It also suggested the gradual introduction of a RIA system and the establishment of a central register for all regulatory requirements. This section reviews actions to that effect taken since 1999. It concludes on a positive note that very significant efforts have been undertaken, although some with mixed results. Policy commitments set out in the Government's March 2003 Regulatory Reform Programme demonstrate a continued drive to improve and adjust these deficiencies.

### **Transparency and predictability**

Transparency of the regulatory system is essential to establishing a stable and accessible regulatory environment that promotes competition, trade and investment, and helps ensure against undue influence from special interests. The issues are handled in most countries by administrative procedure laws, public comments procedures, and other transparency enhancing mechanisms such as consolidated regulatory registers.

*Administrative Procedure Law.* After years of debate, Japan enacted an Administrative Procedure Law (APL) in 1993, which became effective the following year. The APL prescribes uniform rules that are to be followed by all central government ministries and agencies. Among the requirements of the APL is that government agencies are to specify and make public the standards that they use to evaluate applications, and to specify standard processing periods for the granting of licenses, permissions and approvals. As the first Japanese law to apply disciplines to administrative guidance, the APL requires guidance to be put into writing, although only if requested by the concerned business/citizen, and not entailing any “extraordinary administrative inconvenience” (APL, Article 35). The Law also sets out as “general principles” that the agencies issuing administrative guidance should not exceed their authority and that compliance with the guidance is voluntary.

The APL has played an important role in improving administrative transparency and predictability. However as noted by the 1999 Report “the degree of progress in eliminating guidance as a regulatory tool is not clear”, and that “given the long history of the use of guidance, it seems likely that a robust process to monitor compliance with the APL by administrators will be necessary”. Similar concerns have been voiced repeatedly by national and international business communities. Keidanren, the EU and the United States remain worried about the continued prevalence of administrative guidance, both written and oral, and about the absence of efficient reviews of administrative decisions.<sup>20</sup>

The Japanese government has committed itself to review the APL as part of the implementation of its third Three-Year Plan for Regulatory Reform. The review will examine the rationales for making public comment mandatory by incorporating it into the APL. The review will also look at possibilities to strengthen requirements for written answers and disclosure of criteria for reaching administrative decisions. If implemented, properly monitored and enforced, these revisions are likely to further improve administrative transparency and predictability in Japan.

*Public Comment Procedures.* Japan’s Public Comment Procedure became effective on 1 April 1999. It requires central government entities to give advance public notice of proposed regulations, to provide an opportunity for the public to comment on them, and to take the comments into account when they prepare the final regulations. The measures subject to the Procedure include cabinet orders (*seirei*), ordinances of the Prime Minister’s Office (*furei*), ministerial ordinances (*shorei*) and notifications (*kokujii*), as well as guidelines applied uniformly in administrative guidance issued to more than one person (unless the guidance is not made public). The Procedure exempts a number of activities, including advisory council reports and recommendations and the development of bills that are to be deliberated by the Diet.<sup>21</sup> The period provided for public comments is to be approximately one month long, but the actual period is set by each entity. Following the conclusion of the public comment period, ministries and agencies are to finalise the regulation and make public their views on the comments, indicating where they changed the draft regulation based upon the comments.

The Public Comment Procedure has led to a significant increase in the number public consultations. In FY 2002, 399 Cabinet and Ministerial orders were made subject to public comments. In 1999 the number was 256. Government ministries and agencies incorporated comments into final regulations in 14.5% of the rules and regulations open for comment in FY 2002. All announcements of regulations for public comments as well as the comments themselves can be accessed from one government Internet portal.<sup>22</sup>

There are indications that the Public Comment Procedure has not fully met the objectives of improving the transparency and participatory aspects of the regulatory process. A survey from August 2003 by the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) showed that only about half of public comment periods in FY 2002 were at least 30 days. Ministries and agencies are complying with the letter of the procedure, but there is too little time for well-substantiated comments to be properly taken into account. Furthermore, the Procedure is not applicable to advisory council reports and bills prepared for the Diet. Many draft regulations received no or very few comments. One third of all drafts received no comments and around 40% between 1 and 10 comments. 25% received between 11 and 100 and around 5% received more than 100 comments. The level of participation seems to reflect a number of design and incentive issues, including the limited time available for public comments in many cases, as well as the fact that the public comment procedure is a new tool to which business and citizens need time to adapt.

Well functioning consultation mechanisms are contingent on an administrative culture that acknowledges the need and benefits of the government to provide a supportive and facilitating framework for the regulatory process. In the absence of such culture, the temptation to back up new systems of governance with old style administrative measures must be continuously resisted. The Public Comments Procedure needs to become an integral part of the regulatory process. The Japanese government is aware of and shares many of these concerns. The new Regulatory Reform Programme stipulates that consultation periods should be 30 days in principle. Government departments can shorten the period if considered appropriate. The reasoning for shortening the consultation period to less than 30 days should be made public. The new Regulatory Reform Programme also includes a commitment to review the Public Comment Procedure.

To further improve the Public Comment Procedure, the Japanese Government may want to include the following proposals in the review:

- Incorporate the public comment procedure into the Administrative Procedure Act; subsequently, the APA could:
  - ❖ require that all proposed rule making by regulatory agencies be made available for public comment;
  - ❖ establish a reasonable minimum comment period.
- Require that consultation documents include a Regulatory Impact Analysis (RIA).
- Ensure continued monitoring of the use of the consultation process by ministries and agencies. As a minimum, ministries or agencies failing to observe the requirements should be charged with the responsibility to publicly explain the reasons for failing to do so.

No-Action-Letters. The “No-Action Letter” (NAL) system was introduced by the Japanese government in March 2001 in response to the lack of transparency and predictability of regulatory agencies’ implementation and enforcement of regulations. The basic idea

behind the NAL system is that a regulated business entity with concerns about the interpretation of regulations, or about whether proposed practices would require a license or official approval, can seek advance clarification from the regulator. Potentially, the NAL system can significantly improve regulatory transparency and predictability, as it has the capacity to save companies time and money by giving advance guidance on planned business situations.

In its current form a response to an inquiry based on the NAL system *a)* is made from the position of having jurisdiction to enforce the laws and regulations subject to the inquiry, *b)* is premised only on the facts presented by the inquirer, *c)* is made only with respect to the relationship of the prospective business activities to the laws and regulations subject to the inquiry, and *d)* indicates a government department's opinion as of that present time.

Since the introduction of the system more than three years ago there have been very few official no-action letters (9 cases in FY 2001, and 14 in FY 2002). In 2003, METI, (regulating and enforcing regulations in the electricity and gas sectors) and MPHPT (regulating the postal and telecoms sectors) issued no NALs.

The lack of success seems to be due to a number of "design" issues as well to the continued preference of the Japanese bureaucracy – as well as many businesses – for reaching informal solutions and understandings. First, replies are not considered legally binding and there is no clear appeals or confirmation procedure. Each administrative agency has established its own guidelines. This might leave open the risk of inconsistent application and the degree to which a given ministry feels itself to be bound by its replies to requests. Second, there is no legal obligation to publish replies, thus depriving administrative bodies of a useful means of establishing, over time, a published body of reliable precedent. Third, the system is restricted in application to so-called "new business", rather than also permitting the clarification of regulatory issues involving existing products and services. Furthermore, the no-action letters system is not applicable to local government regulations. Fourth, oral replies are still allowed and informal consultations continue. Although such flexibility has its advantages, a continued pattern of informal rejection and/or pre-screening of no-action letters means that no body of interpretation is built up and made available to guide the public. Fifth, there seem to be reluctance among some ministries to use no-action letters. There is anecdotal evidence about cases where officials have orally discouraged the submission of no-action letters.

The introduction of the NAL system is a highly welcome development. However as mentioned above design flaws and implementation problems have limited the intended outcomes. The Japanese government should take measures to address these problems. One important aspect of these measures would include clarification and formalisation of the scope and procedures. However equally important are long term efforts to nurture general attitudes among regulatory authorities towards transparency and clarity, including proactive efforts to identify areas where clarification is needed.

As in the case of Public Comment Procedures, the Japanese Government is aware of and shares many of the concerns about the NALs. In its March 2004 Cabinet decision on a new Regulatory Reform Programme, the Government committed itself to make NAL requests and answers publicly accessible and to expand the scope of the NAL system to existing business activities. The new Regulatory Reform Programme also includes a commitment to review the NAL system.

To further improve the NAL system, the Japanese Government may want to include the following proposals in the review:

- Establish uniform government guidelines for administrative agencies' procedures under the no-action letter system – possibly within the context of the Administrative Procedure Law.
- Make no-action letters legally binding on the issuing administrative body.
- Establish guidelines and procedures allowing regulatees to have responses from government departments to requests for confirmation of previous NALs. Consider establishing guidelines allowing regulatees to appeal against a no-action letter.
- Create an easy accessible and exhaustive data base of no-action letters (this should preferably be created within the framework of an equally accessible and exhaustive database on all laws and regulations in force, see Section 4.3).
- Expand the scope of NALs to local government regulations.
- Expand the current efforts to encourage the use of NALs. This could include making clear that no-action letter requests are welcome, that all requests should be accepted for formal review by the regulator, and that responses – to the extent feasible – be made in writing.
- Expand the current efforts to monitor the implementation of the no-action letters. This could include considerations/assessments of whether consistent criteria are applied for the treatment of requests.

*Accessibility, registration and codification of regulations.* Access to the stock of flow of regulations is a fundamental measure to promote transparency. Registration and codification processes are often a necessary first step to understanding what actually exists in the regulatory system so that systematic reform can commence. Regulations' visibility engenders a new sense of responsibility and discipline by making apparent the size and scope of the regulatory system, as well as possible internal inconsistencies. Codification and accessibility therefore, can improve both juridical and substantive regulatory quality.

Japan has publication requirements for *new* regulations. All laws (*horitsu*), Cabinet Orders (*seirei*) and Ministerial Orders (*shorei*) became available on the Internet as of 1 April 2001 in addition to being published in the Official Gazette of Japan. Internal Orders (*tsutatsu*) remain unavailable through the Internet or the Official Gazette of Japan. Communication Notes (*jimu renraku*) and Administrative Guidance (*gyosei shido*) remain absent from both the Official Gazette of Japan and the Internet. The lack of mandatory transparency requirements regarding Communication Notes and particularly Administrative Guidance signals a continuing weak link in progress towards transparency within the Japanese regulatory system.

Although publication requirements are in place for the flow of most new regulations, there is no single authoritative source for the stock of laws and regulations. A single registry of existing regulatory requirements in Japan would significantly enhance transparency for users in terms of the content and form of permissible regulatory actions, and, as importantly, force a rationalisation of ministry rules.

### ***Understanding regulatory effects: the use of Regulatory Impact Analysis***

Regulatory Impact Analysis (RIA) is a policy decision-making tool that aims to ensure the choice of efficient and effective regulatory options. It is the most important and

frequently used quality assurance tool used by OECD Countries in the process of preparing regulation.

The 1999 Report reviewed Japan's RIA efforts on the basis of a list of OECD best practices, cf. Box 2.4 below. The report noted that RIA was in its infancy in Japan, and that there was no requirement for regulators to prepare RIAs. Until the spring of 2004 this was still the case. Prior to this, reviews of draft regulations by the Ministries of Justice and Finance ensured some quality controls, primarily of legal quality and state budgetary impacts. Furthermore, some ministries – on their own initiative – have been experimenting with *ex ante* regulatory impact assessments.

The new Regulatory Reform Programme endorsed by the Cabinet on 19 March 2004 marked an important step towards the introduction of a systematically applied RIA system

#### **Box 2.4. RIA best practices**

1. *Maximise political commitment to RIA.* Reform principles and the use of RIA should be endorsed at the highest levels of government. RIA should be supported by clear ministerial accountability for compliance.
2. *Allocate responsibilities for RIA programme elements carefully.* Locating responsibility for RIA with regulators improves “ownership” and integration into decision-making. A central body is needed to oversee the RIA process and ensure consistency, credibility and quality. It needs adequate authority and skills to perform this function.
3. *Train the regulators.* Ensure that formal, properly designed programmes exist to give regulators the skills required to do high quality RIA.
4. *Use a consistent but flexible analytical method.* The benefit/cost principle should be adopted for all regulations, but analytical methods can vary as long as RIA identifies and weighs all significant positive and negative effects and integrates qualitative and quantitative analyses. Mandatory guidelines should be issued to maximise consistency.
5. *Develop and implement data collection strategies.* Data quality is essential to useful analysis. An explicit policy should clarify quality standards for acceptable data and suggest strategies for collecting high quality data at minimum cost within time constraints.
6. *Target RIA efforts.* Resources should be applied to those regulations where impacts are most significant and where the prospects are best for altering regulatory outcomes. RIA should be applied to all significant policy proposals, whether implemented by law, lower level rules or Ministerial actions.
7. *Integrate RIA with the policy-making process, beginning as early as possible.* Regulators should see RIA insights as integral to policy decisions, rather than as an “add-on” requirement for external consumption.
8. *Communicate the results.* Policy makers are rarely analysts. Results of RIA must be communicated clearly with concrete implications and options explicitly identified. The use of a common format aids effective communication.
9. *Involve the public extensively.* Interest groups should be consulted widely and in a timely fashion. This is likely to mean a consultation process with a number of steps.
10. *Apply RIA to existing as well as new regulation.* RIA disciplines should also be applied to reviews of existing regulation.

in Japan. The Programme sets out the following framework and considerations for the future RIA system in Japan:

- With effect from 2004 all ministries and agencies must prepare RIAs on a trial basis.
- Requirements to carry out RIA will be mandated within the Government's Policy Evaluation Act.
- Consultations on regulatory proposals under the Public Comment Procedure should include RIAs.
- The CPRR and MPHTP will co-operate with individual ministries to prepare RIA guidelines and collecting experiences from ministries that have already carried out RIAs on experimental basis.
- To the extent possible, RIAs should be based on quantitative analysis. However it will be necessary to rely on qualitative assessments until proper methodologies have been developed.
- Prior to making RIA mandatory for all regulations, the government will specify a trial period and the conditions for reviews during this period.

The challenge is now to implement and make the RIA commitments operational. The Regulatory Reform Programme does not include considerations about this. The above OECD Best Practices for RIA could serve as an important guideline for establishing a RIA system in Japan. Furthermore, recent lessons from OECD countries suggest that particular attention should be devoted to the following issues.<sup>23</sup>

- *Keeping the momentum – ensure ministerial accountability.* It is not easy to keep political commitment to a procedural and technical decision-making tool such as RIA. Requiring ministers to “sign off” all RIAs under their portfolio, guaranteeing their quality and compliance with government guidelines, has proven useful in several countries.<sup>24</sup>
- *Sequence and target RIA efforts.* In efforts to target RIA efforts effectively, most countries have adopted procedures by which draft regulations – depending on their impact – undergo different assessments. Ideally, preliminary RIAs are required for all regulations with non-negligible impacts on business or the state budget, whereas more extensive tests are required for regulations with more significant expected impacts.<sup>25</sup>
- *Include effects on competition and trade.* OECD country reviews have demonstrated that coverage of competition policy and trade perspectives in RIA is often weak, insufficient and unsystematic. This could potentially lead to policy-decisions with an incoherent presentation of regulatory effects on trade and competition. The RIA system should be designed to include assessments of all relevant regulatory effects.
- *Monitor and publish compliance rates.* A centralised review and vetting system should be established with appropriate resources and mandate to carry out reviews and provide guidance to regulatory ministries when preparing RIA. Many countries have found that a central body is needed to oversee the RIA process and ensure consistency, credibility and quality. Regardless of the specific authority of a central body, publication of regulators' compliance with RIA requirement has proven to be an efficient driver towards better RIA standards (“shaming”).<sup>26</sup>
- *Evaluate RIAs.* As countries progress in their development of regulatory policies, increasing attention is put on assessing the performance of the applied regulatory tools. Evaluating RIAs allows for a review of its predictability and the transparency of the process, and for improving the design and implementation of the regulatory policy.<sup>27</sup>

### **Review and simplification measures: Keeping regulations up-to-date**

Regulations that are efficient today may become inefficient tomorrow, due to social, economic, or technological change. Most OECD countries have enormous stocks of regulation and administrative formalities that have accumulated over years or decades without adequate review and revision. OECD's 1999 Report praised Japan for the scope and ambition of its regulatory review programmes. This section looks at efforts to reduce permits and licensing and in simplifying administrative procedures.

*Review of permitting and licensing requirements.* Most regulatory review programmes since 1999 have had as their centrepiece the elimination of supply and demand balancing regulations. Conversion of *ex ante* permits and licenses to *ex post* notifications and report has been another key objective. Section 2.2 of this report noted the success in eliminating most supply-demand adjusting regulations. Despite these efforts and the success in eliminating most supply-and-demand regulations in many sectors, regular surveys carried out since 1985 have found that there is only a very limited reduction of *ex ante* permits and licenses as well as in the total number of permissions/authorisations at the national level, see Table 2.3 below.

**Table 2.3. Number of permissions/authorisations required at national level in Japan**

	1985	1990	1995	1998	1999	2000	2001	2002	2003
<i>Ex ante</i> permits and licenses	n.a.	n.a.	n.a.	5 782	5 989	n.a.	n.a.	5 394	5 591
Notification and reports	n.a.	n.a.	n.a.	4 880	5 126	n.a.	n.a.	4 749	4 930
Other	n.a.	n.a.	n.a.	455	466	n.a.	n.a.	478	486
Total	10 054	10 581	10 760	11 117	11 581	n.a.	n.a.	10 621	11 007

Source: The Government of Japan.

The basically unchanged level of permission/authorisations is somewhat surprising in the light of the parallel elimination of much supply-and-demand adjusting regulation. Part of this may be explained by deregulation. Activities that were previously forbidden or restricted are, after deregulation, permitted under certain conditions requiring permits. New health, safety, environment and business laws may also have required new permissions/authorisations. Moreover, the numbers do not reveal qualitative improvements.

However the steady flow of new *ex ante* permits (in the context of a reduction of supply-demanding balancing regulations) indicates that there are still opportunities and incentives to pursue traditional interventionist *ex ante* regulatory approaches at the expense of *ex post* notifications and control.

*Administrative Simplification.* As in many other OECD Countries, IT mechanisms have become a key driver behind efforts to reduce administrative burdens, but also to pursue broader objectives such as improved and more efficient government services.<sup>28</sup> Japan's e-government policy aims at promoting administrative reform and at making public services more efficient and user-friendly. The goal is to make all existing administrative procedures and transactions possible through the Internet. By April 2004, 97% of procedures handled by the national government (around 13 000) was available on-line.<sup>29</sup>

Administrative simplification – in addition to the impressive efforts to make administrative procedures transactions available on the Internet – could possibly be strengthened by establishing quantitative targets for the reduction of administrative burdens and by establishing mechanisms to measure the economic impacts of administrative burdens. Experience from the Netherlands and Denmark suggest that concrete targets for administrative burden reductions can create additional positive dynamics by exposing inefficient procedures and by focussing efforts towards the most costly practices.

## Notes

1. The role of regulatory quality is to ensure a regulatory framework in which regulations and regulatory regimes are efficient and effective and created through transparent and accountable processes.
2. This is also reflected in the 1997 OECD Report on Regulatory Reform, which recommends that countries “adopt at the political level broad programmes of regulatory reform that establish clear objectives and frameworks for implementation” and the 1995 OECD Council Recommendation on Improving the Quality of Government Regulation, which contains a set of best practice principles against which reform policies can be measured.
3. See OECD (1997). The OECD recommends as a key principle that “regulations should produce benefits that justify costs, considering the distribution of effects across society”. This principle is referred to in various countries as the proportionality principle, or, in a more rigorous and quantitative form, as the cost-benefit test.
4. Keidanren (2003), pp. 14-17.
5. The Special Zones are purely deregulation oriented and do not involve fiscal measures (such as preferential tax schemes).
6. Examples of proposals accepted on a nationwide basis include: relaxing qualification requirements for graduates of international schools to enter Japanese high schools and universities; relaxation of regulation on land ownership and assets to establish schools and universities; authorizing the payment of local taxes through private entities such as convenience stores. Examples of proposals rejected include: Allowing joint stock companies to run publicly owned schools; allowing foreign companies to operate domestic airlines; allowing nurses to exercise functions beyond core nurse functions; and allowing foreign doctors to operate on the domestic Japanese market.
7. MPHPT (2001), Standard Guidelines for Policy Evaluation.
8. The Program Assessment Rating Tool (PART) launched in the United States in 2002 has many similarities to the PES. Both evaluation systems – in principle – provide a framework for assessing regulatory performance in a broader “good governance” and policy performance context. Within PART, “Regulatory Based Programs” constitute one out of seven different types of Federal Programmes. Using PART, each resource management office (typically departmental level) of the Office of Management and Budget is obliged to evaluate all programmes under their portfolio over a five years cycle. PART is comprised of a number of assessment criteria on program performance and management. Most assessment criteria are identical for all programs, regardless of the tools applied. PART is focused on outcomes of programs. This allows for a comprehensive approach to assess program performance, i.e. by looking at the combined effect of program operations including, for instance, the effect of several regulatory measures to reach one particular policy goal. Under PART, all Federal programmes are rated on a scale from 0-100% according to the scores on four dimensions: Program Purpose and Design; Strategic Planning; Program Management, and Program Results/Accountability. Programmes are also provided an overall rating (i.e. effective/moderately effective/adequate/ineffective/results not demonstrated). These ratings are used to propose legislative revisions and new funding levels, as well as management or program improvements. See [www.whitehouse.gov/omb/part](http://www.whitehouse.gov/omb/part).
9. Azuma (2002).
10. According to the Standard Guidelines for Policy Evaluation: “In terms of reflecting the results of evaluation on the budget, each government office examines possible improvements and review of its policy based on the results of evaluation, and tries to reflect the results of the examination appropriately on its budget requests. Also, the fiscal authorities must try to use the results of policy evaluation appropriately during the process of formulating the budget.”

11. The reform established the Cabinet Office integrating the Prime Minister's Office, the Economic Planning Agency and the Okinawa Development Agency, combined with part of the Management and Coordination Agency, the Science and Technology Agency and the National Land Agency. It took up new powerful functions of drafting of plans and comprehensive coordination. Seven Directors General for Policy Co-ordination (*seikatsu-tokatsu*) are responsible for the horizontal coordination with and among the ministries.
12. See Noble, Gregory W. (2003): Reform and continuity in Japan's *shingikai* deliberation councils, in: Amyx (eds.) (2003), pp. 113-133.
13. Independent regulators are public organisations, created by legislation, with regulatory powers (i.e. enforcement, access approval, provision of licenses) operating at arm's length from ministries and the executive. Set out in public law, independent regulators are organisationally separate from ministries and have more or less narrowly defined regulatory functions in areas of policy implementation free of direct ministerial oversight.
14. MPHPT, communication with the OECD Secretariat, February 2004.
15. Op. cit.
16. Government of Japan (2003), pp. 6-7.
17. Op. cit., p. 8.
18. OECD (2003), pp. 130 ff.
19. Administrative guidance can be defined as "administrative actions taken by administrative organs, although without legal binding force, that are intended to influence specific actions of other parties [...] in order to realise an administrative aim" (Shiono). It has also been defined as "a varied and ill defined combination of informal techniques by which a ministry carries out its responsibilities and gets what it wants" (Bingham). The techniques of administrative guidance include recommendations, suggestions, requests and warnings. Source: OECD (1999) quoting Shiono, Hiros, in "Administrative Guidance" in Public Administration in Japan, pp. 221-235, and Bingman, Charles (1989) Japanese Government Leadership and Management, St. Martin's Press, p. 82.
20. The Government of the United States (2003), p. 53; The European Commission (2003), p. 11; Keidanren (2003).
21. The Government of Japan (1999), Sections 1.6 and 1.8.
22. <http://search.e-gov.go.jp/servlet/public>.
23. These observations are based on the findings of OECD's ongoing work on RIA, including the RIA Observatory, OECD (2004).
24. In Canada, Mexico and the United Kingdom ministers or deputy ministers are required to sign off RIAs before they go the Cabinet or Parliament.
25. **EU** adopts two step approaches. Preliminary RIA is required for all the proposed regulations. A central quality review body selects major regulations for which extended RIAs are required. **Australia** requires RIA for regulations which have business impacts. Business impacts arise in the case that proposed regulations: 1) govern the entry or exit into or out of market; 2) control prices or production levels; 3) restrict the quality, level, or location of goods and services available; 4) restrict advertising and promotional activities; 5) restrict price or type of inputs used in the production process; and 6) are likely to confer significant costs on business, or may provide advantages to some firms over others. In **Canada**, all significant regulatory proposals must undergo a cost/benefit analysis. A significant regulation is defined as one with a present value of costs greater than \$50 million or if it has a lower present value of costs and a low degree of public acceptance. In **Korea**, regulations with one of the following characteristics require quantification of cost and benefit: i) the annual cost imposed by a regulation is more than WON 10 billion; ii) the number of people affected is more than a million; iii) the regulation explicitly prohibits competition; or iv) the regulation is inconsistent with international standards. In **Mexico**, there are three types of RIA: "High Impact RIA", "Ordinary RIA", "Periodic regulation RIA". High impact regulations must provide detailed quantification of costs and benefits, whereas RIA requirements for other types of regulation are less cumbersome. In the **UK**, RIAs are required for regulations which have a non-negligible impact on business, charities, and the voluntary sector. Regulations with significant impact are reviewed by the Cabinet Office's Regulatory Impact Unit. In the **USA**, quantification of cost and benefit is required for major regulations. Major regulations are defined as: regulations that impose annual costs exceeding US\$100 million, possibly impose major increases in costs for a specific sector or region, or have significant adverse effect on competition, employment, investment, productivity, or innovation.

26. For example, Australia's Productivity Commission annually publishes a report on compliance with the Australian Government's requirements for the making and review of regulations, see [www.pc.gov.au/research/annrpt/reglnrev0203.pdf](http://www.pc.gov.au/research/annrpt/reglnrev0203.pdf).
27. See [OECD/PGV(2004)5] for a status of on-going OECD work on the evaluation of regulatory tools and institutions.
28. See OECD (2003b).
29. MPHPT (2004), [www.apectel29.gov.hk/download/eg\\_12.pdf](http://www.apectel29.gov.hk/download/eg_12.pdf).

## Bibliography

- Amyx, Jennifer and Peter Drysdale (eds.), (2003), *Japanese Governance, Beyond Japan Inc.*, Rothledge Curzon, London and New York.
- Azuma, Nobuo (2002), *Problems and Prospects of Policy Evaluation System of Central Government in Japan*, downloaded from [www.jbaudit.go.jp](http://www.jbaudit.go.jp).
- Cabinet Office (2003), *Special Zones for Structural Reform*, note prepared by the Office for the Promotion of Special Zones for Structural Reform, August 2003.
- European Commission (2003), *EU Priority Proposals for Regulatory Reform in Japan*, 16 October 2003, Brussels.
- Government of Japan (1999), *Public Comment Procedure for Formulating, Amending or Repealing a Regulation*, Cabinet Decision, 23 March 1999.
- Government of Japan (2003), *Current Status and Future Outlook on the Japan-EU Business Dialogue Round Table (BDRT)*, Recommendations, available from [www.eujapan.com/roundtable/progress\\_jap\\_jan2003.pdf](http://www.eujapan.com/roundtable/progress_jap_jan2003.pdf).
- Government of the United States (2003), *Annual Reform Recommendations from the Government of the United States to the Government of Japan under the US-Japan Regulatory Reform and Competition Policy Initiative*, 24 October 2003. Downloaded from [www.ustr.gov/regions/japan/2003-10-24-reform2.pdf](http://www.ustr.gov/regions/japan/2003-10-24-reform2.pdf).
- Grier, Jean Heilman (2001), *New Tools for Public Participation in the Japanese Regulatory System*. Prepared for Energizing Japanese Politics: New Tools for Citizen Participation 24 April 2001, Washington DC, downloaded from [www.jiaponline.org](http://www.jiaponline.org).
- Keidanren (2003), *Measures for the Promotion of New Regulatory Reforms Aimed at Establishing a Private Sector-Led, Self-Management Economic System. A Regulatory Reform Programme Based on the Nippon Keidanren Vision for Japan 2025*, 20 May 2003. Downloaded from [www.keidanren.or.jp/english/policy](http://www.keidanren.or.jp/english/policy).
- Ministry of Public Management, Home Affairs, Posts and Telecommunications (2001), *Policy Evaluation in the Japanese Government*, guidelines and other documents downloaded from [www.soumu.go.jp/english/kansatu/evaluation](http://www.soumu.go.jp/english/kansatu/evaluation).
- OECD (2003a), *Economic Survey: Japan*. OECD, Paris.
- OECD (2003b), *From Red Tape to Smart Tape: Administrative Simplification in OECD Countries*, OECD, Paris.
- OECD (2004), *The RIA Observatory*, a collection of RIA practices in OECD Countries, available from [www.oecd.org/gov](http://www.oecd.org/gov).

## ANNEX 2.1

*Implementation of the 1999 recommendations*

Recommendations of 1999 Review	Actions taken since 1999 Review	Assessments/recommendations
<b>I. Regulatory policies</b>		
Adopt principles of good regulation based on those accepted by Ministers in the 1997 OECD Report on Regulatory Reform.	Supply and demand adjustment regulations have been reviewed under principles of "eliminating economic regulations and keeping social regulation to a minimum" and "converting <i>ex ante</i> licensing to <i>ex post</i> control".	There is a continued need for a clearer and more comprehensive set of principles to guide reform measures. Similar review criteria should be applied to economic and social regulations.
Eliminate all "supply and demand adjustment regulations" by a specified date.	Supply and demand adjustment regulations eliminated in most sectors.	See above.
Regulatory reform should be expanded and accelerated through development of comprehensive sectoral reform plans containing the full set of steps needed to introduce effective competition, followed by rapid implementation and periodic, public evaluation.	The Three-Year Programmes for Regulatory Reform have been progressively more ambitious, moving toward more comprehensive sectoral reviews. Annual revisions ensure evaluation of progress.	Regulatory Reform activities remain based on an item by item approach. The adoption of concrete review and reform criteria may facilitate more comprehensive reviews and reduce the possibilities of vested interests to water down reform proposals.
Follow up regulatory reform decisions with implementing budget and organizational decisions.	Policy Evaluation System (PES) introduced in 2002. Enables in principle a clearer link between reform decisions and budgetary and organisational consequences.	Expand the PES to systematically cover regulatory performance; Enhance credibility of evaluations by strengthening third party evaluation and review by MPHT.
n.a.	Special Zones for Structural Reform.	Ensure that successful measures can be evaluated and applied on a national basis in a transparent manner and as effectively and expeditiously as possible.
<b>II. Regulatory institutions</b>		
Enhance the capacity of the Deregulation Committee for independent and comprehensive reform recommendations through such means as putting it under the direct control of the Prime Minister or by giving it legal authority to make recommendations.	The Council of Regulatory Reform established in 2001 within the Cabinet Office negotiates directly with the relevant ministries about regulatory reforms. Three-year mandate of the CRR – now renamed the Council of the Promotion of Regulatory Reform (CPRR) – renewed in March 2004.	The influence and capacities of the CRR have been significantly enhanced.
Broaden the mandate of the Deregulation Committee to consider the full range of government policies – beyond a narrow definition of regulation – that impede competition in the sector under reform.	The mandate of the CRR has been expanded to include broader economic issues social service provision and competition policy.	See above.
Expand and strengthen the analytical expertise of the Committee's Secretariat as an interim step to creating a permanent office on regulatory reform responsible to the prime minister.	The CRR has a staff of 30, recruited from the private sector and government ministries.	Establish a permanent unit in the Cabinet Office tasked with vetting the quality of new regulations, and ensuring efficient government co-ordination of the RIA process.

Recommendations of 1999 Review	Actions taken since 1999 Review	Assessments/recommendations
Separate regulatory from industry and policy promotion functions in key infrastructure sectors.	Policy and regulatory functions remain under the control of the relevant line ministries, although carried out by different units within the respective ministries. METI plans to study alternative administrative setups.	The separation of policy and enforcement functions within the same ministries seems to be insufficient to ensure regulatory independence. A more general approach is needed to provoke change across a broader front, and to ensure that institutions are designed on consistent principles of competition, transparency, and accountability for results.
<b>III. Regulatory tools and procedures</b>		
Define in a revised Administrative Procedure Law permissible regulatory activities and provide standardised administrative and legal remedies for those aggrieved by administrative action.	The government has announced a review of the APA. The review will examine the rationales for making public comment mandatory by incorporating it into the APL, strengthening requirements for written answers and disclosure of criteria for reaching.	If implemented, properly monitored and enforced, these revisions are likely to further improve administrative transparency and predictability in Japan.
Establish further checks on non permitted forms of administrative guidance by standardising legal due processes for those abused.	The government has announced a review of the administrative litigation system by 30 November 2004.	
Define the limits of ministry action in the foundation laws and laws delegating regulatory authorities to the public administration.	No action.	
Ensure the effective implementation of public comment procedures, and standardize procedures for openness for the advisory councils.	Introduction of Public Comments Procedure (1999) and No Action Letter system (2001). Government commitment to review and correct observed flaws in both.	Ensure that reviews address key concerns regarding transparency, communication and accessibility (see report for detailed recommendations).
Implement across the administration a step by step programme for regulatory impact assessment, based on OECD best practice recommendations, for all new and revised regulations.	Government decision on 19 March 2004 to establish RIA system.	Establish a RIA system on the basis of OECD Best Practices. Special attention to key design issues such as ministerial accountability; sequencing and targeting; including effects on trade and competition; monitoring compliance rates; ex post evaluation of RIAs.
Establish a centralized registry of all regulatory requirements.	Japan has publication requirements for new regulations, electronically available since 2001.	There is no consolidated overview of regulations in force. A single authoritative source for regulations should be established to enhance transparency and force a rationalisation of ministry rules.

## *Chapter 3*

# Competition Policy

This Report is part of the monitoring of developments since the 1999 OECD Report on Regulatory Reform in Japan (“1999 Report”), with particular attention to the implementation of its recommendations. Japan has made substantial progress in the most important competition policy areas that were highlighted in the 1999 Report. Key issues identified at that time included the scope of exemptions from competition law and non-competitive tendencies in regulation, including the penchant for administrative “supply-demand” balancing to control entry and administrative guidance to encourage industry co-ordination. the 1999 Report recommended that regulators and sectoral ministries, including those in traditional monopolies such as telecoms, electric power and transport, be given a mandate to support competition. For the competition enforcement agency, the Fair Trade Commission (FTC), the 1999 Report called for increasing its independent policy stature and improving its resources, more transparency in its decisions and reasoning and expanded co-operation with other enforcers. To expand the scope of enforcement, the 1999 Report recommended stronger private rights of action, which could be supported by ending the quota limiting the size of the legal profession. Finally, the 1999 Report called attention to the undeveloped linkage between competition policy and consumer issues.

This monitoring report follows the same outline as 1999 Report, dealing with substantive law and application, institutions, coverage and policy issues. The recommendations of the 1999 Report and developments related to their implementation since 1999 are highlighted in boxes. Progress in the reform of economic regulation is demonstrated by the removal from most sectors of supply-demand balancing as a consideration for controlling entry and the elimination of most exemptions from the competition law. Notably, removing the exemption for “inherent monopoly” has permitted the FTC to take more enforcement actions in regulated network industries. The FTC’s independence was underlined by moving it to the Cabinet office in 2003. The FTC has a new economic unit (the Competition Policy Research Centre) and substantially more resources, most of them dedicated to investigation and enforcement. A new law takes some steps against administrative tolerance of collusion, by giving the FTC with new powers to deal with official involvement in bid-rigging. Private suits are now authorised to seek orders as well as damages, and many have been attempted. The March 2004 Cabinet Decision concerning the 3-year regulatory reform plan shows continued government support for active competition policy to make markets function effectively.

Improving the enforcement of competition law is now a high priority. The FTC’s principal enforcement target for the last several years has been bid rigging, one of the most serious problems in the domestic political economy. Results have been mixed. A major prosecution that was filed in 1999 was finally concluded with convictions in March 2004. The next one to be brought was referred for prosecution in late 2003, against repeat offenders, and also resulted in convictions. A change in the law appears to have made sanctions much stronger, because the maximum fine for corporations was increased from JPY 100 million to JPY 500 million, but until prosecution becomes a more serious threat, the increase is a symbolic gesture. Repeat offences and the persistence of *dango* bid-co-ordination show that

deterrence still falls short, despite the efforts of the last 10 years to strengthen the system.<sup>1</sup> A Study Group on the Antimonopoly Act recently undertook a comprehensive review of the entire system of administrative and criminal remedies. The Study Group Report, issued in October 2003, recommended major reforms to the enforcement system. The most important would be to revise the system of financial penalties imposed in the administrative process, to authorise impositions that are more consistent with the sanctions that are being applied now in other major jurisdictions.

### 3.1. Substantive law and applications

The fundamental substantive rule of the Antimonopoly Act (AMA) prohibits “private monopolisation or unreasonable restraint of trade” (Sec. 3). In practice, the most important element has been the prohibition against restraints of trade, which is the strongest law the FTC can apply against horizontal price fixing and bid rigging agreements. Although horizontal price-fixing is considered anti-competitive “in principle” (by the FTC’s Guidelines), the FTC may still need to show that the restraint has been significant or that it has had some actual effect. This requirement makes enforcement more difficult than it is in jurisdictions with a true *per se* rule against horizontal price fixing.<sup>1</sup> Trade associations, a common location for horizontal restraints, are subject to a particular prohibition against imposing any “substantial restraint on competition”.<sup>2</sup> For nearly all other kinds of competition issues, the FTC relies principally on the section of the law that prohibits “unfair practices” (Sec. 19). Here the burden of proof is lower, but the only sanction the FTC can impose is an order to correct the violation. The FTC uses Sec. 19 for cases ranging from distribution restraints, discrimination and tying to refusals to deal and exclusion.<sup>3</sup>

The AMA also contains rules aimed at the particular risks to competition due to the positions of unusually large firms, but most of these rules are not used. There have been only 15 cases in more than 50 years invoking the AMA’s prohibition of “private monopolisation” (Sec. 3), which is analogous to other jurisdictions’ prohibition of abuse of dominance. It appears that the FTC typically deals with large-firm abuses as unfair practices. This approach, which does not involve extensive evidence about market power and effects, preserves enforcement resources for horizontal matters, but it may also be less effective at curbing monopolising practices than the prospect of fines or divestiture that enforcers can employ in Europe and the US. Restructuring and divestiture of monopoly firms appear to be authorised by the special rule for a “monopolistic situation” (Sec. 8-4), but this has never been used. Especially if this static, formalistic provision is repealed, consideration should be given to authorising divestiture and similar structural remedies in appropriate cases brought under Sec. 3, as the Study Group recommended.<sup>4</sup> Repeal of the “inherent monopoly” exemption from the AMA in 2000 has enabled the FTC to pay more attention to issues of network access. Notably, the FTC has examined claims that the incumbent telecoms firms were discriminating against entrants about ADSL facilities, services and pricing practices.

The Study Group Report included proposals for further changes to the law about dominant firms. The AMA’s rules about parallel pricing in concentrated industries have not proven to be useful or important in practice, and these should be eliminated. The other principal recommendation in this area was to authorise the FTC to order access to “essential facilities”. Although this basis for regulating discrimination and refusal to deal has parallels in several other jurisdictions, defining the circumstances in which a firm has a duty to deal with customers and with potential rivals is a complex and controversial task.

The issue is likely to receive further study before any formal proposal appears for new legislation. One common setting for these controversies is traditional “network” monopolies such as energy, telecoms and transport, but issues in many other industries, from financial services to software, can also be framed in the same terms. In principle, the FTC could already deal with such conduct under Sec. 3. To be sure, many cases about these subjects under Sec. 3 would be complex and time consuming, and remedies could be difficult to craft. There may be some controversy about whether Sec. 3 could support an order to restore or create conditions supporting competition, for example through information disclosures. The complexity of the issues and remedies are also reasons to proceed carefully in designing statutes to deal with the problems. Indeed, if the FTC brought more Sec. 3 cases against monopolising conduct, there would be a broader base of experience on which to draw for that purpose. The FTC might facilitate the process by developing guidelines about the interpretation of Sec. 3 in these circumstances.

Merger standards, as set out in the FTC's Guidelines, are being revised. The AMA's merger control rule prohibits mergers whose effect may be substantially to restrain competition in any particular field of trade. The current guidelines, adopted in 1998, describe structural conditions that would normally permit a merger to proceed without further inquiry: post-merger market share under 10%; or, under 25%, if the industry is not oligopolistic, the merged firm is not the top-ranked firm and entry, including through imports, is easy. On the other hand, the Guidelines imply that 3-firm concentration greater than 70% would typically be a cause for concern, for horizontal mergers. For vertical or conglomerate mergers, there are no structure-based presumptions or safe harbours. Proposed new merger guidelines were issued for comment in March 2004. Among other things, these would incorporate the HHI index that is used now in other major jurisdictions and set out general safe harbours based on market share and structure that would apply to all kinds of mergers.

The process of pre-notification consultation about mergers has been clarified. Under the statutory scheme, merging parties must notify the FTC of their plans and wait 30 days from that time before proceeding. After a size threshold was added to the AMA in 1998,<sup>5</sup> the number of mergers requiring prior FTC approval dropped by 90%. This notification and waiting process is not usually the occasion for examining and deciding upon the transaction, though; rather, application of merger control relies on prior consultation and negotiated correction where necessary, as parties to mergers that might raise problems seek to avoid the risk that the FTC will block their plans after they enter the formal statutory procedure. The FTC's December 2002 policy statement about consultation aims to clarify the informal process by setting a timeline for advising the parties whether a merger requires more serious investigation and possibly relief. These are targets, not legally binding deadlines on the FTC's actions. Nonetheless, this commitment represents a step toward the kind of 2-phase investigation process that is becoming standard in other major jurisdictions, and it seeks greater transparency. A condition for following the consultation process set out in the policy statement is that the parties agree that the FTC will explain its action publicly at the end of the process, even if it advises the parties that it has problems with their proposal.

Unfair competition is an important part of the FTC's work; some, but not all, of this enforcement agenda is related to consumer protection. Under the AMA, the FTC has many cases about sales at prices that are “unjustly” low, which are typically competitor complaints about their rivals' price-cutting. Most cases against “unjust low price sales” are

### Box 3.1. Transparency

**Publicise actions and reasoning, to educate the public and the business community about the effects and benefits of competition policy and law enforcement.**

Already in 1999, the FTC was taking steps to deal with long-standing concerns of lack of transparency, by issuing detailed, updated guidelines based on its actual decisions, and by devising ways to explain to the public the cases it has disposed of without formal decisions. The Report urged the FTC to continue its efforts to explain its decisions and to open up its own regulatory process, in part to be a model for other ministries to study. Detailed explanations of FTC decisions would assist businesses in understanding their obligations and develop public support for competition enforcement by demonstrating how it protects the public interest.

The results of this effort become clear in 2001, when the extent of information announced about FTC actions and policies increased notably, particularly for non-Japanese observers. Mergers are a matter of particular interest. Because the review process is non-public, it had been difficult to identify transactions that might have been rejected. There has only been one formal FTC decision rejecting a merger in more than 35 years. Increasingly since 1999, the FTC has tried to publish outlines explaining its treatment of merger matters. In 2002, for the first time, the FTC issued a release in connection with a consultation in which it told the parties that it had concerns which caused the parties to abandon their plans. The proposed consolidation would have produced a near-monopoly in certain key components of paper-making machinery; on hearing that the FTC would object, the parties withdrew their application. The FTC also issued several other releases in 2002 explaining corrective measures and undertakings that it had negotiated in connection with mergers that were ultimately permitted.

An important part of the new consultation process is that the FTC wants to make its actions public – something that merging parties themselves may not want, even though it is valuable for the public at large. The merger consultation process and the basic statutory review process are consistent with the “No-Action Letter” system that the government introduced in 2001, to encourage prompt, public responses to requests about application or interpretation of laws and regulations.

about sales below invoice price, most are resolved by warnings or cautions, and most involve the liquor industry – in 2001, there were 2 500 in that sector alone – and gas stations. The FTC explains its disproportionate attention to the liquor industry, which includes formal guidelines about price cutting, because prices in that sector were deregulated in 2000, and the industry was struggling to adapt to the new conditions. The FTC enforces legislation to protect small businesses by preventing abuses of bargaining power in subcontracting transactions. The Premiums and Misrepresentations Act regulates misleading advertising and unjustifiable premium offers by treating them as a form of unfair competition. Even against misrepresentations that actually harm consumers, an order is the strongest remedy the FTC can impose in these cases.<sup>6</sup> Applying the Premiums and Representations law involves a degree of industry self-regulation, through nearly a hundred fair trade associations and their fair trade codes. The FTC authorises and monitors these institutions and attends their annual meetings. They have been used to establish industry-wide standards about what practices would be considered fair under this legislation; the FTC would like them to concentrate on consumer protection and complaints about misleading advertising.

**Box 3.2. Consumer-competition policy link**
**Establish a clear, public, effective relationship between consumer policy and competition policy**

The 1999 Report recommended that competition policy be connected more clearly to consumer policy. This might require setting up a stronger authority for consumer protection matters. Alternatively, the relationship might be underscored by assigning to the FTC the responsibility for implementing a market-oriented consumer protection policy complementary to the AMA. The Report noted that this could be built on the FTC's responsibility for special statutes, such as those concerning premiums and representations, and on provisions of the AMA that can be conceived in terms of consumer protection policy.

Japan does not yet have a comprehensive consumer protection law or enforcement authority, other than these functions of the FTC. To the extent there are agencies and NGOs with interests in consumer issues, there has been some effort to recognise common interests and co-ordinate actions. The Study Group on Consumer Transactions made some proposals in 2002 of items that the FTC ought to address in the context of consumer transactions. And there have been some exchanges with the “quality of life” policy bureau and the National Consumer Affairs Centre of Japan about consumer transaction issues. New provisions about consumer protection are under consideration.

### **3.2. Institutions and processes**

The FTC was created as an independent body. For several years, the perception of its independence was compromised by its position as an external organ of the Ministry of Public Management, Home Affairs, Posts and Telecommunications. The issue became more acute as changes in law meant that FTC could take more enforcement action in industries that this ministry regulates. To overcome that perception of conflict, and to re-enforce the FTC's enforcement independence, in 2003 the FTC was made an “extra ministerial body” of the Cabinet Office.

The FTC has concentrated its attention on the violations which cause the greatest economic harm, namely horizontal cartels and bid rigging. The FTC has tried to keep abreast of novel policy challenges, such as competition issues in areas subject to social regulation, sectors undergoing deregulation and problems of high technology and intellectual property rights. A special unit about information technology and public utility businesses was set up in the Investigation Bureau in 2001; this unit has produced cases in electric power, bus transport and telecoms. But traditional topics remain the mainstays of its enforcement practice. The most common complaint received at the FTC is about excessive discounts in retailing (that is, “too much competition”), while the most frequent target of actual enforcement action is bid-rigging in construction. The number of formal actions peaked in 2001, at 42. Since 1999-2000, the annual total of sanctions imposed (as surcharges) has dropped substantially – from JPY 18 433 million to only JPY 2 700 million in 2002 – perhaps because parties are insisting on taking cases to full hearings rather than pay the surcharge demanded.

Some aspects of the administrative enforcement process seem informal, but that represents a realistic accommodation to the delays and costs of full proceedings. Most

### Box 3.3. FTC status

#### Increase the visibility and impact of FTC participation in policy-making

Establishing a forum for discussing and clearly deciding about matters that affect competition in the context of overall economic policy is critical for reform to succeed. The 1999 Report called for the FTC to become in fact what it is in theory, the principal “horizontal” authority responsible for assessing as well as applying competition policy. This would require preserving the FTC’s independence from political direction while permitting it to take a more central role in policy formation. The Report suggested that the FTC could build on its then-current roles under the deregulation program and the Deregulation Council, as well as its existing statutory responsibilities and opportunities for consultation.

The move to the Cabinet Office implies a potentially stronger role in government-wide reform. That prospect is probably more important than correcting the appearance of conflict in its previous position attached to the ministry. But it remains a promise, as the FTC role in policy matters appears to be about the same now as it was in 1999.

Other organisational connections to reform, notably to the Council on Regulatory Reform, also remain works-in-progress. Although there had been discussion at the time of the 1999 Report about a formal relationship between the secretariats of the FTC and CRR, that was not actually put in place. The relationship between the 2 institutions is nonetheless good. The CRR Report issued 2 years ago recommending strengthening the FTC led to the Study Group Report and the proposals about enforcement that are now under consideration. The new regulatory reform structure again envisions a connection with the FTC. The chairman of the FTC would be a member of the government “headquarters” unit, supporting the advisory board.

Although the FTC will be involved in the new reform format, some consider it more important to participate in the behind-the-scenes inter-ministerial consultations. It may be that low-key, non-public advice can achieve results on particular projects and build trust within the bureaucracy. It does little, though, to develop public awareness of the relationship between regulation and competition.

enforcement orders and financial sanctions are imposed through “recommendation” decisions, which are issued when the parties do not contest the FTC’s claims and proposed relief. If the respondent rejects the recommendation, the case goes to a hearing process, presided over by another official (or even the FTC itself) in order to separate the functions of prosecution and decision-making. The hearing process can take 2 years or more to produce a decision by the FTC, which might then be appealed in court. The full hearing process takes too long for time-sensitive matters such as complaints about network access; because delay is intolerable, these must often be resolved with only a non-binding warning. Parties are increasingly demanding hearings in order to contest surcharge calculations. There were over 150 hearing cases pending at the end of 2003, compared to 35 in 1998 and 91 in 2002. The Study Group made proposals to streamline proceedings, and several are included in the plans for amendment that the FTC announced in April 2004. One would be to streamline the process, eliminating the “recommendation” step and moving directly to an order; this would entail creating some additional due process protections for parties at that stage. To reduce somewhat the party’s incentive to appeal

**Box 3.4. FTC resources**

**Improve the FTC's economic and legal resources, to enable it to undertake more sophisticated merger and monopoly enforcement, prepare more successful cartel cases and resolve market access problems**

To support increased FTC attention to cartels and bid-rigging, and also to do economically sophisticated cases about mergers and dominance, the 1999 Report recommended that the FTC deepen staff expertise and improve the mix of skills, with greater emphasis on both economic analysis and on investigative and legal techniques.

Overall, the resources available for competition enforcement have continued to increase. The FTC's budget has grown more quickly than that of the government as a whole. Even so, they may still be insufficient, in kind if not in amount, for dealing with an economy as large as Japan's. The budget for FY 2004 calls for an FTC staff totalling 672, compared to about 607 in 2002 and only 478 in 1991. Most of the additional staff hired in the last few years have been investigation officials. Not all are involved in competition policy and enforcement, though, because the FTC is also responsible for deception, marketing and subcontracting cases. The FTC contends that it still needs several hundred more people for AMA enforcement. Government-wide administrative reform policies impose ceilings on staff increases, so the FTC would need to justify an exception from the ceiling on the grounds that it would be consistent with the purposes of the reforms.

More important than the number of staff, though, is their expertise profile. This is improving, but here too more remains to be done. The FTC still has only a few graduate-degree economists on its staff. To facilitate contacts between the FTC and academic experts, in 2003 the FTC established the Competition Policy Research Centre within its General Secretariat. The head of this Centre is Prof. Kotaro Suzumura, of Hitotsubashi University. It is staffed now by eight economists and six legal scholars. the 1999 Report also suggested bringing in experienced prosecutors and other legal experts. A judge is now assigned to be the vice-chair of hearing bodies. In addition, the FTC staff now includes 3 prosecutors, seconded to the FTC to work on investigations and litigation, plus 3 attorneys to work on hearings and one to work on litigation.

simply to delay payment of surcharges, interest due on the amount imposed would accrue during the appeal. And the FTC's orders would be backed by stronger sanctions against companies that violated them.

### **Sanctions for violations and proposals for reform**

The enforcement system has many elements, some of them not very effective. The FTC's own proceedings can result in cease and desist orders ("elimination measures"), and, for certain violations involving effects on price, in a financial imposition, termed a "surcharge". If a case is referred to the prosecutor, at the end of the criminal trial a court could impose criminal fines or even imprisonment. Parties can seek civil damages, and they can now seek court orders too. And there are some special remedies for particular settings, such as termination of subsidy payments and disqualification from bidding. Thus, the law seems to threaten violators with many consequences. Yet reluctance actually to impose large sanctions means that deterrence is weaker than would appear. The 2003 Study Group Report focussed on this issue. In December 2003 the FTC released an

### Box 3.5. International co-operation agreements

**Improve capacities to address international competition problems by reaching agreements with other countries on co-operation and enforcement**

The 1999 Report recommended greater use of bilateral co-operation agreements with other major international competition agencies. Without clear arrangements with the enforcement authorities of its major trading partners, the FTC will be at an increasing disadvantage in taking accurate, timely action in enforcement matters with significant international dimensions.

Since then, Japan has reached agreements with the US (1999), Singapore (2002) and the EC (2003), and is discussing agreements with others, including Canada. The agreements typically call for notification, co-operation, co-ordination, request for enforcement action and consideration of the important interest of the other government. Such agreements are clearly leading to expanded co-operation and co-ordination with other enforcers. In one world-wide price-fixing investigation in 2003, searches and interviews were co-ordinated among enforcement officials from Japan, the US, Canada, and the EC (Hammond, 2003).

outline of its response to the report, which was followed in April 2004 by a more specific proposal for amendments to the AMA to strengthen sanctions and investigative powers.

The principal change would be to increase the surcharge that the FTC can impose. This imposition is analogous to the administrative fines that are applied by many other competition enforcers. It is one of the most important remedial measures the FTC can employ. Surcharges are exacted for violations such as price fixing and output restriction. The surcharge is computed as a percentage of the firm's sales of the affected product during the period of the restraint. The rate is fixed by statute, and the FTC has no discretion to vary it, regardless of any other factors in the case or of the firm's actual "unjust" profits from the violation, even though the surcharge was first conceived as an administrative measure to recapture such profits. This system has advantages of certainty and simplicity, which probably make enforcement more efficient. When the surcharge system was first adopted, the rate was so low – only 1.5% – that the surcharge looked like a cartel license fee. The current rate, of 6% of covered commerce, still looks low by international standards. Deterrence is weakened further by reductions in the rate for violations by small business (to 3%) and in retail (2%) and wholesale (1%) trade.

The Study Group Report recommended raising the surcharge rate, although it did not recommend a particular level. The FTC's April announcement proposes that the current rates be approximately doubled. The rate would still be applied only to the commerce affected by the violation. Rates applied to small businesses and to wholesale and retail trade would also be increased, but they would remain below the basic rate. The FTC also proposes to add about 50% to the surcharge for repeat violators.

Amendments may also apply surcharges to a wider range of AMA violations. Now, the surcharge remedy applies to restraint-of-trade violations that are related to prices, including those that affect price by controlling output. The FTC proposes that surcharges would be applied to a wider range of violations of Sec. 3. These would include restraints of trade about price, volume, market share or customer allocation. It would also be applied to

purchasing cartels. In addition, surcharges could be imposed against those types of “private monopolisation” that, by controlling other firms, had the same price-related effect as a hard-core cartel. Fines or surcharges could be appropriate for especially egregious acts of monopolisation. This would be appropriate when applied to restrictions or exclusionary tactics that have the effect of maintaining non-competitive market conditions. It seems clear from the Study Group Report and the FTC’s subsequent proposals that surcharges are not being considered as a remedy for simple exploitation of market power by charging supra-competitive prices.

Proposals to change the surcharge system have revived questions about the system’s rationale and jurisprudential foundations. It would be unfortunate if extended debate over these issues delayed necessary strengthening of the sanction system. In concept, surcharges are an administrative measure to control or prevent conduct contrary to the AMA rules. Because the current rate is not doing so effectively, the Study Group recommended raising the rate for that purpose. The Study Group Report argued that the existing rate collects the benefit to the party, that is, the unreasonable profits, and that raising the percentage will improve deterrence by making the surcharge higher than the party’s gain from the violation. This implies a belief that 6% is a sound estimate of the likely unreasonable profits from violations. The reported experiences of OECD members about hard-core cartels indicate that gains from collusion are often much higher than 6%. A financial imposition that is greater than the gain to the violator is consistent with economic theory about deterrence, to correct for the possibility that the violator could avoid detection. To reach a level that deters effectively, the rate needs to be much higher than 6%.

The relationships among the surcharge system, criminal penalties and private damages recoveries have drawn attention. The Study Group Report contrasted a “sanctions” system, involving discretion in setting the level of the sanction, considering the violator’s culpability and the losses incurred and correcting for the likelihood of detection, with the “administrative” fixed-rate surcharge system, which is intended to have the same practical effect of economic deterrence of violations but is simpler and more certain. Because setting the surcharge by reference to unjustified gain might make it resemble the criminal sanction, the Study Group called for changing the conceptual basis of the surcharge, from taking back “unjust” profits to recovering the losses inflicted on society, including social losses from consumption foregone or distorted. Yet the Study Group Report argued that surcharges based on losses incurred by victims and society will not duplicate civil damages. The original motivation of the surcharge system in 1977 was the confiscation of unjust enrichment, to distinguish it from the criminal penalty that was already in place. The Study Group Report’s concept of recovering the social loss is also a means of distinguishing the surcharge from the criminal penalty. Of course, an objection to imposing sanctions and criminal fines in the same case on grounds such as “double jeopardy” could be overcome by making some appropriate adjustment, such as applying one sum as a credit against the other. The FTC’s April announcement calls for deducting half of any criminal fines from the surcharge imposed in the same matter.

Offsetting fines would not usually make a significant difference to the surcharge. Surcharges are a much more substantial financial deterrent, because surcharges can be much larger than fines, even at a rate of only 6%. A fine may be levied upon conviction in a criminal trial for violation of Sec. 3 or for a restraint imposed by a trade association. The highest possible fine, JPY 500 million (for an organisation, such as a company), is commensurate with fines that apply to other economic crimes in Japan, but it is

substantially lower than fines being imposed in many other jurisdictions now against price fixing conspiracies. Individual violators might also be punished by up to 3 years in prison and a JPY 5 million fine. The practical deterrent effect of these theoretical punishments is hard to identify, because there are few criminal cases, so fines of any magnitude, against companies or individuals, are rarely imposed. Since 1990, 6 cases have resulted in fines; the highest total fines imposed in a single case, against all defendants, was JPY 130 million. Prison sentences are even rarer, and execution of sentence has always been suspended. No one has ever gone to jail for violating the AMA.<sup>7</sup>

To make enforcement effective, sanctions must be credible. A rate about double the present level would still be lower than the cap on fines in most other jurisdictions. Because the surcharge percentage is a fixed amount, it is not directly comparable to those percentage-based caps on discretionary fines. The fines that are actually imposed in those other jurisdictions are usually well below those caps. Nonetheless, comparison suggests differences in conceptions of effective deterrence. In the systems commonly found in Europe, administrative fines can be as high as 10% of total firm turnover, not just of the commerce affected. In the UK, fines can be up to 10% of turnover over the period of the violation (up to 3 years). Korea, which also conceives its administrative fine as a surcharge, intends to increase the rate to 10% of covered commerce. In several countries, sanctions may be based on the gain from the violation or the harm it caused, estimated in the individual case. In the US, the fine may be up to 2 times the gain or the loss; in Germany and New Zealand, the fine may be up to 3 times the gain. Increasing the rate in Japan will bring it more into line with these levels of deterrence.

A figure well above 10% of covered commerce could be justified, given the difficulties of detection and proof as well as the likelihood that gains and losses due to hard-core conduct are significantly greater. Reports from OECD Members about their experiences are instructive. The Netherlands imposed a fine that amounted to about 18% of covered commerce against a cartel in veterinary medicines; Germany, of 12% against a concrete cartel; Canada, from 11% to 20% against cartels in citric acid, lysine, vitamins and sorbates; EC, 11% against a cartel in graphite electrodes; US, 46% against a cartel in marine construction.<sup>8</sup> If harm resulting from the cartel is the conceptual basis for setting the level, and the harm is typically greater than the gain to the violator, and the gain to the violators from hard core cartels is typically at least 10-15% of turnover (an estimate that is supported by OECD surveys of its members' experiences), then a fixed level of 10% of covered commerce would be on the low side.

### Criminal process

Criminal penalties are employed to some extent, but the threat does not yet deter effectively. For several years, the FTC has announced a "crack down" on horizontal violations and a general policy of seeking criminal penalties against them.<sup>9</sup> Over the 40 year period before the FTC announced a stricter policy in 1990, there had been only six criminal cases; despite the higher priority, there have been only seven more since then. And at the end of the process, serious sanctions have not been applied. In the 7 cases referred since 1990, over 60 individuals were prosecuted, but execution of all of their sentences was suspended. The largest fine against a company was 80% of the statutory maximum that was then allowed (JPY 100 million). That level was reached for the first time in the 2004 jet fuel case. Ineffective deterrence invites repeated violations. The firms that were recently convicted of rigging bids for municipal water meters had previous convictions.

The capacity to prosecute price-fixing violations of the AMA appears constrained. Before the recent water meter case, the last criminal case had been filed in 1999, and it was not decided until March 2004. To be sure, it was a substantial case, against 11 firms and 9 individuals for rigging the bids to supply jet fuel to the Self Defence Agency, and all the defendants were convicted (except one firm that had gone out of business in the meantime). The Board of Audit, which uncovered this scheme in its oversight of the procurement office's role in it, estimated it resulted in losses over three years totalling JPY 49 billion – a figure that is several hundred times larger than the fines that were ultimately imposed. The FTC is now pursuing dozens of bid rigging matters every year. But the prosecutors evidently can only handle one AMA case at a time.<sup>10</sup> That capacity should be expanded, if the AMA's criminal penalties against horizontal cartels and bid rigging are to be applied credibly. This will require overcoming two sets of problems: prosecutors have been reluctant to accept referrals and the FTC operates under handicaps in getting the necessary evidence. (Boling, 2003)

The FTC has sole discretion to refer a matter to the Public Prosecutor General, but it cannot prosecute itself. The referral process begins with dialogue between the FTC and the prosecutors' office, to explore whether there is enough evidence to convict, applying a "no ordinary man would doubt" standard. If it appears likely that this standard would be met, the details of the referral are worked out and it is then approved by the FTC. Criminal AMA cases are handled by the Tokyo High Public Prosecutor, which does the criminal investigation with the aid of the Special Investigations Bureau of the Tokyo District Public Prosecutor, which specialises in white collar crime and corruption cases. But the FTC's evidence is usually the core of the case (although for prosecution, much of that evidence must be re-assembled pursuant to the procedural requirements of the criminal law).

Prosecutors appear to have been wary of the risks of competition cases. A 2001 report about the AMA by the Research Council on Corporate Crime, set up under the Research and Training Institute of the Ministry of Justice, speculated that competition values are relative and matters of convention, that is, that violations of the AMA are not like real crimes. In addition, the report observed that seeking criminal penalties looks like redundant effort, crowding out higher priority prosecutions, if surcharges are also imposed. The FTC has difficulty obtaining the kind of evidence that could overcome scepticism. Notably, the FTC cannot prosecute refusal to comply with its investigative demands. Even if the FTC can nonetheless obtain evidence that meets its standard for administrative relief, it probably cannot get enough to meet the standard for criminal conviction. Moreover, prosecutors in Japan appear wary of taking on uncertain cases. The rate of successful convictions (for all crimes) is over 99%, Thus they may be particularly wary of trying to prove price-fixing violations, where prospects for conviction are complicated by the lack of a clear *per se* rule against the practice.

Despite the problems, the possibility of criminal prosecution is likely to be retained. The Study Group Report strove to make its analysis consistent with imposing criminal penalties against "heinous, serious cases" for which administrative disposition is considered insufficient. The Study Group Report recommended several technical legal changes to make the criminal enforcement process more flexible, in particular, expanding the venues where cases may be filed and thus making the process in competition cases look more like the process that is used to prosecute other kinds of crimes. The FTC's April proposal calls for authorising compulsory investigative measures for criminal

investigations and for expanding venues so criminal cases could be tried in district courts (so that the Tokyo High Court would not be the first instance venue).

### **Leniency programs**

The FTC has been considering whether and how to adopt a formal leniency program, offering lower sanctions to violators who come forward early, to make enforcement more effective. A prerequisite for a leniency program is usually some means of varying the sanction, so that the enforcer can be lenient in appropriate cases. For example, leniency might in theory take the form of reducing or forgoing surcharges for one company. This is difficult if the surcharge is conceived as a fixed, administrative charge. Nonetheless, since Japan's criminal law does not usually countenance the use of leniency in this fashion, a leniency program would have to be applied in administrative proceedings. One approach could be to create a true "administrative fine" sanction under the AMA, similar to sanctions applied in some other areas such as tax law. Another approach could be to extend leniency to individuals, by not recommending prosecution, in order to obtain evidence about corporate violations. A general measure to protect "whistleblowers" against retribution from their employers is being considered in the Diet.

The Study Group Report recommended a leniency program in connection with the surcharge system and proposed ways to implement it. The law would set a lower surcharge rate (even 0) for a company that voluntarily informed the FTC of its conduct before the FTC was investigating and that voluntarily ceased that conduct. Other issues and procedures would be specified in guidelines and FTC policies. Consistent with aspects of effective leniency programs that have developed in other jurisdictions, the program would make clear that total immunity from the surcharge could go only to the first party to come in; those who come in later could get some reduction for co-operation. To ensure that leniency concerning surcharges is not inconsistent with the potential to apply criminal penalties, it may be necessary to make clarifications about criminal liability in the statute too, although that result might be achieved by an FTC promise not to refer for prosecution. The FTC's April announcement includes plans for immunity or reduction in surcharges under conditions to be defined in the statute.

### **Private initiatives**

Public enforcement of competition law is complemented, in theory, by private rights of action. To recover damages, an injured party may file suit under a special provision of the AMA, as well as under the more general provisions of the Civil Code.<sup>11</sup> A claim for damages under the AMA's special provision is only possible after the FTC has found a violation, either after a hearing or through a "recommendation" decision. The private party can then use the decision of the FTC (and the evidence from the hearing, if there is one) to support its claim; an FTC finding of violation means the violator cannot try to avoid private liability by claiming its conduct was not wilful or negligent. Despite these intended advantages, the cases have proved difficult to win. In theory, the recovery appears to be nearly automatic, but in practice, the courts have erected hurdles concerning proof. Moreover, the FTC rarely issues a formal decision with record and opinion providing detailed evidence on which private litigants could rely, although the FTC has been willing to respond to plaintiffs' requests for materials to use in court. Some recent reforms have tried to make private remedies more effective.

**Box 3.6. Private litigation**

**Strengthen rights of private action by providing for injunctions in independent private suits, easing the proof of damages in competition cases, and facilitating consumer and customer recoveries in price-fixing cases. The quota on new lawyers should be eliminated**

The 1999 Report argued that these steps would apply more resources to competition policy issues, expand the base of support for it, and enlist other institutions in developing important policy principles.

A new kind of private relief is now possible under the AMA. Consumers or business may seek an order to correct or prevent unfair practices (that is, violations of Sec. 19) and restraints imposed by trade associations. These suits may not seek damages, though, and there are some controls to discourage frivolous litigation. These cases are filed in local district courts, which must advise the FTC of the filings and may seek the FTC's views about them. The legislation that created this new remedy also improved parties' ability to collect damages after an FTC final decision. Since the new injunction remedy became available in 2001, there have been 25 cases (as of 1 May 2004), mostly about distribution restraints. Plaintiffs have lost the final judgments that have been issued to date, but at least one suit was settled. The new type of action is likely to be useful as an outlet for claimants who cannot persuade the FTC that their problems are serious. But it may be used for important matters, too.

And there has been some action to remove the restraints on the legal profession. The number of new lawyers admitted through the traditional process, based on examination, is increasing. Currently 1 500 in 2004, the plan is to reach 3 000 by 2010. In addition, a new legal education system was introduced in 2004, involving law schools, examinations, and legal apprenticeship. A kind of lateral-entry expansion may also develop, if partnerships between foreign and domestic lawyers are permitted.

### 3.3. Coverage of competition law and policy

Overt or implicit interference in competitive markets through administrative guidance and other channels of official influence appears to be declining, but changes are difficult to identify or measure. If a government entity is involved in anticompetitive conduct, it remains difficult to correct it with the AMA unless the activity is organised through a commercial enterprise. But not impossible: there have been several cases over the years using the AMA to examine such activities as management of a slaughterhouse by a municipality, sales of New Year's cards by a ministry and price surveys done by an incorporated foundation connected to a ministry. The sensitivities raised by applying competition law to official conduct are illustrated by the modesty of the improvement made through the new law, effective in 2003, about public officials' responsibility for or complicity in bid rigging. The FTC can order the procuring agency to investigate the situation, and it can require the agency to take disciplinary action against the individual official involved and to demand indemnity from the official (after the agency's own investigation). But the FTC has no power to issue a fine or other sanction against the agency or the official. If the agency denies the FTC's requirement or order, the only consequence it faces is the embarrassment of bad publicity.<sup>12</sup>

**Box 3.7. Administrative guidance**

**Target enforcement on practices that have been tolerated or promoted by informal administrative guidance, to reinforce the shift in regulatory philosophy away from central direction**

Because a central goal of the reform agenda should be to end anti-competitive co-ordination sponsored by Ministries, the 1999 Report called for exemplary enforcement actions to implement the principles set out in the 1994 FTC guidelines about administrative guidance. Beyond consulting with other ministries and asking them to stop encouraging or tolerating non-competitive behaviour, the Report recommended applying effective and visible sanctions to private parties who try to use the cover of ministerial authorisation in order to prevent competition. FTC oversight of trade association activities, where much of the impact of administrative guidance is felt, must be maintained and even intensified.

The 1994 Guidelines are still in place, and a Cabinet Decision in March 2003 reminded the relevant ministries and government agencies that, bearing in mind the aim of the Guidelines for Administrative Guidance under the AMA, they should have sufficient prior consultation with the FTC to ensure that government regulations are not replaced by anti-competitive administrative guidance after deregulation. The FTC does not report any new, significant cases in recent years challenging conduct that the parties claimed should be excused because it was undertaken pursuant to administrative support or instruction. Perhaps because of reforms there have been fewer problems than the 1999 Report suggested. Or, perhaps it is still too difficult to take these problems on through enforcement action, because ministries that interfere with markets are still powerful and the firms affected by the interference are still reluctant to complain.

Reduction in the number of statutory exemptions from the AMA represents a substantial reform of competition policy. The list of explicit exemptions is not unusually long now – once there were over a thousand – nor are the items that remain exempted particularly unusual. Exemptions for exercise of intellectual property rights and agricultural co-operatives resemble those found in nearly all members countries. Agreements among insurance companies (other than life insurance) related to risk and to certain kinds of compulsory coverage are exempted, largely to permit pooling of risks and assembly of information needed for actuarial reliability. Transport agreements are permitted to facilitate interline operations and joint fares. Export cartels are exempted, presumably because their effects, if any, are likely to be felt elsewhere. And merger control does not apply to share or assets acquisitions in bankruptcy restructuring, where speed and asset preservation are paramount concerns. Of course, repealing an exemption will not by itself change industry behaviour. Instead, the once-exempted industry is likely to try to find ways to continue its cartel behaviour, perhaps with official blessing. An example is harbour services. The exemption from the AMA for ports cartels was abolished in the late 1990s, but as of 2003, the industry association was still reportedly trying to control entry and police competition.

Eliminating the exemption for “inherent monopoly” in 2000 occurred in the context of the liberalisation of electric power. This change has expanded the potential application of the AMA in other network industry settings, too. In telecoms, the FTC has issued

### Box 3.8. Exemptions

**Complete the planned elimination and narrowing of sectoral and other exemptions from the AMA**

These plans were underway for many years, in many stages. the 1999 Report found that it was time for action, to follow through on the plans already announced and, for those items calling for further study, to complete that process and draft legislation to narrow any remaining exemptions as much as possible.

The process of eliminating and narrowing exemptions has been substantially completed. Comprehensive legislation enacted in 1999 abolished the system for depression and rationalisation cartels and a long list of other exemption systems, while limiting the scope of many others. In March 1999, there had been 57 systems of exemption from the AMA; these had been reduced to 21 by the end of 2003. These are summarised in the Annex. In many of these systems, particular agreements must be individually approved in order to be exempted, and for several, none have been approved recently. (Even before repeal, some provisions for exemption had fallen into disuse. For example, the last approved depression cartel had been terminated in 1989.) Agreements that are exempted based on individual laws must typically be approved by the Minister with jurisdiction, following consultation with or notification to the FTC. Approval under these legislative schemes is typically conditioned on meeting requirements concerning the necessity of the exemption to achieve the legislative purpose. Some competition standards are typically imposed, too, such as non-discrimination. Often, the “exemption” does not extend to unfair practices that are prohibited by the AMA.

Guidelines jointly with the Ministry of Public Management, Home Affairs, Posts and Telecommunications which describe conduct that would violate both the AMA and the telecoms law. Similar guidelines about electric power and natural gas have been developed between the FTC and METI. Co-ordination with sectoral regulatory authorities is evidently informal, without explicit protocols or rules requiring joint action, deferral to one or the other body in particular cases or agreement between them on findings about market power.

The most significant remaining basis for limiting the scope of the AMA is the system of exemptions for co-operative organisations of small and medium sized businesses. It only exempts co-operative groups that comply with the AMA's rules, and the exemption does not extend to unfair practices or substantial restraints of competition that lead to “unjust” price increases. That proviso makes it difficult to see what purpose the exemption serves, as there would be no need to exempt conduct that did not violate the law anyway. The exemption does appear to have an effect, if only as an admonition from the legislature to tread lightly here. Actual enforcement against an SME co-operative for exceeding the statutory bounds is very rare. SMEs might also benefit from an exemption that permits agreements on prices and opening hours to prevent “excess competition” in personal services such as hair cutting. Although co-ordination among micro-enterprises could improve efficiency, a habit of overly-permissive exemption could reduce competitive pressure in what should be highly competitive settings. The FTC has not authorised any exemptions for agreements among these “hygienically related businesses” for several years. The provision evidently remains in the law as a symbolic protection for SMEs.

### Box 3.9. Wider responsibility for competition policy

**Explicitly include in the mandates of sectoral ministries and regulators the responsibility to support competition principles and enforcement**

The 1999 Report argued that making other ministries responsible for eliminating constraints on competition within their own jurisdiction would also extend the scope of competition policy and emphasise its broad, horizontal importance. To maintain the FTC's central responsibility, ministries should also be held responsible for co-ordinating with the FTC so that enforcement issues are referred there quickly. The 1999 Report suggested that major ministries might have antitrust bureaux to work with the FTC and to advise industries about their compliance obligations. These steps could be elements of the revisions of the ministries' foundation laws to clarify the relationship between the administration and the market, which were recommended in Chapter 2 of the 1999 Report.

Implementation of this recommendation has been mixed. In telecoms, "promoting competition" is now one of the purposes of regulation. The purposes also include the "public interest" and "sound development" of the industry. These broad and ill-defined concepts give the regulator substantial discretion. Nonetheless, regulation has often stressed helping new competitive entrants overcome incumbent obstruction. But there has been no substantial entry by facilities-based firms, although there are many new firms in services and mobile telecoms. Controversy continues over whether universal service requirements and interconnection charge policies are protecting the interests of the historic incumbents. The FTC has taken some enforcement actions in telecoms, but these have not been co-ordinated with the regulator. The FTC has a case pending concerning NTT's charges for fibre-to-the-home service; this was also the subject of guidance from the Ministry under the telecoms law.

In electric power, by contrast, the principle of promoting competition was not included among the purposes of sectoral regulation. The ministry, METI, still combines the functions of market development and regulation. Its approach to regulation is shifting slowly from prescription to monitoring, preparing for greater competition in the market. The market is responding as competition expands: when sales to consumers using over 500 kW became contestable in April 2004, the Kansai Electric Power Company cut daytime power tariffs for them by up to a fifth. Natural gas is also a METI responsibility, and regulation is being designed to encourage more competition in stages. New legislation will expand provisions for third party access to LNG terminals and pipelines, while requiring accounting separation and non-discrimination.

Another potentially significant exemption permits resale price maintenance for copyrighted works, to promote culture and preserve diversity of views and home delivery of newspapers. Some mechanism to spread risks is common for these products (and a similar exemption from competition law is often found in other jurisdictions), and maximum resale price maintenance might well benefit consumers in some cases. But complete exemption from a basic rule is a striking inconsistency. Another round of consultations about this exemption among publishers, consumer interests and the FTC began in 2003.

How competition policy should apply to social issues is becoming an important issue. In Japan, this topic includes not only education and health, but also agriculture. Legislation about agriculture exempts co-ops in that sector from the AMA by cross-reference to the

exemption for SME co-operatives. The Council on Regulatory Reform is considering whether to revisit the scope of this exemption. In a potentially significant experiment, reforms in some special zones permit corporations to enter agricultural production (by leasing land). The same issue, that permission to enter a sector may be based on the form of doing business, is arising with respect to other public and social services. Such preferences can distort competition. Government decisions on entry into providing health or education services favour entities that are technically considered “non-profit”. Decisions about whether to permit entry by a new for-profit provider are up to local councils, which include representatives of these incumbent “non-profit” providers.

### 3.4. Policy studies and advocacy

A steady accumulation of incremental reforms over the past decade, often ones promoted by the Council on Regulatory Reform and the FTC and its Study Group on Government Regulations and Competition Policy, have led to wide-ranging, pro-competitive changes in Japan's regulatory system. Most notably and fundamentally, competition-suppressing administrative controls on price and entry have generally been eliminated.

#### Box 3.10. Supply-demand balancing

**Eliminate all “supply-demand balancing” aspects of permitting, licensing and other forms of advice or intervention, formal or informal, within a fixed period, such as one year. Fix sunset dates of preferably less than two years on all such requirements that remain**

The most important recommendation in the 1999 Report was the elimination of all “supply-demand balancing” functions that were used to control and prevent pro-competitive entry. The reform programme that was envisioned then promised to move in the right direction, but the Report found that its concrete content was disappointingly limited and the target dates were imprecise. The major constraints, such as limits on entry into transport sectors, were well known, and the Report recommended setting a firm, short deadline for their repeal.

After some steps under the first 3 year reform plan (1995-98), the pace of change accelerated. Regulations setting prices and controlling entry based on ministerial assessment of the balance between supply and demand in the market have been removed from trucking, airlines, ports, petroleum, housing, banking, securities and telecoms. Similar reform of taxicab services is in process now, although the commitment to the principle is ambiguous: control of entry based on supply-demand considerations has in principle been abolished, but the minister can step in if there is excess competition in an area. The most recent regulatory reform plan calls for abolishing the supply-demand criterion for entry in coastal shipping.

But there are points of backsliding and resistance. For example, supply-demand considerations are no longer supposed to be used in issuing licenses for locating retail liquor stores; however, local finance offices are reportedly administering temporary laws to control supposed oversupply. And outside of 9 major harbours, supply-demand considerations are still used to restrict entry into providing port services.

Since the 1999 Reform report, the FTC's Study Group on Government Regulations and Competition Policy has produced 10 more studies and recommendations about competition policy and reform in electricity (2 reports), natural gas, domestic aviation, postal services, public utilities, telecoms and broadcasting (3 reports) and social regulation. Under the current reform plan, health care, welfare, labour and education are the principal themes, and this study group issued a report in November 2002 on promoting competition in the area of social regulation.

The study group's proposals about telecoms included eliminating the distinction between carriers with and without physical facilities, transparent interconnections and increased competition to reduce interconnection access charges, and allocating spectrum through auctions. Its report doubted that the holding company structure for NTT was likely to promote competition and urged that it reduce its holding in mobile telephone service. Many of these recommendations have been adopted, some of them in the revision of the telecommunications law that was proposed by the Telecommunications Council, a group organised to offer advice to the Minister. The study group has also recommended increased competition in postal services. Its 2000 report called for liberalising delivery of commercial bulk mail and value-added mail service and fixing low quantitative thresholds for determining which services are subject to competition. There has been some progress, as the historic incumbent was corporatised in 2003 and service has been liberalised, in principle. In practice, because the design of the universal service obligation discourages entry where that is an issue, there is competition only for commercial services.

### 3.5. Conclusions and recommendations

Important wide-ranging reform measures have been achieved, notably the reduction in reliance on supply-demand balancing and the elimination of a host of measures authorising exemptions from the AMA. In telecoms, the sector regulator is accepting responsibility to support improvement in competition. Changes are most striking in telecoms, distribution, trucking and financial services. Problems due to reduced competition and hence higher costs remain in some sectors, due to industry and regulatory habits that are resistant to change. The legal profession is opening up, but slowly. Issues in particular sectors are described in more detail in the special chapter on product market competition in the 2004 OECD Economic Survey of Japan.

Some of the benefits resulting from these changes are measurable and striking. The Cabinet Office has tried to estimate the effects of implementing some of the major changes in the 3 year regulatory reform programs, in terms of increased consumer surplus (that is, without considering effects such as reducing producer costs). The latest estimate, in 2003, dealt with the effects of reforms in mobile telephony, trucking, domestic airlines, car inspections, electric power, gas, oil, securities commissions, insurance, beverages and food, and products where resale prices had been designated such as cosmetics and pharmaceuticals. In total, the Cabinet Office estimated that these reforms increased consumer surplus by JPY 13.4 trillion per annum, or JPY 112 000 per capita: this amounts to about 4% of GDP. One reform that the 1999 Report pointed out, ending rate and entry regulation in trucking, accounted for JPY 3.9 trillion of this total.

The FTC's profile in reform has improved, with its move to the Cabinet Office. It has taken steps to make its policies and especially its reasoning in particular decisions more transparent. The FTC recognises its need for more sophisticated economic analysis and

legal expertise in complex cartel investigations. Additional resources are concentrating on those areas, but even more could be needed. Improvements in competition law enforcement include the new form of private legal action. As much of the system of conventional economic regulation has been reformed, competition policy now faces new circumstances. The major challenge now is making enforcement more effective, in part to preserve the benefits of reform.

### **Policy options for consideration**

***Sanctions actually applied must be effective to deter hard-core violations: surcharges must be much higher, especially if criminal prosecution remains rare***

Proposals to double the surcharge level would bring Japan closer to the emerging international consensus about the need for strong action against the most serious abuses. Because it is based on covered commerce, not total turnover, the proposed doubled rate might still be too low to deter effectively, though. Adding only 50% to the surcharge for repeat offenders might not be enough to get their attention; that percentage probably should be significantly higher. Retaining distinctions in the surcharge system for different violators is problematic. The rationale for maintaining these distinctions for small business and for wholesale and retail trade is not that there is less need for enforcement in those settings, but that because margins are smaller, smaller sanctions would still have adequate deterrent effect. Even if that were true, retaining these special lower rates preserves a loophole that weakens enforcement. If the threat of criminal sanctions is to be taken seriously, the FTC needs stronger investigative powers and closer co-operation with the prosecutors, to develop the evidence that is needed to support referrals and obtain convictions.

### **Implement a leniency program to detect and deter cartels**

The proposals for a leniency program are also consistent with the emerging consensus among competition law enforcers. Such a system would make Japanese enforcement more effective and may facilitate co-operation with other enforcers, to deal with wide-ranging cartels that harm Japanese consumers. Where there is a very clear advantage to being the first party to come forward (and thus, a very substantial risk in not being the first), and there is some advantage to coming forward even after an investigation has started, some cartels have broken down in a race to confess. Proper attention to matters of process and design of an effective leniency program, such as the relationship between the surcharge system and criminal prosecution, is important, and the FTC's plans show that this issue has received considerable attention. The most important consideration, though, is the enforcement climate: the promise of leniency is an effective enforcement tool only if the threatened sanction that is avoided is substantial and credible.

### **Strengthen consumer protection and its relationship to competition policy**

Japanese consumers still need a stronger voice in the policy process and stronger protections in the law. The relationship between competition enforcement and consumer interests is not always clear enough. At least, the surprisingly large number of FTC actions about price cutting would not inspire confidence in consumers that competition enforcement is promoting their interests. Laws and institutions protecting consumers in Japan need to be strengthened. Giving that responsibility to the FTC could help to focus competition law enforcement on consumer interests, too.

**Table 3.1. Implementation of 1999 recommendations**

Recommendation of 1999 Review	Actions taken since the 1999 Review	Assessment and recommendation
Strengthen rights of private action by providing for injunctions in independent private suits, easing the proof of damages in competition cases, and facilitating consumer and customer recoveries in price fixing cases. The quota on new lawyers should be eliminated.	Consumers or business may now seek a court order to correct or prevent unfair practices and restraints imposed by trade associations. The number new lawyers admitted through examination is increasing; from 1 500 in 2004, the plan is to reach 3 000 by 2010. A new legal education system introduced in 2004 will make an alternative path to entry available.	The new private action is a useful outlet, particularly for minor disputes and competitor complaints. It is not available for major cases under Sec. 3 about unreasonable restraints and private monopolisation; for these, the FTC remains the primary, if not the sole, decision maker.
Increase the visibility and impact of FTC participation in policy making.	The FTC was moved to the Cabinet Office in 2003.	Stronger ties with the formal regulatory reform process, promised in 1999, would still be valuable. The FTC's independent image could be improved further by appointing commissioners from a broader range of backgrounds.
Explicitly include in the mandates of sectoral ministries and regulators the responsibility to support competition principles and enforcement.	Done for telecoms, but not for others, including electric power.	Making the responsibility to support competition explicit concerning transport and energy would also be valuable.
Establish a clear, public, effective relationship between consumer policy and competition policy.	Consultations between the FTC and consumer agencies have continued as before.	A stronger consumer protection system is needed, with a role for the FTC.
Complete the planned elimination and narrowing of sectoral and other exemptions from the AMA.	Substantially done, through enactment of legislation to remove statutory authorities for exemption.	Compliance with the terms of the remaining exemptions, particularly concerning SMEs, should be monitored.
Improve the FTC's economic and legal resources, to enable it to undertake more sophisticated merger and monopoly enforcement, prepare more successful cartel cases and resolve market access problems.	Resources have continued to increase. The FTC staff level is now 672, compared to only 478 in 1991. A policy unit has been set up to improve its economic analysis, and more legal expertise has been brought in.	Stepped up enforcement and new procedures will probably require even more bolstering of legal expertise. Developing a stronger career path at the FTC would reduce the need to rely on seconded personnel.
Target enforcement on practices that have been tolerated or promoted by informal administrative guidance, to reinforce the shift in regulatory philosophy away from central direction.	The 1994 Guidelines are still in place, and a Cabinet Decision in March 2003 reminded Ministries of their obligations to consult with the FTC.	Continued monitoring is necessary. The new, limited powers about official involvement in bid rigging violations should be applied to the maximum extent.
Publicise actions and reasoning, to educate the public and the business community about the effects and benefits of competition policy and law enforcement.	More information about decisions is available on the FTC website and in other outlets. The merger consultation process has tried to create an outlet for explaining FTC reasoning in particular merger cases.	More extensive use of the merger consultation process and public explanations of FTC reasoning would strengthen confidence in the consistency and effects of policy.
Eliminate all "supply demand balancing" aspects of permitting, licensing, and other forms of advice or intervention, formal or informal, within a fixed period, such as one year. Fix sunset dates of preferably less than two years on all such requirements that remain.	Substantially done, through a variety of measures eliminating such criteria for licensing entry.	Some unfinished work remains concerning aspects of transport, and the same process of protecting the profits of incumbent firms against threat from entry, should not be allowed through different, indirect measures.
Improve capacities to address international competition problems by reaching agreements with other countries on co operation and enforcement.	Japan has reached agreements with the US (1999), Singapore (2002) and the EC (2003), and is discussing agreements with others.	These capacities are now being used.

### Complete the process of eliminating unnecessary controls on competitive entry

It is no longer common for entry to be controlled by means of licensing or other administrative decisions based on the balance of supply and demand. A few pockets of resistance to reform remain, though, where these habits persist unnecessarily or where other administrative measures are used to protect incumbents against unwelcome competition.

Table 3.2. Exemptions from AMA

Ministry or agency	Sector or description	Legislative basis	Date of legislation	Exemptions authorised, 2003
Justice	Acquisition of shares of companies under reorganisation	Corporation Reorganisation Law	1952	
Education, Culture, Sports, Science and Technology	Agreements on music licensing fees	Copyright Law	1970	
Financial Services Agency	Insurance cartels Compulsory automobile and earthquake insurance	Insurance Business Law Law concerning Non Life Insurance Rating Organisations	1951 1998	8 2
Finance	Rationalisation cartels	Law Concerning Liquor Business Associations and Measures for Securing Revenue from Liquor Tax	1959	0
Health, Labour and Welfare	Agreements to prevent excessive competition	Law Concerning Co-ordination and Improvement of Hygienically Regulated Business	1957	0
Agriculture, Forestry and Fisheries	Federation of agricultural co-operatives Agricultural association corporation	Agricultural Co-operative Association Law	1999 1999	
Economy, Trade and Industry	Export cartels Federation of small business associations Joint economic undertakings	Export import Trading Law Law on Co-operative Association of Small and Medium Enterprises Law on Co-operatives of Medium and Small Sized Enterprises	1952 1999 1957	0
Land, Infrastructure and Transport	Maritime transportation cartels (international) Maritime transportation cartels (coastal) Transportation cartels Aviation cartels (international) Aviation cartels (domestic) Maritime transportation cartels (coastal) Joint shipping businesses	Maritime Transportation Law Maritime Transportation Law Road Transportation Law Civil Aeronautics Law 1952 Coastal Shipping Association Law	1949 1949 1951 1952 1952 1957 1957	[211] 10 3 (1) [292] 0 1 (1)

Note: Figures for international maritime and aviation agreements are the number of notifications received by the Ministry concerning concluding, amending, or terminating an exempted agreement, not the total number of such agreements in force. In road and coastal transportation, agreements involving one party may apply to several routes or subjects.

Source: FTC.

Most of this principal recommendation from the 1999 Report has been achieved, but it would still be beneficial to eliminate the rest of these constraints – and it will be important to sustaining the benefits of reform to prevent them from reappearing in other forms.

## Notes

1. The original AMA rule about price fixing was a per se rule, that is, one that did not require showing an actual effect in the particular case, and it was explicitly repealed back in 1953.
2. Members can be required to pay surcharges. The FTC keeps its Guidelines about trade association conduct current; they were last re-issued in 1995.
3. A separate section provides a basis for designating products for which resale price contracts are permissible.

4. Other means for regulating industry investment structures are vestiges of the AMA's recently repealed ban against holding companies. An amendment to the AMA effective in 2002 repeals the restriction on total shareholding by a "giant company" (Sec. 9-2), while generalising the prohibition against establishment of (or transformation of an existing company into) a company with an "excessive concentration of economic power" (Sec. 9). In addition there are some restrictions on share holdings by banks and insurance companies.
5. The basic threshold is assets or turnover totalling over JPY 10 B for the combined entity and exceeding JPY 1 B for the acquired entity.
6. There is also a criminal law about unfair competition, which is applied to violations concerning trademark or country of origin and is enforced by the police and prosecutor.
7. On occasion, individuals may be sentenced for bid-rigging under a separate provision of the criminal law, while the companies involved are subject to surcharges for violating the AMA.
8. In some of these cases, the figure was estimated *ex post*, since the proportion of covered commerce was not necessarily used as the basis for computing the fine.
9. The FTC says it is its "active policy to apply criminal penalties to violations that a) substantially restrict competition [...] such as price cartels, supply restraint cartels, market allocation agreements, bid-rigging and boycotts, which constitute serious cases that are likely to have a widespread influence on the national economy; or b) involve firms or industries that are repeat offenders, or do not take appropriate measures to eliminate the violation, and where the administrative measures of the FTC are not considered sufficient to meet the aims of the AMA." (FTC, 2002, p. 6)
10. There have been many more prosecutions under the special provisions of the Penal Code about obstruction and collusion in bidding, though.
11. In addition, citizens can bring actions under the Local Autonomy Act to recover losses due to practices such as bid rigging. These suits have been more numerous, and more successful, than damages claims about AMA violations.
12. The official might face prosecution, if the misconduct amounts to corruption.

## Bibliography

- David Boling (2003), "The Role of Prosecutors in Japanese Antimonopoly Law Criminal Cases", *Antitrust*, vol. 17, No. 2, p. 90.
- Scott D. Hammond (2003), "Beating Cartels at Their Own Game: Sharing Information in the Fight Against Cartels", speech presented to Inaugural Symposium on Competition Policy, Competition Policy Research Centre, Fair Trade Commission, Tokyo, 20 November.
- Government of Japan (1998), Fair Trade Commission, Guidelines for Interpretation on the Stipulation that "The Effect May Be Substantially to Restrain Competition in a Particular Field of Trade" Concerning M&As.
- Government of Japan, Fair Trade Commission and Ministry of Public Management, Home Affairs, Posts and Telecommunications (2002), Guidelines for Promotion of Competition in the Telecommunications Business Field.
- Government of Japan, Fair Trade Commission and Ministry of Economy (2002), Trade and Industry, Guidelines Concerning Appropriate Electric Power Dealings.
- Government of Japan, Fair Trade Commission and Ministry of Economy, Trade and Industry (2000), Guidelines Concerning Appropriate Natural Gas Dealings.
- Government of Japan, Fair Trade Commission (2003), Report of the Study Group on the Antimonopoly Act, October.
- Government of Japan, Fair Trade Commission (2004), Draft Guidelines on Merger Review (press release), 23 March.
- OECD (1999), *Regulatory Reform in Japan*, Paris.
- OECD (2001), Competition Committee, Annual Report of Japan, January-December 2000.
- OECD (2002), Competition Committee, Annual Report of Japan, January-December 2001.
- OECD (2002), *Hard-Core Cartels: Harm, Effective Sanctions and Leniency Programmes*, Paris.

OECD (2003), *Hard-Core Cartels: Recent Progress and Challenges Ahead*, Paris.

OECD (2004), *Economic Surveys: Japan*, Paris.

Kazuhiko Takeshima (2003), Chairman, Fair Trade Commission, "Activities of the Japan Fair Trade Commission in 2002", presentation to the Committee on Economy, Trade and Industry, House of Representatives, 156th Session of the Diet, 19 February.

Veronica Taylor (2003), "Re-regulating Japanese Transactions: The Competition Law Dimension", in J. Amyx and P. Drysdale, eds., *Japanese Governance*, London.

Akinori Uesugi (2004), Secretary-General, Fair Trade Commission, "Enforcement Activities against Cartels: What is Going On in Japan", speech to International Cartel Workshop, American Bar Association, New York (5 February).

---

ISBN 92-64-01715-1

OECD Reviews of Regulatory Reform: Japan  
Progress in Implementing Regulatory Reform  
© OECD 2004

---

OECD Browse\_it Edition  
uʌ Read Only  
• Lecture seule

## *Chapter 4*

# **Market Openness**

The 1999 OECD review of “Regulatory Reform in Japan” explored the theme of market openness within the Japanese regulatory system and made broad recommendations regarding how market openness could be more consistently interwoven throughout it. The 1999 Report was also among the first in the series of cross-economy programme of studies on regulatory reform. Since the inception of this programme, a systematic assessment of the market openness experiences across this series of studies has resulted in the development of an outline of “Illustrative Best Practices”<sup>1</sup> for fostering market openness, as contained in the synthesis report “Integrating Market Openness into the Regulatory Process: Emerging Patterns in OECD Countries”. The Illustrative Best Practices has been relied upon as an analytical structure within this monitoring exercise. The six core principles of market openness forming the foundation of the Illustrative Best Practices have seen minor improvements since the time of the 1999 Report and include: transparency, non-discrimination, avoidance of unnecessary trade restrictiveness, harmonisation towards international standards, streamlining of conformity assessment and competition. Relied upon to assess market openness throughout the series of OECD country reviews of regulatory reform, these six principles thus represent a tested methodology to consider the market openness of regulatory systems, as well as an instrument for integrating market openness within the process of regulatory reform.

Significant policy and institutional changes have been implemented since 1999 which portend well for increasing both the quality and the extent of market openness within the Japanese regulatory system. Two policy initiatives in particular stand out as promising indications for future progress beyond the general programme of regulatory reform contributed to by the Council for Regulatory Reform. First, the announcement by the Japanese Prime Minister Junichiro Koizumi on 31 January 2003 of his intention to implement policies that would double FDI into Japan over a period of five years,<sup>2</sup> appears to signal a shift away from a traditional ambivalence towards foreign commercial activity within Japan. Policies that have already been implemented and are currently under consideration to facilitate inward flows of FDI have natural inter-linkages with the general development of market openness within the Japanese regulatory system. Second, a programme of Special Zones for Structural Reform (Special Zones) was launched in 2003, relying on regulatory innovation and experimentation at the local level in order to identify successful regulatory reforms that may then be considered for eventual implementation on an economy-wide basis. The interaction between these two policy initiatives and their impact on market openness will be explored below within thematic sections addressing recent developments in Japan with respect to the six principles of market openness.

On an institutional level, it is notable that many if not all the significant central government bodies connected with market openness are (or have been re-) located within the Cabinet Office established in 2001. These institutions include the:

- Council for Regulatory Reform (CRR).
- Office of Trade and investment Ombudsman (OTO).

- Japan Investment Council (JIC).
- The Headquarters for the Promotion of Special Zones for Structural Reform, and
- Office for Government Procurement Challenge System (CHANS).

In addition, the Fair Trade Commission (FTC) has moved out of the Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT), and is now an “external organ” of the Cabinet Office. *Prima facie*, the consolidation of these bodies within a single office creates new possibilities for transparency, co-ordination and synergies among and between a set of government bodies responsible for administrative functions connected to market openness. The increased prestige (and resources in some cases) accrued to these agencies due to residency within the Cabinet Office is significant particularly within the Japanese context. An analysis of concrete results in terms of better integrating market openness within the Japanese regulatory system has yielded inconsistent results to date, but the overall trend appears to be positive, and a clear framework has been put into place which could support strong movement towards market openness as will be elucidated below within the thematic sections corresponding to the principles of market openness.

The objective of this monitoring exercise is to discuss these and other important developments which have taken place since the 1999 Review by: assessing the extent to which Japan has implemented the policy recommendations formulated in this review; reporting on the progress made in promoting a free and open trade and investment environment; and highlighting new challenges facing Japan on this front.

#### 4.1. Transparency and openness of decision-making

The transparency and openness of decision making and of appeal procedures are critical factors for domestic and foreign economic actors when making business decisions, including those concerning trade and investment. In the case of potential market entrants, who often must make decisions in a context of asymmetric regulatory information vis-à-vis incumbent firms, the transparency of regulatory systems is a pivotal factor. As alluded to in the 1999 Review, Japan presents a case where consensus based decision making has traditionally been facilitated by informal mechanisms of consultations often leading to decisions provided to government officials under the Administrative Procedure Law in the form of “Administrative Guidance”. In that context, the implementation of measures to ensure transparency may be viewed as creating burdens on administrative actions that were not considered necessary in the past. It is useful to bear in mind however that the degree of transparency facilitates competition and trade and enhances the attractiveness of the Japanese market to domestic as well as foreign investment.

##### **Systematic public availability of information through various channels**

Despite continuing weak coverage of administrative actions that have regulatory effect, Japan has made considerable progress in promoting the systematic public availability of information, particularly through increasing reliance on the Internet as a vehicle for dissemination of government information ([www.e-gov.go.jp](http://www.e-gov.go.jp)). These changes are mostly made within the context of the “e-Japan” policy to better integrate the use of information technology within the administration of public policy (see the *Transparency and predictability* section of Chapter 2 of this report on Government Capacity to Assure High Quality Regulation for further elaboration on the use of information technology within the

administration of public policy). The absence of mandatory transparency requirements within the Public Comment Procedure for Formatting, Amending or Repealing a Regulation (Public Comment Procedure – see below) regarding all Internal Orders, Communication Notes and particularly Administrative Guidance, however, continues to hold back progress towards transparency within the Japanese regulatory system.

Partly as a consequence of the policy announced in early 2003 to double the cumulative amount of inward FDI, foreign and domestic firms now have access to significantly increased levels of information. Notably, the Japan External Trade Organisation (JETRO) has significantly expanded its dissemination of information for facilitating imports and FDI into Japan on top of its more traditional role of supporting Japanese exports goods and services. Among other things, it now provides an English based “single window” Internet portal ([www.jetro.go.jp](http://www.jetro.go.jp)) in which a variety of business information is available, ranging from explanations of procedures for importing goods into Japan, market information down to the sectoral level in some cases and extensive information relating to investment in Japan. The Cabinet Office of the Prime Minister (created in January 2001 to strengthen the working of the Cabinet in fields including regulatory reform and market openness) has a website ([www.cao.go.jp/index-e.html](http://www.cao.go.jp/index-e.html)) that provides an overview of Japanese policy initiatives and their progress. The above are only the most significant of a sampling of English language government information portals accessible through the Internet, which although uneven appears to be gaining momentum. The rapid growth in the quantity and sophistication of information regarding Japanese laws and regulations is notable; also worth pointing out is the quantity of information available in English, although not as comprehensive as that in Japanese.

#### ***Clear open and simple procedures for making and implementing rules and systematic reliance on public consultation***

Since the 1999 Review, two transparency related measures have been implemented which, if improved, would have important implications for transparency both in the development of public consultations regarding and the implementation of rules and regulations in Japan. The first was the implementation in April 1999 of the Public Comment Procedure, which sets out regulations for the implementation of a system for public comments within the rulemaking process. The second was the implementation of a “No Action Letter” (NAL) system, under which firms may seek prior clarifications on how regulations will be applied in certain situations. Both measures are positive steps yet both suffer from defects which reduce their effectiveness in practice.

The Public Comment Procedure makes consultations mandatory for the establishment of Cabinet and Ministerial Orders, except in “... circumstances [...] in need of prompt implementation, in case of emergency or insignificant matters”.<sup>3</sup> However, its impact is diluted by the fact that it is applicable only on a discretionary basis to Internal Orders, Communication Notes, Administrative Guidance and negotiations for international agreements. Under the Public Comment Procedure, consultations may be conducted with the general public (i.e. by post, fax and Internet) or through public hearings (*kochokai*).

In FY 2002, 399 items underwent a public comments process, and only six did not due to invocation of the exceptions indicated above.<sup>4</sup> The Public Comment Procedure has increased the quantity of public consultations as well as the quality of the consultations process according to at least one foreign source.<sup>5</sup> Between FY 1999 and FY 2002, the number of public consultations steadily increased from 265 to 399 per annum and the ratio

of consultations leading to amendments of prior texts stood at 14.5% for FY 2002. In keeping with the recommendation of the Public Consultation Procedure, 51.4% of consultations in FY 2002 were for periods of a month or longer, or an increase of roughly 10% above the ratio for FY 1999. In this light, it is noteworthy that abbreviated consultation periods for some regulatory changes covered by the Public Consultation Procedure have been a continuing source of concern within the foreign business community.<sup>6</sup>

The NAL system was implemented to allow business to seek prior consultations with administrative bodies to learn how laws and regulations would be applied under circumstances where existing laws, regulations and precedents do not provide clear guidance. However, certain features in the NAL system prevent it from achieving the degree of regulatory transparency it might provide. A general reluctance on the part of authorities to provide unequivocal guidance under the NAL system together with the current legal ambiguity of NALs, even when provided, weakens the ability of the NAL system to create regulatory transparency. The result of this is the continuation of deficiencies in the transparency and predictability of the Japanese regulatory systems for firms considering investments within Japan. Foreign businesses which tend to be less familiar with the Japanese regulatory system would likely be disproportionately affected, and thus the inefficiencies of the NAL system in creating transparency over potential regulatory actions in grey areas of regulation are likely to generate a disproportionate and negative impact on the openness of the Japanese market to FDI, beyond its repercussions on domestic investment.

#### *Clear, open effective appeal procedures and efforts to ensure transparency in particular areas*

Two government bodies dealing specifically with issues raised by both domestic and foreign businesses regarding regulations that impede access to the Japanese market were moved to the Cabinet Office in 2001. The greater visibility that this brings them appears to set the stage to increase the effectiveness of the OTO (which deals market access related issues<sup>7</sup>) and CHANS (which deals with government procurement). It should be noted that this organisational change was implemented in 2001 amid a general sense that neither the OTO nor the CHANS had performed to the potential of their organisational mandates. In the case of the OTO, which has handled 1 035 cases as of September 2002, an assessment recently carried out by the Market Access Ombudsman Council governing the OTO has yielded discouraging findings.<sup>8</sup> In a sampling of cases comprising 280 individual items, recommendations for the implementation of “measures to promote imports” by the relevant government body were made for 158 items while the remaining 122 items representing nearly half of the total sample were identified as “not categorised”. Of the 158 items for which the OTO had made specific recommendation for changes to improve market openness, 68% had been implemented by the relevant administrative agencies while, 29% had only been partially implemented and 3% had seen no action. Of the 122 items designated as “not categorised” changes had been made on only 11 items.

It is notable that while the OTO was originally established in part as a response to market access concerns raised by foreign commercial interests, only 32% of the items contained in this sample were received from foreign embassies and economic associations. Although this drop has taken place within the context of a very large real decline in total requests for assistance, reduced confidence within the foreign business community regarding the OTO as a forum for handing market access issues apparent. It is useful to recognise in this light that a partial explanation of declining reliance by domestic and

foreign commercial interests on the OTO can be found in the early successes of the OTO. Early cases handled by the OTO often involved facilitating changes to clear-cut cases in which regulations unnecessarily reduced market access. As the prevalence of such regulations continues to decline, successive generations of complaints characterised by increasing complexity have similarly elevated the difficulty of the solutions. Also relevant is the fact that the establishment of the CHANS in 1995 was conducted in a manner that diverted resources from the already existing OTO. While it is certain that resource constraints facing the OTO serve to undercut its efficacy, it remains too early to tell whether the new location of the OTO will augment its resources or enhance its effectiveness.

In the area of government procurement, the five complaints received by the CHANS between 1996 and September 2003 (including one by a domestic business without any foreign affiliation) have resulted in findings that none of the cases merited corrective action. In addition, a number of inquiries were made which did not proceed to the formal complaint stage and are hence not reflected in these statistics. Concerns raised over transparency within the procurement process include difficulties experienced by firms when seeking to obtain clarifications from relevant authorities regarding the criteria to be employed both when assessing the performance of technical specifications and weighting price versus performance. Importantly, these concerns apply both at the bidding stage of the procurements process as well as following the bidding process. The implementation of a searchable online database of government procurement tenders is currently available on the JETRO website in English as well as Japanese, although information regarding projects is brief.

A boost to transparency in particular areas such as standards development may be seen in the fact that the JETRO website currently maintains what appears to be a regularly updated and accessible catalogue of information pertaining to: technical, sanitary and phytosanitary standards; import regulations and procedures; import procedures for specific products; and related laws and regulations. The Japanese Industrial Standards Committee (JSIC) provides a thorough website ([www.jsic.go.jp/eng](http://www.jsic.go.jp/eng)) containing information about the development of Japanese standards as well as details regarding those under development and subject to a 60 day public comment procedure required by Japan's commitment under the World Trade Organisation (WTO) Agreement on Technical Barriers to Trade (TBT). A spectrum of information regarding relevant laws and regulations to matching services and support facilities designated for potential investors is also available on the JETRO website.

## 4.2. Non-discrimination

With a national constitution that provides for the direct application of commitments under international treaties, the WTO principles of non-discrimination [Most Favoured Nation (MFN) and National Treatment (NT)] are directly applicable with respect to specific liberalisation commitments made by Japan under the WTO and other international legal obligations. Since the 1999 Report, there have been conscious efforts to better integrate non-discrimination within policy processes related to regulatory reform. The extent to which the principle of non-discrimination is operational within domestic regulatory reform processes such as the Special Zones programme described below will condition the quality of competition within the domestic economy and the ability of current reforms to underpin economic growth and progress towards social objectives. Similarly, confidence in non-discrimination within the domestic regulatory environment will influence the contribution that foreign traders and investors make to domestic economic growth.

## **Formal commitment to the principle and minimisation of exceptions in practice**

The March 2004 Cabinet Decision for implementing Three Year Program for Promoting Regulatory Reform (TYPPRR) incorporates an entirely new heading for regulatory reform entitled “Regulatory reforms designed to increase international appeal of Japan”, under which work-streams for regulatory reform are created for the movement of people, goods and investment across borders. Concrete policies already implemented in 2003 (and scheduled for continued broadening in application) include growth in the number of countries from which citizens may visit Japan without visas as well as increasing acceptance of mutual certification of credentials for information technology workers. While it is significant that attention to this topic has led to its inclusion as a separate subject for progress within the process of regulatory reform, well developed approaches do not appear in the March 2004 version of the TYPPRR for proceeding with regulatory reform for goods and investment.

As part of an ambitious effort to radically alter the role played by law within Japanese society, reform of the Japanese legal system was adopted in mid-2003, including landmark revisions to laws governing the ability of foreign and domestic lawyers to co-operate in the provision of legal services in Japan. Box 4.1 below explains links between the intended changes in the role of law and the evolution of market openness in Japan.

### **Contestable markets for government procurement**

Among the signs of progress since the time of the 1999 OECD report, the most significant is probably the increased availability of information on the Internet. In addition, the Japanese government has unilaterally reduced the thresholds above which procurement is subject to international competition. These reductions are bound under the Japan Singapore Economic Partnership Agreement (JSEPA) and, unusually, have been applied to all countries [even beyond members of the WTO Agreement on Government Procurement (AGP)].

Nevertheless, the role of foreign suppliers in Japanese government procurement remains modest. Between 1999 and 2001, the total value of Japanese government procurement secured by foreign firms declined slightly from 13.4 to 12.0%. This may reflect persistent difficulties in the ability of foreign bidders<sup>9</sup> to: secure recognition for foreign experience; pass unclear pre-qualification criteria; respond to unexpectedly narrow specifications; maintain local offices; and anticipate the relative weighting that price versus performance receives in decisions to award contracts. The fact that the Public Comment Procedure is not applied to government procurement removes a potentially useful policy instrument that could be used to address concerns relating to discrimination. Mandatory application of the Public Comments Procedure to the design of criteria that are employed to qualify potential bidders, govern the conduct of the bidding process, and are relied upon within the selection process, would reduce the potential for discriminatory conduct within the government procurement process. In this light, it is useful to recall that one of the five formal complaints filed with the CHANS issued from a domestic firm with no foreign affiliation, which highlights the possibility for overlap between discrimination related concerns raised by foreign as well as domestic firms regarding government procurement practices within Japan.

### Box 4.1. Reform of the judicial system in Japan

The Japanese Government initiated reform of its judicial system in July 1999. On the basis of recommendations made to the Prime Minister by the Council for Judicial Reform, the Japanese Government began to transmit bills regarding the implementation of reforms to the Diet session of 2002. These reforms are expected to influence broadly the Japanese legal environment and the degree of market openness reflected in the Japanese legal system as well as in the economic environment.

Planned reforms include: reductions in the time required for civil lawsuits, additional measures to secure the enforcement of cases related to intellectual property rights, strengthening of the civil execution system, securing effective execution of rights, expansion of access to the courts, reinforcement and vitalization of Alternative Dispute Resolution (ADR) mechanisms, reinforcement of the ability of the justice system to act as a check vis-à-vis the administration and the initiation of a new system of legal education in Japan in order to sharply increase the number of legal professionals in Japan.

The overall objective of these reforms is to significantly alter the relatively underdeveloped role that law has historically played within Japanese society by enhancing both the transparency of the legal system and the degree to which law is relied upon as a means of resolving disputes. Strengthening the role of law within the Japanese economy will benefit both domestic and foreign producers by enhancing the transparency and predictability of an economic system traditionally less reliant on the open application of rules than on discretion and custom as a means of resolving disputes. The envisaged reforms are expected to have an asymmetric and positive impact on foreign producers (particularly potential market entrants), who have customarily found it difficult to operate effectively under the discreet and complex business customs characterising the Japanese economic system a slow and difficult process. Successful implementation of legal reform in Japan would likely have significant implications both in terms of the transparency and predictability of the Japanese economic environment and thus for the market openness of the Japanese economy.

With respect to the openness of the legal services market itself, the recommendations of the Council for Judicial Reform mentioned above gave disappointingly little consideration to accepting foreign practitioners with legal experience outside Japan to practice in Japan. Although progress has been made with respect to freedom of association between Japanese and foreign lawyers and of equality in treatment between Japanese and foreign lawyers, gaps remain in the areas of requirements for qualifying as a foreign lawyer in Japan, becoming a partner of law firms and enabling the provision of cross-border legal advice. It is important to recognise that the market openness of the Japanese legal profession has important spill-over effects for the transparency and predictability of the Japanese legal environment experienced by foreign and domestic businesses alike.

Source: The recommendation report of the Council for Judicial Reform: [www.kantei.go.jp/foreign/policy/sihou/singikai/990612\\_e.html](http://www.kantei.go.jp/foreign/policy/sihou/singikai/990612_e.html).

Views of The European Business Community in Japan: [www.ebc-jp.com](http://www.ebc-jp.com).

### **Lead responsibility for ensuring implementation of non-discrimination and other WTO obligations**

The 1999 Report indicated that responsibility to ensure non-discrimination within the Japanese regulatory environment was shared by the Ministry of Foreign Affairs (MOFA) and the Ministry of Economy Trade and Industry (METI). As described above, there has since

been a consolidation of market openness related administrative bodies under the Cabinet Office and increasing indications political resolve to enhance market openness. It is not clear, however, whether overarching responsibility has been assigned for ensuring non-discrimination in the regulatory environment.

### ***Efforts to avoid discriminatory effects in regulation (de facto discrimination)***

The reduction of *de facto* discrimination tends to be one of the most difficult areas to address as discrimination is rarely explicit in the text of regulations or laws. The strongest support for *de jure* non-discrimination probably comes in the area of access to information or other means to ensure regulatory transparency – even though the same legislation also contains elements of non-discrimination. The Public Comment Procedure explicitly indicates its scope of application to include “... both citizens and non-citizens, individuals and corporations, in Japan and abroad”. However, the degree to which this provision enhances non-discrimination in transparency *de facto* may be somewhat curtailed in practice by the fact that its application remains voluntary for a variety of administrative conduct including: Internal Orders, Communication Notes, Administrative Guidance and negotiations for international agreements. The potential for such *de facto* discrimination negatively impacts the transparency and thus the openness of the Japanese economy to both domestic and foreign firms when compared to incumbent firms within various sectors.

Difficulties in this regard highlighted in the 1999 Report remain unresolved, including the *de facto* discriminatory impact of laws against tandem motorcycle riding on expressways, which tends to disproportionately reduce demand for large foreign motorcycles. Although public comment procedures are now applied to the development of standards through the Internet on the JSIC website, the extent to which this procedure reduces the potential for discrimination remains uncertain, due to the relatively strong role played by industry associations and professional services associations in the development of standards.

### ***Demonstrated commitment to open regionalism***

The entry into force of JSEPA on 30 November 2002 and the recent agreements in substance on major elements of an economic partnership agreement (EPA) with Mexico signal a departure from Japan’s traditional policy of near exclusive reliance on multilateral trade negotiations and open regionalism<sup>10</sup> as approaches to achieving trade objectives. Although free trade agreements (FTAs) are inherently discriminatory against non-signatories, JSEPA reflects global trends in the development FTAs in that it covers a range of issues beyond existing WTO disciplines. Due to the fact that the text of the Japan-Mexico EPA is not yet available, analysis here will be limited to JSEPA. Provisions relating to mutual recognition agreements linked to JSEPA will be addressed in that thematic section.

In considering JSEPA from the perspective of discrimination, it is worth bearing in mind that both Japan and Singapore have very low simple MFN average applied tariff rates on industrial products, 3.9% in the case of Japan and 0% in the case of Singapore. For agricultural products, Japan has a simple MFN average applied tariff rate of 18.6% and Singapore applies tariffs on only four alcohol beverage related tariff lines across its entire tariff schedule.<sup>11</sup> In this light, the trade effects of discriminatory (preferential) tariff treatment between Japan and Singapore is likely to be very limited.

With respect to bilateral liberalisation of services and investment, the results for the two most significant service sectors specifically included in the negotiations

(telecommunications and financial services) appear fairly modest. In addition, JSEPA allows a limited number of medical and dental practitioners to provide services in the other party based on a quota determined under separate arrangements conducted in the context of JSEPA. This programme is a forerunner for a similar programme within the context of the Special Zones programme which currently has the potential to be extended nationwide (see below).

Beyond liberalisation under JSEPA, the establishment of an investor-State dispute settlement mechanism is notable for the fact that access to the mechanism is asymmetric in a way that reduces the extent of departure from the principle of NT for investments in Japan. Whereas disputes concerning Japan can be brought before the mechanism in Japan by permanent residents in Singapore, Japanese nationality is required in the case of disputes concerning Singapore brought in Singapore. Due to the fact that residency is less difficult to establish than nationality, the accessibility of the JSEPA investor-State dispute settlement mechanism to investors with permanent residency in Singapore is much broader in the case of disputes *vis-à-vis* Japan than in the converse situation. The extent to which a broader cross-section of foreign businesses have access to investor-State dispute settlement provisions *vis-à-vis* Japan, reduces the degree of derogation from the principle of NT. In fact, the expansive network of subsidiaries comprising operations of multinational corporations in the modern global economy suggests that access to the investor-State dispute settlement mechanism under the JSEPA would be broad in practice.

In sum, the impact of tariff discrimination affecting trade in goods and services resulting from JSEPA is unlikely to be significant, although certain other aspects of the Agreement will inevitably favour the respective signatories. Nevertheless, Japan's departure from a longstanding reliance on multilateral trade liberalisation as the key instrument for achieving trade policy objectives and its interest in negotiating additional FTAs raises questions about possible increases in discriminatory trade practices in the future.

### ***Liberal policies towards foreign ownership and investment.***

As an advanced economy, Japan has relatively open policies towards foreign ownership and investment. Nevertheless, there have been some advances in the Japanese regulatory environment since the 1999 Report, such as the establishment of a formalised mechanism allowing foreign commercial interests to contribute at the formulation stage to reform in the area of regulations related to inward FDI. Equally significant is the integration of foreign investment as a key component within the Special Zones programme.

The inclusion of ten foreign experts in the Expert Committee of the JIC is an innovation in light of traditional Japanese reliance upon discreet consensus between government, the private sector and academia. Although no changes have been made to provisions in the Foreign Exchange Law or other individual laws that have a discriminatory impact on inward FDI, as detailed in the 1999 Report, an important amendment to the Foreign Exchange Law occurred in 1998 which allowed investors to benefit from *ex post* reporting of FDI into Japan when conducted in sectors not appearing on a negative list.<sup>12</sup> This provision remains in operation and reduces a regulatory burden on foreign investors that is common in many economies.

However, the continued existence of specific discriminatory provisions conditioning the manner in which foreign investors may acquire Japanese firms continues to provide domestic firms with an artificial advantage over foreign firms. One provision is a

restriction against the ability of foreign firms to effect 100% acquisitions by way of share swaps (*kabushiki kokan*) when such transactions are permitted in identical situations involving only domestic firms. In addition, complaints from within the foreign business community persist regarding a tax deferral mechanism (*kazei kurinobe*) under which share exchanges conducted between two domestic firms may receive a tax deferral on capital appreciation while identical situations involving foreign partners do not.<sup>13</sup>

With respect to the Special Zones programme, an opportunity now exists for experimentation with advances in non-discrimination in areas well beyond current practices in many advanced economies. As in the case of some of the measures taken specifically to strengthen openness to FDI, the Special Zones programme reflects the principle of non-discrimination by applying to foreign as well as non-incumbent domestic firms, in the context of both policy development and implementation. Recommendations for the provisional relaxation of regulations by local governments under this programme are accepted from domestic and foreign parties alike. An example of relaxation of discriminatory regulations can be seen in a zone in which English language education for primary through high school is provided by foreign instructors. The health care sector received a boost from the decision made under the Special Zones programme on 27 February 2003 which supported nationwide measures allowing Japan to accept more foreign medical practitioners. Importantly, this decision supported relaxation of the requirement for reciprocal recognition of Japanese medical credentials as a pre-condition for foreign doctors to provide medical services in Japan. Conditions not touched upon by this decision include the requirement for passing the Japanese medical examination in English as well as a restriction that the foreign medical practitioners may only provide services to nationals of their home countries. An increase in the amount of foreign medical practitioners allowed to practice in Japan is expected.

Other reforms under trial include: relaxing visa permits for foreign researchers and IT specialists; extending the length of stay allowable under such visas from three to five years; and expanding the privileges granted under such visas to include the establishment of companies in Japan. The formal decision made in March 2004 to allow private institutions to operate health care institutions is also being implemented on a non-discriminatory basis under the Special Zones programme. The design and implementation of the Special Zones programme reflects input from foreign investors and individuals not only in the development of regulatory reforms, but also as key participants within the broader process of structural adjustment which the reforms are intended to facilitate.

### 4.3. Avoidance of unnecessary trade restrictiveness

As recommended in the 1999 Report, Japan has very recently implemented a system of regulatory impact analysis (RIA). However, it is not yet clear how RIAs will operate nor the extent to which effects on market openness effect will be considered. Other useful approaches to avoiding unnecessary trade restrictiveness in regulations as suggested from OECD experience include reliance on performance rather than design criteria when defining and implementing regulations; and consideration of regulatory alternatives. The 1999 Report pointed out a variety of areas in which design based criteria prescribed under then existing regulations were more trade restrictive than would have been necessary to successfully achieve the same regulatory objectives by other means. Performance criteria are equally useful for the simplification of trade-related administrative requirements, as in such areas as customs clearance, where the cost of

meeting administrative requirements may affect the ability of foreign suppliers to compete in the market. Although some progress has been made in these various fields it is clear that better integration into the regulatory system of the need to avoid unnecessary trade restrictiveness would enhance the business environment and help avoid future disputes with trading partners

### ***Efforts to encourage awareness of market openness considerations when making regulations***

In accordance with the TYPPRR in March 2004, RIAs are to be conducted by Ministries and Administrative Agencies on planned and existing regulations beginning in April 2004, as appropriate. Due to the novelty of RIAs within the Japanese regulatory system, the text of the Plan does not itself indicate the criteria to be employed in conducting RIAs. Instead, the sense of the Plan is that the development of binding obligations regarding RIAs will result from experimentation and experiences accumulated by ministries and administrative agencies during the current introductory phase. In this light, the degree to which the implementation of RIAs in Japan will reflect best practices distilled from OECD work on regulatory reform and market openness remains uncertain (see the *Understanding Regulatory Effects: The Use of Regulatory Impact Analysis* section of Chapter 2 of this report on Government Capacity to Assure High Quality Regulation for further discussion on RIAs). Most importantly from a market openness perspective, it is not clear to what extent effects on foreign trade and investment will be effectively considered, as is the case in countries such as the United Kingdom and the Netherlands.

### ***Efforts to favour trade-friendly regulatory approaches***

Since 1999, efforts to reduce complex and unnecessarily burdensome regulations and administrative procedures have registered broad progress, despite some unevenness in areas such as agriculture. The resolution of regulatory issues related to construction and building materials was characterised as a “notable achievement” by one trade partner in 2001.<sup>14</sup> In the telecommunications services sector, recent revisions to the Telecommunications Business Law substantially eased *ex ante* reporting requirements for non-dominant firms and complex licensing requirements concerning Type I and Type II regimes.<sup>15</sup>

With respect to food and agriculture,<sup>16</sup> conclusive progress has not been recorded since the 1999 Report regarding Japanese quarantine and inspection services. An example of the diverse and complex issues arising here is burdensome restrictions on apples to prevent transmission of fireblight, which a WTO panel has found inconsistent with the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). Another example is the case of plant fumigation, where it has been questioned whether the trade restrictiveness of present practices is necessary for the achievement of regulatory objectives. Very broad requirements for the fumigation of horticultural products such as fresh fruits, vegetables and cut flowers entering Japan may entail costs and delays without significantly contributing to protection against the introduction of new pests into Japan.

Further issues related to agricultural products that have remained or have arisen since the 1999 Report include: regulations concerned with labelling for biotechnology products, which some trading partners consider excessive; application of import bans on products containing certain food additives, although the same additives are approved for use in traditional foods not normally produced outside Japan; etc.<sup>17</sup> Such recent experience

suggests a need for more effective approaches to avoiding unnecessary trade restrictiveness in regulations.

One recommendation of the 1999 Report was that the Japanese Government attempt to promote public understanding of the benefits of regulatory reform. Active efforts have been made in this regard, in particular with respect to inward FDI. In a context of generally improving conditions for FDI since 1999, particular impetus was given by Prime Minister Koizumi's decisive efforts to foster positive public attitudes (characterised in the 1999 Report as "widespread mistrust of foreign ownership")<sup>18</sup> as part of his goal to double the amount of cumulative inward FDI into Japan over five years. Prominent Japanese academics<sup>19</sup> have led the intellectual side of a public education campaign to change misperceptions that foreign investment is predominantly composed of destabilising short-term capital flows or vulture (*hagetaka*) capital seeking to purchase distressed companies for rapid re-sale. This campaign has emphasized that inward FDI is normally long term, brings technology and can be a key element for revitalising the Japanese economy.

In many ways, the conscious effort by the officials to polish the image of inward FDI is a novel break from the past and suggestive of a change in government attitudes. However, it is premature to assess the degree to which changing public perceptions might translate into political support for further reform of the regulatory environment for foreign investment. Problems are still perceived in the complexity of legal provisions applying to mergers and acquisitions and in the discriminatory aspects highlighted above. Improvements are also called for in the transparency of accountancy regulations. At the same time, it should be noted here that allowing the adoption of international accounting standards is one of the reforms reflected in the Special Zones programme. Moreover, sources have indicated gradual improvement in the levels of cross-shareholding (criticised in the past as being abnormally high by international standards) and of publicly traded common stock (criticised as being low).

### **Simplification of administrative requirements**

The simplification of administrative requirements can often be focused in two areas: the reduction of the paper burden on business and the creation of simplified, automated customs procedures for foreign trade. Since the 1999 Report, Japan has made significant improvements in the reduction of paper burdens (see the *Review and simplification measures: Keeping regulations up-to-date* section of Chapter 2 of this report on Government Capacity to Assure High Quality Regulation for a description of how information technology has been used to reduce the paper burden on business). Progress in areas of particular interest to market openness are described below.

The law concerning the Use of Information and Telecommunications Technology on Administrative Procedures entered into force on 3 February 2003. It very quickly had an effect on administrative procedures directly related to commerce, since METI was the first Ministry to issue an ordinance under the law to enable applications, notifications, notices of action and other procedures to be conducted online. To facilitate the implementation of paperless administrative procedures, some processes were entirely re-engineered to allow for the substitution of electronic certificates where copies of certain documents were originally required. In other instances, earlier requirements for the submission of copies of certain documents were omitted entirely during the process of re-engineering. Procedures once requiring multiple copies of forms were reduced to a single set of documents and a process

of simplification and standardisation of forms was initiated. Progress by METI under the Action Plan for Putting Administrative Procedures Online appears in Table 4.1 below.

**Table 4.1. Current progress by METI under the action plan for putting administrative processes online**

Procedures administered by national government agencies	Implementation plan for putting procedures online					Re-examination of procedures	Procedures difficult to put online
	2000	2001	2002	2003	Total		
A. Applications and notifications	96	233	2 122	334	796	1 002	
B. Other procedures	24	3	712	1 891	468	34	
Total	120	236	2 834	2 225	5 415	1 036	0

Procedures administered by local authorities	Implementation plan for putting procedures online					Re-examination of procedures	Procedures difficult to put online
	2000	2001	2002	2003	Total		
A. Applications and notifications	0	0	796	0	796	182	
B. Other procedures	0	0	439	29	468	3	
Total	0	0	1 235	29	1 264	185	0

Source: METI (2004).

In addition, two innovative programmes have been implemented to facilitate the establishment of new businesses. One is reliant on reducing unnecessary paper burdens and the other on reducing unnecessarily high start-up capital requirements. Both are non-discriminatory in that they require foreign applicants only to have received Japanese visas reflecting “investor/manager” status. The clearest advance in the reduction of the paper burden on business is the implementation of an online business application and approval system, which is currently operating on a trial basis.<sup>20</sup> In April 2004, an evaluation of this programme will be conducted, including an analysis of the composition of online business applications. On this basis, a decision will be made on whether to continue this programme. Efforts to stimulate commercial activity have also taken the form of a provisional relaxation of minimum capital requirements for the first five years of a company’s existence, which came into effect on February 2003. On that date, the capital start-up requirements dropped to 1 JPY (from JPY 3 million for companies that do not issue stock and JPY 10 million for companies that do). At the end of five years, the companies are expected to conform to the previous capital requirements. Figures available on the METI website indicate an increase of 8 400 to 93 012 in the number of new company registrations in 2003 over the previous year suggesting that these policies have led to an increase in the number of incorporated commercial actors. As noted above both of these programmes are being introduced on an essentially non-discriminatory basis.

Advances in the reduction of paper burdens have been paralleled by progress (although not as dramatic) in reducing costly and lengthy approval processes in certain areas, as identified in the 1999 Report. For example, difficulties remaining in introducing new medical devices and treatments include: vague classification criteria for many insurance categories; discrepancies between prices prescribed by law and those prescribed by administrating officers; and long periods needed for approval for new treatments. Progress on issues concerning pharmaceuticals has been more positive, particularly with the merging of two regulatory agencies into one.<sup>21</sup> The new organisation will be responsible for the entire approval process from development to market entry, thus

addressing previous difficulties associated with meeting regulatory requirements by differing agencies. Issues relating to new vehicle registration have recorded progress in accelerating Japanese harmonisation towards international norms. Trade partners have indicated gradual improvement in licensing procedures for new entrants in insurance and asset management.<sup>22</sup> In light of the progress recorded in the reduction of unnecessary trade restrictiveness in areas highlighted in the 1999 Report, current difficulties with unnecessary trade restrictiveness seem to centre on procedures for gaining approval for the introduction of new products and services that do not yet exist in the Japanese market. Although this change reflects an improvement in the situation of openness in market entry related concerns, it also highlights the crucial importance that standards and licensing procedures are coming to play in defining the openness of the Japanese market.

#### **4.4. Use of internationally harmonised measures**

Reference to international standards is a practice clearly prescribed under Article 2.4 of the WTO Agreement on Technical Barriers to Trade (TBT Agreement) and Article 3 of the SPS Agreement. Two approaches to the use of internationally harmonised measures exist, the first reliant on international standards as a basis for domestic measures where it is appropriate and feasible. The second is the acceptance of foreign measures as equivalent even where such measures are different, as long as they meet regulatory objectives. Both approaches contribute to market openness by reducing costs associated with meeting regulatory requirements for imports into Japan. It is also important to recognise that like products produced in an economy with a regulatory regime reflecting a high degree of international harmonisation are also more likely to be accepted by other economies conforming to their standards, thus presenting a potential positive externality for efforts in this area. Attention to the benefits that harmonisation towards international standards may hold for Japan can be seen in the Three-Year Program for Promoting Deregulation (TYPPD) as amended for 1998 (as well as subsequent versions of TYPPDs), which identified advancing conformity to international standards as one of six main pillars of the reform programme.

In the area of international co-operation, Japan has prominently supported work to facilitate the international harmonisation of standards. Japan continues to participate actively in the Asia Pacific Economic Co-operation (APEC) Sub-Committee on Standards and Conformance (SCSC) which was established to facilitate progress at the regional level in standards and conformance under areas such as alignment activities, mutual recognition agreements (MRAs) and activities related to Good Regulatory Practice (GRP). The SCSC holds meetings three times a year and Japan is a leading economy in alignment activities. Within the context of the Asia-European meeting (ASEM), Japan has been a participant in the standards and conformity assessment (SCA) meeting under the Trade Facilitation Action Plan (TFAP) dealing with four main areas including: Best Regulatory Practices (BRP) (which parallels the GRP under APEC), alignment activities, MRAs and technical co-operation.

Japan's efforts in the international field are reflected domestically in increasing referencing of international standards as the basis of national standards and domestic regulation. Available data indicates that Japan has made noteworthy progress in the areas of voluntary standards as well as mandatory standards. In terms of voluntary standards for industrial products, while roughly 21% out of 8 000 Japan Industrial Standards (JIS) standards were aligned to international standards at the time of the 1999 Report, the rate of alignment has increased dramatically to 90% of the 8 932 JIS existing by 31 March 2002.<sup>23</sup>

**Box 4.2. Customs clearance: trade facilitation, technology and labour\***

Improvement has been registered with respect to many of the problems highlighted in the 1999 Report concerning customs clearance, e.g. long delays due to lack of intra-governmental co-ordination particularly in Japanese ports. Major progress has been achieved through implementation of an Electronic Data Interchange (EDI) system. However, labour issues resulting in an inability to secure significant decreases in cargo carriage time remain an important cause of continuing delays.

Despite the progression of customs-related improvements indicated below, the time from entry to clearance for ocean-borne consignments was only reduced from 86.7 to 73.8 hours between 1998 and 2001. The time required for customs clearance was reduced from 5.6 to 4.9 hours during the same periods. In brief, the major component of the delays in the clearance of cargo stem not from customs procedures but from the time required for entry and carriage to the bonded area for customs inspection. Inability to alter the efficiency of the dock facilities due to labour issues remain the key barrier to substantial further improvements in the efficiency of Japanese ports.

**Improvements in customs administration**

**Modernisation in customs procedures:** A Single-Window System for import/export and port procedures was implemented in July of 2003. By creating a single integrated electronic document, all documentary requirements associated with import and export could be dealt with in a single electronic filing under this system. Growth in the use of the Single-Window System for ocean freight increased rapidly from 4% of total customs clearances for ocean in July 2003 to 22.9% in January 2004. Large X-ray equipment was introduced in February 2001 as a means to enable inspection of containers without the need to unload containers from trailers. An imaging system for visual inspections was implemented in June 2003 thus obviating the need for certain documentary requirements.

**Operating hours:** A policy for customs offices to remain open 24 hours a day, 7 days a week, was implemented on a trial basis in October 2002 and was later fully implemented in July 2003.

**Customs clearance-related fees:** Fees for use of the EDI system for ocean were reduced by 50% in April 2002. Overtime charges have been reduced by 50% on a trial basis in certain locations under the Special Zones programme.

**Accelerated import procedures:** A pre-arrival examination system to allow for completion of customs procedures before the arrival of cargo imports by air and sea has existed since April 1991. Parallel systems for export by air and sea were introduced in April 2001 and February 2004, respectively. An instant import permit upon arrival system for ocean was introduced in September of 2003, to join a similar system for air implemented in April 1996. This system enables importers to secure import permits before cargo enters customs areas. A simplified declaration procedure was introduced March 2001 and then improved in April 2003. It allows for the provisional release of goods before the declaration of certain types of information related to customs duty payment as well as customs payment. An adjustment of customs procedures for Vendor Management Inventory was implemented in April 2003 to enable non-residents to conduct customs procedures.

\* Data source: Japanese Customs Authority.

As for agricultural products, the Ministry of Agriculture, Forestry and Fisheries (MAFF) has made efforts to align voluntary Japan Agricultural Standards (JAS) to international standards as indicated by recently revised standards on margarine and processed tomato products. In this light, it should be born in mind that while 38% of existing JAS standards were considered as “corresponding” to international standards by May of 2002,<sup>24</sup> no comparable international standards exists for many other JAS standards such as soy sauce.

In terms of mandatory regulations, the percentage of JIS standards quoted as mandatory regulations within Japanese Laws and government/ministerial ordinances nearly tripled from 7% in 1997<sup>25</sup> to 20% in 2001.<sup>26</sup> No data could be found regarding trends in the relationship between voluntary and mandatory agricultural standards. Despite a lack of data regarding the precise overlap between JIS standards that are aligned to international standards and those that are mandatory, the information provided suggests that at least half of Japanese mandatory industrial standards were aligned to international standards in 2002<sup>27</sup> and that the evidence presented is suggestive of accelerating progress. In case of automobiles, while Japan had already joined the UN/ECE 1958 Agreement on the Mutual Recognition of Type Approval for Vehicles by the time of the 1999 Report, it had since committed to adopting 30 out of roughly 100 relevant regulations. For agricultural standards, a significant increase in the percentage of standards identified as corresponding is suggestive of progress although no data on mandatory standards was available.

While there is no evidence of a continuing programme to monitor systematically efforts to use international standards, it is noteworthy that every revision of the TYPPD since the 2000 has supported increasing the use of international standards. Trade partners found the Progress Report on Reviewing the System of Standards Certification published in 2001 a useful addition to the transparency Japanese system of standards administration and the rapid rise in the number of JIS standards aligned to international standards since 1999 indicates progress in efforts towards harmonisation. Since 1999, the MAFF has undertaken a process of reviewing JAS standards every five years to take account of international standards. This process of review, which incorporates a mechanism on conformity assessment procedures, supports the improvement of gains already made, and provides a context for further progress in standards not yet aligned.

Since 1999, Japan has made rapid progress in aligning JIS standards to international standards and has substantially increased the number of JAS standards conforming to international standards. Reflecting circumstances similar with that of many OECD economies which have undergone regulatory reviews,<sup>28</sup> no evidence of a regular and functioning regulatory framework under which acceptance of foreign standards as functionally equivalent has been found in Japan. Similarly, no laws or regulations governing assessment of equivalence were identified that provide clearly-defined criteria for ascertaining equivalence and clearly-defined avenues for demonstrating equivalence. Further gains under the use of internationally harmonised measures could be made in terms of increasing transparency regarding the number of mandatory standards that have been aligned to international standards and the establishment of a routine administrative mechanism with clear rules for establishing and demonstrating equivalence for products meeting foreign standards, as conforming to Japanese standards.

## 4.5. Streamlining conformity assessment processes

If use of internationally harmonised measures rests on one side of a coin, streamlining of conformity assessment processes rests on the other. Conceptually, a variety of approaches may be employed to streamlining conformity assessment, but two stand out as the most common and pragmatic. MRAs and Suppliers Declaration of Conformity (SDoC) have recently experienced high growth among OECD economies including Japan. A third approach practiced in Japan whereby domestic and foreign factories may be designated with the authority to affix the JIS standard for industrial products, has shown some growth since 1999.

### **Demonstrated flexibility towards use of alternative approaches for avoiding duplicative conformity assessment procedures**

As in the case of harmonisation towards international standards, all versions of TYPPD following the 2000 version emphasised that responsible ministries and agencies should endeavour to adopt mutual recognition agreements and to eliminate redundant inspections. Japanese efforts in this area since 1999 have resulted in the conclusion of two sets of mutual recognition agreements and the implementation of a limited SDoc system for telecommunications equipment. Japanese mutual recognition agreements with the European Union and Singapore have strong similarities in design and coverage. The MRA between Japan and the European Community entered into force on 1 January 2002 and covers telecommunications terminal equipment and radio equipment, electrical products, good laboratory practice (GLP) for chemicals and good manufacturing practice (GMP) for medical products. The MRA concluded with Singapore as part of the JSEPA includes provisions concerning mutual recognition in areas including: telecommunications terminal equipment and radio equipment and electrical products listed in two sectoral annexes to the agreement.

Implementation of an SDoc system for product certification can be considered the most advanced method for avoiding duplicative conformity assessment procedures. In the Japanese context, reorienting the philosophical approach of authorities away from an *ex ante* and towards an *ex post* system of regulation was identified as a new area for reform under the new “Cross-Sectoral Fields” heading of Second Report Regarding the Promotion of Regulatory Reform – Priority Reform Measures to Promote Economic Vitalization prepared by the CRR in 2002. The first international application of this new regulatory approach within Japan can be seen the establishment of an SDoc system for fixed line telecommunications terminals on a general basis and for eight specific types for radio equipment on 26 January 2004. This first application of an *ex post* regulatory system within Japan is a very significant first step in a potential re-orientation of Japanese regulatory philosophy. Broadened application of SDoc systems into other areas will further enhance the efficiency gains that such systems can bring to the Japanese economy as a whole.

Substantial gains have been made in terms of establishing the first foreign certification bodies for industrial standards, an increase in the number of foreign factories able to affix the JIS standard and growth in the number of foreign certification bodies for agricultural products. By 1 May 2002, METI accredited the first two foreign organisations as JIS mark certification bodies marking an important gain for the reduction of duplicative conformity assessment procedures. The number of foreign factories able to append the JIS symbol has increased since 1999. Between April of 1999 and March 2002, the number of foreign factories enabled to affix the JIS mark rose by 50 to 400, spanned 22 economies and covered 630 products. For agricultural products, the JAS Law revised in 1999 enabled

foreign certification bodies to be registered as Registered Foreign Certification Organisations (RFCOs). As the number of RFCOs has increased, the number of certified foreign operators and factories has jumped remarkably since 1999. The MAFF has already accredited 21 RFCOs on organic products which have in turn certified 730 foreign operators to apply JAS marks, thus covering 8 700 foreign farmers in 38 economies as of 2003. The MAFF has also accredited 10 foreign certification bodies on forestry products which have certified 370 foreign factories to apply JAS marks in 21 economies as of 2002.<sup>29</sup>

### **Establishing market confidence through accreditation mechanisms**

Trade partners continue to experience difficulties with the Japanese accreditation mechanisms in terms of domestic capacity for accreditation, ease of access to the accreditation processes and a lack of international co-operation in the field of accreditation, despite active Japanese efforts in the area of alignment of standards. Recognition of the need for greatly increasing the number of "Designated Inspection Bodies" was noted as early as April 1996 when the Government's Eighth Long-term Standardisation Plan commenced, but inadequacies in Japan's conformity assessment regime remain. This reality was highlighted in the discussant's suggestion that Japan consider appointing more private and foreign testing bodies in order to provide more inexpensive and satisfactory testing service to importers during 2002 peer review of Japan's Individual Action Plan (IAP). Also suggested was that Japan could simplify procedures so that more quality certification bodies could be established. Despite clear efforts to engage international fora to promote harmonisation towards international standards and various technical assistance activities regarding standards, Japan's international co-operation in the areas of conformity assessment has been less pronounced.

## **4.6. Application of competition principles**

When anticompetitive actions by incumbent producers prevent market access, benefits stemming from the entry of foreign products and producers may be undermined even where domestic regulatory systems otherwise reflect a high degree of market openness. Weak enforcement of competition rules in an economic environment characterised by anticompetitive practices injures the efficiency of the domestic economy once by reducing competition among domestic producers and again by reducing the ability of foreign producers to compete within the domestic economy. In the Japanese context, the significance of private anticompetitive practices to market openness was highlighted in the WTO case *Japan – Measures Affecting Consumer Photographic Film and Paper*, in which the United States claimed that Japan had not honoured liberalisation commitments made under the WTO in the area of consumer photographic film. It is indicative that although the panel decision pointed out that WTO rules applied to government actions, and not private anticompetitive practise which impact market access in ruling for Japan, it did not dispute that market access may have been hindered by private anticompetitive practice. Where internationally negotiated market liberalisations are countered by anticompetitive practices, domestic economies suffer losses in competitiveness that liberalisations would normally be expected to bring.

**Open, accessible complaint procedures for challenging regulatory or private actions which may impair market openness**

The 1999 Report indicated that the Anti-Monopoly Law as implemented by the FTC provided clear, non-discriminatory avenues for complaints. Issues discussed generally related to weak investigatory and enforcement powers, problems in certain sectors and the location of the FTC within the Japanese regulatory system. Important progress has been made in some areas since, particularly in the area of regulatory reforms allowing rights of private action (see the Private initiatives section of Chapter 3 of this report on Competition Policy for further discussion on rights of private action), which is of particular importance to non-incumbent businesses including foreign ones. Still, strides that have been made in this and other areas described below remain to be matched by progress in the area of enforcement. Although recent changes have cleared important ground for further improvements, it is too early to assess the degree to which reforms undertaken since 1999 will lead to effective and resilient reductions in anticompetitive behaviour thus supporting market openness.

Although there have been efforts to improve enforcement since 1999, deficiencies in the investigative and enforcement powers of the FTC to implement competition policy in sectors of importance to market openness remain. The inability of investigative officials to employ legal instruments similar to those available to tax authorities, or to offer leniency in order to detect and break-up illegal cartel arrangements remain as shortcomings in the investigative power of competition authorities.<sup>30</sup> Although the maximum criminal fines were raised fivefold as of 29 June 2002, the deterrent effects are still insufficient to deter anticompetitive behaviour. The comparatively low level of financial sanctions that can be imposed in the administrative process, combined with the lack of a clear *per se* rule against horizontal price-fixing and weak enforcement of criminal penalties, lead to inadequate deterrence. Repeat offences show that violations may be economically rational (profitable) to violators despite the threat of fines. In addition, the FTC's limited analytical capacity in economics reduces its ability to deal with complex cases, particularly ones related to regulated and network industries. The FTC has taken steps to increase these capacities but those steps appear limited so far.

In terms of specific market openness related competition issue areas public utilities and bid rigging (*dango*) have both recorded some progress. The liberalisation of public utilities such as telecommunications and electricity, which were both subjects in the 1999 Report, remains subject to circumstances in which stronger enforcement of competition policy would bring benefits to Japanese consumers. In the telecommunications sector, high prices hampering access to fixed line networks prevent foreign firms from entering the telecommunications services market in Japan. Although the FTC has brought some enforcement actions about regarding telecommunications issues, the lack of experience with complex monopolisation cases under Japan's competition law restricts the ability of the FTC to intervene. Increasing liberalisation in energy services has reduced the prominence of trade issues related to high technical standards required for energy equipment produced by foreign companies and turned attention towards issues similar to those in the telecommunications sector where high prices charged for access to infrastructure for distribution such as power grids effectively restrict foreign participation in that sector.

Bid rigging is often singled out by foreign trade partners as an anticompetitive practice that favours incumbent and normally domestic firms while disproportionately impacting

foreign firms in the field of procurement. Progress since 1999 includes the implementation of the Bid Rigging Involvement Prevention Act designed specifically to address continuing difficulties resulting from official involvement in the bid rigging (*kansei dango*). This new law enhances procedures for recovery of overcharges by firms taking part in bid rigging and facilitates legal actions by citizens to recover overcharges suffered by local governments. The FTC also has a role now in the process of disciplining official involvement in bid rigging. Although a minor improvement in enforcement terms, the new law is symbolically important.

During the time of the 1999 Report, a significant issue raised by foreign trade partners was that the location of the FTC within the administration of the MPHPT, which is responsible for the administration of Japanese telecommunications services, reduced its independence to address anticompetitive practices within that sector. The official transfer of the FTC under the Cabinet Office of the Prime Minister on 3 April 2003 is expected by Japanese trade partners to improve the administrative independence of the FTC. Joining the Cabinet Office may have three interrelated positive effects on the synergies between the competition policy enforcement and market openness. First, administrative proximity to the CRR places the FTC within an administrative context where the development of competition policy enforcement may better foster symbiotic links with the overall process of regulatory reform. Second joining other market openness related organisations such as the JIC, OTO and CHANS may set the stage for better development of the relationship between the role of competition policy and market openness. Finally, joining a Cabinet Office headed by a Prime Minister favouring strong growth in inward FDI may focus increasing attention on the role that anticompetitive practices play in reducing inward FDI, and may also provide some insulation against political pressures seeking to forestall vigorous interventions where required. Significant legal and institutional changes have taken place since the 1999 Report, replying to the question of whether these potential synergies for market openness will be occur is premature.

#### **4.7. Making progress in implementing the recommendations from the 1999 Report**

Although positive incremental changes have taken place across many of the areas highlighted in the conclusions and recommendations of the 1999 Report, most of the general regulatory difficulties relating to market openness within the Japanese economy still exist today. Nevertheless, the results of this monitoring exercise suggest that the stage has been set for significant gains in the market openness of the Japanese regulatory environment. Reforms proposed in the 1999 Report have for the most part taken their place in the Three Year Plans for Regulatory Reform prepared by the CRR, or as organisational changes introduced since the establishment of the Cabinet Office. This rather formal recognition of the ideas behind the recommendations has been a first step to their subsequent implementation. The policy to double inward FDI and the Special Zones programme appear as key initiatives in “catalysing” the market openness aspect of broader process regulatory reform. The FDI policy will entail the implementation of investment friendly policies and the Special Zones process of experimental regulatory reform allows consideration of proposals for reform from domestic and foreign parties. Importantly, both regulatory reform initiatives are seen as domestically driven and not the result of foreign pressure (*gaiatsu*). This supports one of the recommendations in the 1999 Report that is of fundamental importance for the ultimate success of regulatory reform in Japan, namely the need to inform public attitudes about the benefits of such reform.

Changes in the attitudes of the general public towards regulatory reform could have a significant influence on the evolution of a regulatory system implemented by public officials who continue to retain a high level of discretion over economic regulation. The conclusion to the market openness chapter of the 1999 Report pointed out: "Even though the current programmes [of regulatory reform] have been largely based on Japan's own initiatives, the Japanese public still seems to relate them to foreign pressures... While this image helped promote reform against strong domestic opposition, it also helped to make Japanese regulatory reform programmes incremental, defensive and conservative."<sup>31</sup> Even today, reports from the foreign business community in Japan suggest that despite recent advances, the general attitude of government officials particularly in favouring micro-regulation over macro-supervision remains a key impediment to greater contributions by the private sector to the Japanese economy.

In this light it is notable that the policy to double inward FDI and the Special Zones programme both address non-incumbent domestic as well as foreign parties, at the level of policy development as well as implementation. Both of these complementary policy processes reflect a break from the past by providing a sense of "policy ownership" to the Japanese public while also incorporating foreign participation in reform processes bearing a strong market openness component.

An important factor in the progress being made on regulatory reform – and in particular trade and investment-friendly regulatory reform – has been the high-level political support from which it has benefited. The two main policy initiatives discussed here are both closely associated with Prime Minister Koizumi and accord with consolidation of market openness administrative agencies described in the introduction. Although the consolidation of these government agencies within the Cabinet Office took place under the previous Prime Minister (Yoshiro Mori), the degree of political support shown by the Koizumi government towards them also highlights the fact that the institutional setting of the Cabinet Office is, more so than other ministerial level government organs, a political one. The continuity of the policy process and even the institutions of market openness remain highly sensitive to disturbances that could be brought about by political change.

## Notes

1. OECD (2002), p. 5.
2. Japan Investment Council (2003), p. 1.
3. Section I of the Public Comments Procedure.
4. MPHPT (2004).
5. European Commission (2003a), p. 11.
6. *Ibid.*
7. These include issues related to: the formulation of standards, the review of domestic standards, the recognition of foreign test data, the efficiency of the customs and quarantine services, the simplification and facilitation of import procedures and others.
8. Market Access Ombudsman Council (2003).
9. Some of the issues raised apply equally to non-incumbent domestic firms.
10. Where agreements negotiated to liberalise at the regional level are then applied on an MFN basis during the implementation stage, as characterised in the Asia-Pacific Economic Co-operation (APEC) process.

11. WTO (2002), p. 29, and WTO (2000b), p. 42.
12. A negative list of sectors for which prior notification to the Minister of Finance and the Minister in charge of the industry involved is required is available through the Internet.
13. ACCJ (2003a), p. 2.
14. USTR (2001), p. 2.
15. Information provided by the Government of Japan.
16. EBC (2003a), pp. 74-75.
17. USTR (2003), p. 213.
18. OECD (2003a), p. 248.
19. Fukao, Kyoji and Tomofumi Amano (2003).
20. This programme is being applied on a national basis and is not part of the Special Zones programme.
21. EBC (2003a), p. 50 and USTR (2003a), p. 200.
22. EBC (2003a), pp. 28 and 31 and USTR (2003a), p. 201.
23. WTO (2002), p. ix.
24. Defined as "primary aspects sharing a common scope".
25. WTO (2000a), p. 21.
26. WTO (2003), p. 36.
27. From the data above indicating that 90% of JIS standards are aligned to international standards and that 20% of JIS standards are mandatory, it can be deduced that at least 10% of JIS standards are aligned to international standards.
28. OECD (2002), p. 29.
29. Information provided by the Government of Japan.
30. EBC (2003a), p. 4.
31. OECD (1999), p. 268.

## Bibliography

American Chamber of Commerce in Japan (ACCJ) (2001), 2001 US-Japan Business White Paper, available at: [www.accj.or.jp/content/advocacy/tmp/BWP2001.pdf](http://www.accj.or.jp/content/advocacy/tmp/BWP2001.pdf).

ACCJ (2003a), ACCJ Applauds Koizumi Foreign Direct Investment Pledge, available at: [www.accj.or.jp/document\\_library/PressReleases/1052721421.pdf](http://www.accj.or.jp/document_library/PressReleases/1052721421.pdf).

ACCJ (2003b), From Goals to Reality: FDI Policy in Japan, available at: [www.accj.or.jp/document\\_library/1068424402.pdf](http://www.accj.or.jp/document_library/1068424402.pdf).

ACCJ (2003c), The Long Road to Reform, available at: [www.accj.or.jp/tmp/longroadE.pdf](http://www.accj.or.jp/tmp/longroadE.pdf).

Cabinet Office of the Prime Minister (2004a), Japan's Government Procurement: Policy and Achievements Annual Report (FY 2002 version) – Toward Government Procurement Open to the World, available at: [www.kantei.go.jp/foreign/procurement/2002/index.html](http://www.kantei.go.jp/foreign/procurement/2002/index.html).

Cabinet Office of the Prime Minister (2004b), Special Zones for Structural Reform, The Headquarters for the Promotion of Special Zones for Structural Reform, available at: [www.kantei.go.jp/foreign/policy/kouzou2/sanko/030326setumei\\_e.pdf](http://www.kantei.go.jp/foreign/policy/kouzou2/sanko/030326setumei_e.pdf).

DG Trade, European Commission, Market Access Sectoral and Trade Barriers Database, <http://mkaccdb.eu.int>.

Economist Intelligence Unit (2003), *Country Report: Japan*.

European Business Community in Japan (EBC) (2003a), "Promoting Foreign Investment through Decisive Reform: The EBC Report on the Japanese Business Environment 2003", available at: [www.ebc-jp.com/2003%20EBC%20WP%20Publicity%20for%20Web.doc](http://www.ebc-jp.com/2003%20EBC%20WP%20Publicity%20for%20Web.doc).

- European Business Community in Japan (2003b), *Comments on Japanese competition policy (... and related regulatory issues)* (Prepared for 2003 OECD Country Survey Mission to Japan), available at: [www.ebc-jp.com/news/2003%20OECD%20Brief%20\(Japanese%20Competition%20Policy\)%20\(27%20MARCH%202003\).pdf](http://www.ebc-jp.com/news/2003%20OECD%20Brief%20(Japanese%20Competition%20Policy)%20(27%20MARCH%202003).pdf).
- European Commission (2003a), EU Priority Proposals for Regulatory Reform in Japan, available at: <http://jpn.cec.eu.int/english/eu-relations/proposals2003e.pdf>.
- European Commission (2003b), EU Supplementary Proposals for Regulatory Reform in Japan, available at: [http://europa.eu.int/comm/enterprise/enterprise\\_policy/gov\\_relations/japan\\_rrd/f1625.pdf](http://europa.eu.int/comm/enterprise/enterprise_policy/gov_relations/japan_rrd/f1625.pdf).
- Fukao, Kyoji and Tomofumi Amano (2003), "From Goals to Reality: FDI Policy in Japan", available at: [www.accj.or.jp/content/advocacy/FDI](http://www.accj.or.jp/content/advocacy/FDI).
- Japan Investment Council (2003), Japan: An Attractive Destination for International Investment, available at: <http://www5.cao.go.jp/access/english/jic/20030327b-jic-e.pdf>.
- Market Access Ombudsman Council (2003), Recommendations on Market Access Issues as Concerns Standards, Certifications and Others: "Report of the Comprehensive Review", available at: [http://www5.cao.go.jp/access/english/oto\\_main\\_e.html](http://www5.cao.go.jp/access/english/oto_main_e.html).
- Ministry of Economy Trade and Industry (METI) (2004), "Putting Administrative Procedures Online", available at: [www.meti.go.jp/english/information/data/cProceduresOnlinee.html](http://www.meti.go.jp/english/information/data/cProceduresOnlinee.html).
- Ministry of Public Management, Home Affairs, Posts and Telecommunications (MPHPT) (2004), Public Information Website, available at: [www.soumu.go.jp/english/](http://www.soumu.go.jp/english/).
- Nohara, Satoshi (2003), *Special Zones for Structural Reform (Deregulation) in Japan*, Industrial Structure Policy Division, Ministry of Economy, Trade and Industry (METI), 30 June 2003.
- OECD (2003a), *OECD Economic Surveys: Japan – Vol. 2003, Issue 18*, Paris.
- OECD (2003b), "OECD Economic Survey of Japan, 2003 – Summary", in the *OECD Observer*, Paris.
- OECD (2002), *Integrating Market Openness into the Regulatory Process: Emerging Patterns in OECD Countries*, Paris.
- OECD (1999), *Regulatory Reform in Japan*, Paris.
- OECD (1999b), *Regulatory Reform in Japan: Government Capacity to Assure High Quality Regulation*, available at: [www.oecd.org/dataoecd/48/23/2478664.pdf](http://www.oecd.org/dataoecd/48/23/2478664.pdf).
- OECD (1992), *Public Management Profiles: Japan*, available at: [www.oecd.org/dataoecd/9/13/1901994.pdf](http://www.oecd.org/dataoecd/9/13/1901994.pdf).
- Tanaka, Nobuo (2003), "Japan's Perspective on Regulatory Reform and the DDA: Towards better integration of domestic and external economic policy", presentation delivered at the OECD Forum on Global Governance.
- United States Trade Representatives (USTR) (1995-03a), "National Foreign Trade Estimate Report on Foreign Trade Barriers", available at: [www.ustr.gov/reports](http://www.ustr.gov/reports).
- USTR (2003b), "Annual Reform Recommendations from the Government of the United States to the Government of Japan under the US-Japan Regulatory Reform and Competition Initiative", available at: [www.ustr.gov/regions/japan/2003-10-24-reform2.pdf](http://www.ustr.gov/regions/japan/2003-10-24-reform2.pdf).
- World Economic Forum (2004), *Global Economic Competitiveness Report: 2003-2004*.
- WTO (1998), "Trade Policy Review – Japan", Report by the Secretariat, Trade Policy Review Body, 5 January 2002, WT/TPR/S/32.
- WTO (2000a), "Trade Policy Review – Japan", Report by the Secretariat, Trade Policy Review Body, 17 October 2000, WT/TPR/S/76.
- WTO (2000), "Trade Policy Review – Singapore", Report by the Secretariat, Trade Policy Review Body, 29 February 2000, WT/TPR/S/67.
- WTO (2002), "Trade Policy Review – Japan", Report by the Secretariat, Trade Policy Review Body, 9 October 2002, WT/TPR/S/107.
- WTO (2003), "Japan – Measures Affecting the Importation of Apples", AB-2003-4, Report of the Appellate Body, Appellate Body, 26 November 2003, WT/DS245/AB/R.

## ANNEX 4.1

### *Implementation of the 1999 recommendations*

Recommendations of 1999 review	Assessment of actions taken since 1999 review	Further recommendations
Enhance transparency from the international perspective through concrete and wide ranging steps.	In keeping with recommendations made in the previous report, great strides have been made in the availability of information on the Internet as well as the implementation of the Public Comment Procedure and the NAL system. Reforms in all three of these areas have the potential to alleviate significant transparency issues raised in the 1999 Report, particularly if developed further in certain ways.	<ul style="list-style-type: none"> <li>– Provision of information over the Internet should also be mandatory for Internal Orders, Communication Notes, Administrative Guidance and negotiations for international agreements, with English versions to the extent possible.</li> <li>– Application of the Public Comment Procedures should be made mandatory for all Internal Orders, Communication Notes, Administrative Guidance and negotiations for international agreements.</li> <li>– Responses to requests for NALs should be mandatory, in writing and legally binding.</li> </ul>
Heighten government capacity to promote market openness perspectives in regulatory reform.	Attention to this recommendation is reflected in the integration of essentially all regulatory agencies concerned with market openness under the Cabinet Office. <sup>1</sup> This situation enhances both the capacity and the potential for an integrated consideration of market openness perspectives in the process of regulatory reform. It also brings increased visibility and prestige. However, decisive examples of increased co ordination and dialogue remain lacking.	<ul style="list-style-type: none"> <li>– The implementation of measures guaranteeing the permanence of the administrative agencies under the Cabinet Office in the event of changes in the political climate would enhance the persuasiveness and durability of the reforms conducted by them.</li> <li>– Increased co ordination among the administrative agencies under the Cabinet Office, would fortify the capacity, coherence and effectiveness of efforts to promote market openness within the Japanese regulatory system.</li> <li>– The Headquarters for the Promotion of Special Zones for Structural Reform, the soon to be established Headquarters for the Promotion of Regulatory Reform, the OTO and CHANS should be unified into a single agency comprised of a common facility and staff. Such an approach would virtually guarantee policy coherence between the two key government agencies involved in the design and implementation of regulatory reform. Placing the OTO and CHANS into this new agency should serve to ameliorate the resource difficulties currently facing these two agencies. More importantly, it would integrate the institutional knowledge of market openness within the articulation of regulatory reform.</li> </ul>

Recommendations of 1999 review	Assessment of actions taken since 1999 review	Further recommendations
<p>Establish a systematic approach to cope with recurring themes in the trade debate, such as lack of openness procedures, unnecessary trade restrictiveness as well as harmonisation of standards and recognition of foreign conformity assessment.</p>	<p>Progress in the areas referred to here can be seen <i>e.g.</i> in the greater alignment of Japanese to international standards and the accreditation of two foreign conformance assessment bodies since the 1999 Report. While little substantive progress has been seen in terms of developing and implementing systematic approaches to addressing these various issues, the consolidation of market openness related administrative agencies under the Cabinet Office provides a clear focal point for progress in systematising efforts to enhance procedural openness, reduce unnecessary trade restrictiveness, consolidate gains in harmonisation of standards and broaden recognition of foreign conformity assessment. Further specific steps to make progress in implementing the recommendation would include the following.</p>	<ul style="list-style-type: none"> <li>– The Cabinet Decision establishing the JIC should be amended to provide it with implementation responsibilities beyond its current duties largely limited to the collection and dissemination of information. Institutional co ordination between the JIC and the new agency proposed above should be provided for.</li> <li>– Specifically mention the six market openness principles as guiding themes under the new heading “Regulatory reforms designed to increase the international appeal of Japan” contained in the March 2004 revision of the TYPERR report of the CRR, thereby formalising criteria for progress that would be subject to review in subsequent reports of the CRR.</li> <li>– Make market openness considerations an obligatory area of consideration within the developing RIAs.</li> <li>– Establish clearly defined criteria for ascertaining equivalence and clearly defined avenues for demonstrating such equivalence, as means to underpin progress toward increasing the scope of action for accredited foreign conformity assessment bodies.</li> </ul>
<p>Engage pro actively in public affairs to enlighten the Japanese public, including consumers, of the economy wide benefits of regulatory reform and market openness.</p>	<p>Probably the most substantive efforts have been made in this area of particular importance to the market openness component of the regulatory reform process. By encouraging contributions from the foreign business community to regulatory reform on a policy level and supporting the image of FDI as an agent of healthy economic revitalisation, important groundwork has been laid for important changes in public attitudes towards regulatory reform and market openness. Success in this area will have far reaching implications for market openness within a regulatory system that continues to reserve a high degree of discretion for public officials. Further efforts to mainstream market openness within domestic public perceptions may take place in the following ways.</p>	<ul style="list-style-type: none"> <li>– Promoting and dissemination of studies regarding success stories in Japanese regulatory reform beyond the area of inward FDI such as under the Special Zones programme would serve to enhance public support behind further reform.</li> <li>– Increasing the visibility of regulatory reform success stories in other economies would further supplement public confidence to engage deeper reform.</li> </ul>
<p>Enhance regulatory co-operation with other countries.</p>	<p>The conclusion of MRAs with the European Community and Singapore represent important gains in this area since the last report. Co-operation with the American Chamber of Commerce and European Business Community in Japan demonstrates an area of co-operative effort with other economies that could serve as a template for substantive progress in co-operation within other economic fields. Approaches may include the following considerations.</p>	<ul style="list-style-type: none"> <li>– Supplement efforts to facilitate harmonisation toward international standards by engaging in co operation and capacity building in the area conformity assessment with a view to increasing the number of Japanese accredited foreign conformity assessment bodies.</li> <li>– Continue dialogue with economies receiving high rates of inward FDI regarding the design of mergers and acquisitions laws that would enhance the attractiveness of Japan to FDI.</li> <li>– Actively engage bilateral co operation in the field of competition policy as described in the competition policy section.</li> </ul>

Recommendations of 1999 review	Assessment of actions taken since 1999 review	Further recommendations
Strengthen competition policy enforcement recognising its increasing importance in promoting market openness.	Although indications of progress in this area were found, continued enhancement of the competition policy enforcement will have implications for the market openness of the Japanese economy. As part of the Cabinet Office, the FTC is now institutionally closer to market openness administrative agencies including the OTO, CHANS and JIC as well as at the centre work for the development for regulatory reform the CRR.	<ul style="list-style-type: none"> <li>– Increased dialogue with partner administrative agencies in Cabinet Office should serve to enhance the sensitivity of the FTC to the market openness implications of this work as well as strengthen role of competition policy within the larger programme of regulatory reform, which should also serve to enhance the market openness aspect of Japanese regulatory reform.</li> <li>– Improving economic analytical capacity will further enhance the ability of the FTC to handle competition issues, particularly in the network utilities sectors, which have important market openness implications.</li> <li>– Continue improvement of enforcement capacities in line with recommendations set out in the competition policy section.</li> </ul>

1. Including the: Council for Regulatory Reform (CCR), Office of Trade and Investment Ombudsman (OTO), Japanese Investment Council (JIC), The Headquarters for the Promotion of Special Zones for Structural Reform, Office for Government Procurement Challenge System (CHANS) and Japan Fair Trade Commission (FTC).

OECD Browse\_it Edition  
uʌv Read Only  
• Lecture seule

OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16  
PRINTED IN FRANCE  
(42 2004 10 1 P) ISBN 92-64-01715-1 – No. 53607 2004