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discussion paper

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**Regulatory Reform and Market
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Mark Tilton

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Abstract

This paper examines the nature of Japanese regulation, its effect on international trade, and the reasons for the slow progress of deregulation. It argues that the informal and discretionary power of the Japanese bureaucracy, combined with a continued protectionist, pro-producer, and pro-insider bias to the manipulation of the regulatory system, continues to maintain high prices and discourage imports into Japanese markets. The paper also argues that Japan's weak anti-trust enforcement allows cartels to play an important role in regulating Japanese markets, particularly in industries such as steel and chemicals. While liberal initiatives have introduced some important regulatory reforms, they have not fundamentally transformed the Japanese regulatory system because neither business nor the bureaucracy genuinely want drastic reform or free-wheeling markets. Liberal reformist measures in Japan are an important corrective and supplement to mercantilist policy, but are not likely to fundamentally transform Japan's political-economic system.

Zusammenfassung

In dieser Studie werden Konzept und Realisierung der japanischen Regulationspraxis analysiert sowie ihre Auswirkungen auf den internationalen Handel und die Ursachen für den langsamen Fortschritt bei der Deregulation. Dabei wird die Meinung vertreten, daß als Folge der informellen Macht der japanischen Bürokratie mit ihrem großen Ermessensspielraum, kombiniert mit der fortdauernden protektionistischen, Unternehmer- und Insiderfreundlichen Grundeinstellung zur Beeinflussung des regulatorischen Systems, sowohl hohe Preise als auch die Abschottung der japanischen Märkte vor Importen aufrechterhalten werden. Außerdem ist zu berücksichtigen, daß die nur schwach entwickelte japanische Anti-Trust-Politik den Kartellen die Möglichkeit gibt, eine einflußreiche Rolle bei der Regulierung der Märkte zu spielen, vor allem in der Stahl- und Chemiebranche. Auch wenn einige Liberalisierungsinitiativen durchaus erkennbare regulatorische Reformen gebracht haben, so haben sie doch nicht das japanische regulatorische System in seiner prinzipiellen Wirkungsweise verändert. Weder die Unternehmen noch die Bürokratie wollen eine wirklich durchgreifende Reform oder freie Märkte. Liberale Reformmaßnahmen in Japan sind wichtig als Korrektiv und Ergänzung der merkantilistischen Politik, aber es ist unwahrscheinlich, daß sie Japans politikökonomisches System verändern.

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Introduction

There is an odd paradox in Japan. A long-standing regulatory reform movement, with Japan's top business organization, Keidanren (Japan Federation of Economic Organizations), at its head, energetically demands that the bureaucracy step aside and let the market work. Keidanren president and director general, Miyoshi Masaya, said after the 1996 election that "our top priority [for the new government] is the abolition and relaxation of government regulations."¹ Foreign governments have hoped that domestic pressure for regulatory reform would make markets more competitive, and in the process, open them to imports. Yet prominent Japanese observers of the economy, not to mention foreign firms trying to export to Japan, say that government regulation and other non-tariff barriers continue to block imports. They argue that Japan must wean itself away from government regulation and open its markets in order to make Japan's international trade relations fair and sustainable and to make its economy more efficient and flexible. The Mitsubishi Research Institute reports that, "we must recognize that the framework of Japan's economy is, by international standards, so far divorced from market economic principles that it not only creates friction with other countries, but also stands in the way of Japan's growth in the 21st century."² Economist Shimada Haruo argues that Japan needs an unregulated free trade zone that could serve as an "airhole into the Japanese regulatory state."³ He argues that the lack of open markets for goods and services keep prices high and imports out: "The market does not function rationally; that is, there are a number of barriers preventing free competition, so that despite the rise in the yen, cheap goods and services are not being imported from overseas in sufficient quantities."⁴ Keidanren Vice-Chairman Kumagai Naohiko warns that international trust in Japan has weakened because of regulations and other invisible barriers that block trade and investment from overseas.⁵

What are we to make of this paradox? To understand why the regulatory reform movement has failed to free the market from these barriers, we need to look closely at the goals of Japanese business and government. While in the United States arguments for regulatory reform point to its benefits for

¹ *Japan Times*, November 18, 1996, p. 17.

² Mitsubishi Sôgô Kenkyû Jo, *Nihon Kaikaku* (Reforming Japan), (Tokyo: Daiyamondo Sha, 1996), p. 44.

³ Shimada Haruo, *Japan Crisis* (Tokyo: Kodansha, 1995), p. 65.

⁴ Shimada Haruo, *Japan Crisis* (Tokyo: Kodansha, 1995), p. 101.

⁵ Kumagai, Naohiko, "Nihon ni shinrai o torimodose" (Let's bring back trust in Japan), *Gekkan Keidanren*, July 1996, p. 48.

expanding consumer welfare, Japanese advocates of reform have focused on the need to strengthen Japan's international competitiveness.⁶ And while the U.S. deregulation movement expresses strong faith in fluid markets, Japanese business appears to be comfortable with the power of bureaucracy and business to order markets, despite the liberal arguments of top business leaders. The focus of the Japanese regulatory reform movement has been to relax regulations selectively when this will increase the competitiveness of Japanese business. Free market arguments provide useful leverage to make strategic modifications to the inefficient excesses of a heavily regulated system, but it would be a mistake to conclude that the dominant thinking of Japan's business or political leaders is oriented to wholesale promotion of free competition. As pointed out in Chapter 1, the ordinary term that corresponds to "deregulation" in Japanese, "kisei kanwa", merely means "relaxation of regulations," a much less ambitious goal than deregulation. Rather than an overall opening of markets, we should expect regulatory reform to lead to selective market opening based on a combination of strategic concerns, the political clout of certain factions of business, market factors, and pressure from foreign governments.

One of the best indicators of the failure of regulatory reform to introduce real competition into Japanese markets is the fact that Japanese prices continue to be far higher than those in other advanced industrialized countries. A 1994 MITI survey of business costs found Japanese prices for raw materials, intermediate goods, and capital goods to be 30 percent higher than in the U.S., 19 percent higher than in Germany, and 46 percent higher than in South Korea. Prices for services were 51 percent higher than in the U.S., 96 percent higher than in Germany, and 475 percent higher than in South Korea.⁷ A November 1995 survey by Japan's Economic Planning Agency estimated that prices for durable goods were 47 percent above US prices, though 8 percent below German prices. Clothing and shoes were 93 and 35 percent higher respectively, and other manufactured goods 54 and 15 percent higher respectively.⁸ Sazanami, Urata, and Kawai concluded from their comparison of Japanese domestic and import prices that nontariff barriers add 174 percent to the prices of tradable goods in Japan. For machinery the "implied nontariff barrier rate" was 140 percent, for chemicals 127 percent, and for metal products 60 percent.⁹

⁶ Interview with Glen Fukushima, published in, "Minkan de dekiru jigyo wa minkan ni saseru, kore ga kihon desu," *Keidanren Geppô*, Vol 44, No. 7 (July 1996).

⁷ MITI, *Tsûshô hakusho* (Trade and industry white paper), 1995, p. 140.

⁸ Keizai Kikakuchô Bukka Kyoku, *Seikeihi chôsa (1995 nen) ni yoru kôbairyoku heika oyobi naigai kakakusa no gaikyô* (Purchasing power parity and domestic/international price gap based on the survey of living costs (1995) (Based on November 1995 prices), May 1996.

⁹ Yoko Sazanami, Shujiro Urata, and Hiroki Kawai, *Measuring the Costs of Protection in Japan* (Washington, D.C.: Institute for International Economics, 1995), pp. 6-7.

1. Regulatory Barriers to Competition and Trade: Licensing

There are three layers of problems with the Japanese regulatory system. First, at the systemic level, the bureaucracy continues to enjoy considerable informal and discretionary power. Other systemic problems are that Japan tends to produce exclusive and discriminatory industrial standards and lacks strong anti-monopoly policy. A second level of problem is the protectionist, pro-producer, and pro-insider bias to the way the regulatory system is used. The third level of problem is the outcome: barriers to imports and upward pressure on prices, that hurt Japan's consumers and hurt Japan's trading partners by unfairly creating domestic sanctuary markets for Japanese firms.

Japanese regulation is based on broad powers held by the bureaucracy that are to an important extent based on licensing authority. Regulation tends to benefit insiders and prevent market change and is often pointedly directed at importers. Japanese bookstores abound with books complaining about the power of the bureaucracy to impose its will, often in arbitrary, nonsensical ways. For example, a company was forced by the Ministry of Transportation to spend \$10,000 on a wind gauge for a ski lift at an indoor ski run since regulations said that all ski lifts had to have them, despite the fact that there was obviously no wind inside the building and therefore no legitimate need for a wind gauge. In another case the former captain of a cruise ship that was being taken out of service bought it to use as a floating hotel in Beppu, Kyushu. The Ministry of Transport first told the company that the ship was no longer really a ship, since it was not registered as one and that the firm should be licensed by the Ministry of Construction. The Ministry of Construction then ordered the passageways widened, the cabins taken out, and the wood paneling replaced with fireproof materials. Without cabins, the company gave up on the idea of running a hotel and decided to turn it into a restaurant instead. At that point the Ministry of Transport said that since it was still floating it should be licensed as a ship. The extra work required cost 4.5 billion yen (roughly \$US 40 million) and forced the sale of the ship to a company in China, where it was possible to use it as a hotel.¹⁰ The point of such stories is that licensing authority gives the bureaucracy enormous power even vis-à-vis domestic firms, and that there is often no recourse to it when it acts unreasonably.

An executive at one of Japan's top electronics firms recounted an example of how MITI uses its general power to grant licenses and distribute information to get its way in areas not directly related to a specific license. MITI asked electronics firms to contribute money to a new high tech information institute, the purpose of which seemed to be mainly to pay high salaries to MITI retirees.

¹⁰ Nihon Keizai Shinbun Sha, *Kisei ni idomu* (Challenging regulation), (Tokyo: Nihon Keizai Shinbun Sha, 1996), p. 28

Though employees in other parts of the firm argued against wasting company money on the institute, the people directly in charge put money into it anyway because they feared that otherwise MITI at some point might withhold crucial information or permits. The electronics executive went on to say, "Bureaucrats legally don't have power. But we're still afraid of being called in to present documents over some issue. When I think of being called in to explain something to some bureaucrat who is younger than me, my hands shake. It would be shameful to have to do that. It's not just a matter of money. And bureaucrats can always find something to penalize you over. For instance, you might make some small oversight or mistake that would normally be overlooked, but if you're on the outs with bureaucrats they'll call you in over it. Say for instance, maybe you were supposed to import 20% of your semiconductors and you only imported 19.8%. They can find some pretext to fine you."¹¹

Licensing powers have been key to restricting the establishment of large discount stores, thus protecting small shops and the domestic manufacturers that sell to them. One of the principal means of preventing the opening of discount stores is the Large Store Law, created in 1973 to protect small stores from competition. The law requires prospective new store owners to consult with pre-existing store owners to get their approval before beginning construction. The applicant must submit complete blueprints, which are normally not accepted in full, requiring new plans to be drawn up at considerable expense and restricting the size and efficiency of the new retail operations. The Large Store Law also restricts the days and hours that big stores can do business and their use of vending machines and advertisements.¹² Although the law has been loosened somewhat, the Japan Fair Trade Commission has complained that it is still a powerful barrier to retail competition and that "regulatory reform efforts have so far not tackled the major problems inherent in the retail sector."¹³ MITI said in April 1995 merely that it would review the law within three years. Not only are retailers forced to scale back floor plans to get a license, the local small shop associations also use their influence over the licensing process to informally pressure large retailers to accept other restrictions on their operations. Thus for instance while 200 Daiei stores have liquor licenses, fifty of them can only sell imported liquor because of special extra restrictions written into their licenses. Although new discounters like Toys R Us and Daiei have expanded recently, there are still only 370 Daiei and some forty Toy R Us outlets in a market 60 percent the size of the US.

One of the practices the FTC complained about is the extensive use of licensing to limit the number of new stores. For instance, the Ministry of

¹¹ Personal interview, Tokyo, July 1994.

¹² Iwasaki, *Kanryô tōsei rettō*, p. 11.

¹³ *Nikkei Weekly*, June 26, 1995.

Finance uses licenses to limit the number of liquor and tobacco dealers in any given area. New liquor stores must be a certain distance from pre-existing stores, and if the Finance Ministry, represented by local government officials, thinks there are too many a lottery is held to allocate a license. The extensive and complicated licensing system is an obstacle to many kinds of new stores. For example, to open a supermarket one needs forty-five different licenses, requiring the submission of two hundred pages of applications under seventeen different laws. This includes separate applications to different agencies for licenses to sell meat, fish, milk, bread, tofu, pickles, ice cream, cakes, tea, frozen foods, box lunches, etc. The Daiei supermarket chain estimates the application process costs 160 million yen (about US\$1.4 million) per supermarket.¹⁴

Obstacles to opening large stores has enabled small stores to hold onto a much larger share of the market than in the U.S. In Japan in 1991 stores with 1-4 employees were 79.4% of total retail outlets in contrast to the 44.7% accounted for by small shops in the U.S. in 1989.¹⁵ Restricting discounters has been important for keeping prices high for Japanese manufacturers and limiting access to foreign competitors. Discount stores sell electronics and other goods more cheaply and successfully negotiate for lower wholesale prices. Small shops charge higher prices and in the electronics market tend to be controlled by manufacturers, a unique feature of the Japanese distribution system that makes it harder for importers to break into the market.¹⁶ Itoh Motoshige writes that during the period when the Japanese electronics industry was establishing itself as the world leader by selling large volumes of inexpensive, high quality products overseas, manufacturers' control of domestic electronics retailers enabled them to act as a "cartel" and charge high prices in the Japanese market.¹⁷ Although the market share of discount stores has risen and that of manufacturer-controlled electronics stores has fallen below fifty percent in recent years, they are still important for manufacturer profits.¹⁸

¹⁴ Iwasaki Hiromitsu, *Kanryô tōsei rettô Nihon ga abunai* (The bureaucrat-controlled Japanese archipelago is in danger), Tokyo: Goma Shobō, 1994, pp. 14-16.

¹⁵ Iwasaki, *Kanryô tōsei rettô*, p. 72.

¹⁶ Itoh Motoshige. *Nihon no bukka wa naze takai no ka, kakaku to ryûtsû no keizaigaku*. NTT Shuppansha, 1995, pp. 85, 197.

¹⁷ Itoh Motoshige. *Nihon no bukka wa naze takai no ka, kakaku to ryûtsû no keizaigaku*. NTT Shuppansha, 1995, p. 83.

¹⁸ Tajima Yoshihiro, *Kisei kanwa, ryûtsû no kaikaku vijon*. Tokyo: Nihon hōsō shuppan kyōkai, 1994, p. 234.

2. Product Standards That Discriminate Against Imports

Another way in which the bureaucracy favors domestic manufacturers over importers is through discriminatory use of product standards. Standards often fit the strengths and peculiarities of the domestic industry rather than serving any clear public interest in safety or quality. A common problem is that standards require specific designs that are unique to Japanese manufacturers, rather than fulfillment of performance criteria. Design-based standards are a significant barrier to construction materials imports. The Construction Standards Law bases standards on traditional Japanese designs; standards for these are not even consistent between different regions of Japan.¹⁹ The Construction Ministry has revised standards to allow in low value-added products such as two-by-four lumber, but has not introduced broader performance-based changes to allow in nails, prefabricated housing, or other building materials. Japan also has many safety standards that Japanese critics say are unnecessarily strict and that seem to serve mainly to keep out goods made in countries with more ordinary standards. Examples of such product categories are high pressure gas equipment, boilers, and electric equipment. Antiquated standards for water lines make it hard to import superior Western plumbing supplies.²⁰ Foreign pharmaceutical companies complain about the slow and sometimes opaque approval process for foreign goods, and arbitrary regulations that, for instance, prevent certain products from being sold in gelatin capsules.²¹ Jay Tate argues that Japanese standards have greater power to block imports than American or European standards in part because Japan tends to develop a single national standard under the guidance of the Japan Industrial Standards Committee, a government office supervised by MITI. Tate emphasizes that, "while major European standards organizations are also quite centralized (some more so than Japan) they are private; it's the state role that gives the system its trade barrier bite."

A second feature of Japan's standards process that impedes imports is the JIS system of government testing and certification, which requires JIS factory approval before goods can be labeled with the JIS seal. "Consumers who have come to rely on the JIS mark are less likely to buy products from factories that have not been granted permission to affix the JIS mark to their products." In contrast, the more pluralistic American standardization process often produces multiple, competing standards, that are not usually backed by state authority.²²

¹⁹ Katô Masashi, *Kisei kanwa no keizaigaku*. Toyo Keizai Shinpôsha. 1994, p. 73-74.

²⁰ Katô Masashi, *Kisei kanwa no keizaigaku*. Toyo Keizai Shinpôsha. 1994, p. 75.

²¹ United States Trade Representative, *1996 National Trade Estimate Report on Foreign Trade Barriers* (Washington, D.C.: United States Government Printing Office, 1996), p. 179.

²² John Jay Tate, "Making Things Better: Technical Institutions and Industrial Innovation in Japan," talk presented to the Ph.D. Kenkyukai, International House of Japan, Tokyo, November 27, 1996. Also see, John Jay Tate, *Driving Production Innovation Home*:

The Japanese government has set up the Office of the Trade and Investment Ombudsman (OTO) to arbitrate foreign firms' disputes over such problems as discriminatory standards, but the office has no power to enforce its decisions and foreign firms have generally not been satisfied with the results.²³

Similarly arbitrary rules block imports of auto parts. The Ministry of Transportation (MOT) requires frequent, costly inspections of cars at a network of certified garages that pressure car owners into making unnecessary repairs to pass government inspections, creating an artificial market for parts.²⁴ "Critical parts" for auto repairs can only be sold by certified dealers. Onerous requirements for certification have limited it largely to shops tied to Japanese auto makers. The shops reward MOT for its patronage by hiring a large number of MOT retirees. The list of critical parts tends to ensure that consumers buy Toyota parts for Toyota cars rather than cheaper alternatives and enables Japanese auto firms to charge high prices for parts that cross-subsidize their sales of autos. A 1991 Commerce Department and MITI survey found that Japanese auto parts cost more than twice as much as US parts.²⁵ The Japanese government agreed to changes to open up the repair, inspection, and parts market in 1995 that brought down the cost of car inspections 13% by 1996.²⁶ But regulations still unnecessarily burden Japanese consumers, keep imports out, and allow Japanese car companies to charge exorbitant prices for parts.

In addition to setting arbitrary standards that keep imports out, bureaucrats also often add procedures that add to the cost of importing. For instance, imported alcoholic beverages are taken to a tax warehouse, where a seal is affixed by hand to each can or bottle. The cheapest beer costs 17.3 yen a can at 100 yen/dollar, but the cost of the seal adds about 5-6 yen per can, or 30 percent of the cost of imported beer. Liquor taxes of 77.70 yen push the price of beer up to 120 yen per can.²⁷

Guardian State Capitalism and the Competitiveness of the Japanese Automobile Industry (Berkeley: University of California at Berkeley, BRIE, 1995), pp. 200-203.

²³ United States Trade Representative, *1996 National Trade Estimate Report on Foreign Trade Barriers* (Washington, D.C.: United States Government Printing Office, 1996), p. 178.

²⁴ Yoda Kaoru, *Nihon no kyoninka seido no subete* (All about Japan's licensing system) (Tokyo: Nihon jitsugyô shuppan sha, 1993), p. 24.

²⁵ United States Commerce Department and Japanese Ministry of International Trade and Industry, "U.S.-Japan Price Survey 1991", (May 1991).

²⁶ Isowa Harumi, "Kisei kanwa keikaku kaitei de kurashi wa dô kawaru ka," *Kokumin seikatsu*, August 1996, pp. 46-49.

²⁷ Nihon Keizai Shinbun Sha, *Kisei ni Idomu* (Challenging Regulation), (Tokyo: Nihon Keizai Shinbun Sha, 1996), p. 17.

3. Weak Anti-Monopoly Policy and Informal Regulation by Industry Associations

The third systemic regulatory problem is the absence of strong anti-monopoly policy, which is key to creating the kind of genuinely competitive markets which would bring down domestic prices and pressure Japanese firms to seek out products that are a good value, rather than automatically buying domestic products.

In many cases the most important rules restricting competition in Japanese markets are actually imposed by private trade associations. These private rules are often supported by discriminatory government regulation, so that private and public regulations work together as a system. Opening Japanese markets in a meaningful way requires both changing government regulation so that it does not discourage imports, and using aggressive antitrust policy to do away with the discriminatory and usually informal rules established by trade associations. One of the strategic choices of the regulatory reform movement has been to focus on regulation by government bureaucrats and to largely ignore the market controls of private trade associations. The result has been to chip away at some public restraints on the market, which largely affect services, while leaving intact the private restraints on competition that are especially important in markets for manufactured goods. In response to US government pressure during the SII talks the Japanese government increased penalties under the Anti-monopoly Law somewhat, though not as much as the US government and the Japan Fair Trade Commission requested. Opposition to the larger increases came from the Keidanren, the LDP, MITI and the Construction Ministry and suggests a lack of interest in increased competition.²⁸

Although by some measures the Japanese Fair Trade Commission (FTC) has a budget and staff that is roughly comparable to US anti-trust agencies, Japan lacks the private lawsuits and award of treble damages that make American firms pay attention to anti-trust law.²⁹ Moreover, the FTC does not enforce the Anti-monopoly Law aggressively. Michael Beeman notes that this is in part because the FTC's limited power to gather evidence that will stand up to appeals in the courts restricts its ability to enforce anti-trust law. He also finds that historically the LDP has responded to spates of increased enforcement with threats to water down the Anti-Monopoly Law that have forced the FTC to back off, and that fears of an LDP backlash may temper the

²⁸ *Nihon Keizai Shinbun*, March 3 and 4, 1992.

²⁹ Tony Freyer, "Japanese Antitrust in a Global Economy," Abe Autumn Colloquium, Tokyo, October 2, 1996.

FTC's enforcement efforts.³⁰ Another reason the FTC holds back on enforcing the law is that it often weighs the importance of promoting manufacturing with stable, high prices more heavily than consumers' interests in low prices. One prominent Japanese anti-trust scholar stated: "The contrast between the US Justice Department or FTC [Federal Trade Commission] and the Japanese FTC is that in the US the enforcers of anti-trust law see themselves as administering law. In Japan, the people in the FTC wish they were industrial policy bureaucrats, and that's how they carry out their duties."³¹ Although the FTC has stepped up its enforcement of the law in recent years, by and large it has had little impact on competition; prices even for internationally tradable goods are still sky-high by world standards and cartels continue to operate flagrantly.

Much of the regulation which blocks access to Japan's markets is in fact carried out by private industry, often with the help of supplementary government regulation. Informal industry self-governance is strongest in the basic materials sector, which accounts for one-third of the value added in Japanese manufacturing. Such goods as steel, cement and plastics are readily transportable and largely standardized. Although Japanese prices for such goods are high by international standards, Japan runs trade surpluses in most basic materials industries. These industries have long been considered key to Japan's economic security and have been supported by industrial policy and government-backed cartels. Official cartel policies have been discontinued because of U.S. complaints that they constituted an unfair trade barrier, but informal cartels remain strong and constitute the most powerful form of governance in the basic materials sector.

The gap between high domestic prices and low export prices reveals the cartels' success in preventing firms from undercutting one another's prices in their home markets even though they will sell cheaply abroad. The price gap is the ephemeral result of fluctuations in exchange rates, but has been long-lasting. For example, domestic prices for all of the major standardized ethylene based petrochemicals averaged 60 percent over export prices for 1980 to 1992, and 64 percent over import prices.³² From 1980-1985 Japanese domestic undelivered cement prices averaged 46 percent over its export prices, and with the rise in the yen they averaged 154 percent over export prices from 1986-1993. Domestic cement prices from 1986-1993 averaged 68 percent over import prices. The "big buyer price," used for at least half of Japan's

³⁰ Michael Beeman, "Slave, Sycophant or Cinderella? The FTC and Japan's Anti-Monopoly Law", presentation to Ph.D. Kenkyukai, International House of Japan, Tokyo, October 22, 1996.

³¹ Personal communication, October 1996.

³² The discussion of basic materials industry cartels here is drawn from Mark Tilton, *Restrained Trade: Cartels in Japan's Basic Materials Industries* (Ithaca, N.Y.: Cornell University Press, January 1996).

steel, was 19 percent above the export price for steel plate from 1981-84, and 42 percent higher from 1985-91. It was 31 percent above import prices from 1981-84 and 57 percent higher from 1985-91. The discipline of domestic cartels can be seen not only in their prices, but also in their behavior. Some analysts have emphasized individual firm preferences for long-time ties with suppliers as the reason for persistent high prices and resistance to imports in Japanese markets.³³ But in the basic materials industries individual long-term ties do not stand up on their own, relying instead on industry-wide cartels for support. A good example of this is the petrochemical market, where buyers emphasize long-term ties in order to assure security of supply, and in some cases to get suppliers to invest in producing custom grade chemicals. But long-term ties are never strong enough to prevent some price competition in the domestic market and the inefficiency of domestic manufacturers makes them vulnerable to the danger that domestic competition might drive prices down to international levels. In order to prevent such competition, domestic petrochemical firms have used a price formula since 1983 that ties commodity chemical prices to the cost of materials. Petrochemical industry officials deny the existence of the price-setting formula and acknowledge that it would be illegal. However newspapers regularly report its use and chemical buyers for the auto industry report that it is "a rule that the whole industry abides by."³⁴ This acknowledgment that buyers consider the cartel legitimate underscores its character as a form of informal, but publicly supported regulation.

The cement industry also has a cartel that not only sets prices, but threatens refusals to deal to keep buyers from going around the cartel and buying imports. That is, the trade association threatens domestic construction companies that they will not be able to buy domestic cement if they dare to buy imports. The implementation of this industry strategy to keep imports out was supported by government non-tariff barriers and appears to remain strong. Newspapers reported in 1993 that ready-mix concrete companies were hiring gangsters to scare off outsiders to the cartel that used imports, and was arranging special loans from financial institutions to reimburse cartel members for price-cuts designed to run import-using competitors out of business.

The steel cartel is not as elaborate or visible as the chemical or cement cartels, yet is at least as strong and its existence is an open secret. In 1996 I asked a marketing executive in a large Japanese steel firm, who had been posted by his firm for several years to the U.S., about how competition in the Japanese steel market compared with that in the U.S. He replied, "Oh, it's totally different. In the US you have free competition. Here it's like we're

³³ Ronald Dore, *Flexible Rigidities: Industrial Policy and Structural Adjustment in the Japanese Economy 1970-1980* (London: Athlone Press, 1986); Takabumi Suzuoki, "From Flying Geese to Round Robin: The Emergence of Powerful Asian Companies and the Collapse of Japan's Keiretsu," unpublished paper, Program on U.S.-Japan Relations, 1996.

³⁴ Personal interview, Tokyo, February 1992.

violating the Antimonopoly Law everyday. The steel companies get together and talk about what the price ought to be."³⁵

Buyers buy from the cartel rather than buying cheaper imports in part because of a belief that it is their patriotic duty to support the domestic industry. For instance, shipbuilders buy Japanese steel even though it costs forty percent more than Korean steel and they face tough competition from Korean shipbuilders. As one shipbuilding executive put it, "People often say, 'Steel is the state'. It's true. If steel gets weak all of industry will get weak. If we switch to imported steel, the country will stop developing."³⁶ He also acknowledged that the shipbuilding industry benefits specifically by having a domestic steel industry that has provided it with good quality steel and convenient delivery. In return for these long years of service, he said his firm owed a great moral debt (onkei) to the steel industry. An executive at one of Japan's largest electronics firms told me his firm also paid a premium for domestic chemicals and steel because of concern with the national industrial base: "It's hard to imagine buying 30-50% of our supplies from overseas. Buying our supplies overseas would be a last stage. If we and other big companies buy our steel overseas, then the steel companies would go out of business and we would lose our customers. Our company would have to leave Japan too. And if we go overseas we couldn't use Japanese trading practices."³⁷ It is enlightening that major steel buyers talk about loyalty to the national industry as a whole rather than particular suppliers. It is nationalism rather than simply long-term ties with individual suppliers that keeps them from buying imports.

Nevertheless, the steel cartel also uses coercion to enforce its monopoly in the domestic market. The Nihon keizai shinbun reports that , "it is common knowledge that the domestic steel makers use tacit pressure to keep out imports and support the price structure. The ... shearing and coil center firms haven't spoken openly about using imported steel because of fear of reaction from the blast steel makers. The big trading firms haven't handled imports openly."³⁸ Iketani Masanari, president of Tokyo Steel, the largest of the mini-mills attempting to compete with the steel oligopoly, laughed at the suggestion that the FTC played any role in preventing the steel makers from bullying their buyers and said that, "To sell your products, you have to find some person at each company who is not afraid of retaliation [from the big steel companies]."³⁹

³⁵ Personal interview, Tokyo, September 1996.

³⁶ Personal interview, shipbuilding executive, Tokyo, July 1994.

³⁷ Personal interview, Tokyo, July 1994.

³⁸ Nihon Keizai Shinbun, May 10, 1994.

³⁹ James Sterngold, "Elusive Price Cuts Intrigue Japan," *New York Times*, November 9, 1994, pp. C1, C11.

Iketani told me in November 1995 that nothing had changed. He added that overseas the Japanese steel firms had actually retaliated against those going around the cartel. According to Iketani, Japan's five big steel companies have handled their exports as a cartel. In China for instance, the five companies negotiated a single price with Min Metal, the state trading company handling most of China's steel imports, and allocated sales among both among themselves and among the Japanese trading companies which served as intermediaries. In 1993 the Mitsubishi Corporation, one of the trading companies, offered Tokyo Steel a contract to sell 20,000 tons of hot rolled coil to Min Metal. Though Tokyo Steel had been selling bar steel in China, its hot coil sales were seen as a threat to the cartel. The five major steel companies retaliated against the Mitsubishi Corporation by excluding it from rail sales to China. Joint sales negotiations by the five companies with Min Metal were officially stopped as of 1995, but Iketani thinks that in fact they still continue.⁴⁰

Japanese cartels are not omnipotent; buyers try to negotiate lower prices and are often successful. Though in the main large industrial buyers have remained loyal to their domestic suppliers, car companies have bought some foreign steel in part to pressure their domestic suppliers to lower prices. Nevertheless, the fact that major Japanese firms continue to sell cheaply overseas before they will undercut their competitors' prices in the domestic market suggests the cartels continue to exert strong discipline.

Private cartels are often supported by government regulation. MITI requires special, onerous tests for cement imports, a trade barrier that helps insulate the domestic industry from foreign competition. And the Construction Ministry provides regulatory barriers to keep outsiders to the steel cartel out of the construction market, which absorbs half the nation's steel. Although in principle public works projects are supposed to be open to all, the Construction Ministry indirectly fixes prices and designates suppliers. Groups affiliated with the Construction Ministry publish two books that list prices for construction materials and lists companies that are allowed to supply them.⁴¹ Tokyo Steel complains that this informal rule about construction supply sources restricts government steel purchases to firms that belong to the domestic cartel, even though Tokyo Steel sells more cheaply than cartel members. For example, Tokyo Steel has a MITI license to make sheet piles, interlocking pillars used to support building foundations, and sells them for 55,000 yen a ton, far below the 87,000 yen official price. But the company is kept out of the market for government projects. This discrimination carries over into the private sector as well. Since sheet piles are often pulled up and reused, they are commonly leased. But because the leasing companies are punished in the private sector if they use cartel outsiders' sheet piles in the public sector, they stick to cartel

⁴⁰ Personal interview, November 1995.

⁴¹ The books are *Kensetsu bukka*, put out by the Kensetsu Bukka Chôsa Kai, and *Sekisan Shiryô*, put out by the Keizai Chôsa Kai.

insiders in the private sector as well. Some small leasing companies and trading companies will use Tokyo Steel sheet piles, but the large companies avoid them for fear of retribution.⁴²

The basic materials cases show us that private regulation through informal cartels is a major force in regulating Japanese markets and keeping out imports, that the FTC tolerates blatant cartels, and that government regulation often reinforces them. They also show that private and public regulations are not the only trade barrier. Company executives say that their firms avoid buying foreign inputs because it would weaken the larger national economy. The fact that managers make this argument even for completely standardized products like sheet steel makes one suspect that the barriers of mercantilist attitudes in high tech sectors are at least as high. Sung Joon Roh argues that managers of Japanese corporations are able to indulge their mercantilist beliefs because widespread cross-shareholding of Japanese firms relieves them of strong pressures to produce high profits.⁴³ The basic materials cases show the strength of adherence of Japanese managers to the norm that Japan should produce key materials domestically whenever possible.

Industry self-regulation is also enforced through group boycotts with bureaucratic support in the retail sector. Kraft, Inc., Japan's largest pharmacy chain, ran into such problems in 1993 when it opened an outlet in Saku, Nagano Prefecture, near the area's largest hospital.⁴⁴ In retaliation the local pharmacists association expelled Kraft from the organization, which acts as a conduit for information from local health authorities and shares inventory among members, and membership in which is required to avoid onerous equipment requirements by the Ministry of Health and Welfare.⁴⁵ The association also carried out an organized attack on the new pharmacy, distributing leaflets at hospitals urging patients to use only pharmacies that belonged to the association. The campaign was successful in limiting business to only 10 percent of what Kraft had expected. To top it off, all three of the local pharmaceutical wholesalers refused to sell to Kraft because it is not a member of the regional association. Kraft for its part believes the wholesalers were afraid of being boycotted by the members of the association.⁴⁶

Paradoxically, regulation by the Fair Trade Commission also helps industry groups organize to discourage competition through the Fair Trade Promotion Associations, set up in 107 different industries. The associations are headed by

⁴² Personal interview with Iketani Masanari, Tokyo, November 1995.

⁴³ Sung Joon Roh, "Agency Capitalism: The Logic of Managed Competition in Japan," MITI Doctoral Dissertation, August 1996.

⁴⁴ *Nikkei Weekly*, July 11, 1995.

⁴⁵ Nihon Keizai Shinbun Sha, *Kanryô: kishimu kyodai kenryoku* (Bureaucrats: the weakening behemoth)(Tokyo: Nihon Keizai Shinbun Sha, 1994), p. 23.

⁴⁶ *Nikkei Weekly*, July 11, 1995.

industry leaders like the president of Matsushita, Matsushita Masaharu, Toyota's Toyoda Eiji, and Ishino Kiyoharu of Shiseido and act as liaisons between firms and the FTC. Legal affairs specialists of member firms frequent both the FTC and the Fair Trade Promotion Councils in order to discuss FTC guidelines. The discount cosmetic dealers association has complained that the tie between the FTC and the Fair Trade Promotion Councils is too close and opaque. Former LDP lower house diet member Kuranari Masa has said that the FTC's meetings with the Fair Trade Council "make it look like companies could avoid investigations if they join the associations."⁴⁷ Kodak complains that the photographic supplies promotion association, with FTC support, have enforced rules against discounting and promotional activities. The photographic supplies Fair Trade Promotion Council has asked members to be on the look out for firms that are discounting cameras and other goods and report them to the FTC for discipline. Trade association members in the film industry have been quite clear that the purpose of the maintaining high domestic prices is to create a sanctuary market in Japan. In 1986, when cheap, re-imported Fuji film was threatening high domestic prices, Zenren, the retailers association affiliated with Fuji, criticized the retailers: "This is unacceptable. Domestic products cover the cost of selling goods cheaply abroad. Therefore, Zenren says that [re-imported film] should be sold at the same price [as domestic Fuji film] so as to stabilize the market."⁴⁸

One of the functions of the FTC Promotion Councils is to enforce FTC rules that actually limit competition by limiting the use of promotional gifts. These restrictions have been loosened in some industries, though in others, such as banking, the trade associations restrict them on their own.⁴⁹ The real estate industry is currently pressuring the FTC to tighten the restrictions on promotional gifts. The FTC prohibits promotional gifts worth more than ten percent of the value of a product worth more than 500,000 yen. In the case of housing, gifts include items as extravagant as cars. Consumer groups complain that if real estate companies can afford to give away cars with a new house, pricing must bear little relation to costs.⁵⁰ Here the prospect of tighter regulations on promotional gifts is a symptom rather than a cause of lack of competition. The deeper problem is the absence of meaningful anti-trust policy.

Antitrust legal expert Harry First argues that the thrust of the FTC's stepped up enforcement efforts since 1991 has been in enforcing laws restricting retail price maintenance. In 1991 the FTC issued new guidelines on

⁴⁷ Nihon Keizai Shinbun Sha, *Kanryô: kishimu kyodai kenryoku* (Bureaucrats: the weakening behemoth)(Tokyo: Nihon Keizai Shinbun Sha, 1994), p. 27.

⁴⁸ *Zenren Tsûhō*, November 1986, pp. 8-9, cited in Kodak materials.

⁴⁹ Isowa Harumi, "Kisei kanwa keikaku kaitei de kurashi wa dô kawaru ka," *Kokumin seikatsu*, August 1996, pp. 46-49.

⁵⁰ *Nihon keizai shinbun*, September 16, 1996.

resale price maintenance and has pursued cases in drugs, cosmetics, and pre-recorded audio products.⁵¹ First argues that the decision to cut resale price favors manufacturers over the retail sector and will enable big retailers to cut distribution margins and consumer prices at the expense of inefficient small stores, which will be unable to compete. Ultimately this will force distribution companies rather than manufacturers out of business.

Though clearly the FTC has made greater enforcement efforts in this area, its impact even on resale price maintenance has been feeble. The FTC's actions in the cosmetics industry have attracted the most attention because of the extremely high prices in this market. Sazanami, Urata and Kawai estimate the rate of implied non-tariff protection in cosmetics at 660 percent.⁵² The FTC has ruled that Shiseido has illegally used threats to cut off deliveries to Jusco, Daiei, and the Consumers Co-ops in retaliation for discounting. However, it has allowed Shiseido to use face-to-face counseling requirements as an excuse for cutting off sales to smaller discounters. In 1990 Shiseido cut off deliveries to discounter Fujiki Shôten, saying it had broken its contract to only sell cosmetics through direct sales in order to provide face-to-face counseling. Fujiki Shôten argued that although it sold cosmetics over the telephone, it provided face-to-face counseling for any customers who requested it. In this regard, its sales were parallel to Shiseido's own subsidiary, Za Ginza, and to the major department stores, which also sell by telephone. What Fujiki does differently is deeply discount prices.⁵³ The FTC investigated the case, but said there was insufficient evidence to decide against Shiseido. A lower court decided in favor of Fujiki, but this decision was overturned by a higher court, and is now under consideration by the Supreme Court. The upshot is that Fujiki is still unable to get deliveries from Shiseido, as is Kawachiya, another discounter. Sensui Fumio notes that while the European Union also allows suppliers of certain types of products to restrict supplies to certain dealers, there must be objective criteria for excluding sellers and these must be applied without discrimination. He notes critically that the Japanese FTC has brought neither consideration to bear in reviewing cosmetics cases.⁵⁴ The *Shûkan tôyô keizai* (Weekly oriental economist) cites an "observer knowledgeable about the FTC" as saying, "Within the FTC there are many voices that are critical of giving too much support to discount stores."⁵⁵ The larger discount stores have

⁵¹ Harry First, "Antitrust Enforcement in Japan," *Antitrust Law Journal*, Vol. 64, Issue (Fall 1995), pp. 137-182.

⁵² Sazanami, et al, pp. 6-7.

⁵³ Toyonaga Hiroshi, "Fumon ni tsukesareru keshôhin no 'teika' hanbai," *Shûkan tôyô keizai*, August, 1996, pp. 62-65. My thanks to Ron Bevacqua for sending me this article.

⁵⁴ Sensui Fumio, "Keshôhin no ryûtsû seido to dokusen kinshi hô: sentakuteki ryûtsû seido no Nichi-o Hikaku" (The cosmetics distribution system and the Anti-Monopoly Law: A Japanese-European Comparison of the selective distribution system) *Jurisuto*, No. 1090 (June 1, 1996), pp. 141-145.

⁵⁵ Toyonaga Hiroshi, "Fumon ni tsukesareru keshôhin no 'teika' hanbai," *Shûkan tôyô keizai*, August, 1996, pp. 62-65.

been cautious about discounting cosmetics. Even Daiei, frequently cited as a champion price-cutter, is only timidly discounting the high-end cosmetics that require counseling by a maximum of ten percent in the form of stamps good for purchases only at Daiei. According to the *Nihon Keizai Shinbun*, "It is thought that Daiei is trying to maintain the price the manufacturer wants and thus avoid provoking a reaction."⁵⁶ Supermarkets have been discounting cosmetics that don't require counseling since 1995, but have not discounted cosmetics that do require it because of resistance from manufacturers.⁵⁷ In short, even in its showcase area of enforcement, the FTC appears ineffective and compromised.

4. Business, State Interests in Regulatory Reform

Both top business leadership and MITI argue that Japanese business needs regulatory reform to lower the domestic costs of production and maintain the competitiveness of domestic business. The Industrial Structure Council, which advises MITI, has called for "rapid regulatory reform" and the "correction of private practices that restrict competition."⁵⁸ Why, then, is so little changing?

Part of the answer is that, despite the calls for regulatory reform by top leadership, the broader business community is content with the status quo. A *Nikkei Shinbun* survey on market liberalization and regulatory reform found large firms ambivalent about the need to scrap informal bureaucratic supervision of business or close cooperation within industries. Though 82 percent of firms say they want regulations changed, only 35 percent want changes in administrative guidance, that is, informal bureaucratic supervision and regulation, and a mere 6 percent want to change the pattern of government-business cooperation. While 56 percent think that there should be change in Japan's "yokonarabi kyôshô", or "side-by-side competition," a pejorative term that means the absence of real competition, only 9 percent want to change the system of "industrial cooperation," a positive term that also implies cooperation rather than competition. Few respondents express strong support for maintaining these features of Japan's political economy either, suggesting that firms are content to let the system muddle along as is. Overall, big business is evenly split over whether Japan "definitely needs" an "economic and business system based on market principles" or only needs one "to a certain extent."⁵⁹ The survey indicates no groundswell of business support for strong anti-bureaucratic, pro-market reforms.

⁵⁶ *Nihon keizai shinbun*, September 10, 1996, p. 13.

⁵⁷ *Nihon keizai shinbun*, September 10, 1996, p. 13.

⁵⁸ "Kisei kanwa suishin shô ni henshin" (A changed ministry that is [now] promoting regulatory reform), *Nikkei bijinesu*, need exact date, December 1994.

⁵⁹ *Nihon keizai shinbun*, October 19, 1996, p. 8.

Though individual industries are naturally interested in removing the taxes and restrictions which affect them directly, a review of the journals published by Japan's auto, electronics, telecommunications, and chemical industry trade associations suggests these industries have no broader complaint with bureaucratic guidance. The journals prominently feature articles by bureaucrats explaining future industry trends and the policies that will be taken to deal with them. They also express no urgent desire for freer markets. The Japan Chemical Industry Association Monthly, under the mistaken impression that Japan has an especially tough anti-trust policy, wants it watered down to European and American levels.⁶⁰ The Japan Auto Chamber of Commerce News argues against deregulating the taxi industry, because regulatory reform would lead to "excessive competition" among taxi drivers.⁶¹ While of course the larger auto industry has an interest in keeping taxi fares up in order to give people an incentive to buy their own cars instead of using taxis, it is interesting that the industry that is the foremost representative of internationalism still uses the term "excessive competition." Though American observers often hope that the drive to cut costs will cause Japanese industries to abandon domestic partners in favor of more efficient foreign firms, the auto industry publication urges additional subsidies to keep Japan's uncompetitive domestic shipping industry in business. It argues that Japan needs a domestic international shipping industry for the sake of security in Japan's international shipping, and to give Japan bargaining power with foreign shipping firms.⁶² Again, there is no broad business mandate for usurping the role of bureaucrats, introducing rigorous market competition, or running uncompetitive strategic industries out of business in the name of efficiency.

But aren't global competitive pressures forcing Japan to deregulate? Economists like to think that Japanese markets cannot stay rigged, because consumers won't put up with it and because high prices make firms uncompetitive on world markets. The Keidanren and MITI also argue that high costs are driving Japanese manufacturing overseas, and thus "hollowing out" Japanese industry. It is true that increasing Japanese overseas investment has closed some factories and produced some "reverse" imports from Japanese overseas plants into Japan. But MITI says that reverse imports are far outweighed by Japan's exports of parts and capital goods to its overseas factories. In 1993 exports to Japanese factories accounted for \$102 billion, far more than the \$28 billion in imports from these factories.⁶³ In my view, the cries of alarm about hollowing reflect a paranoid fear of imports of manufactured goods, more than any real threat to the economy. International

⁶⁰ *Nikkakyô geppô* (Japan Chemical Industry Association Monthly), December 1995 issue.

⁶¹ *Jidôsha Kaigisho nyûsu*, published by Nihon Jidôsha Kaigisho (Japan Auto Chamber of Commerce), No. 643, September 1996, pp. 2-21.

⁶² *Jidôsha Kaigisho nyûsu*, published by Nihon Jidôsha Kaigisho (Japan Auto Chamber of Commerce), No. 642, July 1996, pp. 2-3.

⁶³ MITI, *Tsûshô hakusho* (Trade and industry white paper), 1995, p. 72.

trade can only meaningfully be said to hollow an economy that is running a trade deficit. Although imports of manufactured goods have increased, Japan is still by far a net exporter in the vast majority of industrial categories.

It is true that Japanese goods and services are expensive compared to world prices and that theoretically this should impose high costs on firms competing in world markets. But Japanese firms do not sell most of their products in competitive world markets. They sell at high prices in a domestic sanctuary market, cover their costs there, and sell at lower prices overseas. As long as Japanese consumers pay high prices for the end product, domestic manufacturers are by and large able to make ends meet. Although proponents of regulatory reform have emphasized the drag that inefficient sectors place on the export sectors, these inefficient sectors also in turn support the export industries by paying their high domestic prices. Japanese construction companies charge more than twice as much as American companies for the same construction work, but provide a docile and captive market for expensive domestic steel and cement.⁶⁴ Japanese consumers may pay high rates for insurance, but the insurance companies support manufacturing by investing their capital quietly in Japanese business without pressuring manufacturers for immediate high profits. Japanese travelers pay high domestic air fares, but the airlines support the fledgling domestic aerospace industry. There is plenty of room to increase efficiency, and change will no doubt continue, but it is not an impossible situation that business is desperate to change. Despite dire predictions, Japanese manufacturing has not gone bankrupt in the decade since the yen jumped in value after the Plaza Accord of 1985.

5. Ideological Dualism: Explaining the Paradox of Regulatory Reform

If Japan is not really being forced to change, then why all the talk about regulatory reform? The regulatory reform movement is part of a larger pattern of ideological and institutional dualism that provides checks and balances in the governance of the economy. Developmentalist mercantilism ideology exists alongside economic liberalism. Developmental mercantilism holds that society's primary economic goal is the development of strong and secure domestic industry.⁶⁵ The state is to set broad goals for industry and provide regulatory support for exclusive and collusive arrangements between

⁶⁴ Itoh, *Nihon no bukka*, p. 30.

⁶⁵ Though neither use exactly this term, see Richard J. Samuels, *Rich Nation, Strong Army: National Security and the Technological Transformation of Japan*, (Ithaca: Cornell University Press, 1994), and Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Stanford: Stanford University Press, 1982).

competing firms to keep price high, imports out, capital stable and loyal, and business well funded. In contrast, liberal economic doctrine makes consumer welfare the goal, trusts the market to achieve it, and is opposed to bureaucratic intervention, price collusion, or protectionism. While liberalism has not achieved the mobilizing depth of belief of an ideology, it nevertheless enjoys a broad legitimacy that enables various institutions and aggrieved interests to put some limits on the inefficiencies of the developmental state and private cartels. However, the principal spokespersons for liberalism--the FTC, economists, and lawyers--do not have the power, even if they had the desire, to impose a liberal order on the economy.

The contrast between developmental mercantilism and liberalism was behind the fruitful tension between market and state ordering that Chalmers Johnson says was key to the success of Japanese industrialization in the 1948-75 period.⁶⁶ As Japan has become more deeply enmeshed in the international trade system and as overseas expectations that it open its markets have increased, liberalism has gained something close to a monopoly hold on legitimacy in public discourse about the economy and mercantilist visions of the economic order have retreated into the background. The ascendancy of liberalism is one of the factors propelling the regulatory reform movement. The rise in the yen since 1985 and the resulting domestic-external price gap has created many aggrieved parties who want particular markets loosened, and the regulatory reform movement has given a home to grievances about bureaucratic excesses. Various bureaucracies and interest groups, such as the Keidanren, MITI, and MOF, use liberalism to argue for specific reforms, but the regulatory reform movement has not done away with discretionary bureaucratic governance of markets nor brought about aggressive anti-trust policy. There is no crisis that is forcing a fundamental change in values. Developmental mercantilism is still the common sense that guides the economy beneath the patina of liberalism.

There is of course dissonance between developmental mercantilism and free-trade liberalism. How is it possible intellectually for the two ideologies to coexist? How can a noisy, self-righteous regulatory reform movement and a liberal academic establishment espouse liberal goals or describe Japan as a liberal polity while also promoting developmental mercantilism or ignoring developmental mercantilist practices? The intellectual dissonance is dealt with in four ways.

1. "Theory and practice." First, liberal economics can be treated as the overarching general theory and the practice of developmental mercantilism as the messy facts which are best ignored in theoretical discourse or high-minded discussions of policy. Liberalism is the ideal type of how an

⁶⁶ Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford: Stanford University Press, 1982).

economy ought to work and provides a vague and distant goal. An extensive literature written mainly by Japanese economists attempts to fit theory and reality together by explaining the rationality of a range of practices that involve long-term vertical ties between buyers and sellers and non-market pricing schemes in terms transaction cost efficiency.⁶⁷ But this literature largely avoids discussing horizontal price cartels and direct discrimination against imports through such means as group boycotts, perhaps because they are harder to justify in terms of liberal economic theory.

2. National customs. Another way of managing the dissonance between the two forms of thought is a variant of the theory-practice split, but with clear recognition that Japan diverges from liberal trade and economic theory more than other advanced industrialized countries. This was brought home to me during an interview with a senior official of a large Japanese cement company in 1988, before the U.S. levied punitive tariffs on the industry for dumping or the Japanese FTC fined it for price fixing. The official candidly described the group boycotts which prevented construction companies from buying cement from outsiders to the cartel, which were all foreign. He lamented the plight of American cement companies which had long suffered from low prices and said that Japanese firms were buying up cement plants in the U.S. in order to bring new hope to the American cement industry. He lauded the openness of the international economy which made it possible for Japanese firms to export large amounts of cement all over the world and invest in the U.S. and for imports to enter Japan (albeit in tiny amounts and in spite of the system he had just described). He wound up the interview by saying that he expected that my book would lead to greater U.S.-Japanese understanding.⁶⁸ The official, trained in economics at one of Japan's top universities, seemed to unashamedly believe that it was legitimate for Japan to protect its markets and export freely to the US, because the two countries have different national customs and "when in Rome ..."
3. Professional compartmentalization. A third way of dealing with the conflict between developmental mercantilism and liberalism is to compartmentalize policy and academic work on the economy so that no one has to challenge or change core mercantilist practices. A number of Japanese academics work on safe topics, such as cartels in the historically distant 1930s, long-term contemporary legal ties between firms, the history of administrative guidance, the dribs and drabs of anti-competitive behavior that the FTC has taken action on, and contemporary legal industrial policy, but very few Japanese scholars take on the big, obvious contemporary cartels or informal import protection.⁶⁹ I gave a talk in October 1996 explaining the workings of

⁶⁷ Mari Sako, *Prices, Quality and Trust: Inter-firm Relations in Britain & Japan*, Cambridge Studies in Management, Cambridge University Press, 1992; Iwao Nakatani, "The Economic Role of the Financial Corporate Grouping" in Masahiko Aoki, ed., *The Economic Analysis of the Japanese Firm* (North Holland, Elsevier Science Publishers B.V., 1984), pp. 227-258.

⁶⁸ Personal interview, Tokyo, November 1988.

⁶⁹ A major exception is the Sazanami, Urata, and Kawai volume.

major Japanese cartels to a group that included prominent Japanese antitrust legal scholars, probably as close to the heart of theoretical liberalism in Japan as one can get. One of the law professors said to me, “What you have written about is extremely important. However, we can’t write about these things because we can’t use the kind of interview and newspaper sources you use as documentation.” In other words, “It’s not my beat. I’m a scholar. I only comment on what the FTC tells us.” Business scholars have told me the same thing.

4. Japan’s dirty little secret. The same law professor went on to add that, “It is very useful to have an outsider like you come in and write critically about Japanese cartels. Even if I were willing to use the sources you do, a person like me can’t write about these things, because of my connections in Japanese society.” Liberal scholars also avoid talking about cartels and regulatory barriers to trade because they are aware that they are illegal and that powerful interests prefer them kept secret. I believe this scholar is sincere in his criticism of anti-competitive behavior, but he is aware of the professional disadvantages of calling attention to it. Similarly, a newspaper reporter who specialized in chemical prices carefully explained to me an illegal and unofficial sales consortium of PVC pipe makers that MITI organized in order to support the chemical industry. He was eager for me to write about the consortium, but said that he himself couldn’t because chemical companies would stop giving him information.⁷⁰

To argue that Japanese liberal/mercantilist ideology is dualistic is not to argue that Japan is unique. All kinds of nationalist, racist, and religious beliefs having nothing to do with maximizing individual material benefits or overall efficiency have coexisted with liberalism in many countries and shaped both policy and individual behavior. Japan does, however, appear to have a stronger developmental mercantilist ideology than either the super-liberal US or the countries that are tightly bound into the multinational European Union. It is important to recognize that rational people can plausibly act on their beliefs that bureaucratic leadership, industry collusion and informal import protection are often good for the national economy while at the same time believing that in principle government should intrude as little as possible and that free markets are best.

The dualist model helps us make sense of the regulatory reform movement. There is too much evidence of deep support for bureaucratic and industry governance of the economy to think that the regulatory reform movement could impose uniformly open markets. At the same time, the regulatory reform movement’s calls for vigorous competition are clearly aimed at a domestic audience and cannot be dismissed as meaningless. A dualist model helps us see that the tension between liberalism and state/cartel

⁷⁰ Personal interview, Tokyo, February 1992.

governance has long been one of the keys to Japan's economic success, and while changing in its particulars is by no means destined to be swept away by internationalist liberalism. It helps us recognize the achievements of the Japanese regulatory reform movement without exaggerating the impact the movement is likely to have on general liberalization of the economy or expansion of opportunities for imports.

6. Conclusion

Overall the impact of the regulatory reform movement has been to introduce new competition in significant, if gradual and limited ways. It has reminded people of the discrepancy between domestic and international prices and of the imperative of introducing efficiency and rationalization. Even if it has not moved quickly it has prepared business people for change. While it may be slow in opening many discount stores, it discourages twenty year olds from thinking they have a future taking over their parents' small shops.

At the same time, the persistence of developmentalist mercantilism ensures that debates over regulatory reform will discuss whether regulatory reform will strengthen or weaken strategic industries rather than whether it will benefit consumers. Telecommunications is an example of this. Although Nippon Telephone and Telecommunications was partially privatized with the sell-off of one-third of its stocks, it still has monopoly control over the local phone network. The Ministry of Posts and Telecommunications and NTT's competitors say NTT should be broken up because this control allows it to charge exorbitant access charges to its competitors, unfairly restrict interconnection availability, and acquire sensitive information about its competitors. But Keidanren opposes the breakup of NTT on grounds that it would weaken NTT's ability to invest in R & D, and thus handicap its international competitiveness. David Boling notes that the contrast between the debates over breaking up telephone monopolies in the US and Japan reflects the difference between America's consumer orientation and Japan's industrial policy orientation. "Rather than focusing on increased consumer welfare, [Japanese] critics have focused on international competitiveness because of the power the issue has with Japanese citizens. During the debate over AT&T's corporate structure, the focus was on anticompetitive acts that harmed consumer welfare, not the ability of AT&T to compete internationally."⁷¹

⁷¹ David Boling, "The Debate in Japan on the Breakup of NTT: Regulatory reform May be Japan's Preferred Path to Increased Competition," *East Asian Executive Reports*, Vol. 18, No. 3 (March 15, 1996), pp. 9, 15-20.

Within the framework of the current Japanese debate over regulatory reform we are not going to see the kind of broad deregulation that would dismantle Japan's system of dense, informal governance by bureaucracies and trade associations and open Japan's markets indiscriminately to imports. Economic liberalism provides legitimacy for gradual, limited freeing of some markets, in response to market pressures and foreign governments' demands. But developmental mercantilism will ensure that as much as possible regulatory reform will be carried out in ways that are understood to benefit strategic domestic manufacturing sectors. As Steve Vogel argues, when decisions are made to expose key domestic industries to greater competition to make them more efficient, the change will take place slowly and in such a way as to avoid overwhelming them.⁷² While cost pressures are pushing Japanese business to seek regulatory reform to lower some prices, high domestic prices also largely enable Japanese manufacturers to cover their costs. There is no broad support within business for sweeping reforms that would fundamentally change government-business relations or initiate aggressive antitrust policy. In short, Japan's trading partners cannot just sit back and relax, comforted by the notion that the market is forcing Japan to deregulate and open its markets. Continued trade pressure is essential.

Ozawa Ichiro has argued that it is time for Japan to become an "ordinary country" by adopting an ordinary foreign policy. I would argue that the most important way in which Japan should make its foreign policy ordinary would be to abandon the widespread use of covert trade protection. Japanese bureaucrats, businesspersons, academics and especially politicians should take a leading role in making the case for why it is in Japan's own interest to open its markets to imports and strengthen its anti-monopoly policy.

The original logic of Japanese mercantilism was to give Japan economic and military security by ensuring that key products were produced by Japanese firms, preferably at home, but if not then overseas. Mercantilism is no longer in Japan's broader security interests. Japan continues to depend for its security on an alliance with the United States, but its protectionism is a needless irritant that undermines the security relationship. Although the US has long tolerated Japanese protectionism for the sake of maintaining the alliance, the end of the Cold War means that this trade-off is less attract to the United States. Japan's security interests now lie in developing reciprocally beneficial trading relationships of mutual interdependence, not only with the United States, but with Japan's Asian neighbors and Europe.

Full market opening and greater competition would also open up new opportunities for growth and prosperity in Japan. Inexpensive imports would benefit Japanese consumers, and freer trade would give the economy as a

⁷² Steven Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrialized Countries* (Ithaca, New York: Cornell University Press, 1996).

whole large productivity gains from increased specialization in industries in which it is most competitive. Drops in production in Japan's uncompetitive industries, such as steel, chemicals, auto parts, and telecommunications equipment, would be largely counterbalanced by increased exports of cars and other goods. Genuine opening to imports would force some inefficient firms out of business, but would lower costs for the remaining competitive sectors.

Japanese leaders still are reluctant to pursue policies to promote more competitive markets that would seem slow to liberalize without pressure from outside. Kaneda Seiichi, a Minshuto Dietmember in the lower house who has been critical of Japan's weak FTC, says that there is almost no interest in stronger anti-monopoly policy in the Diet and that to make progress Japan is going to need more *gaiatsu* (foreign pressure).⁷³ For Japan to make progress with deregulation in ways that open up opportunities for foreign firms, the US and other nations will need to continue to supply Japan with exactly this.

⁷³ Personal interview, Tokyo, February 13, 1997.