



DEPARTMENT OF JUSTICE

Japan Information Access Project Conference

JAPANESE DEREGULATION: WHAT YOU SHOULD KNOW

**"THE FRUSTRATION AND PROMISE
OF JAPANESE DEREGULATION"**

BY

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I am very pleased to have been invited to kick off this very interesting and exciting program on Japanese deregulation and to give a government's-eye view of the deregulatory process in Japan. There are many of you in the audience who have great expertise on the economics and politics of deregulation in Japan. So I am keenly looking forward to listening to the discussions and panels that will follow my presentation.

When I was in Japan last November to meet on deregulation matters, I traveled to Nagoya with some of my colleagues for a round-table discussion with local business and labor leaders on deregulation in Japan. After we finished our presentations and opened the floor to discussion, one of the Japanese participants asked why the United States was demanding that Japan deregulate. He said that we were pushing Japan too hard and didn't understand the pain that deregulation caused the Japanese people and business community. As I was composing a response to his point, the image of an old television commercial popped into my mind. It had to do with purchasing some automobile oil filters in order to prevent serious and costly engine damage later. The punch line of the commercial --delivered by an auto mechanic -- was "You can pay me now, or you can pay me later."

I responded to my Japanese interlocutor in that vein. I pointed out to him that Japan is facing a number of serious economic and social crises, including a long period of slow growth, threats to its competitiveness, hollowing out of its manufacturing base and a rapidly aging population. I said that Japan can choose to deregulate now with some moderate short-term pain, while benefiting Japanese consumers and domestic and foreign enterprises, or it could continue its current course of tentative deregulatory efforts and suffer much more painful consequences later.

But his question did raise an important point. Why is the U.S. Government interested in Japan's deregulation efforts? If the Japanese Government wants to shoot itself in the foot by delaying needed deregulation, shouldn't we just let them and reap the benefits of a less competitive Japanese economy?

The answer is that the United States has a strong interest in promoting deregulation in Japan. First of all, appropriate deregulation should lead to a more dynamic Japanese economy, one that is fueled by increased consumption at home, rather than through Japan's traditional route of export-driven growth. This is in the U.S. interest. Japan's economy is the second largest on Earth, and the health of its economy, like the U.S. economy, has great significance to the vitality of the global economy. Second, and equally important, deregulation in Japan is necessary to improve market access for foreign goods and services, and to stimulate foreign investment. Japan needs to remove the barriers to competition caused by direct and indirect government regulation, especially since many of its regulations were put in place in order to protect the position of entrenched domestic interests and have had the effect of severely impeding foreign participation in its market. A deregulated and open Japanese market not only would increase U.S. exports to Japan, but would also open up export opportunities for third countries, thereby allowing the Japanese market, like the U.S. market, to act as an engine for economic growth for many developing countries.

I should make clear at this point, what I mean by "deregulation." Economists often discuss deregulation in terms of the removal of government regulation over the pricing or supply of products or services. Our notion of deregulation in Japan is somewhat more

expansive. We want to see Japan remove regulatory regimes in which the government directly or indirectly controls prices or the number of competitors -- insurance and airlines, for instance. However, we also want to see Japan reduce and if possible eliminate regulations that make it difficult for new products and competitors to enter and compete successfully in its marketplace. Examples might include certification and licensing systems that are biased toward incumbents and costly and cumbersome for foreign firms to navigate, or product standards that are based on the design of a product, rather than its performance. In addition, we want the Japanese Government to eliminate, or at least make fully transparent, its use of informal regulation. Informal regulation takes many forms in Japan. It includes such practices as unwritten administrative requirements or guidance, refusals to accept license applications in order to accomplish regulatory objectives or delegations of regulatory authority to industry associations. In other words, by deregulation we mean the creation of an open and competitive Japanese market, one that is governed by market forces rather than by government fiat.

The United States has been pursuing deregulation in Japan for many years. In the U.S.-Japan market-oriented, sector selective -- or MOSS -- talks on forest products, medical and pharmaceutical products and telecommunications that began in 1985, most of our discussions were focussed on reducing or eliminating Japanese regulations that acted as serious impediments to the ability of U.S. companies to sell their products in Japan.

After the initial MOSS talks in the mid-1980s, we realized that many of the barriers we found in Japan's market and in its regulatory regime cut across individual sectors. And so in 1989 we embarked on the Structural Impediments Initiative discussions, the most

ambitious effort up to that time to address the structural problems in Japan that we have all come to know so well. In those talks, we sought deregulation in areas such as distribution, land use and investment that impacted whole ranges of products and sectors. For example, it was in the SII discussions that we first began calling for elimination of the burdensome restrictions contained in the Large Scale Retail Store Law, a goal that we are still pursuing 8 years later. The SII process was, in my view, successful in highlighting -- and in a few areas effectively addressing -- some of the endemic problems faced by foreign companies in the Japanese market. However, we also came to recognize that the SII process by itself was insufficient to deal with the many technical, industry specific regulations that have thwarted efforts by American companies to penetrate the Japanese market.

The Clinton Administration therefore wanted a new approach to dealing with our market access problems with Japan. With that goal in mind, the U.S. and Japan agreed to address these issues under the Framework for a New Economic Partnership. The Framework included five baskets or groups of issue-areas -- Government Procurement, Regulatory Reform and Competitiveness, Automotive, Economic Harmonization, and Implementation of Existing Agreements. Most of the baskets dealt with specific sectoral issues and negotiations. However, we also agreed to establish within one of the baskets the Deregulation and Competition Policy Working Group, of which I am currently co-chairman with Byron Sigel at USTR. The idea behind this Working Group was to have a forum in which specific regulatory problems in a variety of sectors could be addressed,

while at the same time taking up broader structural issues, such as competition policy and administrative reform, that are integrally related to successful deregulation.

In June 1994 the Japanese Government announced that it would issue a Deregulation Action Plan in March 1995. The Action Plan was originally formulated as a 5-year plan, but was subsequently shortened to three years. We agreed to organize the efforts of the Deregulation and Competition Policy Working Group so that it coincided with Japan's internal process for formulating its deregulation priorities under the Deregulation Action Plan. Each fall, beginning in November 1994, the U.S. Government has submitted a substantial and detailed set of recommended deregulatory measures to the Japanese Government that we proposed be included in the original Action Plan or its subsequent revisions. The Working Group met several times each year to discuss our recommendations and the reactions of the relevant ministries as to whether our recommendations could be accepted.

Our last set of recommended deregulatory measures was submitted to the Japanese Government in November 1996. It included more than 250 specific deregulation recommendations in 13 sectors, as well as detailed proposals on competition policy and administrative reform. We also included in our submissions a set of seven basic principles that we believed the Japanese Government should follow in its deregulation efforts. The first principle calls for freedom from regulation in principle, with regulation only as an exception. The second is that the Japanese Government should review of all regulations -- whether formal or informal or whether they are social or economic regulations, on a continual basis. Third, there should be transparency and accountability in the regulatory

process, with publication of all regulations and administrative guidance. Fourth, agencies should avoid delegating regulatory authority to quasi- or non-governmental entities such as trade associations, unless specifically authorized by statute. Fifth, the Japanese Government should ensure that deregulation at the national level is not simply replaced or undermined by local government regulations. Sixth, all new regulations should include sunset provisions. And seventh, Japan should rely on market mechanisms, supplemented by an effective antimonopoly enforcement policy, rather than government regulation.

These principles, almost all of which have been endorsed by the Japanese Government in principle, although not necessarily in practice, have provided the framework for the discussions of our sector specific deregulation recommendations. However, they have also provided the basis for our insistence that a strong competition policy and meaningful administrative reform are essential components of any effective deregulation in Japan.

The importance of vigorous antitrust enforcement in safeguarding deregulated markets is, I believe, well understood. Our own experience with deregulation has shown that industries accustomed to protected markets and government coddling will, when faced with deregulation and the removal of other long-standing market barriers, often attempt to seek refuge in private anticompetitive arrangements to thwart new competition. The success of deregulation in Japan and elsewhere depends on whether market forces, unhindered by anticompetitive activities designed to thwart the competitive process, will be free to determine which products and competitors will succeed or fail.

We have had three principle competition policy goals for the deregulation exercise in Japan. First, we have been encouraging Japan to strengthen the power, resources and fortitude of the Japan Fair Trade Commission -- Japan's antitrust enforcement agency -- so that it is fully willing and able to prevent anticompetitive practices from undermining the government's deregulation efforts. Second, we have argued for elimination of JFTC regulations that, while purportedly promulgated to protect competition, have actually had the opposite effect. And third, we have pushed for actions by other Japanese government agencies to support, rather than undermine, the mission of the JFTC in areas such as bidrigging, administrative guidance and elimination of antimonopoly exemptions.

In addition to our recommendations on sectoral issues and on competition policy, we have also made specific recommendations in the area of administrative reform. Our focus has been on encouraging Japan to reform both its formal and informal regulatory processes. In this context we have called for greater transparency in the issuance of administrative guidance, adoption of fair and transparent rulemaking procedures that would allow public input before new regulations are promulgated, enactment of an information disclosure law, institution of fair and open procedures for advisory bodies and elimination of informal delegations of administrative authority to industry associations.

When the Deregulation and Competition Policy Working Group got started in the Fall of 1993 there were high expectations about the seriousness of the Japanese Government's commitment to deregulation and about the possibilities of meaningful achievements. By the time that the Deregulation Action Plan was published in March 1995, however, it was apparent to most observers that while some positives would come out

of this process, we were not likely to see the ambitious deregulation and resulting increases in market access that we had hoped for. Although the Japanese Government publicized the number of deregulatory actions included in its plan, closer scrutiny revealed that there was much less there than met the eye. Many of the items in that first plan were not new, but simply actions that the ministries had previously taken. Many others were very vague or promised only studies of issues without a commitment to results or even a direction and timetable. And overall, there was little effort to take deregulatory actions that would provide meaningful market access for foreign companies. The revisions to the Action Plan in March 1996 added only incrementally to the original plan.

As you may know, last Friday the Japanese Government announced its final revisions to the Deregulation Action Plan. Although we have not completed our analysis, our initial review indicates that while the revised plan includes a few significant deregulatory steps, for the most part it appears to fall short of what we had hoped. Of the 2800-odd deregulatory actions that are in the final plan, less than one-third of them are new actions. And like the original Action Plan, many of these new actions are no more than announcements of an intent to study possible deregulation in the future.

Let me be clear. There have been some positive, and even some significant, improvements as a result of this process. The most significant in terms of potential improvements in market access for U.S. exports is probably in the area of housing construction, where Prime Minister Hashimoto's Housing Initiative augers major changes in the regulatory impediments faced by foreign building suppliers. The financial services sector also saw some significant reforms and, for the longer term, the announced Financial

Big Bang for the year 2001 has tremendous possibilities. There have also been some important improvements in the areas of insurance, auto parts and some aspects of telecommunications.

However, for the most part, Japan's deregulatory actions have been quite modest. A good example is the recent announcements on trucking deregulation. We have long been recommending that the Japanese Government undertake decisive deregulation in the trucking sector and, more recently, that deregulation be extended to freight forwarding as well. Among other suggestions, we have called for replacing prefecture-by-prefecture trucking licenses with a nationwide license, eliminating minimum truck requirements in order to obtain a license and ending restrictions on pricing. Last week's final Action Plan included some helpful measures addressing these issues. However, in what could be considered a microcosm of the whole deregulation process, the Government partially liberalized rather than completely eliminated these regulatory barriers. Instead of moving to a nationwide licensing system, they announced their intention to move to regional licenses by the year 2001. Instead of eliminating the minimum number of trucks, they announced their intention to reduce the minimum from 10 trucks to 5 trucks by the same year. And instead of allowing for free pricing and deregulating freight forwarding, they simply made some marginal changes and announced that they would continue studying these issues.

As a general matter, I believe that there are some intrinsic limitations in the way the Japanese Government is approaching the deregulation process that explain much of the

reason for the slow progress toward deregulation that we are seeing in Japan. I'd like to talk about four of these limitations in more detail.

First, the primary responsibility for coming up with and implementing deregulatory initiatives has, for the most part, been given to the regulators themselves. Although the Administrative Reform Council -- a private-sector advisory body established by the Prime Minister -- has been charged with making independent recommendations on appropriate deregulatory actions, it does not have the authority to require that its recommendations be adopted. It is also dependent in large part on the bureaucrats for providing it with information and for implementing any deregulation initiatives. This obviously cannot and has not worked. The trucking sector measures I described are just one of many examples where the Japanese Government, instead of simply deregulating, has opted for partially liberalized rules that allow for continued ministry oversight of, and continued regulatory power over, the industry concerned.

Although we would like to believe that Japanese government officials always act for the greater good, it simply is not realistic to ask bureaucrats to give up power voluntarily or to propose elimination of their own jobs. Moreover, deregulation threatens not only their present power and job security, but their post-government careers as well. The low mandatory retirement age for Japanese government officials, combined with industry's need to keep on the good side of their regulators, has led to a well developed *amakudari* system where ministry officials have effectively been guaranteed jobs after they retire in the industries that they regulate. We hope that the Hashimoto government's administrative reform efforts will address this problem.

The second impediment to effective deregulation has been a tendency of Japanese agencies to hide behind social welfare arguments as justifications for continuing certain regulatory regimes, instead of simply acknowledging the true goals of protecting existing competitors. This is particularly important because the Japanese Government has tried to place regulations in one of two categories -- economic regulation or social regulation, with priority for deregulation only being given to the first. However many so-called "social" regulations are really at their core economic regulations.

Take the minimum fleet size requirement for trucking firms for example. The Ministry of Transport has tried to justify the need for a continued requirement on a minimum number of trucks on safety concerns -- that a firm that has less than 5 or 10 trucks will not pay adequate attention to inspecting and maintaining its vehicles. However, a more appropriate way to deal with any safety concerns would be to design regulations that directly address the protection of workers or traffic safety, rather than through indirect regulation that arbitrarily limits entry.

One of my favorite examples of economic regulation hiding behind a social regulation exterior is the JFTC's regulation of premiums and other sales promotion devices. The JFTC restricts firms from offering a free gift with the purchase of another product if the gift is valued at more than 10% of the price of the purchased product. They also prohibit a retail store or other service provider from making entry forms available in their store for an open sweepstakes promotion -- that is, a sweepstakes in which no purchase is required. Industry-specific fair competition codes have imposed even more restrictive rules on a sector-by-sector basis. The JFTC tries to justify these regulations on

the grounds that they are protecting consumers from unscrupulous promotions. However, given the highly-educated nature of Japanese consumers, it is apparent that disclosure rules like we have in the U.S. could effectively protect consumers from misleading promotions. Rather, the real effect of these restrictions on marketing practices has been to protect the position of entrenched Japanese firms, particularly small and medium sized firms. Although we have been a fervent supporter of a strengthened JFTC and antimonopoly policy, this is one area where we have long taken exception to the JFTC's stance. In fact, our brief in the WTO film dispute places heavy emphasis on the protective and trade-restricting consequences of this set of regulations.

The third limitation in Japan's current deregulatory effort is that the Government's primary objective is improving the competitiveness of Japanese products in world markets, rather than benefiting Japanese consumers. And since improving consumer welfare is only a secondary goal at best, there is little impetus, other than from foreign pressure, for Japan to focus on deregulation that will improve market access. As a consequence, the traditional deregulation model in which new entry drives deregulation hasn't worked particularly well in the Japan context, since new entry has always been difficult in many Japanese sectors and there is no real effort to remedy that problem through deregulation policy.

That is not to say there have been no actions that have a consumer focus. The proposed allowance of some limited price competition among taxi companies, for example, cannot be easily explained in terms of improving international competitiveness. However, the Japanese Government's most sustained and serious efforts have clearly been aimed at

the elimination of regulations that are believed to harm Japan's international competitiveness.

Maybe the most visible example of the low priority that consumer welfare gets in the deregulation calculus is the resolution of the debate on whether to deregulate local phone service and break up NTT. The Japanese Government resolved the debate by deciding not to break up NTT, but simply to allow NTT to reorganize into three companies under the umbrella of a holding company, and to consider deregulation at a later date. Although early deregulation would have provided the greatest benefits to Japanese consumers, the decision to reorganize NTT under the cover of its existing monopoly appears to have been driven by two other goals: a desire to maximize NTT's international competitiveness and a desire to maximize the value of the government's remaining equity interest in NTT. While it is undeniable that NTT's value -- at least in the short term -- would be greater as a monopolist than in an uncertain deregulated world, it is Japanese consumers who will pay the price for NTT's continued monopoly position.

Another example of the dominance of competitiveness concerns over consumer welfare goals is the elimination of the ban on holding companies. Over the past two years, the LDP and Keidanren have spent an enormous amount of energy trying to eliminate the Antimonopoly Law's 50-year ban on holding companies, a ban that was placed in the law to prevent the re-emergence of the pre-war *zaibatsu*. The Government and business community for some reason see this change as a great boost for Japanese competitiveness and have been willing to work hard to obtain it. However, this issue was so contentious that it almost resulted in a split in the ruling coalition last year. If the political will and

muscle used to win the abolition of the holding company ban had been applied to some of the significant regulated sectors, there is no telling what could have been achieved!

The fourth and, in my mind, most significant limitation in Japan's deregulation process is that there remains in the Japanese Government an intrinsic lack of faith in the market mechanism. Fundamentally, Japanese Government officials continue to believe, even today, that the government is better able to determine the most efficient allocation of resources than is the market. Whether it is continued regulation in the transportation sector, or new legislation such as the 1995 Business Reform Law that puts the government at the center of adjustment plans for industry, Japanese officials apparently have a very hard time just allowing the market to work, unadulterated by government intervention. They see the value of competition, but believe that competition needs to be managed. This distrust of the competitive process may all boil down to a repugnance by Japanese bureaucrats in allowing existing competitors to be forced to exit the market. But without the possibility of exit, deregulation is doomed to fail, since protecting firms from having to leave the market means continued involvement of the government.

Surprisingly, many in the Japanese business community, I'm afraid to say, seem to share that view as well. This was brought home to me just two weeks ago at a deregulation program at Columbia University where the Keidanren official stated in a speech that one of the benefits of Japanese-style capitalism that should be retained is the close government-business relationship. In any event, unless the government and the business community are able to accept free and open competition as a model for the Japanese economy, I'm

afraid we may never see the fervent commitment to deregulation necessary to make the changes that we and others have been calling for.

This, unfortunately, also has grave ramifications for my favorite subject -- competition policy. There has been much rhetoric coming from our Japanese counterparts about the new commitment of the Japanese Government to strong and effective antimonopoly enforcement. There have been some positive steps taken toward this goal over the last several years -- the JFTC's staff levels have been increased, criminal enforcement has been reinstated, administrative surcharges and criminal fines have been increased substantially, a large number of antimonopoly exemptions will soon be eliminated and the JFTC's administrative status was recently upgraded. At the same time, however, the JFTC has been under vigorous attack by the same government agencies that have been espousing new-found support for the JFTC's mission. For example, the rate of the JFTC's staff increases was cut this year on the grounds that the upgrade in its administrative status obviated the need for substantial personnel increases. And the JFTC is under constant pressure from the Diet, other ministries and the business community to reign in "excessive" price competition. For example, just last week the press carried a report that MITI, on behalf of the refined petroleum industry, has asked the JFTC to establish guidelines to prevent "unreasonable" price competition in this sector. The petroleum products industry has been complaining that last year's abolition of the restrictions on imported petroleum products has caused cut-throat price competition among oil distributors. Some of you who know your Antimonopoly history may recall that this industry, with MITI involvement, had engaged in collusive practices in the early 1970s

that became the subject of some high-profile JFTC actions. It doesn't appear that much as been learned over the last 20 years on this subject.

Now that I have outlined some of the reasons why the current environment for deregulation in Japan is less than ideal, it is not hard to understand why that deregulation process seems to be going so slowly. I cannot deny that we've become somewhat frustrated with the current deregulation exercise in Japan and with the lack of real progress in our Deregulation and Competition Policy Working Group discussions. Rarely do the meetings of our Working Group result in closure on any particular issues. Instead, we have noted that each year there seems to be less and less willingness on the part of our Japanese counterparts to address in a serious way the concerns and recommendations we have raised. I suppose we shouldn't be surprised at this, given that improving market access has not been a high priority of the Deregulation Action Plan. But the bottom line is that the current process hasn't achieved as much as we had hoped for, particularly in the sectors of greatest interest to the United States from a market access perspective.

So the obvious question is where do we go from here? Some in our business community have called for the U.S. Government to discontinue its efforts to promote deregulation in Japan, primarily on the grounds that the end result may be a more competitive Japan. We do not agree. We continue to believe that deregulation can be a win-win exercise. If deregulation can result in a Japanese market that is more open to international competition and can lead to sustained domestic demand-led growth of the Japanese economy, we shouldn't shy away from it just because it may result in a more

competitive Japan. We have always welcomed the opportunity for our companies to compete with their Japanese counterparts on a level-playing field.

Therefore, I fully expect that deregulation in Japan will stay a high priority for the United States. We are urging the Government of Japan to strengthen its efforts to achieve meaningful deregulation. There has been a lot of talk recently within the Hashimoto government about the need to focus on administrative reform issues. Some of their administrative reform objectives may well be appropriate -- indeed, we have made a number of recommendations in that area as well, not the least of which is enactment of an effective information disclosure law. However, we do not believe that Japan's administrative reform objectives should be pursued at the expense of continued efforts to accomplish meaningful deregulation. To this end, we hope that an independent body will be tasked anew with making deregulation recommendations and monitoring implementation of deregulatory measures, either by extending the mandate of the Administrative Reform Council past its December 1997 expiration date or by establishing a new independent deregulation body.

In terms of our bilateral dialogue on deregulation issues, it is apparent that we will need to find ways to improve the current process for addressing these matters. We are now in the process of preparing some new ideas on this point, and so I can't give you many specifics at this time. What I can say is that some greater focus on deregulation in particular sectors is probably warranted and that we need to find a way to reach closure on deregulation issues that we discuss. At the same time, however, we will need to continue a dialogue on broad, cross-cutting issues such as competition policy, administrative reform

and investment that have direct implications on the success of the deregulation process in Japan.

In conclusion, despite all of the caveats, worries and frustrations that I have discussed this morning, I still believe there is hope for meaningful deregulation in Japan. The fact that Prime Minister Hashimoto has committed his Government to substantial deregulation is very encouraging, and has led to heightened expectations in Japan that will be difficult to ignore. In addition, the recent Action Plan includes commitments to undertake a variety of studies that hold out the promise of significant changes in the future. And so we will continue to watch, encourage and hope that Japan will remain on the right path, will pick up its gait, and will make the fundamental changes in its regulatory system that we all see as both necessary and beneficial to Japan and the rest of the world.