

# Law and Economics analysis of the current Japanese antimonopoly legislation

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## **Abstract:**

The central building block of Japanese economic law is the antimonopoly act. It serves the promotion of free and fair competition, entrepreneurship, employment, real income, contributes to the democratic and wholesome development of the national economy and enhances the general interest of consumers.

Despite its socio-economic goals, the institution charged with the implementation of the act, the Japan Fair Trade Commission (JFTC), has encountered severe domestic political pressure in its enforcement.

This paper examines the current legislation from an industrial economic perspective and sheds light upon the idiosyncrasies of Japan's antitrust regime. The Japan Fair Trade Commission's substantial effort towards independent enforcement of the act is examined in light of its policies concerning cartels and abuse, surcharges, holding companies, mergers, exemptions, international co-operation, institutional settings and enforcement, and transparency.

The overall finding is that although meaningful progress has already been made, more still needs to be done until competition law firmly takes root in Japan. With regard to the reviewed issues, concrete suggestions are made to further strengthen the institutional capacities and the enforcement prospects of the act.

## 1. Introduction

From its very beginning in 1947, Japanese antimonopoly law (AML) has faced much opposition and criticism<sup>1</sup>. Perhaps even worse, it faced a high degree of misunderstanding<sup>2</sup>. It was very much alien to the common understanding of how business should be conducted, about how people should interact in close, and repeating business transactions based upon trust and loyalty. The Supreme Commander of Allied Powers (SCAP)'s attempt to install democracy by destroying the *zaibatsu*<sup>3</sup>, control agencies<sup>4</sup> and by installing the AML<sup>5</sup> were in part successful but could not prevent the continuation of the pre-war economic order<sup>6</sup>. SCAP's actions were regarded as an attempt to destroy the war riddled Japanese economy and as intended to hinder its development<sup>7</sup>. The strong anticompetitive oriented establishment<sup>8</sup>, Marxist oriented economists<sup>9</sup>, industrialists in America<sup>10</sup> and Japan as much as the general public welcomed the emasculation of the AML<sup>11</sup> which finally took place when SCAP left the country<sup>12</sup>. The Japanese could continue to emphasize harmonic collusion<sup>13</sup> and co-operation over cutthroat competition.

Despite the Japan Fair Trade Commission (JFTC)'s activism regarding restraints of competition and price fixing cases<sup>14</sup>, the decade of the 1960s has to be viewed as one of relatively weak antitrust enforcement<sup>15</sup>. Though considerably stronger than the 1950s, pro-

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<sup>1</sup> Despite the opposition of economic bureaucrats and big business, their more lenient proposals (Schaede, U., (2000) p. 74 states that the Ministry of Commerce and Industry (later Ministry of International Trade and Industry (MITI) renamed Ministry of Economics Trade and Industry (METI)) drew up a marginally revised version of the 1931 Important Industries Control Law which was not quite what SCAP had envisaged) were not entertained by SCAP and the strict versions of the AML and the Trade Association law have been implemented with only one significant change: the removal of the treble-damage provision of private law suits. See Beeman, M., (1997b) p.39. With regard to civil servants lack of sympathy for the AML, see Johnson, C., (1982) p. 221.

<sup>2</sup> Johnson, C., (1982) p. 175 reports that some of the Japanese bureaucrats were indeed puzzled by SCAP's proposals. Headley E., (1970) p.120 states, that its critics found it difficult to understand why one would need a Deconcentration law (Law No. 207 of 1947) and an antitrust law.

<sup>3</sup> The *Zaibatsu* were large often family dominated holding companies which traditionally had been very influential and contributed substantially to Japan's war effort. Nissan, generally cited as one of the 10 zaibatsu has never been family dominated. See Headley, E., (1970) p.21.

<sup>4</sup> Control agencies (*tōseikai*) were special legal entities, comparable to a government authorised cartel with compulsory membership, whose explicit function it was to allocate raw materials and to set prices in line with government orders and to distribute products to the member firms. See Johnson, C., (1982) p. 153, Schaede, U., (2000) p. 251ff..

<sup>5</sup> The interested reader be referred to Bisson, T.A., (1954) Headley, E., (1970) and Yamamura, K., (1967).

<sup>6</sup> See Headley, E., (1970) pp. 69, 79, 99, 115 and elsewhere. But also Johnson, C., (1982) for insights.

<sup>7</sup> See Headley, E., (1970) p. 11.

<sup>8</sup> Indeed, viewed historically Japan feared well by emphasizing cooperation and market allocation over free competition. See Schaede, U., (2000) p. 74.

<sup>9</sup> Gao, B., (1997) p. 61 – 63 describes the Marxist orientation of Japanese economists.

<sup>10</sup> See Yamamura K., (1967) p. 33 ff..

<sup>11</sup> See Bisson, T.A., (1954) p. 187 ff., Schaede, U., (2000) p. 76.

<sup>12</sup> Law No 214, promulgated on June 18<sup>th</sup>, 1949.

<sup>13</sup> Beeman, M., (1997b) p. 41 states that the conservatives groups within society were generally hostile while the socialist and communist groups saw the AML as an American tool to subdue Japan and that the inherent dangers of monopolisation could not be overcome by it, while the generally supportive social democrats were weak and fractioned and not convinced of the legislation's effectiveness and demanding several AML exemptions. Yamamura K., (1967) p.55 states that the socialists and labour unions half-heartedly opposed AML amendments while small and medium business and consumer groups fiercely opposed AML amendments.

<sup>14</sup> Schaede, U., (2000) p.161.

<sup>15</sup> While Yamamura K., (1967) p.84 and Schaede, U., (2000) p.97, view the prospects of effective AML enforcement with serious doubts other authors such as Beeman, M., (1997b) p.48 ff, Matsushita, Mitsuo, (1993)

collusive forces were in effect shaping the regulatory framework<sup>16</sup> and contributed to a reduction in enforcement statistics, particularly after 1964 when Japan assumed more international obligations<sup>17</sup>. Increased recognition of consumer's interests lead to more active enforcement at the end of the decade<sup>18</sup>.

In the 1970s, the Commission's enforcement potential rose considerably. This was in part attributable to the Nixon shocks<sup>19</sup>, the oil crisis and the general poor economic situation<sup>20</sup>. The JFTC stepped up its enforcement, also in respect to larger companies<sup>21</sup> and for the first time, Tokyo High Court ruled that the widely used 'administrative guidance' was insufficient to allow illegal cartels<sup>22</sup>. The reform of 1977 was the first one to unambiguously strengthen the AML<sup>23</sup>.

Economic hardships of those industries depending heavily on energy imports and on the exchange rate were supported by the Depressed industries law (1978-1983) and its follower, the Industry structure law (1983-1988)<sup>24</sup>. The Ministry of International Trade and Industry (MITI, now Ministry of Economics Trade and Industry (METI)) assisted industries to scrap excess capacities. The relationship between MITI and the JFTC moved from a rather antagonistic one to one characterised by cooperation. The specific provisions for depressed industries phased out at the onset of the bubble economy (1987-1991). Despite a comparatively low enforcement record during the 1980s, a fundamental change in enforcement pattern towards bid rigging is recognisable<sup>25</sup>. This in turn underlines the newly gained confidence of the JFTC. As can be seen from the large number of changes the AML has undergone over the course of the decades, the guardians of Japanese competition policy have been quite active to strengthen the legislation and enforcement potential.

This paper critically evaluates the contemporary legislation from an economic perspective and sheds some light upon the idiosyncrasies of Japan's antitrust regime. Particular emphasis will be paid to the significant changes that have occurred during the last two years. While often it has been argued that on paper Japan's antitrust legislation looks good, while in

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p.82, Iyori, H., Uesugi A., Heath C., (1994) p.13ff, do consider a broader picture and argue that while the JFTC had to give ground in some areas, it advanced in others.

<sup>16</sup> See Schaede, U., (2000) p. 86.

<sup>17</sup> See Johnson, C., (1982) p. 264.

<sup>18</sup> The Law against false product advertising and labelling and unjustified premiums, Law No. 154 of May 15<sup>th</sup> 1962 and the Consumer Protection Fundamental Act, Law No. 78, enacted May 30<sup>th</sup> 1968 widened the scope of competence of the JFTC. See Schaede, U., (2000) p.138. See also Iyori, H., Uesugi A., Heath C., (1994) p. 63-70 for the most elaborate representation.

<sup>19</sup> The introduction of a 10% surcharge of Japanese imports in 1971 was a shock because Japan heavily dependent on US exports and had maintained a fixed exchange rate since 1949. See Gao B., (1997) p. 181, Yamamura K., (1967) p.29 ff.. The reassessment of Sino-American relations was a major political shock for Japan. See Buckley, R., (1999) p.120 ff.. Despite the signing of the Sino-Japanese Peace and Friendship Treaty of 1978, the relationship between the two nations is still far from harmonious.

<sup>20</sup> See Schaede, U., (2000) p. 98, Johnson, C., (1982) pp.294, 298-300.

<sup>21</sup> Schaede, U., (2000) p. 99.

<sup>22</sup> For this case see Haley, J.O., (1998) p.899. The court decision was taken in 1980.

<sup>23</sup> See Beeman, M., (1997b) p. 159 ff..

<sup>24</sup> See Beeman, M., (1997b) Chapter 6. Schaede, U., (2000) p. 103, Young, M.K., (1991) p. 137, Tilton, M., (1996) p. 39ff..

<sup>25</sup> While only slightly more than 30% of the formal actions (in comparison to over 70% in 1967-1976) regarded price fixing in the period of 1977-1986, unfair trade practices, retail price maintenance cases more than doubled and bid rigging more than quadrupled, reflecting favourable upon the newly gained confidence of the JFTC.

practice it is but a shadow of its potential<sup>26</sup>, the most recent developments in Japan are indeed very promising.

In the following critique, I will evaluate the insufficiencies and shortcomings of the contemporary Japanese antitrust legislation will be evaluated from a law and economics perspective. This paper will consider (2) cartels and abuse, (3) surcharges, (4) holding companies, (5) mergers, (6) exemptions, (7) international co-operation, (8) the institution and enforcement and last but not least (9) transparency. A conclusion will summarise the main points.

## **2. Cartels and abuse**

Historically, critiques emphasised cartel exemptions granted by acts other than the antimonopoly law. While the number of officially permitted cartels has considerably fallen over time, illegal cartels become a focal point of critique. Important issues regarding illegal cartels are the interpretation of vertical restraints, conscious parallelism, and the burden of proof to establish cartels. Thereafter dominance is addressed. Each point will be taken in turn.

Vertical restraints of competition are mainly adjudged as falling under Article 19 AML as unfair trade practices and are thus interpreted as being of a punitive nature<sup>27</sup>. There are, however a number of vertical restraints, which qualify as boycotts in convert with customers, suppliers or competitors, which fall within the ambit of Article 3 AML<sup>28</sup>. In the presence of low deterrence possibilities under Article 19 AML, a more stringent treatment under Article 3 AML, as unreasonable restraint of trade will allow the application of penal law. The possibilities of overall higher punishment is expected to enhance the effectiveness of the law by establishing a higher level of deterrence.

The 'mutual restriction' clause implies that those cases where retailers approach producers to set resale prices in order to stabilise cartels at the retail level are not interpreted as a violation of Article 2 (6) AML and thus does not constitute an act of 'unreasonable restraint of trade'. For lack of coercive measures, the JFTC is only able to interpret this conduct as 'unfair restraint of trade' subject to 'cease and desist' orders. The non-practicability of this clause is reflected in the fact that vertical restraints in distribution systems are wide spread in Japan. The reasoning behind the mutual restriction clause should be examined and its abolishment considered in order to be able to employ stricter measures against violators.

Based on Article 18 (2) AML, markets where the total price of goods or services of the same description supplied in Japan was in excess of 60 billion Yen and the ratio of the total amount of such goods or services supplied by the three highest ranking companies exceeds 70% were ordered to report parallel price increases. In 2004, 87 goods and service markets fell within the ambit of Article 18 (2) (1) AML<sup>29</sup>. The Study Group on the Antimonopoly Act<sup>30</sup> criticised the administrative burden for firms, the persistent difficulty to distinguish normal conduct with no communication from illegal cartel conduct with skilful communications and the fact that also less concentrated markets demonstrate the ability to increase prices in parallel. The

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<sup>26</sup> See Martin, S., (1994) p.66.

<sup>27</sup> The most stringent punishment under Article 19 AML is a 'cease and desist' order under Article 20 AML.

<sup>28</sup> See JFTC, (1991) chapter 2, p. 6.

<sup>29</sup> See JFTC, (1977) as amended December 17, 2004, Appendix 1.

<sup>30</sup> JFTC, (2003B) p. 68 ff..

2005 AML amendment has abolished the reporting requirement<sup>31</sup>. It has long been suggested that firms got used to the reporting requirement and that it was losing its effect<sup>32</sup>, particularly since implicit collusion, even if detected, cannot be punished effectively<sup>33</sup>.

Economic insights regarding collusion appear to be clear<sup>34</sup>: the more concentrated the market, the more standardized the product, the more comparable the costs and rates of time preferences across firms, the more likely a firm is to adhere to cartel agreements. The larger a firm's market share, the lower its time preference may be and the easier it is to detect cheating and consequently, the more likely it is for the firm to adhere to cartel agreements. Even in the absence of a reporting requirement the need to rigorously prosecute collusion is evident. It is hoped that the abolition of the reporting requirement frees resources that can be devoted to investigate the motivation behind parallel price increases.

The burden of proof regarding prosecution of (illegal) cartels is excessively high and seems to undermine effective cartel prevention. Schaede (2000) describes the three necessary steps to initiate formal enforcement procedures against cartels<sup>35</sup> as 'prove of evidence of joint decision', 'adherence to the plan' and 'evidence that the conduct demonstrably affects competition'. Regarding 'prove of evidence of joint decision', circumstantial evidence<sup>36</sup> of agreements is accepted by courts and is, however, undermined by the large number of business meetings, and the possibility to alter the implementation speed of a cartel to provide the 'adherence to the plan', the JFTC has to show what actions had been planned and that there were mutually binding restrictions, i.e. methods of coercion. If the JFTC doubted that cases would withstand a judge's scrutiny with respect to the third criterion, there is a danger that cases that could have been challenged formally might be dealt with informally and only lead to the issuance of a warning or a caution. Reducing the burden of proof to establish the existence of cartels and introducing a *per se* illegality of these may well lead to a higher number of convictions<sup>37</sup>. This, in turn, may lead to substantial gains in both consumer surpluses and enhanced allocative efficiency.

As in other antitrust legislation<sup>38</sup>, the term 'dominant position' is not defined. While this potentially gives rise to business uncertainty, the broad interpretation of the Supreme Court mitigates this aspect. The court interprets 'dominance' not only with regard to a particular business position but also with regard to a particular transaction, implying that also small and medium sized companies (SMEs)<sup>39</sup> can also be convicted. An exact analysis of the actual application and interpretation of the stipulations concerning 'dominance' is necessary, since one could expect a rise in competition in Japan to be associated with a reduction of the traditionally employed mutually beneficial long term- and cooperation oriented business relationships. Given that contracts are much less precise in Japan than in other countries, this may expose trading partners to significant pressure which might even be of an abusive nature.

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<sup>31</sup> JFTC, (2005C) p.5.

<sup>32</sup> See Iyori, H., Uesugi A., Heath C., (1994) p. 60.

<sup>33</sup> Schaede, U., (2000) p. 126.

<sup>34</sup> This passage is based on Martin, S., (1994) p. 192.

<sup>35</sup> See Schaede, U., (2000) p.124 ff.

<sup>36</sup> Schaede, U., (2000) p.124 cites that it is sufficient that the JFTC shows that a meeting took place, that limits on behaviour were discussed and that firms behaved uniformly afterwards.

<sup>37</sup> During the period of 1947-2003 (the latest available figures) the JFTC initiated 1210 formal cases. See JFTC annual reports and Schaede, U., (2000) p. 156.

<sup>38</sup> See for example the British and the European antitrust legislation.

<sup>39</sup> But one example is the Mizakawa case (Supreme Court Decision, 20 June 1977, Minshu, Vol. 31, No. 4, p. 449 (1977). See Matsushita, M., (1990b) p. 63 ff..

### 3. Surcharges

Enforcement effectiveness of competition law is determined by the overall amount of opportunities to compete<sup>40</sup> and the inclination of firms to restrict competition<sup>41</sup>. Whether firms choose to engage in unlawful competition restricting activities depends on the associated costs of establishing and maintaining<sup>42</sup> such practices and of course on the punishment incurred when found guilty of violating existing competition laws. If firms are assumed to act rationally<sup>43</sup>, they will restrict competition when costs of doing so are lower than the expected benefits<sup>44</sup>. The costs of violation is a function of rigid enforcement (detection), the level of punishment associated with a violation and the likelihood of actual prosecution. Two points shall be made against the existing surcharges on economic grounds.

Firstly, holding cartels responsible for the whole duration of the violation and depriving them of at least all of the unjustly obtained economic profits is justifiable on economic grounds<sup>45</sup> and is effective. Yet the current surcharge system limits the liability for violations to 3 years<sup>46</sup>. To the extent that the prosecution and surcharge level do not create a negative expected value for companies engaging in illegal activity, the surcharge system has to be viewed as being imperfect<sup>47</sup>.

Secondly, it has long been criticised that the surcharge levied was too low to effectively serve as a deterrent. Iyori et al. (1994)<sup>48</sup> note that the surcharge system was not intending to punish but to recoup undue profits. Experience with price-fixing and bid-rigging conspiracies in the

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<sup>40</sup> Which are in turn determined by the existence of private property rights, organization of factor markets, influence of the size and nature of the public sector as well as the legal framework restricting competition.

<sup>41</sup> See Waldenberger F., (1996) p.193.

<sup>42</sup> Maintaining a cartel agreement can indeed be costly, since adherence cannot normally be compelled by legal actions. Retaliation schemes like the basin point systems create inherent instability if freight absorption and cross-hauling aggravates relationships of participating firms. For a discussion of cartel stability, the interested reader be referred to Martin, S., (1994) chapter 6.

<sup>43</sup> The interested reader be referred to Becker, G.S., (1962) pp.1-13, who shows that even economic subjects acting irrationally may chose outcomes similar to those rational actors would have selected.

<sup>44</sup> If one would not only punish legal persons but also the decision makers directly, with sentences they can not easily be compensated for by the company, it might be assumed that incentive structures may be skewed in favour of refraining from illegal activity. One example is the threat of imprisonment as a form of legal liability of managers, rather than a monetary amount that could be reimbursed to them by the company.

<sup>45</sup> Becker, G.S., (1968) states on p. 207 that "illegal activities 'would not pay' (at the margin) in the sense that the real income received would be less than what could be received in less risky legal activities". So whenever the expected return from unlawful activity is positive rational actors are tempted to engage in such activity. Whether the social cost of internalising formerly incurred social costs (by recuperating the dead weight loss and monopoly profits from the whole period of legal violation) is to large or to small, is however a different matter. If it lead a firm, which was unable to redeem the social costs (disregarding any other punishment for unlawful activity), into bankruptcy, the associated costs of unemployment etc. may be so undesirable, that a milder sentence internalising only part of the losses borne by society may be socially desirable. This however may depend as much on social preferences as on the particular case itself.

<sup>46</sup> See Article 7 (2) AML. A number which is far lower than the empirical findings of a study of US industries involved in price fixing 1975-1980 which found an average cartel life span of 73.8 months. See US Department of Justice, Chemtop, S., (2000) p.5. In a personal conversation a JFTC official explained on 17.04.2003 that the JFTC's difficulty to extend the time limitation of surcharges was related to a practical problem. Firms in Japan are not required to keep accounting books long enough so that it is impossible for the JFTC to determine the surcharge level for cartel durations exceeding 3 years.

<sup>47</sup> Suzuki K., (1999) p.7, outlines that the Japanese 3 year limitation potentially reduces the punishment for long term violations.

<sup>48</sup> Iyori, H., Uesugi A., Heath C., (1994) p. 91-92 use the terms *Mehrerlösabschöpfung* and *Gewinnabschöpfung* ('forfeiture of inappropriate economic gains' in the language used by JFTC, (2003B) p. 17) and state that the surcharge system is not a sanctioning tool.

US has led to the estimate that prices were inflated by approximately 10%<sup>49</sup>, a level which did exceed the formerly prevailing surcharge levels in Japan of 6%, 2% and 1% for large manufacturers, large retailers and large wholesalers, respectively. Even though Yamada (2001)<sup>50</sup> rightly states that it is impossible to determine, by merely evaluating the percentage values in Japan, whether the EU's 10%<sup>51</sup> surcharge of offender's turnover has a more deterrent effect, it is clear that the level of fines is one of the elements which entrepreneurs take into account before deciding to infringe against the AML. Iyori and Uesugi (1994)<sup>52</sup> suggest that in those cases where the surcharge level was insufficient to deter cartels, a criminal case might be appropriate. This, however, will only be effective if the threat of initiating criminal sanctions is indeed credible<sup>53</sup>.

If one considers criminal sanctions under the AML to be insufficient to serve as a deterrent, the most recent amendment of the AML has to be evaluated as being a step in the right direction. Following the JFTC's submission on October 2004, the bill to strengthen the AML has been promulgated on the 27<sup>th</sup> of April 2005<sup>54</sup>. Large manufacturers, large retailers and large wholesalers are now subject to a 10%, 3% and 2% surcharge. For Small and Medium Sized enterprises, the figures increase from 3% to 4%, from 1% to 1.2% for Manufacturers and retailers but remain the same for wholesalers (1%). This increase certainly gives the surcharges a more punitive character but whether it is sufficient to function as a deterrence tool, is subject to further research. Yet judged by the figures stated in the Report of the Study Group on the AML<sup>55</sup>, detection rates are thought to be within the range of 10 to 30 percent and hence even the new surcharge levels are unlikely to serve as an effective deterrent. From an economic point of view, it is lamentable that the surcharge system is not intended to serve as a deterrence tool.

A much-lamented aspect of the AML has been that it did not have any stipulations to contain repetitive volitions. To the extent that repeated trespassing is an indication that the benefits of violating the AML exceed the costs, an increase in punishment would be desirable. This critique too, has found its way into the latest Amendment of the Antimonopoly Act<sup>56</sup>. Repeat violations occurring within a period of 10 years are fined with 150% of the normal respective surcharge rate.

Furthermore, the scope of surcharges is broadened. Not only unreasonable restraints on trade of goods and services affecting the price or the quantity are subject to charges but also restraints of purchase, market share, customers or suppliers<sup>57</sup>. In addition, private monopolization through controlling the business activities of other enterprises which restrains the price of their goods or services or which may affect the price of their goods or services by substantially restraining the volume of their supply, market share or customers<sup>58</sup>, is also

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<sup>49</sup> See US Department of Justice, Chemtop, S., (2000) p.5.

<sup>50</sup> JFTC, Yamada, A., (2001) p.5.

<sup>51</sup> Until 1<sup>st</sup> of May 2004 this threshold was spelled out in Article 15(2) of Regulation 17/64. Nowadays infringements of European Competition law are fined under Article 23 (2) of Regulation 1/2003 which equally allows for the levying of a fine which does not exceed 10% of the total turnover during the preceding business year.

<sup>52</sup> Iyori, H., Uesugi A., (1994) p. 260.

<sup>53</sup> This point is made by Schaede, U., (2000) p.118.

<sup>54</sup> See JFTC, (2005C).

<sup>55</sup> JFTC, (2003B) p. 18.

<sup>56</sup> See JFTC, (2005C).

<sup>57</sup> JFTC, (2005C) p. 3.

<sup>58</sup> JFTC, (2005C) p. 3.

caught. While this is a very laudable development as such, what is of relevance from an economic perspective is whether it pays at the margin to engage in anticompetitive conduct. To the extent that surcharges are too low to serve as an effective deterrence, criminal sanctions remain decisive.

An effective means to undermine cartel stability, which is complementary to a sufficiently high surcharge level, is the introduction of leniency. The claim to empower the JFTC to flexibly set surcharge levels for whistle blowers has already been made<sup>59</sup>. While the protection of whistle blowers is directed against employees of companies who can be protected against charges, leniency policies constitute a standardised administrative tool requiring companies to report. Two powerful examples<sup>60</sup> where the JFTC has been unable to obtain sufficient information to take action due to the absence of a leniency policy while other competition authorities have been able to convict cartel members, are the graphite electrode<sup>61</sup> and the vitamin cartel case<sup>62</sup>. The Economic Affairs Bureau of the JFTC was discussing the introduction of such a scheme as early as 2003<sup>63</sup>. This has led to the promulgation of a leniency policy in 27<sup>th</sup> of April 2005<sup>64</sup>.

Leniency does not only destabilises domestic cartels, but also international ones. International cartel members are more likely to approach competition authorities if they are protected in all the countries in which they are operating. Funahashi (2004) emphasizes the importance of an international proliferation of leniency policies and the closer international cooperation between competition authorities.

With all these recent changes firmly in place, deterrence and enforcement are expected to improve, which means the JFTC is better able to secure competition in Japan. A timely development of the surcharges collected by the JFTC is presented in figure 1. It clearly depicts an upward trend, which in turn may suggest a more vigorous antitrust enforcement. Yet as can clearly be seen in this figure, surcharges levied in Japan are much lower than surcharges imposed by the US Department of Justice. Whether this is equitable to a better enforcement of competition law in the US cannot be established on the basis of these figures, but if the propensity to engage in anticompetitive conduct and the likelihood of detection and conviction were equal, and one would account for the fact that the US economy is about twice as large as the Japanese, than clearly higher levels of fines imply a higher level of deterrence.

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<sup>59</sup> See, USTR, (2002) p.23 It may be noted that the Cabinet Office is currently (as of Spring 2003) examining to introduce regulations to provide incentives and protection to whistleblowers in relation to food related issues (food security and safety). Personal conversation with a Cabinet Office official on 18.03.2003. Such policy would concentrate on the protection of whistleblowers within a firm. From a legal perspective a leniency policy regarding the AML, would require the reduction of punishments for direct illegal actions by independent firms.

<sup>60</sup> This point has been made by Funahashi, K., (2004).

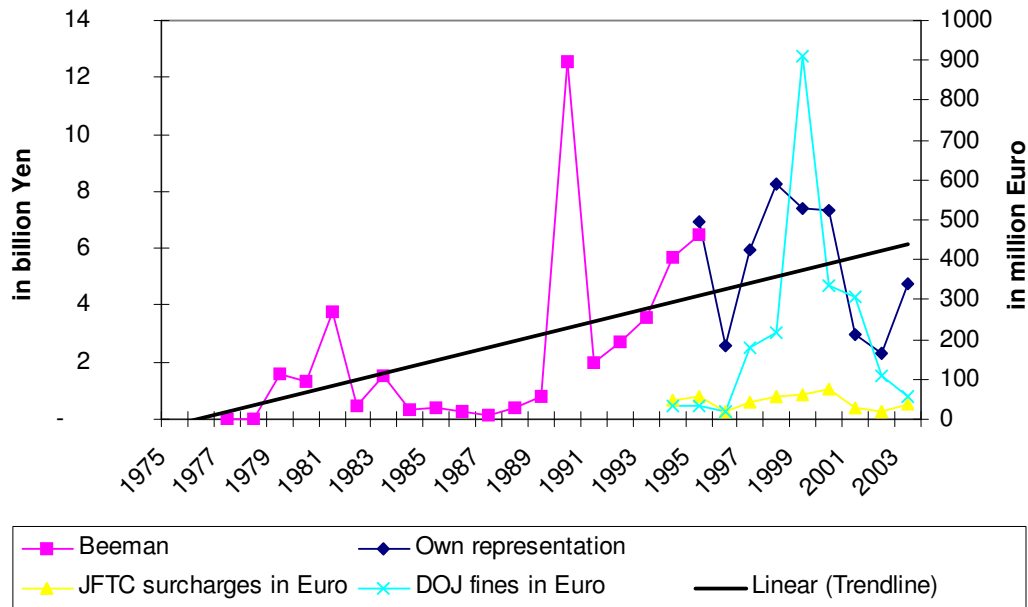
<sup>61</sup> See Funahashi, K., (2004) Annex 2.

<sup>62</sup> See Funahashi, K., (2004) Annex 2.

<sup>63</sup> The JFTC recognises that leniency programs work best if there is sufficient incentives for cartel members to default. Given the low level of surcharges incentives may be limited. Personal conversation with a JFTC official on 17.04.2003. But see also JFTC, (2003B).

<sup>64</sup> See JFTC, (2005C).

Figure 1 Surcharge development



Source: JFTC data taken from Beeman (1997) and JFTC annual reports. Department of Justice, (2004) p. 12. Exchange rates taken from European Commission, (2005), AMECO 15, nominal exchange rates.

#### 4. Holding companies

Political considerations have led to the prohibition of holding companies. The lifting of the restriction is evaluated positively since it establishes more market flexibility by allowing more diversification. To what extent this change will have negative externalities<sup>65</sup> in excess of positive competitive and investment stimuli still has to be seen. Existing studies broadly examining this aspect are not known to the author and constitute a promising field of research.

#### 5. Mergers

Another element, potentially contributing to increasing market concentration and the amalgamation of economic influence, regards the merger provisions of the AML. Martin (1994) praises the provisions of vertical and conglomerate merger guidelines as a laudable element in Japanese antitrust legislation and as making use of economic theory<sup>66</sup>. Yet it should be emphasised that multi-market contacts of conglomerate firms can have an anticompetitive effect, especially in Japan, where the private sector is home to a number of

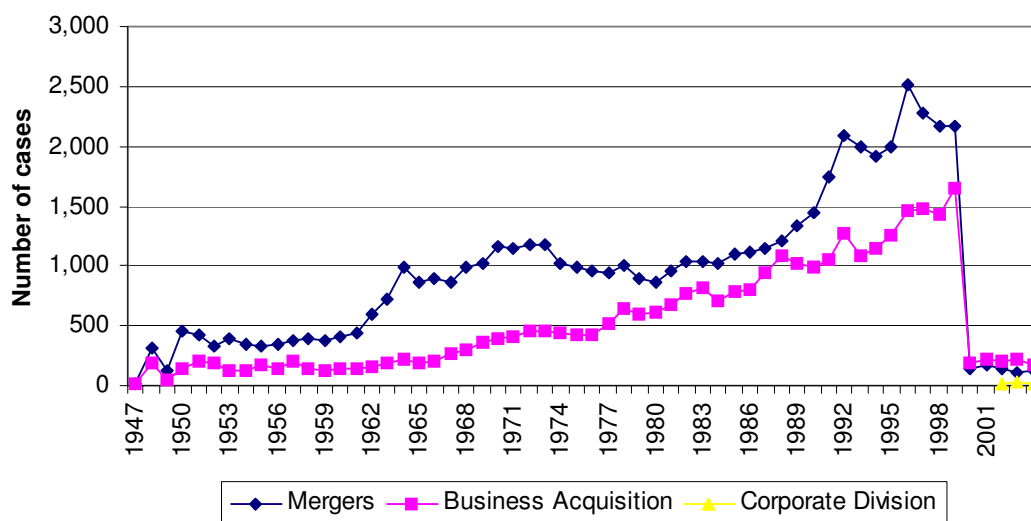
<sup>65</sup> Examples are the rising concentration of economic power of a relatively small number of individuals and the increasing market integration which might limit competition. Suzuki notes the JFTC's reluctance of intruding in areas of political interest of the Ministry of Finance, see Suzuki K., (1999). Taking Suzuki's observation as a starting point, the abolition of the holding clause can be viewed from a different angle as it, after all, "...paved the way for large-scale bank mergers and corporate restructuring". See Pacific Council on International Policy, (2002) p.15. While bank failure may remain a threat to contemporary Japan, one may assume that by merging, banks may have indeed become to 'large to fail'.

<sup>66</sup> See Martin, S., (1994) p. 433.

large conglomerates<sup>67</sup>. Provisions for multi-market contracts should be included into the guidelines for business combinations<sup>68</sup>.

The application of the 1999 merger and acquisition notification requirements<sup>69</sup> led to a strong reduction of mergers and acquisitions that must be filed with the JFTC. This has led to a strong reduction in the official number of mergers and acquisitions. This can be seen in figure 2. Though no well-founded analyses are known to the author, it might be suspected that the adverse anticompetitive effect is in reality quite limited, since the majority of mergers and acquisitions are well below 10 billion yen<sup>70</sup>. It is hoped that the JFTC staff will be able to concentrate on those cases that would have the most perverse repercussions on free market competition and thus make efficient use of scarce resources<sup>71</sup>. Despite potential positive effects, critiques remain sceptical of the desirability of Japan's merger system.

Figure 2 Mergers and acquisitions over time



Source: Own representation based on JFTC annual reports.

Note: The corporate division system (either through joint establishment or acquisition) was created by the amendment to the AMA in May 2000 and came into force in April 2001.

In Japan, concentration increasing horizontal mergers and business acquisitions are much more frequent than vertical ones. Furthermore, it shall be noted that there appear to be differences between the nature of vertical integration on an international level. Ramseyer (1997)<sup>72</sup> conducted a cross section analysis of vertical mergers and its underlying incentives and postulates that there is a greater prevalence of vertical integration in the United States.

<sup>67</sup> According to the JFTC annual report, JFTC, (1997) p. 82-83, in Fiscal year 1996, 44.6% of the mergers (regional expansion: 11.4%, Commodity range expansion: 9%, outright: 24.4%) and 46.4% of the acquisitions (regional expansion: 6.7%, Commodity range expansion: 8.8%, outright: 30.9%) took place between conglomerate firms. According to an JFTC official, multimarket contacts are not viewed as a problem in Japan. Personal conversation on 17.04.2003.

<sup>68</sup> See JFTC, (2004B) pp. 35 ff..

<sup>69</sup> See JFTC, (1999).

<sup>70</sup> See JFTC, (1997) p.75-91. In fiscal year 1996, 46.1% of the acquisition cases were under 1 billion yen. 30.1% of the cases were between 1 billion and 5 billion yen. 86.1% of the mergers were below 10 billion yen.

<sup>71</sup> It shall be noted that other countries have also opted for such legislative reforms, excluding 'tifle' cases in order to focus on those which potentially produce a stronger anticompetitive effect. One example regards the German legislation and its 6<sup>th</sup> novel of 1999. See Rudo, J., (1999).

<sup>72</sup> See Ramseyer, M., (1997).

His findings also establish that American firms tend to acquire 100% of a respective firm, while their Japanese competitors are predominantly striving for a commanding share majority.

## 6. Exemptions

Another determinant of effective enforcement is the number of existing exemptions. The vast amount of exemptions granted by the Japanese AML and the number of individual industrial laws not administered by the JFTC have decreased significantly<sup>73</sup>. At first sight, this suggests a positive development. Yet whether or not the deregulation and reduction of exemptions as well as the harmonisation of administrative guidance between the JFTC and the ministries is sufficient to rapidly enhance competition, is quite questionable. Schaeede et al. (1997)<sup>74</sup> are critical and lament, “the process of product market deregulation, including more rigorous antitrust enforcement, has only recently begun, and market competition is still far from taking over as a disciplinary function.”<sup>75</sup> Terry (1998)<sup>76</sup> adequately differentiates between the number and nature of scraping regulations and asserts that the number of regulations is not at the core of the discussion but their actual implications on a free economy and maintains that “regulatory relaxation” is about easing Japanese bureaucrats out of the control seat. And this is precisely what is widely questioned.

Increasing self regulation<sup>77</sup> and the collusive business practices of industries, such as the basic material industries<sup>78</sup>, and in light of the still huge differences between the international and domestic price level<sup>79</sup> and the remaining obstacles to penetrate the Japanese market<sup>80</sup>, give the impression that the regulatory advances made have not translated sufficiently into perceivable results. An ongoing point of critique in this context regards the exemption of SMEs. The broader exemption system<sup>81</sup> does not only focus on size related disadvantages of such enterprises but also envisages a public interest criterion in stating that due to their size they are more vulnerable to recession and thus have to be protected. This has to be evaluated critically since support of smaller firms or their associations cannot be justified by their mere size. Even though similar provisions exist in other countries as well, it does constitute a misuse of the AML, at least if a liberal economic perspective is taken as a benchmark<sup>82</sup>.

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<sup>73</sup> Suzuki, K., (1998?) p.7, notes that the reduction in exemption cartels was attributable not to the efforts of the JFTC, but primarily to the change in the attitude of other ministries which had established exemption rules on their own.

<sup>74</sup> Schaeede, U., et al., (1997) p.6 argue that due to decreased control of house banks in Japanese industrial sectors important external corporate control mechanisms have depleted while competition as a substitute has not yet been able to fill the „governance vacuum“.

<sup>75</sup> Schaeede, U., et al., (1997) p.6.

<sup>76</sup> Terry E., (1998) p. 241.

<sup>77</sup> Evidence presented in Schaeede, U., (2000).

<sup>78</sup> See Tilton, M., (1996).

<sup>79</sup> The interested reader is referred to OECD (2005) for interesting data on the purchasing power parity and to Tilton, M., (1998) p.163.

<sup>80</sup> USTR, (1999) p.246 notes improvements by the JFTC yet argues that the body’s efforts “fall short of those needed to ensure that Japanese markets are open to (foreign) competition...”, a statement made by the US Trade Representative.

<sup>81</sup> The law is applicable to SME associations in all industry sectors and accompanied by additional legislations in the following acts: The Small and Medium sized enterprise Organisation Act, the Act Concerning Improvement of Operation of Business Relating to Environmental Sanitation and Fishery Production Co-operation Association Act. See OECD, (1997b) p.3.

<sup>82</sup> Tilton, M., (1998) pp. 184-5 warns to interpret the ongoing reforms in Japan as an attempt to overthrow the developmentalist capitalism and to establish a hybrid form of liberal capitalism.

## 7. International co-operation

As one of the biggest national economies in the world and home of large enterprises, Japan has started to recognise the global interdependence and the complementary nature of competition policy and trade liberalisation<sup>83</sup>. Building upon the annual consultations between the US Fair Trade Commission and the Antitrust Division of the Department of Justice and the JFTC established in 1976, the United States and Japan have signed a Bilateral Antitrust Agreement in 1999. Taking Budzinski's typology of co-operations of competition agencies as a benchmark<sup>84</sup> this bilateral antitrust agreement reaches a high level of intensity. It embraces notification of enforcement activities, enforcement cooperation and coordination, conflict avoidance and consultations, positive comity and confidentiality and use limitations<sup>85</sup>. Similarly the cooperation agreement concluded with the EU in 2003<sup>86</sup> and with Canada in 2005<sup>87</sup> contains comparable stipulations. Less far-reaching agreements have been signed with Singapore and Mexico. The agreement with Singapore contains notification, exchange of information, technical assistance, supply of information and consultation provisions<sup>88</sup>. The agreement with Mexico is more limited in scope. It contains general provisions to counter anticompetitive activities and co-operation on controlling anticompetitive activities non-discrimination and a fairness clause<sup>89</sup>.

Though it may be assumed that such bilateral agreements do foster a mutual understanding and eventually lead to a harmonised approach to competition policy<sup>90</sup>, current differences still remain. For example, unlike the Directorate General Competition for example, the JFTC has not been applying the 'effects doctrine'. So far there has not been any case in Japan, which made the implementation of the 'effects doctrine' necessary<sup>91</sup>. Yet in the future, the necessity may arise<sup>92</sup>. Furthermore it should be stressed that Japan does not appear to be striving to establish a liberal economic order, so that it may be rendered more difficult to find a strong common ground with all competition regimes. Recognising diverging objectives and approaches to competition policy entails potentially higher costs associated with the establishment of a workable international antitrust regime.

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<sup>83</sup> Budzinski, O., (2002b) p.2ff. (forthcoming). The author recognises that in economic models, trade policy and competition policy are substitutes. He argues that trade and competition policies become complements when the following assumptions are relaxed: a) total product homogeneity, b) perfect competition, c) archetypical oligopolies and d) that trade liberalisation leads to a proportional increase in competitive pressure on domestic industries. For an overview of the JFTC's international activities, the interested reader is referred to JFTC, (2002A) p. 25 ff..

<sup>84</sup> Budzinski, O., (2002b) p.10 ff. (forthcoming). The Author distinguished 6 levels of cooperation intensity: notification, consultation, administrative aid, negative comity, positive comity and lead jurisdiction model.

<sup>85</sup> US FTC, (1999) p.1.

<sup>86</sup> Signed on July 9, 2003 entry into force on August 9, 2003. See JFTC, (2003A).

<sup>87</sup> JFTC, (2005A).

<sup>88</sup> JFTC, (2002A) The Agreement was Signed on January 13, 2002 entry into force on November 30, 2002.

<sup>89</sup> JFTC, (2005B) Chapter 12. Signed on September 17, 2004 enters into force on April 1, 2005.

<sup>90</sup> For an insightful paper on the discussion of centralisation and decentralisation with regard to international competition policy, See Budzinski, O., (2002a) (forthcoming).

<sup>91</sup> The MDS Nordion Inc. case of June 24<sup>th</sup> 1998 has been dealt with under Article 3 AML, see JFTC, (1998). I am indebted to an JFTC official for this comment made on 17.04.2003.

<sup>92</sup> Personal conversation with a JFTC official on 17.04.2003.

## 8. Institution and enforcement

This section examines the enforcement activities of the JFTC in more detail and takes due consideration of the institutional capabilities. Subsequently the current enforcement record is reviewed and a number of impediments to enforcement are highlighted.

The economic critique regarding the institutional setting of the JFTC's focuses on the Commission's independence and its enforcement record. The JFTC has historically been criticised for being influenced by the government, the ministries and the private sector<sup>93</sup>, which in turn casts doubt on the effective enforcement prospects. Positive support for law enforcement was expected to stem from the institutional reforms of 1996 and January 2001<sup>94</sup>. Forming part of a Ministry might have led to an increase of its voice in parliament<sup>95</sup> and to a reduction of the perceived 'ability gap' of civil servants among different 'qualified institutions'<sup>96</sup>. The 'ability gap' is related to 'academic snobbism' of graduates of prestigious universities<sup>97</sup>, performance of civil servants in the entrance examinations<sup>98</sup> and the small size of the institution, which would allow good bureaucrats to rise rapidly above their mediocre fellow colleagues.

It has been the declared objective of the new JFTC chairman Takeshima to bring the Commission back under its former position of the Prime Ministers Office. In comparison to the more cautious approach under chairman Negoro, chairman Takeshima appears to be following a more aggressive line. Also in part attributable to substantial foreign initiative<sup>99</sup>, Prime Minister Koizumi proclaimed that the JFTC would become a part of the Cabinet Office in April 2003<sup>100</sup>. The bill to transfer the Japanese Fair Trade Commission from the Ministry of Public Management, Home Affairs, Post and Telecommunications to the Cabinet Office was approved by the diet on 2<sup>nd</sup> of April 2003 and has been promulgated on 9<sup>th</sup> of April 2003. It has been hoped that this would enable the JFTC to emancipate further from outside pressure<sup>101</sup>. Looking at the recent changes, it appears that the new institutional arrangement may live up to its high expectations.

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<sup>93</sup> Private sector leverage enters via „descending from heaven“, i.e. the entering of the private sector after having had a civil service career. See Johnson, C., (1982) p.63, Buckley, R., (1999) p.178 and elsewhere. Suzuki K., (1999) p.11 following and p.17 argues that the expected benefits from „descending“ are the establishment or strengthening of the connections through which business interests could be communicated effectively to influence government policies. Yet, with progressing deregulation the expected benefit for enterprises decreases and a positive effect on the private sector's bargaining position is expected. In this context, the author identifies the 'amicable' relationship between the Fair Trade Association and the JFTC as questionable.

<sup>94</sup> In the Reform of 1996, the FTC saw the redefinition of the FTC secretary as a „General Bureau“ and the upgrading of two divisions into bureaus. Suzuki K., (1999) p.6 ff. notes that this change may well have increased the FTC's power since the new title puts the FTC on equal footing with other public officials.

<sup>95</sup> Since it did not have any representative in Parliament to defend its interests and to push for amending existing laws, it is hoped that situations may improve now.

<sup>96</sup> This passage is predominantly based on Suzuki K., (1999).

<sup>97</sup> For a detailed view on cliquishness and crony personnel policies for MITI, see Johnson, C., (1982) chapter 3.

<sup>98</sup> This would have been the case if the required score on Level I Examinations for the National Civil Service would be more demanding for entering the Ministry of Public Management, Home affairs, Posts and Telecommunications than those for the FTC.

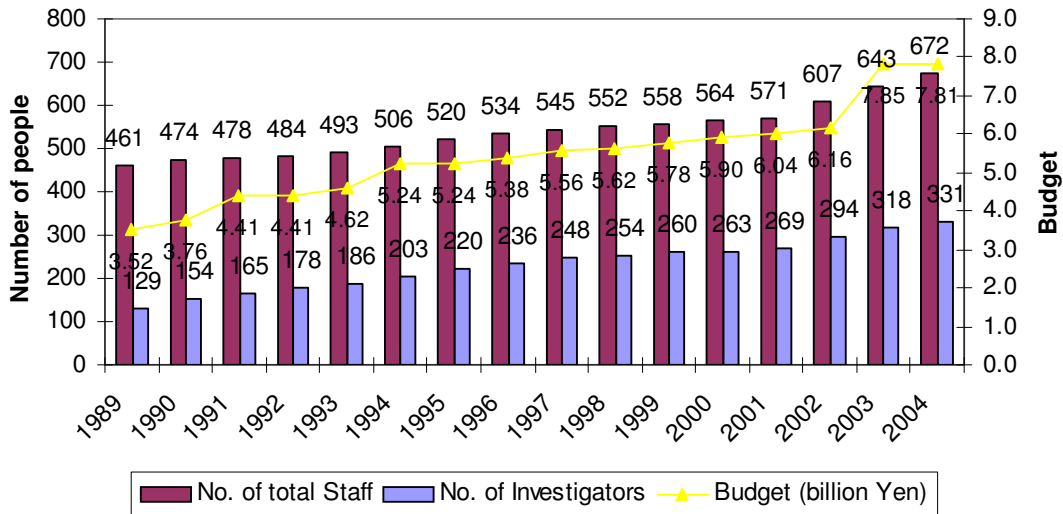
<sup>99</sup> The US and the EC have long been suggesting that the JFTC should be placed directly under the Cabinet Office to maximise its independence.

<sup>100</sup> See Prime Minister Koizumi's speech before the Diet on 31. January 2003; Koizumi, Junichiro, (2003).

<sup>101</sup> Some scholars emphasised the need of an independent JFTC but feared that insufficient protection of the JFTC would make it as vulnerable to outside pressure as the Bank of Japan. Furthermore an independent position of the cabinet office, it was feared could render it more difficult for the JFTC to summon effective support in the parliament and among ministries.

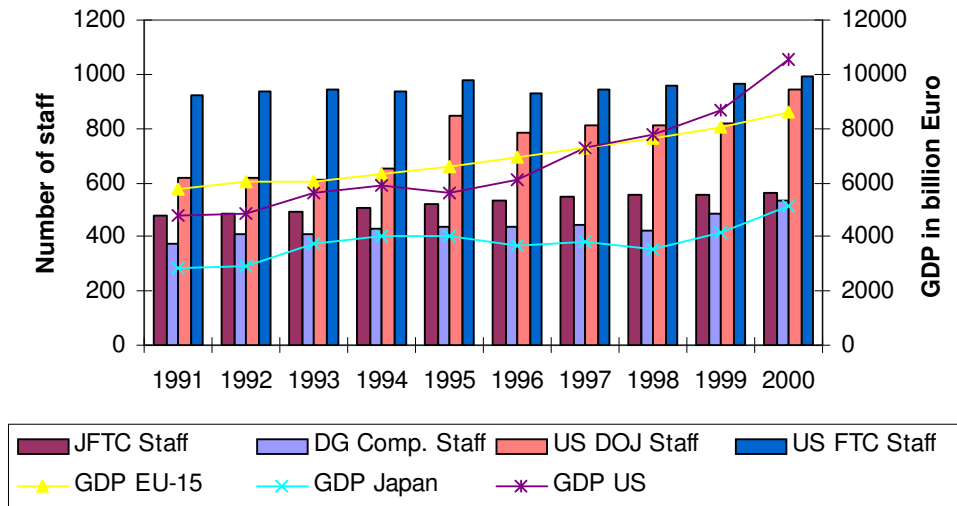
Positive institutional developments regard the strong increase of both the total number of personnel and in particular the number of investigators, which supports the impression that the significant legal changes may be followed by perceivable and persistent results. Yet setting the number of JFTC staff in relation to the country's GDP, yields a different picture. The amount of economic activity, measured in billion of Euro, a JFTC civil servant has to overlook, does not only compare unfavourable to the situation in Europe or the US but the situation has also deteriorated over the years. This can be seen in figures 3, 4 and 5. Thus it is to be welcomed that American pressure does not get tired of demanding even stronger increases of well-educated<sup>102</sup> investigators.

Figure 3 The JFTC's Labour force and its budget



Source: JFTC, Annual reports on Competition policy.

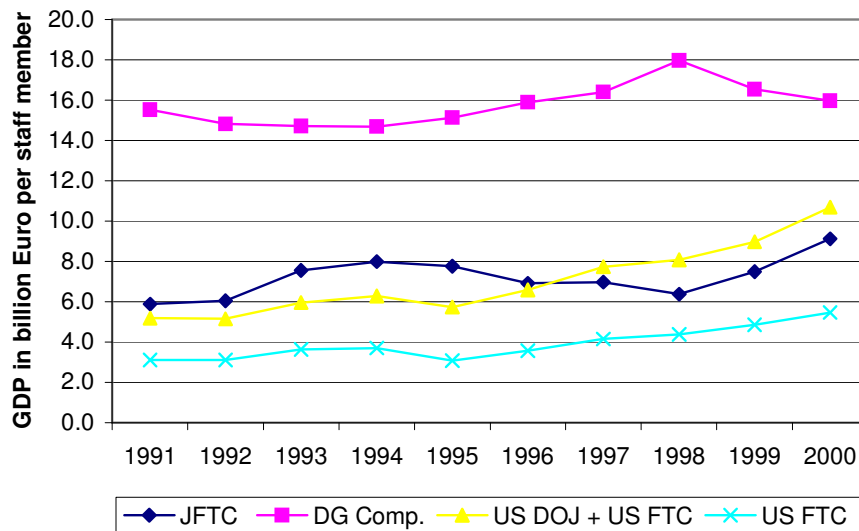
Figure 4 Cross-section comparison: GDP and Staff



Source: European Commission, (2005) AMECO 07, Gross domestic product at current market prices, Mrd. ECU/EUR (Standard aggregation), JFTC, (2002B).

<sup>102</sup> See USTR, (2002) p.23.

Figure 5 Cross-section comparison: GDP per staff



Source: European Commission (2005) AMECO 07, Gross domestic product at current market prices, Mrd ECU/EUR (Standard aggregation), JFTC, (2002B).

American claims that JFTC officials should be well trained may suggest that these civil servants indeed lack the necessary economic expertise. I would view such a claim as doing more harm than good in discrediting JFTC official's abilities and impede change rather than propelling it. Indeed, the JFTC has introduced special courses<sup>103</sup> and officials appear to be well informed, diligent and extremely hard working<sup>104</sup>. Besides, it is expected that JFTC staff will benefit from the work and expertise of the Competition Policy Research Center. Established in 2003, the Center is charged with the task to build and improve functional and sustainable cooperative platforms between outside researchers and practitioners and JFTC staff members in order to reinforce the theoretical foundation on which the JFTC operates, plans, proposes, and evaluates competition policy from a current, medium- and long-term perspective<sup>105</sup>.

Increasing the number of investigators may not directly lead to a more stringent AML enforcement. Plotting the number of cases to the number of investigators, as depicted in figure 6, shows a large variance in number of cases handled by each investigator. Noteworthy is the continuous decline in work load since the 1980s and growing importance of formal actions in the 1990s. The lack of a clear cut relationship between work load and the relative share of formal actions suggests that there were other relevant enforcement factors than resource availability<sup>106</sup> which were influencing enforcement during the period prior to the 1990s. A correlation analysis of the number of formal investigations and changes in the consumer price index yields considerable support to the hypothesis that public support pays

<sup>103</sup> The first ever JFTC 12-day training course has been conducted in September 2002. Topics included the history of the AML, key legal rules and guidelines, legal theory and case law covering restrictive business practices, monopolisation, merger rules and vertical restraints. Investigative powers and hearing procedures. Also basic economics of competition theory, deregulation in the energy sector, rules on sub-contracting, consumer protection, etc.

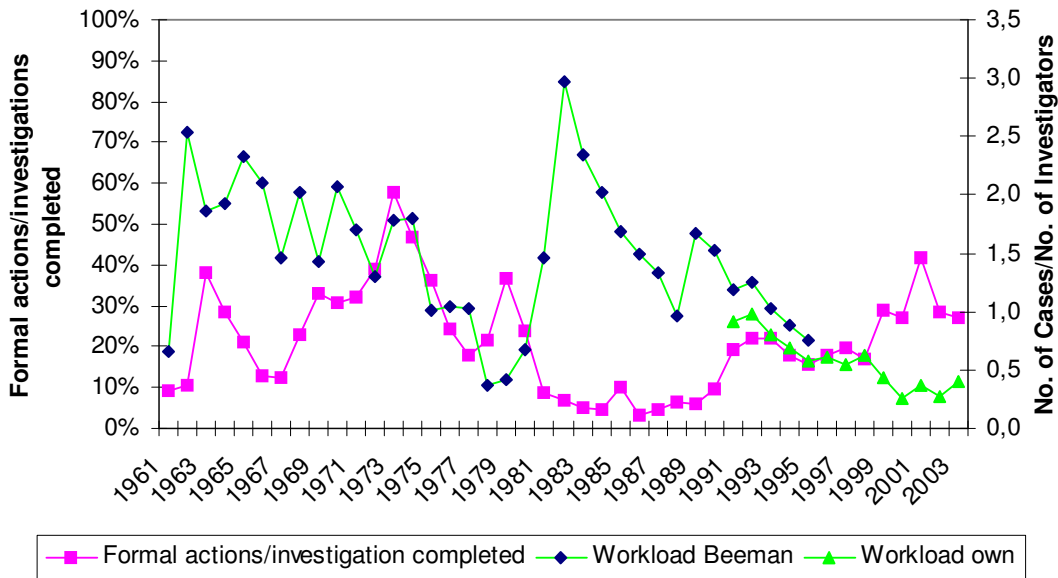
<sup>104</sup> Private conversation with an EU official in February 2003.

<sup>105</sup> See CPRC webpage.

<sup>106</sup> See Beeman, M., (1999).

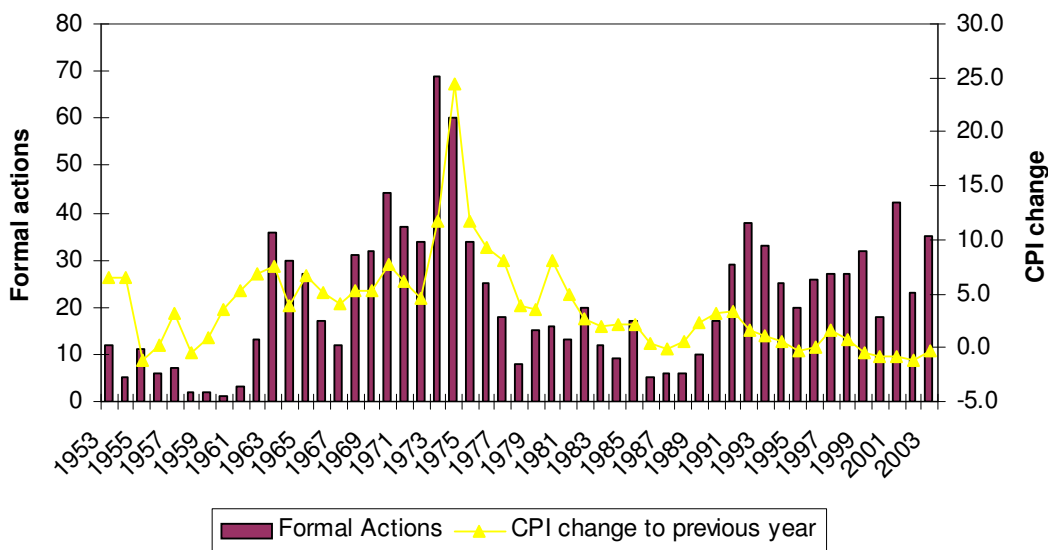
an important role in antitrust enforcement. During the period 1953-1989<sup>107</sup>, the correlation coefficient of the inflation rate and formal actions is 0,736 and negative for the period thereafter (1999-2003) (-0,092). The strong correlation and break at the end of the bubble economy is depicted in Figure 7.

Figure 6 Investigators per formal action taken: a degree of activism



Source: Until 1995 based on Beeman (1997), thereafter own calculation based on JFTC annual reports.

Figure 7 Formal actions and inflation

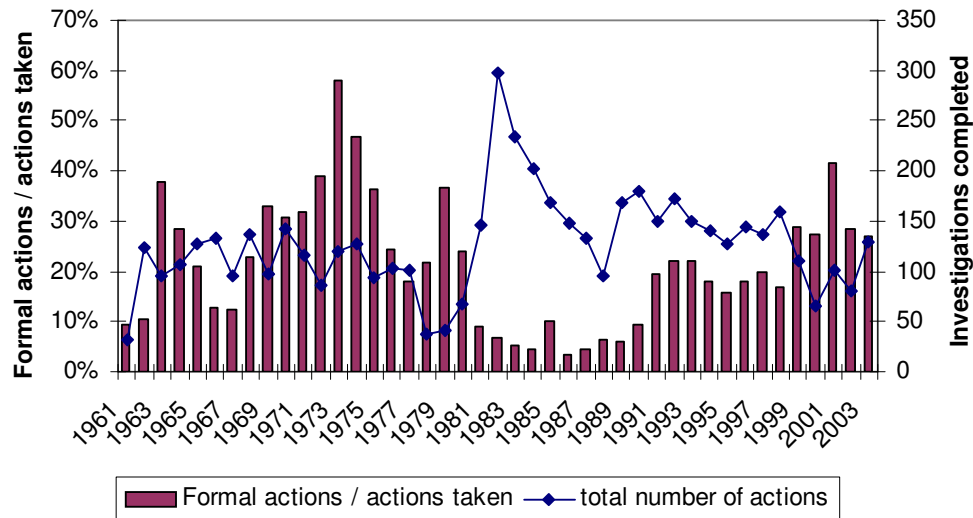


Source: Until 1995 based on Beeman (1997), thereafter own calculation based on JFTC annual reports. CPI data taken from the Japanese Bureau of Statistics (2005).

<sup>107</sup> 1953 has been selected as a starting date because volatile inflation rates and SCAP's support of the JFTC prior to this date are expected to represent a strong bias of the data. The ending year, 1989, was the end of the bubble economy.

While Yamada views the rising number of trials and convictions as being promising<sup>108</sup>, it should be noted, that the total number of investigations completed has fallen in the last decade. If one takes the increasing ratio of formal cases over the total number of actions as an indication<sup>109</sup> of enforcement dedication, the decade of the 1990s is indeed lower than the level in the 1970s. This can be seen in figure 8. Certainly one has to recognise that such crude measures do not account for the anticompetitive effect, i.e. the ‘quality’ of actual enforcement, and bearing in mind the information asymmetry with respect to the actual amount of offences committed, it reduces this finding to a mere observation.

Figure 8 Formal actions as a percentage of cases completed



Source: Until 1995 based on Beeman (1997), thereafter own representation based on JFTC annual reports.

Somewhat more promising is Beeman’s finding that the JFTC has started to initiate a greater number of cases involving condemnation of acts regarding some components of government-business relations<sup>110</sup>. Lamentably an empirical examination of the enforcement record regarding the fierceness of AML enforcement quality could not be produced. Even though the most important formal cases are outlined in the JFTC annual reports, incompleteness of data effectively forecloses a sound statistical evaluation. What, however, could be produced was a split up of some of the areas of the Commission’s enforcement activities. As is shown in figure 9, the 1990s saw an increased enforcement in the field of bid rigging while enforcement in the fields other than price cartels remains low<sup>111</sup>.

A concentration on bid rigging appears to be favourable since it does generate public attention and helps to save taxpayers money. An analysis of the construction sector predicts that costs of public construction works could be reduced by 30%<sup>112</sup> if bid-rigging practises

<sup>108</sup> See JFTC, Yamada, A., (2001) p.6 on the growing number of law suits.

<sup>109</sup> As done by Beeman, M., (1999).

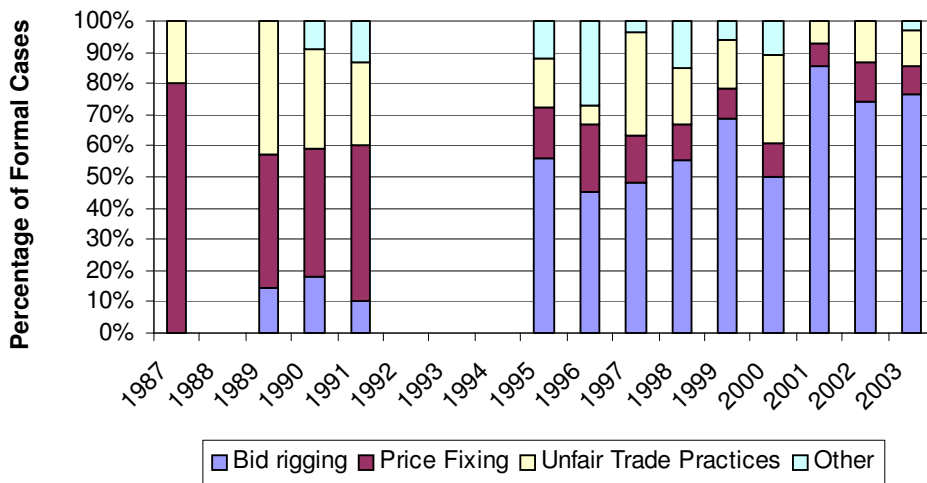
<sup>110</sup> Beeman, M., (1999) p. 14.

<sup>111</sup> Beeman, M., (1999) p. 12 assumes that it is due to the less clear criteria and that international support is not comforting enough to JFTC staff members who are unable to build successful careers outside the commission.

<sup>112</sup> This passage is in part based on USTR, (2002) p. 6, p. 23 -27. While I am not aware of any econometrical analysis in this field, one can only imagine by how far the actual price of public works would come down if the supplying industries to construction were also made competitive. It would certainly constitute an important field of research that would help the common public to understand the implication of a strong and independent JFTC.

were eradicated. Besides taking direct action, the JFTC should hold seminars for judges to understand the implications of anticompetitive behaviour and assist plaintive in legal disputes pursuant to Article 242 of the Local Autonomy Act, regarding waste of taxpayer's money<sup>113</sup>. The 'Act Concerning Elimination and Prevention of the Involvement in Bid-Rigging' promulgated in January 2003 is to be viewed as an important means to counter bid-rigging. It is hoped that the publicity generated by the non-binding stipulation of the law allowing the JFTC to demand that the procuring entity investigates involvements of civil servants in bid-rigging conspiracies and to publish a report thereof, will in fact help to contain bid-rigging. Despite its voluntary character, the law may generate proactive results in a 'shame oriented' society. The law's first application was the bid-rigging scandal of the city of Iwamizawa which led to 91 violators being surcharged with a total amount of 520,940 thousand yen<sup>114</sup>.

Figure 9 Decomposition of formal cases



Source: own representation of various issues of the JFTC annual reports. Unfair Trade Practices is any violation pursuant to Articles 19 AML (unfair trade practices), and the application of unfair trade practices in connection to Article 6 AML (international contacts), and 8 AML (trade associations). It embraces a) restraint of free competition: refusal to deal, discriminatory pricing, unjust low price sale, resale price restrictions etc., b) conduct that cannot be deemed fair: deceptive methods or unjust benefits and tie-in sales, c) unreasonable: abuse of dominant bargaining positions. See JFTC, (2002) p. 11.

Before the 2005 amendment, AML enforcement could be criticised on five grounds. These are the quasi-judicial status of the institution, the hearing procedures, administrative guidance, private enforcement and penalties. Each aspect is treated in turn. This approach allows me to emphasise the remarkable achievements which have been recently made.

Firstly, the quasi-judicial status of the institution has been criticised. If vested with the power of a public prosecutor, it is argued, an investigation would be more effective, since documents could be searched and not only asked for<sup>115</sup>. Beeman (1999) suggests that the JFTC should be granted the same investigatory powers as the National Tax Agency<sup>116</sup>. The

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Furthermore, given the future expenditures on infrastructure, which are currently planned, a focus on bid-rigging appears to be desirable.

<sup>113</sup> The interested reader be referred to a good working paper on Article 242 of the Local Autonomy Act. See Marshall, J., (2001).

<sup>114</sup> See JFTC, (2004A).

<sup>115</sup> One might have the impression that such a JFTC 'raid' is more akin to a 'shopping trip'.

<sup>116</sup> See Beeman, M., (1999) p.17

indirect criminal charges derived from intentionally concealed information is a less than perfect substitute. It has to be ensured that the penalties associated with such offences are sufficiently high as to function as an effective deterrent<sup>117</sup>. The 2005 AML amendment strives to enhance the JFTC's powers with respect to criminal investigations<sup>118</sup>. The introduction of compulsory measures for criminal investigation eliminates the problems from the standpoint of due process regarding Article 46(4) AML and allows the JFTC to transfer evidence to the public prosecutor's office<sup>119</sup>. The low penalties<sup>120</sup> for interference with inspections (Article 94 AML) are considerably strengthened from 200.000 Yen to 3 million Yen or a penal servitude of 1 year. Corporations are subject to a fine of up to 300 million Yen if they are held liable for contravening an elimination order.

Secondly, allowing defendants to propose self-restrictions or suggest remedies to benefit from a consent decision during a hearing procedure<sup>121</sup>, may be viewed critically since firms are expected to agree on voluntary self-restrictions, if that is in their own self-interest and thus potentially leads to sub-optimal outcomes<sup>122</sup>. It may be argued, that the costs of exempting voluntary self-restrictions exceed those of a simple prohibition<sup>123</sup>. Besides, the inter-firm contact necessary to reach an agreement, it might foster further agreements on other issues<sup>124</sup>.

From a procedural economy point of view, an additional point of critique is to be raised. The consent decision system assumes full acknowledgement of all facts and charges as spelled out in the initiation decision. New facts and charges brought to light in the process of the hearing cannot be taken into account. If it were deemed desirable to reach consent decisions, then a more flexible approach regarding partial acknowledgement of facts and charges as well as regarding new charges would be recommendable<sup>125</sup>.

While consent decisions are not altered, the new amendment of the AML suggests a number of changes that will counter the expected rise in the currently already high number and the stronger complexity of hearing procedures, which are expected to result from increased surcharges and the introduction of leniency policies<sup>126</sup>. The broadening application of surcharges and leniency cases implies that facts established during a hearing procedure will immediately relate to criminal facts. This poses problems from a procedural point of view. The rejection of part of the facts results directly into a non-consent decision while the levy of administrative sanctions allows for prior notification, tendering opinions and the submission of evidence prior to an order. Therefore recommendation procedures have been abolished and a single procedure has been established. In this procedure the JFTC issues elimination orders after having provided the respondent the opportunity to submit its opinions and to initiate

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<sup>117</sup> The US makes similar claims, providing conducive pressure for change. In addition, the US proposes the extension of cease and desist orders and the expansion of imprisonment for criminal violation and statute limitations to 5 years. See, USTR, (2002) p.23 ff..

<sup>118</sup> JFTC, (2005C) p. 3 ff..

<sup>119</sup> See JFTC, (2003B) p.32 ff..

<sup>120</sup> See JFTC, (2003B) p.35 ff..

<sup>121</sup> Article 53(3) AML.

<sup>122</sup> The line of argumentation is similar to the kind of arguments put forward against Voluntary Export Restraints, see Krugman P. and Obstfeld M., (1996) chapter 4.

<sup>123</sup> This would be the case if self regulation would have to be vigilated or if it would lead to socially undesirable outcomes.

<sup>124</sup> As Smith, A., (1937) already noted: „People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.“

<sup>125</sup> See JFTC, (2003B) p.42.

<sup>126</sup> This passage is based on JFTC (2003B) p.38 ff. and JFTC, (2005C) p. 4 ff..

hearing procedures when the elimination orders are objected. Since both the elimination measure and the surcharge payment procedure is unified, the time limits during which the JFTC can apply these instruments have been harmonised as well. The time limit of elimination orders has been extended to three years. In order to counter firm's incentives to prolong hearing procedures in order to circumvent payment of surcharges, a system in which the payment order does not lose effect if hearing procedures are initiated is established. These changes are expected to safeguard effective operability of the adjudicative system, which in turn is expected to enhance AML implementation and save scarce resources.

Thirdly, a reporting requirement regarding administrative guidance affecting business competition and a reporting requirement of civil servants, if an AML violation is being suspected, would allow the JFTC to prosecute a larger number of cases of amicable government – business relations<sup>127</sup>. Such requirements can also serve to mitigate the dual threats of licensing<sup>128</sup> and trade association's self-regulation<sup>129</sup>.

Fourthly, private enforcement of antitrust legislation<sup>130</sup> has been identified as an effective means of deterring antitrust violation in the US. The file charge of 1% of the claimed charge levied in Japan would have adverse effects if it would impede plaintiffs from suing another party in order to internalise damage incurred. Furthermore only direct damage<sup>131</sup>, not indirect costs, can be claimed. Experience will show to what extent the new legislation will be able to mitigate the number of law suits and be a stable pillar for antitrust violation deterrence. Furthermore the burden of proof for civil level cases should be reduced as to increase the number of private cases and thus allow a more active implementation of the law. This could be achieved by inviting outside experts to JFTC hearing procedures<sup>132</sup>.

Fifthly, an increase in penalties would make violations of the AML more costly and thus reduce the expected benefits from unlawful conduct<sup>133</sup>. One example to be cited is the more rigorous treatment of vertical restraints. These restraints are not normally condemned as unreasonable restraints of trade (Article 3 AML) but only as unfair trade practices (Article 19 AML)<sup>134</sup>.

## 9. Transparency

The JFTC has made considerable improvements regarding transparency. Laudable elements of this policy embrace an antimonopoly-consulting network organized in collaboration with the Chambers of Commerce and Industries across the country in 1998<sup>135</sup> and the large number of guidelines that have been published to have the business community and other 'qualified Agencies' prompted on antitrust enforcement. An additional consideration, which

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<sup>127</sup> Beeman, M., (1999) p.18.

<sup>128</sup> Sohn, Y., (1998) p.29 and Tilton, M., (1998) p.165 ff..

<sup>129</sup> See Schaede, U., (2000).

<sup>130</sup> Private law suits suing for triple damages amount to 90% of the antitrust cases in the US. See Richards, J.D., (1993) p. 443.

<sup>131</sup> To prove causal relationship is perceived as difficult and courts are not easily convinced.

<sup>132</sup> See Beeman, M., (1999) p.17.

<sup>133</sup> In addition to a substantial increase in surcharge levels, the US recommends an extension of surcharge systems, also and particularly to SMEs. See USTR, (2002) p.24.

<sup>134</sup> See Beeman, M., (1999) p.10, as established by the 1953 Newspaper Route and the 1953 Toei Shin Toei decisions by the Tokyo High Court.

<sup>135</sup> See JFTC, (2001b) p.6.

is utterly important in the presence of business favouring governments<sup>136</sup> and strong ministries<sup>137</sup>, is the maintenance of a momentum for effective antitrust enforcement<sup>138</sup>. Measures geared to inform the public include the upgrading of the JFTC webpage and the introduction of school visits<sup>139</sup> to educate students about the AML.

Even though the JFTC's approach towards transparency is laudable and clearly aids the institutional emancipation, fosters business certainty and enforcement predictability, its limitations have to be noted. The traditional monopolisation of information in Japan is still perceivable and the Commission is no exemption. Obtaining specific information remains difficult and the incoherency and incompleteness of data published complicates attempts to conduct a sound economic analysis of the JFTC's enforcement practices.

## 10. Conclusion

The recent developments in Japanese Antitrust legislation, also and in particular with regard to the 2005 AML amendment, the emancipation of the JFTC and express government support are to be evaluated very positively from an economic point of view. Despite the considerable advancement, a caveat long raised by Martin (1994) is to be cited. Martin states that the legislation that frames Japanese antitrust and competition policy is "delightfully vague"<sup>140</sup> and that the definitions of Article 2 AML give an appearance of precision, which does not alter the role of the Tokyo High Court in interpreting the law. It is not the law, but its interpretation that is of relevance. All the more important is the work of the Competition Policy Research Center in supporting and systematically assessing the hard work of the JFTC and making the intend and capabilities of competition policy known to a wider public.

Speaking in 2001 Yamada Akio, a former Secretary General of the Fair Trade Commission, stated in a speech: "Unfortunately, however, I can't say that the Antimonopoly Act has taken root through Japan"<sup>141</sup>. Yet the unambiguous strengthening of the AML in this first reform since 1977 is clearly a major step into the right direction!

This paper has analysed the legal text of the AML from an economic perspective and a number of deficiencies and recommendations for improvements have been given. The most important points to further strengthen the institutional capacities and the enforcement prospects of the AML are summarized in this section:

- Broadening the scope of vertical restraints that fall as unreasonable restraints of trade under Article 3 AML can increase deterrence.

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<sup>136</sup> Suzuki, K., (1998?) p.16. argues that, traditionally, the LDP marginalized competition policy and that in the absence of a qualified opposition (associated with active Antitrust enforcement) is more inclined to follow industry's interest.

<sup>137</sup> Personnel contributions and budgetary dependence on the diet (i.e. the governing party) and the MoF have been raised before in this paper. In addition, Johnson, C., (1982) p.75 following, outlines the interministerial struggles and empire building approaches of bureaucrats and ministries and speaks of „battles for the outposts“ (weaker agencies to be infiltrated by staff exchange which is to be viewed as a serious part of the policy-making process).

<sup>138</sup> Buckley, R., (1999) p. 98 notes: „In Japan change is more often incremental. Gradualism may win where confrontation will fail“.

<sup>139</sup> JFTC, (2004C).

<sup>140</sup> Martin, S., (1994) p.66.

<sup>141</sup> See JFTC, Yamada, A., (2001) p. 12.

- The reasoning behind the mutual restriction clause of Article 2(6) AML, should be examined and possibly abolished in order to be able employ stricter measures against such violations.
- Resources freed due to the abolition of the reporting requirement under Article 18 (2) AML, should be used to investigate the motivation behind parallel price increases.
- Reducing the burden of proof to establish the existence of cartels and introducing a *per se* illegality of these, may well lead to a higher number of convictions.
- An exact analysis of the factual application and interpretation of the ‘dominance’ should be conducted. Particular regard should be taken of the change in business relationships in Japan and the less elaborate nature of contracts.
- Cartels should be held responsible for the whole duration of their anticompetitive activity and not only for 3 years.
- Surcharges should be high enough to recoup all undue profits made and it should be examined to attribute a deterrence function to surcharges.
- To the extent that surcharges are too low to serve as an effective deterrence, criminal sanctions remain decisive and leniency will fall back behind its capabilities.
- Provisions for multi-market contracts should be included into the guidelines for business combinations.
- Existing exemption schemes need to be examined. The inclusion of public interest criteria to protect SMEs, constitutes a misuse of the AML.
- More well educated investigators will enable the JFTC to better fulfill its tasks and to improve the detection of AML violations.
- Defendants should not be allowed to propose self-restrictions or suggest remedies when benefiting from a consent decision during a hearing procedure.
- The introduction of a reporting requirement regarding administrative guidance affecting business competition and a reporting requirement of civil servants, if an AML violation is being suspected, would allow the JFTC to prosecute a larger number of cases of amicable government – business relations.
- Private enforcement should be stepped up by reducing the filing charges, and by allowing the claim of indirect damages.

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