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## COMPETITION POLICY, CAPACITY BUILDING, AND SELECTIVE ADAPTATION: LESSONS FROM JAPAN'S EXPERIENCE

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### I. INTRODUCTION

Over the past twenty years there has been a remarkable increase in the number of jurisdictions that have implemented comprehensive competition policies.<sup>1</sup>

The enactment of competition legislation has become a global phenomenon. Competition law has, in effect, become the latest fashion. To be someone, it appears, everyone—including the members of the APEC [Asia-Pacific Economic Corporation] community—must have a competition statute. For some (particularly the countries of Central and Southeastern Europe as well as the Baltic states) the explanation lies in more than pure fad. To be someone means to be a member of the European “club” and true to the tradition of elite clubs everywhere. Proper dress—in this case competition legislation acceptable to those who run the club—is one of the prerequisites of membership.<sup>2</sup>

There are a number of factors, besides faddishness, that explain this recent proliferation of competition policy regimes. Developing countries with emerging market economies recognize the benefits that such policies can provide for the development process. Countries in transition from centrally planned to market economies see a role for competition policy, both as a mechanism to encourage the operation of efficient markets and as an antidote to entrenched, recently privatized dominant firms in specific industries. There has been encouragement (and sometimes pressure) from

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1. The term “comprehensive” is used to indicate an explicit, unified set of rules intended to protect competition. Nearly all economies have long had rules, generally scattered among multiple pieces of legislation that reflected certain elements of competition policy.

2. John O. Haley, *Competition Law for the Asia-Pacific Economic Cooperation Community: Designing Shoes for Many Sizes*, 1 WASH. U. GLOBAL STUD. L. REV. 1, 2 (2002).





trading partners and trade organizations for the adoption of rules that will curb anti-competitive structures and behaviors that impair international trade. The accession to free-trade groups, such as the European Union (EU), has required the establishment of competition policy. As a result, many jurisdictions with little competition policy experience and quite different motivations are striving (and sometimes struggling) to implement such policies. In response, jurisdictions with mature competition policy regimes have assisted in capacity building, both individually and collectively.

The development of competition policy is largely based on North American, and, recently, Western European experiences. United States antitrust policy, with a century of development, is mature and, in the view of most commentators, comprehensive and largely consistent with modern economic thought. Despite this recognition, capacity builders helping to implement competition policies do not recommend that their clients simply adopt the American rules.<sup>3</sup>

It stands to reason that competition policy systems will be influenced by the economic, institutional, legal, and cultural settings of the adopting jurisdiction. The question is how the system will be influenced. It is important that solutions to competition issues achieve the overarching goal of competition policy—the effective operation of markets. Capacity builders do not have a clear-cut understanding of how the mix of economic, legal, institutional, and cultural influences impinges on the implementation of an effective system. Indeed, they spend considerable effort trying to determine the best building tools as they choose between assistance in drafting rules, training the judiciary, training competition agency officers, and seconding their own experienced staff to work with newly established agencies.<sup>4</sup> If there were a way to predict how specific policies would be adapted to local conditions, and which local conditions would be amicable or inimical to effective policy implementation, the job of capacity building would be much easier.

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3. Russell W. Damtoft, Counsel for Int'l Technical Assistance, Bureau of Competition, U.S. Fed. Trade Comm'n, *Lessons Learned in the Delivery of Technical Assistance: The United States Experience*, Address Before the International Competition Network Second Annual Conference 4 (June 23, 2003), available at [http://www.internationalcompetitionnetwork.org/media/library/conference\\_2nd\\_merida\\_2003/merida\\_speech6.pdf](http://www.internationalcompetitionnetwork.org/media/library/conference_2nd_merida_2003/merida_speech6.pdf).

4. See, e.g., International Competition Network, *Competition Policy Implementation Working Group*, available at <http://www.internationalcompetitionnetwork.org/index.php/en/working-groups/competition-policy-implementation> (last visited July 6, 2007).





One potential tool to assist in this regard is Potter's selective adaptation model.<sup>5</sup> The model identifies the role of local conditions in the adaptation of foreign rules. It has been successfully applied to China's adaptation of property law, administrative law, and corporate governance rules. The question we address is whether and how the model can be applied to the adaptation of competition policy.

This Article reflects our first steps towards an answer. It involves an *ex post* descriptive analysis of the initiation and first fifty years of enforcement of anti-cartel and merger control rules in Japan. The analysis is conducted from the perspective of the selective adaptation model. We rely largely on secondary sources (and there is extensive, voluminous literature), and we acknowledge that we are neither Japanologists nor legal scholars. Nonetheless, we think the exercise provides some insight into how competition rules will likely be adapted in developing and transitional economies, and what the sponsors of capacity building should emphasize in pursuit of successful policy implementation. The current Secretary General of the Japanese competition policy authority, the Japan Fair Trade Commission, acknowledges that Japan's mixed experience with competition policy can provide lessons for capacity builders.<sup>6</sup> The purpose of this research is to identify those lessons.

Therefore, unfortunately, it must be said that Japan had experienced too late as well as too small steps taken in the field of competition law.

However, this might mean that Japan can offer valuable lessons to many countries in the world that are going to start serious enforcement efforts of their competition laws from now on. After 1990, many countries had adopted competition laws, but it seems to be very difficult for the enforcement agency of competition laws to establish itself in such a short period of around 10 years in view of the experiences of our country.<sup>7</sup>

This Article begins by describing the selective adaptation model. It then identifies the core areas of competition policy and the basic elements

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5. Pitman B. Potter, *Globalization and Economic Regulation in China: Selective Adaptation of Globalized Norms and Practices*, 2 WASH. U. GLOBAL STUD. L. REV. 119, 119–50 (2003).

6. Akinori Uesugi, Sec'y-Gen. of the JFTC, *Enforcement of Competition Laws in Japan*, Speech Before the International Competition Enforcement Conference 1 (Apr. 20–21, 2005) (updated transcript reflecting the amendment of the AML on Apr. 20, 2005), available at <http://www.jftc.go.jp/e-page/policyupdates/speeches/050420uesugi.pdf>.

7. *Id.*





of implementation (i.e., the rules, enforcement, and outcomes). Subsequent sections explore Japan's experience with two of the core elements of competition policy (cartel and merger control) through the lens of selective adaptation.

## II. SELECTIVE ADAPTATION

The basic premise of the selective adaptation model is straightforward: when a jurisdiction adopts an alien set of rules, it will not do so holus-bolus. The rules, and more importantly the implementation of the rules, will be adapted to local conditions. The more challenging task is identifying and measuring the forces that influence the direction and extent of the adaptation. Why is it that one jurisdiction can take a set of rules "off-the-shelf," clone the implementation procedures of established regimes, and achieve the desired policy goals; however, in other cases adaptation is extensive, painfully slow, and sometimes results in policy with unforeseen and undesirable consequences?

The selective adaptation model sets out a number of factors that will condition the establishment and implementation of foreign norms as reflected in "rules, structures, processes and practices."<sup>8</sup> It starts by asking how much room the local jurisdiction has to adapt or modify the foreign norms.<sup>9</sup> Then it asks which factors influence the level and direction of adaptation given binding constraints.<sup>10</sup>

The room for adaptation depends first on the power relationship between the source of the foreign norms and the local jurisdiction.<sup>11</sup> At one extreme there might be no power issue at all. For example, a local jurisdiction in transition from a centrally planned to a market economy might voluntarily adopt a purely Western-style competition policy with little modification to facilitate the transition, even though the policy is "foreign." At the other extreme, a foreign jurisdiction might be in a position to force its norms on the local environment, as in the case of military occupation. The power of the source of the foreign norms can come through the "carrot or the stick." The promise of sought-after membership in a customs union can provide a powerful enticement to

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8. Potter, *supra* note 5, at 120.

9. *Id.* at 120–21.

10. *Id.*

11. *Id.*





voluntarily adopt foreign regulatory norms;<sup>12</sup> the threat of trade sanctions can provide an equally powerful incentive.<sup>13</sup>

Once the binding constraints are set, the degree and direction of adaptation depends upon perception, legitimacy, and complementarity.<sup>14</sup> Local perceptions of the purpose (both declared and undeclared), content, and effects of foreign rules and regulatory norms impinge upon the implementation of such rules in the local context. If foreign and local perceptions are parallel, modification of the foreign norms will be more moderate when all things are equal.<sup>15</sup> Legitimacy involves the extent to which the members of the local jurisdiction agree with the purpose and projected results of the foreign rules.<sup>16</sup> Complementarity is defined as the extent to which foreign and local regulatory norms can be combined to achieve a desired outcome.<sup>17</sup> In other words, if the foreign rule assists in achievement of a local priority, it is more likely to be accepted. Conversely, if the foreign rule is seen as impairing achievement of the local priority, it is more likely to be resisted (or adapted in a form that is non-recognizable).<sup>18</sup>

### III. COMPETITION POLICY

Before applying the selective adaptation model to the Japanese experience with competition policy, it is necessary to identify which specific policies are to be considered and what elements (such as rules, enforcement, and outcomes) are emphasized.

#### *A. Core Areas of Competition Policy*

There is no universal agreement as to precisely what comprises competition policy. Some would include a broad set of policies that influence industrial structure, conduct, and performance, including direct regulation (and deregulation), privatization policies, foreign investment policies, and antitrust policies. Others point to antitrust policies alone. To

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12. See, e.g., Potter, *supra* note 5; *id.* at 122–24 (describing the case of China’s ascension to the World Trade Organization (WTO)).

13. Seung Wha Chang, *Interaction Between Trade and Competition: Why a Multilateral Approach for the United States*, 14 DUKE J. COMP. & INT’L L. 1, 1–38 (2004).

14. Potter, *supra* note 5, at 120.

15. See *id.* at 120–21.

16. *Id.* at 121.

17. *Id.* at 120.

18. *Id.* at 120–21.





make the analysis tractable, we focus on two of the three core areas of antitrust policy: horizontal agreements and mergers.<sup>19</sup>

Horizontal agreements are arrangements between direct competitors that constrain independent behavior.<sup>20</sup> They include joint ventures, specialization agreements, joint research and development projects, joint advertising campaigns (or agreements to restrict advertising), some trade association activities (such as agreements to adhere to common standards or common terminology), purchasing groups, bid-rigging, and outright cartelization intended to restrict supply and raise prices.<sup>21</sup> Jurisdictions with mature competition policy regimes almost always have strong, well-enforced rules prohibiting naked cartelization such as bid rigging, price fixing, and market sharing.<sup>22</sup> This is for two reasons. First, there is near-universal agreement amongst economists that naked cartels result in inefficient outcomes.<sup>23</sup> Second, the remedy for an offensive horizontal agreement is obvious—the parties must stop the offensive behavior.<sup>24</sup> This combination of agreement over the deleterious effects of the behavior and an obvious, operational remedy has caused the control of cartels to be a primary concern of both established and emerging competition policy regimes.

Horizontal mergers involve the amalgamation of competing businesses.<sup>25</sup> By definition, the removal of a competitor from the market reduces competition; however, the end result might well have no impact on equilibrium prices or quantities. On the other hand, some mergers can create or substantially increase market power with likely harmful effects on prices and quantities.<sup>26</sup> Compared to cartelization, there is much less consensus amongst economists on the social welfare impact of horizontal mergers between significant market participants. Nonetheless, in many

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19. For the purposes of this Article, the third core (but less frequently enforced) set of antitrust rules dealing with “abuse of a dominant position” are ignored.

20. Louis Kaplow & Carl Shapiro, *Antitrust*, (Harvard Law School Discussion Papers Series, No. 575, reprinted in A. MITCHELL POLINSKY & STEVEN SHAVELL EDS., *HANDBOOK OF LAW AND ECONOMICS*) 51–52 (forthcoming 2007)

21. *Id.*

22. Jens Høj, *Competition Law and Policy Indicators for the OECD Countries* (OECD Economics Department Working Papers, No. 568) (2007).

23. Here and throughout this Article the notion of efficiency is meant to encompass allocative efficiency (i.e., production and consumption of the optimal quantity and mix of products and services), technical or productive efficiency (i.e., production of the optimal quantity and mix of products and services at the lowest resource cost), and dynamic efficiency (i.e., the optimal introduction over time of new products and processes).

24. Kaplow & Shapiro, *supra* note 20, at 58–59.

25. *Id.* at 59.

26. *Id.* at 59–78.





mature competition policy jurisdictions, merger rules are well-developed and are actively enforced.<sup>27</sup> This has much to do, once again, with the existence of an obvious, operational remedy. Parties to a proposed merger can simply be prohibited from proceeding.<sup>28</sup> It is well recognized that anti-competitive, extant market structures are often very difficult to correct.<sup>29</sup> High levels of concentration can lead to interdependence and a dampening of competition.<sup>30</sup> But if market shares have been honestly won, it is difficult to alter the market structure.<sup>31</sup> Dismemberment is strong medicine and is rarely prescribed. However, it is relatively easy for public policy to stop the accretion of market share through horizontal mergers.

### *B. Elements of Policy*

In attempting to operationalize the application of the selective adaptation model to the implementation of these areas of competition policy, we will focus on two elements: the rules and the enforcement.

Adaptation can begin with the actual drafting of the rules. For example, a current area of concern among competition policy practitioners, particularly in Canada, is the role of an efficiency defense in merger cases.<sup>32</sup> On the surface, the issue is fairly simple. Should an anticompetitive merger be allowed if it generates substantial efficiencies? And if such a defense exists, how is the trade-off to be measured? Societal norms come into play in answering these questions. In a jurisdiction that puts great faith in the ability of markets to achieve efficiency without resorting to anticompetitive mergers, the rules might not allow for an efficiency defense. Where such a defense is allowed, the rules might stipulate how the trade-off is to be measured. (Is it to be total social surplus, consumer surplus, or some hybrid?) Again, norms will play a role. The United States adheres to a “price test.”<sup>33</sup> If an anticompetitive merger results in cost savings so great that the post-merger price is expected to

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27. See Høj, *supra* note 22.

28. U.S. DEPT. OF JUSTICE, ANTITRUST DIVISION POLICY GUIDE TO MERGER REMEDIES, 7–8 (2004), available at <http://www.usdoj.gov/atr/public/guidelines/205108.pdf>.

29. RICHARD A. POSNER, ANTITRUST LAW 101–02 (2d ed. 2001).

30. Kaplow & Shapiro, *supra* note 20, at 35–36.

31. Even in the case of monopoly, U.S. courts are reluctant to impose structural remedies such as dismemberment. The recent Microsoft legal action is a case in point. See David Evans, Albert Nichols & Richard Schmalensee, United States v. Microsoft: *Did Consumers Win?*, J. COMPET. L. & ECON. 515 (2005).

32. Thomas W. Ross & Ralph A. Winter, *The Efficiency Defense in Merger Law: Economic Foundations and Recent Canadian Developments*, 72 ANTITRUST L.J. 471–504 (2004)

33. *Id.*







fall, the merger may be allowed.<sup>34</sup> Here the norm emphasizes consumer well-being at the expense of the producer. Currently Canadian jurisprudence is struggling with this trade-off as the legislation explicitly allows for an efficiency defense but does not provide much guidance on how it is to be measured.<sup>35</sup>

Regardless of the substance of the rules that are adopted, the efficacy of the policy will depend upon its enforcement, which is obviously susceptible to adaptation. The composition, role, resources, and attitudes of the enforcement body will directly influence the way in which the rules are implemented.

#### IV. THE JAPANESE EXPERIENCE

We now turn to a descriptive analysis of Japan's implementation of competition policy. The story begins with a very brief sketch of the historical context.

##### A. Introduction

The business history of Japan leading up to the 1947 introduction of competition policy by the American occupying forces has been extensively documented.<sup>36</sup> Nonetheless, we briefly discuss some key parts that are relevant to our analysis.

The legacy of government-led industrialization in Japan beginning in the Meiji period was critical. Dating back to the Tokugawa Shogunate, Japanese industry was regarded as an "instrument of national policy" and therefore was developed and directed by political elites.<sup>37</sup> The 1868 Meiji

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34. *Id.*

35. *Id.*

36. See, e.g., RICHARD E. CAVES & MASU UEKUSA, INDUSTRIAL ORGANIZATION IN JAPAN (1976); ELEANOR M. HADLEY, ANTITRUST IN JAPAN 3–106 (1970); HIROSHI IYORI & AKINORI UESUGI, THE ANTIMONOPOLY LAWS OF JAPAN 1–10 (1994); MASAYO OHARA, DEMOCRATIZATION AND EXPANSIONISM: HISTORICAL LESSONS, CONTEMPORARY CHALLENGES 13–165 (2001); Harry First, *Antitrust in Japan: The Original Intent*, 9 PAC. RIM L. & POL'Y J. 1, 6–16 (2000); Yoshio Kanazawa, *The Regulation of Corporate Enterprise: The Law of Unfair Competition and the Control of Monopoly Power*, in LAW IN JAPAN 480–506 (Arthur Taylor von Mehren ed., 1963); Hugh T. Patrick, *The Economic Muddle of the 1920's*, in DILEMMAS OF GROWTH IN PREWAR JAPAN 211–66 (James William Morley ed., 1971); Alex Y. Seita & Jiro Tamura, *The Historical Background of Japan's Antimonopoly Law*, 1994 U. ILL. L. REV. 115 (1994); Arthur T. Tiedemann, *Big Business and Politics in Prewar Japan*, in DILEMMAS OF GROWTH IN PREWAR JAPAN 267–316 (James William Morley ed., 1971); SPECIAL SURVEY COMMITTEE, JAPAN MINISTRY OF FOREIGN AFFAIRS (1946), compiled and translated in SABURO OKITA, POSTWAR RECONSTRUCTION OF THE JAPANESE ECONOMY (1992).

37. Kanazawa, *supra* note 36, at 480–82.







Restoration of imperial rule and the associated impetus for development was conducive to government intervention and guidance of the economy.<sup>38</sup> Thus, government-led development through active investment in, and control of, the economy persisted through the turn of the century.<sup>39</sup> The Meiji government actively promoted specific large-scale sectors starting with defense-related industries such as munitions and shipbuilding and turning later to consumer goods industries.<sup>40</sup> Policies included creation of state enterprises and encouragement of technology transfers from the West to equip those enterprises.<sup>41</sup> In the 1880s, government ministries fostered the growth of trade associations in small and medium scale industries to facilitate the Meiji development agenda.<sup>42</sup> Through these trade associations, government ministries occasionally administered horizontal agreements in specific industries (such as paper manufacturing and cotton spinning) to avoid excessive competition and declining product quality, which were thought to be inevitable in the absence of cartels.<sup>43</sup> Eventually the state of public finances led to privatization of these large state-developed enterprises. The public assets were sold to private interests, and ended up being concentrated in the hands of “preferred” business groups, which eventually became the *zaibatsu*.<sup>44</sup>

In the 1920s, cartelization policies were championed by government ministries to prevent excessive competition among the *zaibatsu* combines<sup>45</sup> that had come to dominate the Japanese economy.<sup>46</sup> From the government’s perspective, cartels prevented destructive competition and served as a mechanism for guiding the economy.<sup>47</sup> Given these perceived benefits, cartels were encouraged and enforced through trade associations, beginning with export industries in 1925.<sup>48</sup> Legislation termed the “Export Society Law” and the “Major Export Commodities Industrial Association Law,” legalized horizontal agreements among export sectors and gave government ministries the ability to force firms to join export cartels.<sup>49</sup>

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38. HADLEY, *supra* note 36, at 37.

39. First, *supra* note 36, at 8–16.

40. Kanazawa, *supra* note 36, at 480–82.

41. *Id.*

42. MARK TILTON, RESTRAINED TRADE: CARTELS IN JAPAN’S BASIC MATERIALS INDUSTRIES 27–29 (1966).

43. *Id.*

44. Kanazawa, *supra* note 36, at 481–82.

45. A “combine” is defined as “a complex of corporations displaying unified business strategy arising primarily out of an ownership base.” HADLEY, *supra* note 36, at 20.

46. *Id.* at 482.

47. HADLEY, *supra* note 36, at 363–64.

48. *Id.* at 364–65 (citing Kanazawa, *supra* note 12, at 482).

49. *Id.* at 365.





More extensive cartelization of the economy followed the Great Depression and the subsequent militarization of Japan. During the 1930s, garden-variety cartel agreements appeared in sectors such as wholesaling, coal mining, cement, and textiles.<sup>50</sup> These arrangements, which were often enforced by government ministries, restricted production, fixed prices, and allocated markets.<sup>51</sup> Leading up to World War II, trade associations in strategic industries were transformed into wartime control associations (*toseikai*) under direct bureaucratic control while trade associations in other sectors operated as independent cartels with government support.<sup>52</sup>

Norms and practices influencing merger policy also emerged during the pre-war period. As noted earlier, government-directed development and the eventual divestiture of assets to privileged families led to the formation of the *zaibatsu*.<sup>53</sup> These business groupings exerted control over their subsidiaries through a variety of measures including shareholding through holding companies, interlocking directorates, “centralized buying and selling,” written agreements, and ownership of financial institutions.<sup>54</sup> These “control techniques” laid the groundwork for the post-war structure of the economy. In particular, the main bank system, in which business groups (*zaibatsu* and later *keiretsu*) were associated with a particular bank, grew out of these *zaibatsu* control techniques and would later have a significant effect on merger policy.<sup>55</sup> The practice of cross-shareholding (between firms linked to business groups as well as between firms and their main banks) was an essential aspect of this control system which also became ingrained in Japanese economic practice during this period.<sup>56</sup>

During World War II, the 1938 National General Mobilization Law gave the government authority to force mergers in strategic industries.<sup>57</sup> In 1941, the Major Industries Association Ordinance gave industry “control associations” the ability to compel horizontal mergers between small firms.<sup>58</sup> These laws were designed with wartime command of the economy in mind and resulted in increased concentration and decreased competition in the immediate post-war Japanese economy.<sup>59</sup> More significantly, they

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50. Kanazawa, *supra* note 36, at 483.

51. MICHAEL L. BEEMAN, PUBLIC POLICY AND ECONOMIC COMPETITION IN JAPAN 14 (2002).

52. TILTON, *supra* note 42, at 28.

53. See HADLEY, *supra* note 36, at 21, 35; Kanazawa, *supra* note 36, at 480–82.

54. HADLEY, *supra* note 36, at 28–29.

55. See *infra* notes 239–41 and accompanying text.

56. HADLEY, *supra* note 36, at 28–29.

57. Kanazawa, *supra* note 36, at 483–84.

58. First, *supra* note 36, at 12–14.

59. *Id.* at 12–13.





established the principle that mergers, like horizontal agreements, were subject to bureaucratic guidance and permission.<sup>60</sup>

At the end of World War II, Japan was put under an American-led occupation termed the “Supreme Command of Allied Powers” (SCAP).<sup>61</sup> The United States believed that the restructuring of Japan’s economy to attain “economic democratization” was a necessary step towards avoiding future conflict, and three primary policies were recommended to achieve this end.<sup>62</sup> First, the *zaibatsu* was dissolved in order to de-concentrate economic power. Second, Japan was directed to draft and implement antitrust legislation. In 1947 the “Law Concerning the Prohibition of Private Monopoly and the Maintenance of Fair Trade” (popularly known as the Antimonopoly Law or AML) was passed, and a new body, the Fair Trade Commission of Japan (JFTC) was created to enforce this law.<sup>63</sup> Third, the harmful conduct of trade associations was to be halted. In 1946, SCAP began dissolving the wartime control associations as part of this economic democratization, but the process was never fully completed for fear of serious economic destabilization.<sup>64</sup> In order to deal with the potential anti-competitive behavior of trade associations, the “Trade Association Law” was passed in 1948 prohibiting all of the significant functions of these organizations.<sup>65</sup> These new laws were not well received by government ministries (particularly the Ministry of Commerce and Industry, which later became MITI and more recently METI<sup>66</sup>) or by businessmen accustomed to the pre-World War II government guidance and cartelization, since the AML and the Trade Association Law severely restricted their ability to continue these practices.<sup>67</sup>

While pre-war Japan was characterized by a plethora of horizontal agreements, many mandated by the government, it is important to note that industries were not particularly highly concentrated in an industrial organization sense during this period.<sup>68</sup> Although aggregate concentration

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60. *See id.* at 13–14.

61. *Id.* at 32.

62. *See id.* at 24–30.

63. First, *supra* note 36, at 21–29.

64. ULRIKE SCHAEDE, SELF REGULATION, TRADE ASSOCIATIONS, AND THE ANTIMONOPOLY LAW IN JAPAN 73 (2000).

65. *Id.* at 77. Under the Trade Association Law, trade association activities were limited to “the areas of exchange of technical information, quality and standard regulation, and negotiation with labor unions.” *Id.*

66. *See* MINISTRY OF ECONOMY, TRADE AND INDUSTRY, HISTORY OF METI, available at <http://www.meti.go.jp/english/aboutmeti/data/ahistory.html> (last visited Nov. 10, 2007).

67. HADLEY, *supra* note 36, at 372.

68. JOE STATEN BAIN, INTERNATIONAL DIFFERENCES IN INDUSTRIAL STRUCTURE—EIGHT NATIONS IN THE 1950S 81–90 (1966).





was high in that a handful of *zaibatsu* controlled a large share of industrial assets, the *zaibatsu* were generally conglomerates and did not focus on single industries and markets.<sup>69</sup> Seller concentration in individual markets, which is a basis for the market power concerns of competition policy, was not significantly greater than what was found in the United States in the 1950s.<sup>70</sup> Based on data from the early and mid 1950s, Bain found that top-level seller concentration in Japan was approximately equal to or slightly greater than the concentration in the United States.<sup>71</sup> A decade later, Caves and Uekusa came to much the same conclusion using a broader sample of industries and a later time period.<sup>72</sup> In summary, during the early post-war period, Japan's industrial structure, in terms of concentration measures, was no less competitive than that of the United States. Industry conduct certainly differed, but industry structure did not. It follows that a productive competition policy would focus on anticompetitive conduct and, when necessary, implement conduct-oriented remedies.

In the discussion that follows, we will refer to two key economic indicators: the annual rate of growth of real GDP and annual percent changes in price levels. These are shown in Figure 2. The years 1953 to 1973 were boom years with annual GDP growth averaging ten percent. Growth dropped with the first oil shock in the early 1970s and then maintained a healthy average of four percent until the end of the 1980s. The 1990s and first years of the new century were marked by economic stagnancy. Inflation was very modest in the 1953-1972 period. It spiked with the oil shock, and then fell back to its pre-shock level. The 1991-2004 period experienced very low inflation, and in some years experienced actual deflation.

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69. Eugene Rotwein, *Economic Concentration and Monopoly in Japan*, 72 J. POL. ECON. 262-77 (1964).

70. See *infra* notes 71-72 and accompanying text.

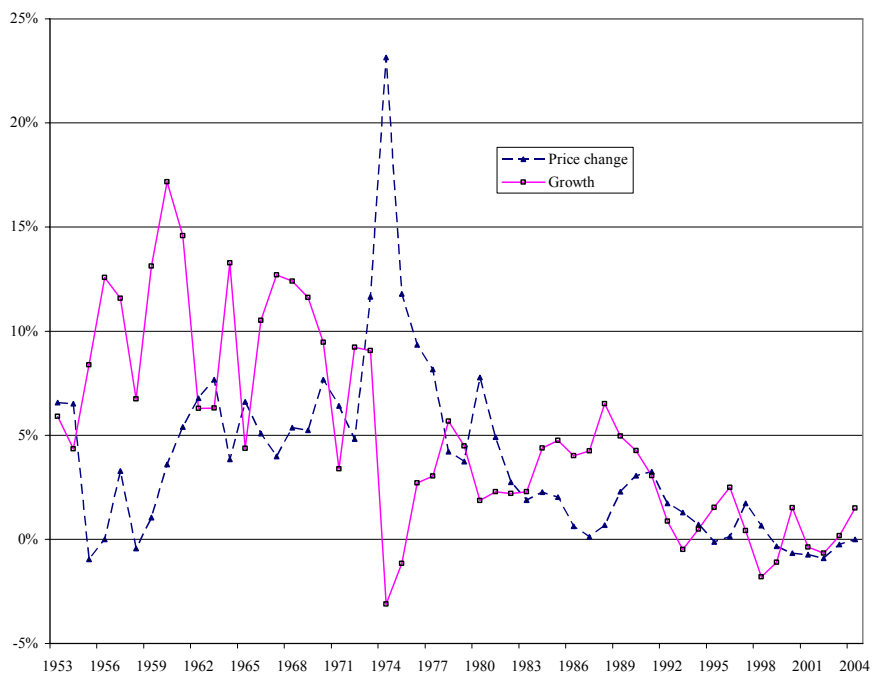
71. BAIN, *supra* note 68, at 81-90.

72. CAVES & UEKUSA, *supra* note 36, at 16-28.





FIGURE 1  
YEAR-TO-YEAR CHANGES IN CONSUMER PRICES AND REAL GROSS  
DOMESTIC PRODUCT<sup>73</sup>  
JAPAN 1953–2004



### B. The Regulatory Norms

A thorough description of a society's norms is a daunting task, and one best left to initiates. Here we identify what most commentators believe to be the basic norms underlying a jurisdiction's views on competition policy. In the case at hand, American rules were imported into Japan, so the norms in these two jurisdictions warrant review.

Most, if not all, U.S. undergraduate textbooks dealing with antitrust economics include a discussion of the political, social, cultural, legal, and economic underpinnings of that country's competition policy. There are usually references to the importance of liberal individualism (whether

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73. Derived from Search of International Monetary Fund Databases electronic data files, series 158/64.x, 158/99B.C., 158/99BVR, SFU Library (Nov. 2005) (Growth rates are year-to-year changes in real GDP).





couched in those terms or not), emphasis on the concepts of freedom of opportunity and freedom of choice, and acknowledgement of Americans' abiding mistrust of the concentration of power in either public or private hands.

American historian Richard Hofstadter claimed there were three kinds of goals in U.S. antitrust policy:

The first were economic; the classical model of competition confirmed the belief that the maximum of economic efficiency would be produced by competition . . . . The second class of goals was political; the antitrust principle was intended to block private accumulation of power and protect democratic government. The third was social and moral; the competitive process was believed to be a kind of disciplinary machinery for the development of character, and the competitiveness of the people—the fundamental stimulus to national morale—was believed to need protection.<sup>74</sup>

This is not to say that the norms underlying antitrust policy have been completely consistent over the past century. When markets falter, faith in individual efforts and fear of big government and big business can diminish.<sup>75</sup> Nonetheless, while enthusiasm for antitrust enforcement might wax and wane depending upon the economic and political mood of the country, the antitrust laws have remained in place. “Throughout the 20th century, America’s antitrust laws have coexisted uneasily with policies that favor extensive government intervention in the economy through planning, ownership, or sweeping controls over prices and entry.”<sup>76</sup>

Ignoring for a moment the support for antitrust policy on economic efficiency grounds, the core values or norms that underlie Americans' commitment to antitrust policy are a dedication to the protection and enhancement of individual freedom and a concomitant distrust of concentrated economic power.<sup>77</sup> According to Eleanor Hadley, this runs counter to core Japanese norms. “The Japanese tradition puts emphasis on the group, and further lacks the notion that power is likely to be abused. In our Western individualistic tradition we worry about power and suspect

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74. RICHARD HOFSTADTER, *THE PARANOID STYLE IN AMERICAN POLITICS AND OTHER ESSAYS* 199–200 (1965).

75. William E. Kovacic & Carl Shapiro, *Antitrust Policy: A Century of Economic and Legal Thinking*, 14 J. ECON. PERSPECT. 43, 47–48 (2000).

76. *Id.* at 58.

77. HADLEY, *supra* note 36, at 372.





the motives of businessmen gathering together to discuss output, prices, etc.<sup>78</sup>

There seems to be some (but not complete) consensus that there was a significant difference between these two countries in terms of regulatory norms—individualism versus group orientation and statism versus antistatism.<sup>79</sup> Clearly, there are other important societal norms, but this subset, which we call regulatory norms, are particularly important with respect to competition policy. In turn, these regulatory norms are ingrained in observable rules as well as the processes and practices of enforcement and adjudication institutions.

Conformity with regulatory norms leads to certain types of behavior. For example, a group orientation leads to an emphasis on social harmony and consensus.<sup>80</sup> This emphasis in turn leads to an aversion to competition and a lack of faith in market mechanisms because these forces could upset the maintenance of harmony within the group.<sup>81</sup> Combine this with a statist propensity, and the result is a set of norms that is consistent with state intervention in the economy and a disinterest in pro-competition policies. And so it was in Japan.

As noted in our brief historical sketch, Japan's rapid industrialization after the Meiji Restoration owed much to state intervention. The overall policy was an obvious success and understandably legitimized government intervention in the economy.

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78. *Id.*

79. It is an incomplete consensus because some observers take issue even with this conventional wisdom. For example, Fukuyama makes the observation that much of the literature on national competitiveness of the late 1980s and early 1990s made the assumption that Japan is a 'group-oriented' society and the United States is the epitome of an individualistic society. He contends that the United States is less individualistic than Americans believe it to be but does accept that Americans are much more antistatist than the Japanese. See FRANCIS FUKUYAMA, TRUST—THE SOCIAL VIRTUES AND THE CREATION OF PROSPERITY 269–81 (1995).

80. *Id.*

81. See, e.g., HADLEY, *supra* note 36, at 372; CAVES & UEKUSA, *supra* note 72, at 1–2, 47–48; KANJI ISHIZUMI, ACQUIRING JAPANESE COMPANIES 13 (1990); Leszek Leszczynski, *Economic Guidance and The Antimonopoly Law: Tradition versus Legal Changes*, in JAPAN'S SOCIO-ECONOMIC EVOLUTION: CONTINUITY AND CHANGE 221, 222 (Sarah Metzger-Court and Werner Pascha eds., 1996); J. Mark Ramseyer, *The Costs of the Consensual Myth: Antitrust Enforcement and Institutional Barriers to Litigation in Japan*, 94 YALE L.J. 604, 638 (1985); Douglas E. Rosenthal & Mitsuo Matsushita, *Competition in Japan and the West, Can the Approaches be Reconciled?*, in GLOBAL COMPETITION POLICY 313, 319 (Edward M. Graham and J. David Richardson eds., 1997); Steven K. Vogel, *Can Japan Disengage? Winners and Losers in Japan's Political Economy, and the Ties that Bind Them*, 2 SOC. SCI. JAPAN J. 3 (1999) (expressing aversion to liberalization in an effort to maintain societal stability).







Harry First<sup>82</sup> argues that Japan's history of economic development led to what he calls a "bureaucratic regulatory culture," which he defines in the following terms:

A bureaucratic regulatory culture is focused on how the economy should be structured and run. Its core concern is economic welfare and it works by guidance. This type of regulation is group-oriented, theory-based, and forward-looking. The decisionmaking model is consensual, and rigorous justification for particular decisions is not only unnecessary but may be unwise.<sup>83</sup>

Within this normative framework, cartels and trade associations played a valuable role by enabling the government to (1) guide the economy towards particular industrial policy goals, (2) gather information about industries, and (3) communicate with industries.<sup>84</sup> Information exchange (facilitated by trade associations) was particularly useful and was fostered by the government within this regulatory culture.<sup>85</sup> Mergers and acquisitions were also important in this type of regulatory regime; control of mergers allowed the bureaucracy to shape the economic structure as it saw fit.<sup>86</sup>

First distinguishes between the regulatory cultures that characterized the conception and implementation of antitrust in the United States and in Japan.<sup>87</sup> The United States competition policy operates within a framework of "legalistic regulation" intended to protect victims from "improper business conduct."<sup>88</sup> "Antitrust in Japan was placed in a very different regulatory culture, one which viewed antitrust (and economic law) as a tool of government that bureaucrats might use to guide and manage the economy."<sup>89</sup> Hiroshi Iyori has the same view: "the [antimonopoly] law in Japan is, by contrast [to the law in the West], considered primarily an instrument of government control, especially bureaucratic control."<sup>90</sup> Along these same lines, J. Mark Ramseyer argues

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82. First, *supra* note 36, at 5–6; cf. Harry First, *Antitrust Enforcement in Japan*, 64 ANTITRUST L.J. 137, 138–45 (1995).

83. First, *supra* note 36, at 6.

84. TILTON, *supra* note 42, at 27.

85. SCHAEDE, *supra* note 64, at 17–18.

86. See *infra* notes 268–70 and accompanying text.

87. First, *supra* note 82, at 138.

88. First, *supra* note 36, at 4.

89. *Id.*

90. Hiroshi Iyori, *Antitrust and Industrial Policy in Japan: Competition and Cooperation*, in LAW AND TRADE ISSUES OF THE JAPANESE ECONOMY 62 (Gary Saxonhouse & Kozo Yamamura eds., 1986).





that this “perception of harmony is crucial, for it plays a central part in legitimating bureaucratic rule in Japan.”<sup>91</sup>

### *C. Application: Cartels*

For convenience we have divided the evolution of cartel policy into a number of periods. Each is marked by a change in the environment that impacted the adaptation process.

#### *1. Adoption: 1947–1952*

The power relationship between foreign and local regulatory norms during the post-war occupation of Japan is clear.<sup>92</sup> By all accounts, Japan’s Antimonopoly Law was drafted and passed under pressure from American authorities.<sup>93</sup> “The record of the drafting of the Antimonopoly Law reveals an authority imbalance between the two sides. The U.S. side set the broad policy for the direction of the legislation, a policy direction that the Japan side, under occupation, had little choice but to follow.”<sup>94</sup> In the years immediately following the imposition of the AML, the presence of the occupation forces maintained similar power relations between the two parties.

Under these circumstances, there was little room for the Japanese negotiators to selectively adapt the rules dictated by the victors. The U.S. terms were adopted regardless of whether the underlying norms fit with Japanese views in terms of perception, legitimacy, and complementarity.<sup>95</sup>

There is some debate as to Japanese perceptions of the purpose and goals of the AML. First contends that “negotiators from Japan’s government understood perfectly well what the legislation was about.”<sup>96</sup> Richard E. Caves and Masu Uekusa argue that the AML “employed novel terms such as ‘public interest,’ ‘substantial,’ and ‘competition’ that conveyed no clear meaning to the Japanese public who would have to comply with it.”<sup>97</sup> Hideaki Kobayashi, a high-ranking official in the JFTC, states that “the competition law, when it was introduced 50 years ago, was something totally unknown to political leaders, government officials, and

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91. Ramseyer, *supra* note 81, at 638.

92. First, *supra* note 36, at 67.

93. *Id.* at 68.

94. *Id.* at 67.

95. *Id.*

96. *Id.* at 1.

97. CAVES & UEKUSA, *supra* note 72, at 142.





the general public in Japan”.<sup>98</sup> Rather than being simply “unknown,” some Japanese apparently believed there were sinister motivations behind the policy viewing the AML as a foreign method of keeping Japan weak and subordinated to the U.S. “There are many who profess, and in all appearance honestly believe, that the Antimonopoly Law, along with the Standards of Labor Law, was forced by the victors upon the defeated nation for the covert purpose of keeping down her economy in a weak condition.”<sup>99</sup>

In any case, given the statist views held by Japanese policymaking elites, it was not surprising that policies to facilitate unregulated, competitive markets were not embraced.

But what were the preferred policies? In his analysis of the original intent of the AML, First emphasizes the role of the Special Survey Committee (SSC), a group of economists and technical experts that was formed just before cessation of hostilities to plan for post-war reconstruction.<sup>100</sup> The SSC report was published in September 1946 and was comprehensive,<sup>101</sup> providing valuable insights into the Japanese position on issues relevant to competition policy generally, and horizontal agreements specifically. The recommendations of the report were not directly implemented, but they did provide a conceptual basis for economic planning over the next decades.<sup>102</sup> The career of the report’s initiator, Saburo Okita, reflects that influence.<sup>103</sup>

The SSC’s proposals for revamping the organization of Japanese industry merit review:

*Reorganization of the Industrial Setup.* The industrial setup was as firmly connected to the State structure as was the financial setup. In order to democratize the industrial setup it will be therefore

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98. Hideaki Kobayashi, Deputy Sec’y-Gen., Fair Trade Comm’n of Japan, Competition Policy Objectives—A Japanese View, Speech Before the Competition Workshop 1 (June 13–14, 1997), available at <http://www.jftc.go.jp/e-page/policyupdates/speeches/97-0613.html>.

99. HADLEY, *supra* note 36, at 11 (quoting RESTRICTIVE TRADE PRACTICES STUDY TEAM, JAPAN PRODUCTIVITY CENTER, CONTROL OF RESTRICTIVE TRADE PRACTICES IN JAPAN 8–9 (1958)).

100. *See* First, *supra* note 36.

101. Takafusa Nakamura, *Introduction*, in OKITA, *supra* note 36, at 1 ix.

102. *See* First, *supra* note 39, at 16–21.

103. Saburo Okita, an electrical engineer by training, became interested in economic planning after analyzing possibilities for the development of power resources and industrial development in occupied China where he served from 1939 to 1941. In the immediate post-war years he held research positions in the Ministry of Foreign Affairs and the Economic Stabilization Board. In 1956 he was named Director of the Planning Bureau of Japan’s Economic Planning Agency. He ultimately served as Japan’s Foreign Minister. In 1992, he compiled an English version of the Special Survey Committee (SSC) Report.





necessary to get rid of the past feudalistic and militaristic capitalist system by relieving the industries of State power once and for all. This will make it difficult in principle for big business to make an appearance in Japan in the future. On the other hand, in order that technological levels be elevated and the rationalization of business management be accomplished it is desirable that big business management be accomplished and that big business enterprises grow. Such basic industries as railways, communication, electric power generation, steelmaking, coal mining, and fertilizer manufacture absolutely need large-scale operations. In a country like Japan, where domestic markets are small and the raw materials base is weak, free competition in these basic industries would not necessarily result in their growth, and the need will arise to nationalize these industries or give them a public character. Nationalization however, will have to be accomplished by measures designed to wipe out the bureaucratic inefficiency of the past.

At the same time, those basic industries which serve domestic non-governmental or export demand and do not necessarily require a large scale operation need to be encouraged to compete as freely and fairly as possible. Export industries especially would need a system that is so flexible as to allow them to undertake dynamic production in accordance with changing world market conditions.

It will be necessary, in this context, that the Toseikai (Control Associations), which was founded during the war, should be reorganized into an autonomous association and given the character of an organ representing the collective will of business entrepreneurs. At the same time a system should be established in which public control will be exercised over industries so that the interest of consumers can be protected.<sup>104</sup>

Basic industries that produced public goods or verged on natural monopoly should be nationalized or “given a public character,” which presumably meant they should be subjected to direct regulation.<sup>105</sup> Basic industries with limited scale economies that produced for domestic private sector demand or export markets should compete without government ownership or direct regulation.<sup>106</sup> However, the wartime cartels (“control

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104. OKITA, *supra* note 36, at 115–16.

105. *Id.* at 115.

106. *Id.* at 116.





associations” or Toseikai) that were mandated and effectively controlled by the government should be resurrected as private organizations, operating without government interference (except in protecting consumer interests). Ultimately this did not happen due to the implementation of American anti-monopoly policies.<sup>107</sup>

The proposals for smaller, non-basic industries also called for cooperation between competitors.

Smaller enterprises posed serious economic and social problems in the past. We should not, in eager pursuit of ease in the immediate future, allow them to present such problems again in a more serious form in the modern age . . . . It must not be forgotten, however, that more essential measures are to improve the quality of these enterprises by introducing technical rationalization and economic organization into them. The following are the principal measures that should be taken . . . .

## *2. Promotion of Cooperation among Smaller Enterprises*

Industrial associations need to expand their past function of purchasing raw materials and selling products jointly to include technological interchanges, joint use of productive equipment, and improvement of working conditions. Smaller firms may be enabled in this way to benefit substantially from the advantages of large-scale business management. It is also quite desirable that smaller enterprises thus collectivized rationally would compete with other collectivized regional groups of smaller firms and collectively improve their technological level and efficiency.<sup>108</sup>

In short, horizontal agreements among competitors were viewed by the Japanese as legitimate and complementary to programmes for post-war construction.

The dominant position of the occupiers in the power relationship was clearly reflected in the original wording of the sections of the AML dealing with cartels. Simply, Article 4 of the law prohibited cartels *per se*. As such, any “agreements among enterprises in competitive relationship

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107. Tetsuji Okazaka, *Government Firm Relationship in Postwar Japan: Success and Failure of Bureau-Pluralism* 4 (Apr. 2000), available at <http://www.e.u-tokyo.ac.jp/cirje/research/dp/2000/2000cf69.pdf>.

108. OKITA, *supra* note 36, at 117–18.





(Cartels) as regards price, territory of activities, quantity of production, and other terms of business” were prohibited unless the impact of the agreement on competition was “negligible.”<sup>109</sup> The inclusion of the outright *per se* prohibition of cartels was at the firm insistence of American negotiators to the dismay of Japanese negotiators of the AML.<sup>110</sup> In the final stages of drafting, the Japanese representatives requested (to no avail) that the wording of Article 4 be changed such that cartels would only be prohibited if they “substantially restrained competition . . . contrary to the public interest.”<sup>111</sup>

Despite this *per se* prohibition, another potential source of horizontal agreements remained in trade associations. As discussed above, in 1946 SCAP dissolved the wartime control associations because of their role in cartelization of the Japanese economy.<sup>112</sup> Nevertheless, many of these dissolved associations reappeared within a few years as trade associations under different names while maintaining very similar functions and personnel.<sup>113</sup> Although the trade associations were private sector institutions, the bureaucracy continued to wield significant influence, employing the associations in their efforts to control and direct the economy.<sup>114</sup> The inability of the Occupation authorities to prevent the re-emergence of previously dissolved associations resulted in the passage of the “Trade Association Law” in 1947 to complement the AML, which specifically dealt with antitrust violations by trade associations.<sup>115</sup> Price-fixing by associations was made *per se* illegal, and they were prohibited from engaging in a broad range of activities that could assist inter-firm cooperation.<sup>116</sup> Furthermore, any undue influence wielded by bureaucrats over trade associations was considered a violation.<sup>117</sup> Here the Japanese government’s and business community’s adaptation to the original order to dissolve the *Toseikai*, through public reformation of trade associations,

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109. MITSUO MATSUSHITA, *INTERNATIONAL TRADE AND COMPETITION LAW IN JAPAN* 78 (1993). The exemption for cartels that have a “negligible” effect on competition does move the prohibition slightly away from a strict *per se* status. Apparently a completely ineffective cartel could escape censure. *See id.*

110. First, *supra* note 36, at 63.

111. *Id.*

112. SCHAEDE, *supra* note 64, at 73.

113. *See* First, *supra* note 36, at 76–77.

114. LEONARD H. LYNN & TIMOTHY J. MCKEOWN, *ORGANIZING BUSINESS: TRADE ASSOCIATIONS IN AMERICA AND JAPAN* 26–27 (1988).

115. SCHAEDE, *supra* note 64, at 77 (For example, “Glorious Bören” was a cotton spinning association that was dissolved by SCAP in 1947 but reformed directly with the same firms and staff, and was later (1952) able to successfully cartelize cotton spinning production and output.).

116. TILTON, *supra* note 42, at 31.

117. SCHAEDE, *supra* note 64, at 77.





was thwarted by supplementary legislation from the Occupation authorities.

The Japan Fair Trade Commission (JFTC), a new quasi-judicial agency, was created to enforce the AML.<sup>118</sup> In First's view, the most "critical point(s) of contention" between the Americans and the Japanese was how independent the commission would be and "to which government official it would report."<sup>119</sup> Ultimately the JFTC was given a good deal of independence and, at the recommendation of the Americans, made accountable to the Prime Minister.<sup>120</sup> The JFTC was not given cabinet rank and this, according to James Fry, put it in a subservient position relative to other ministries responsible for economic regulation, specifically the Ministry of International Trade and Industry (MITI) and the Ministry of Finance.<sup>121</sup> This relationship became quite important during the 1952-1972 period.

In effect, the JFTC was given exclusive jurisdiction over enforcement of the AML. Yoshiro Miwa and Ramseyer, First and Tadashi Shiraishi, and Michael Beeman argue that this "monopoly over antimonopoly services" impaired enforcement from the outset.<sup>122</sup>

The point of departure for any discussion of the JFTC's role must be the fact that the Commission essentially maintains a monopoly on antimonopoly services in Japan . . . . One Japanese scholar has labeled the JFTC's commanding position over antitrust enforcement the "original sin."<sup>123</sup>

According to First, Japanese negotiators of the AML knowingly sought to hobble private enforcement by requiring victims of anticompetitive acts to channel complaints through the JFTC.<sup>124</sup> As a result, an aggrieved party can file a damage suit only after the agency makes a decision. Also, unlike

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118. *Id.* at 75.

119. First, *supra* note 36, at 58.

120. *Id.*

121. James Fry, *Struggling to Teethe: Japan's Antitrust Enforcement Regime*, 32 LAW & POL'Y INT'L BUS. 825, 835 (2001) (citing ELLIOTT J. HAIN, JAPANESE BUSINESS LAW AND THE LEGAL SYSTEM 132 (1984)).

122. See generally Yoshiro Miwa & J. Mark Ramseyer, *Toward a Theory of Jurisdictional Competition: The Case of the Japanese FTC*, 1 J. COMP. L. & ECON. 247, 251-55 (2005); Michael L. Beeman, *Japan's Flawed Antitrust Regime* (The Friendship Comm'n Pub. Policy Series Working Paper 1999) (Revised Nov. 11, 1999), available at <http://www.jiaponline.org/whatsnew/events/2000/june5/FinalJapansFlawedAntitrustRegime1199.pdf>; Harry First & Tadashi Shiraishi, *Concentrated Power: The Paradox of Antitrust in Japan* 16-21 (New York University Law and Economics Working Papers: Paper No. 11 2005), available at <http://lsr.nellco.org/nyu/lewp/papers/11>.

123. Beeman, *supra* note 122, at 8.

124. First, *supra* note 36, at 68-70.







in the United States, there was no provision for treble damages.<sup>125</sup> These disincentives, combined with other more general constraints on litigation, led Ramseyer to conclude that “[t]he institutional barriers to litigation in Japan have, it appears, all but eliminated private antitrust damage suits.”<sup>126</sup>

First concludes his review of the original intent of the AML by arguing that the enforcement mechanism was intended to keep competition policy a component of bureaucratic economic regulation.

[T]he Japan side fought so hard to keep antitrust enforcement within the control of the bureaucracy by narrowing the private right of action and resisting all efforts to provide the antitrust enforcement agency with a legal staff that could independently seek relief in court. Antitrust enforcement would be a component of bureaucratic economic regulation rather than a part of a legal structure which could be utilized by those harmed by anticompetitive conduct.<sup>127</sup>

In sum, the power relationship during the drafting of the AML obliged Japan to enact anti-cartel legislation that was not reflective of Japanese regulatory norms. On the other hand, the mechanics of enforcement, specifically the role of JFTC, were consistent with those norms.

### 3. *Adaptation: 1952–Present*

Given the brief time period in which the AML was crafted, and the dominant power of the Occupation authorities, the initial period of implementation of competition policy in Japan might better be described as adoption rather than adaptation. When the Occupation ended in 1952, the previously binding power constraints weakened and adaptation became possible.<sup>128</sup> The following half century can be divided into three periods: (1) the so-called “Dark Ages” of Japanese antitrust from 1952 to 1972, during which time competition policy was brought into line with the local regulatory norms; (2) a period of resuscitation from 1972 up to the late 1980s, when local norms slowly came into greater alignment with foreign norms; and (3) the period from the early 1990s to the present, when altered power relationships combined with a failure by the bureaucratic regulatory

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125. Ramseyer, *supra* note 91, at 643.

126. *Id.*

127. First, *supra* note 36, at 70.

128. See *infra* notes 131–33 and accompanying text.





regime to maintain economic performance led to a more profound acceptance of the principles and practices of American antitrust policy.<sup>129</sup>

What follows is a broad descriptive analysis. We do not provide a complete review of the vast literature dealing with the evolution of Japanese competition policy. The purpose is simply to see whether the selective adaptation model can help to explain the evolution.

*a. The Dark Ages: 1952–1972*

The later years of the American Occupation marked a “reverse course” in U.S. policy.<sup>130</sup> With the onset of the Korean War, the United States recognized a strong strategic interest in a robust Japanese economy, an economy that was struggling with reconstruction.<sup>131</sup> “Democratization” of the economy took a backseat to recovery, and American interest in the enforcement of the AML and industrial restructuring waned.<sup>132</sup> Also in 1952, the formal conclusion to the Occupation produced a fundamental change in the power relationship between Japan and the United States.<sup>133</sup>

These changes in the power dynamics empowered Japanese elites to express local regulatory norms. “No sooner had the Antimonopoly Law been enacted than agitation began for its amendment.”<sup>134</sup> Of particular importance to government and business leaders was reform of the cartel provisions, which they perceived as detrimental to reconstruction efforts and achievement of higher growth rates.<sup>135</sup> The Trade Association Law was also a major point of contention, as it essentially eliminated all significant functions of trade associations and viewed all scales of organization as synonymous (in that the two businessmen gathering together were treated the same as an industry association with five hundred members), creating widespread opposition.<sup>136</sup> The absence of any significant political will to enforce the AML against cartels, combined with pressure from the business lobby and government ministries to relax the cartel provision, led to amendment of the AML in 1953.<sup>137</sup> The *per se* prohibition of cartels was removed from the law, and “cartels were now

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129. IYORI & UESUGI, *supra* note 36, at 10.

130. Fry, *supra* note 121, at 831.

131. *Id.*

132. *Id.*

133. *Id.* at 832.

134. Kanazawa, *supra* note 36, at 487.

135. See BEEMAN, *supra* note 51, at 16; Fry, *supra* note 121, at 832; Kanazawa, *supra* note 36, at 487–88.

136. SCHAEDE, *supra* note 64, at 77.

137. BEEMAN, *supra* note 51, at 16–18.





prohibited only if they caused substantial restraint of competition in a particular field of trade.”<sup>138</sup> Importantly, the amendment allowed for rationalization (Article 24(4)) and recession cartels (Article 24(3)) subject to JFTC approval. “This aspect of the amendment signified a change in policy towards cartels in the sense that under this amendment, there were ‘good cartels’ and ‘bad cartels’, whereas in the original AML all cartels were regarded as basically ‘bad.’”<sup>139</sup> The Trade Associations Law was also repealed in the 1953 amendment.<sup>140</sup> Rules governing trade associations were amalgamated into Section 8 of the amended AML.<sup>141</sup> The modified legislation was severely weakened because it removed all specific prohibitions on trade association activities (in particular relating to information gathering and sharing), replacing them with broad provisions<sup>142</sup> “leading to a revival of cooperation within trade associations.”<sup>143</sup>

This amendment did not satisfy the pro-cartel forces. Government bureaucrats (especially MITI personnel) and businessmen wanted to be able to establish and enforce cartels of their own accord, independent of the JFTC and above the application of the AML.<sup>144</sup> Their lobbying efforts were rewarded with the passage of laws granting AML exemptions to government encouraged cartels (to restrict production, fix prices, and allocate markets) for exporters and small and medium enterprises.<sup>145</sup> These were the Export-Import Transactions Law and the Medium and Small Enterprise Stabilization Law.<sup>146</sup> Additional laws exempting cartels, usually targeted at specific industries, were passed at the recommendation of MITI throughout the 1950s and 1960s.<sup>147</sup> Some of the industries affected included coal mining, fisheries, and distilling.<sup>148</sup>

Another sort of cartel exemption that emerged in the early 1950s was the so-called “administrative guidance” cartel.<sup>149</sup> A government ministry

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138. Matsushita, *supra* note 109, at 79.

139. *Id.* at 80.

140. Lynn & McKeown, *supra* note 114, at 40.

141. *Id.*

142. TILTON, *supra* note 42, at 31.

143. SCHAEDE, *supra* note 64, at 80.

144. BEEMAN, *supra* note 51, at 18.

145. Kanazawa, *supra* note 36, at 496–97.

146. Kanazawa, *supra* note 37, at 497.

147. BEEMAN, *supra* note 51, at 18–20.

148. Franz Waldenberger, *The Changing Role of Competition Policy in Japan*, in JAPAN’S SOCIO-ECONOMIC EVOLUTION, *supra* note 81, at 208.

149. See BEEMAN, *supra* note 51, at 16–21; Kanazawa, *supra* note 36, at 496–97; Kotaro Suzumura, *Formal and Informal Measures for Controlling Competition in Japan: Institutional Overview and Theoretical Evaluation*, in GLOBAL COMPETITION POLICY 439, 450 (Edward M.





(typically MITI) would recommend cartel measures (typically production cutbacks) through informal guidance offered to an industry association in response to perceived problems in that industry. Relevant government ministries negotiated with a particular industry to cut back production in the face of the recession creating a de-facto output cartel.<sup>150</sup> The justification for the output recommendations was that quotas were determined by MITI, when in fact quotas were often the product of prior negotiations among the firms within their industry associations.<sup>151</sup> Beginning in 1952 with the Glorious *Boren* cotton-spinning output cartel,<sup>152</sup> similar arrangements proliferated in trade associations throughout the Japanese economy.<sup>153</sup>

MITI's active encouragement of cartels through trade associations as a countermeasure to recession signaled to industries that cartels were not only permissible but desirable . . . . Companies learned that the default reaction to an economic problem was to talk to the other companies in the industry . . . . Over time, the repeated negotiations among firms resulted in an increasing propensity to cooperate in many industries. The "cartel-mindedness" of the Japanese *zaikai* [business circles], which SCAP had tried to expunge, was revived.<sup>154</sup>

The resulting cartels were exempt from the AML on a quasi-legal basis in that they were the result of an administrative measure of the government.<sup>155</sup> The JFTC generally did not immediately take action against these cartels at first.<sup>156</sup>

Table 1 shows the proliferation of cartels that were explicitly exempted from the AML. Waldenberger estimates that there were relatively few implicitly exempted administrative cartels during this period.<sup>157</sup>

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Graham and J. David Richardson eds., 1997); Matsushita, *supra* note 109, at 145; Kanazawa, *supra* note 37, at 496–97.

150. SCHAEDE, *supra* note 64, at 82–83.

151. *Id.* at 83.

152. *See supra* note 116 and accompanying text.

153. SCHAEDE, *supra* note 64, at 84; Tilton, *supra* note 42, at 33.

154. SCHAEDE, *supra* note 64, at 85.

155. *See id.*

156. BEEMAN, *supra* note 51, at 18.

157. Waldenberger, *supra* note 148, at 198.





TABLE 1  
EXPLICIT CARTEL EXEMPTIONS: 1954–1973<sup>158</sup>

	1954	1957	1960	1963	1966	1969	1973
Recession & Rationalization Cartels (AML 24-3 and 24-4)	0	7	13	12	30	12	12
Laws Exempting Cartels among Small and Medium Enterprises*	77	289	542	888	989	866	911
Other Special Cartel Exemption Laws	2	15	40	51	60	76	56
Total	79	312	595	951	1079	954	979

The reasoning behind these explicit and implicit exemptions was usually the suppression of “excessive competition.”<sup>159</sup> Interestingly, these exempted cartels were not present in the highly productive and highly competitive sectors of the economy, but rather were concentrated in low-productivity sectors of the economy characterized by small and medium enterprises.<sup>160</sup> As shown in Table 1, the overwhelming majority of legal cartels fell under the small and medium-sized enterprises exemption. The granting of exemptions in these sectors is reflective of the adaptation process. Without horizontal agreements, there would have been serious structural adjustments in these low-productivity industries and this would have engendered the “destruction of societal harmony and stability.”<sup>161</sup>

When Iyori and Uesugi labeled the 1952–1973 period the Dark Ages of antitrust in Japan, they aptly summarized the enforcement of cartel provisions (or the lack thereof) during this time.<sup>162</sup> By the early 1950s the JFTC was forced to change its approach after having been relatively active in enforcing against cartel violations under the guidance and support of American Occupation authorities.<sup>163</sup> Following the end of the Allied

158. Data is taken from Waldenberger and refers to the number of cartels in effect on March 31 of a given year. *See* Waldenberger, *supra* note 148, at 198. This category includes four laws legalizing cartels in industries dominated by small and medium enterprises: (1) the Medium and Small Enterprise Stabilization Law; (2) the Law Concerning the Organization of Small and Medium Enterprises; (3) the Export-Import Law; and (4) the Law Concerning the Appropriate Conduct of Business Relating to Environmental Hygiene. *Id.* at 208.

159. *See* Seita & Tamura, *supra* note 36, at 181; Suzumura, *supra* note 148, at 444–45; Waldenberger, *supra* note 148, at 215.

160. Micheal E. Porter & Mariko Sakakibara, *Competition in Japan*, 18 J. ECON. PERSPECT. 27, 35–40 (2004); Waldenberger, *supra* note 148, at 209.

161. Seita & Tamura, *supra* note 36, at 184.

162. IYORI & UESUNG, *supra* note 36, at 10.

163. *See* First, *supra* note 82, at 148–53.





Occupation, limited enforcement and avoidance of legal action against violations became the *modus operandi* of the JFTC.<sup>164</sup> The JFTC launched forty-eight formal actions against cartels between 1953 and 1973.<sup>165</sup> These actions generally involved a recommendation decree by the JFTC to the offending parties to correct anti-competitive behavior.<sup>166</sup> No criminal action was taken against cartels in this period.<sup>167</sup> As a result, there was little deterrence to cartels even if they did not qualify for one of the many exemptions. There was no real penalty, monetary or otherwise.<sup>168</sup>

It is clear that the Japanese cartel policy was extensively adapted and brought into line with the bureaucratic regulatory norm during this early period. In effect the anti-cartel provisions were weakened, if not gutted, by the removal of the *per se* prohibition, the revival of trade associations, the establishment of explicit and implicit exceptions to the general prohibition, limited enforcement, and weak remedies.

*b. Resuscitation: 1972–1989*

In the early 1970s, several forces came together to alter the state of selective adaptation of anti-cartel rules in Japan. Inflation stemming from the 1973 oil shock became a serious public concern as economic growth faltered.<sup>169</sup> The widespread cartelization of the economy was seen as part of the problem,<sup>170</sup> which de-legitimized the local regulatory norms that had promoted horizontal agreements to begin with.

Local regulatory norms faced serious challenges in the political and economic context of the high inflationary period of the 1970s. JFTC enforcement actions against cartels reached record highs in 1973, but apparently this had little effect on deterring further violations.<sup>171</sup> In an effort to assert its ability to combat and deter these violations, the JFTC launched a criminal action against an oil industry cartel in 1974.<sup>172</sup> This was a suitable target given the public outcry against cartelization and the

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164. BEEMAN, *supra* note 51, at 16–17.

165. Waldenberger, *supra* note 148, at 198.

166. *Id.*

167. BEEMAN, *supra* note 51, at 16–24.

168. See Fry, *supra* note 121, at 854–56; Waldenberger, *supra* note 148, at 201.

169. See Figure 2.

170. See BEEMAN, *supra* note 51, at 40–41; Kenji Sanekata & Stephen Wilks, *The Fair Trade Commission and Competition Policy in Japan*, in *COMPARATIVE COMPETITION POLICY: NATIONAL INSTITUTIONS IN A GLOBAL MARKET* 104 (G. Bruce Doern and Stephen Wilks eds., 1996); Beeman, *supra* note 47, at 40–41.

171. BEEMAN, *supra* note 51, at 46.

172. *Id.* at 46–48.





inflation related to the oil price shock.<sup>173</sup> This case marked the first criminal action against cartelization in the history of the AML.<sup>174</sup> Several oil companies were accused of price-fixing and production limitation arrangements.<sup>175</sup> The companies pleaded innocence, claiming they were following the administrative guidance of MITI in the context of the oil crisis.<sup>176</sup> The companies certainly did have a case, as MITI had offered guidance relating to output limitation,<sup>177</sup> but it was clear that the companies had gone beyond those recommendations in their arrangements.<sup>178</sup> Since they were at least partly following the administrative guidance of MITI and there was some doubt as to whether they knew they were breaking the law, the sentences imposed on the colluding executives were suspended.<sup>179</sup> As Kenji Sanekata and Stephen Wilks characterized the era, “[t]he JFTC won on theory but lost on enforcement.”<sup>180</sup> The decision of the Japanese Supreme Court in this case did not take a definitive stance as to whether administrative guidance cartels were legal. “The court stated in *dicta* that an agreement to restrain competition could be justified, even without exempting laws, if it was based on a directive or entrustment of the government.”<sup>181</sup>

While the decision did create a potential precedent for exemptions under administrative guidance, legislation soon aligned with the public’s growing hostility towards cartelization. In the wake of the oil cartel case, the AML was amended in 1977 to allow for administrative surcharges against firms involved in cartel violations.<sup>182</sup> The surcharges were set at two percent of sales for the period of cartelization, although small and medium enterprises were subject to only half this rate.<sup>183</sup> In addition, the JFTC worked to reduce the number of explicitly exempt cartels throughout the economy (see Table 2).

In the span of five short years between 1973 and 1977, the FTC had registered record numbers of formal measures against AML violations, including the use of two criminal accusations; [and]

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173. *Id.* at 46–47.

174. *Id.* at 46–48.

175. *Id.*

176. *Id.*

177. Matsushita, *supra* note 109, at 48.

178. BEEMAN, *supra* note 51, at 47–51.

179. *Id.*

180. Sanekata & Wilks, *supra* note 170, at 104.

181. Matsushita, *supra* note 109, at 147.

182. *Id.* at 83.

183. *Id.* at 83; Waldenberger, *supra* note 149, at 213.







successfully undertaken an initiative that nearly halved the total number of legal cartels . . . . The basis for the FTC's successes is inseparable from the turbulent political and economic environment in which change took place.<sup>184</sup>

TABLE 2  
EXPLICIT CARTEL EXEMPTIONS: 1974–1992<sup>185</sup>

	1974	1977	1980	1983	1986	1989	1992
Recession & Rationalization Cartels (AML 24-3 and 24-4)	0	2	2	4	0	4	0
Laws Exempting Cartels among Small and Medium Enterprises*	851	487	459	444	401	265	215
Other Special Cartel Exemption Laws	57	39	30	23	25	9	6
Total	908	528	491	471	426	278	221

In this new policy environment, the JFTC enacted “Guidelines Concerning the Activities of Trade Associations Under the Antimonopoly Law” in 1979.<sup>186</sup> These guidelines clarified the JFTC’s interpretation of Section 8 of the AML and indicated what activities the JFTC would view as likely violations. Price-related violations cited by the guidelines include establishment of a minimum sales price, a standard price, a common pricing formula, and limits on rebates.<sup>187</sup> The JFTC also articulated violations for quantity related and various other general acts. And the guidelines clarified available exemptions, in particular setting out in some detail what types of information exchange would be viewed as beneficial and what types would be viewed as facilitating illicit horizontal agreement.<sup>188</sup>

With time, inflationary pressures subsided and economic growth recovered, albeit not to the very high levels of the earlier period (see Figure 2). With the return to prosperity, enforcement of anti-cartel

184. BEEMAN, *supra* note 51, at 67.

185. Waldenberger, *supra* note 149, at 216. *See also supra* note 159 and accompanying text.

186. *Guidelines Concerning the Activities of Trade Associations Under the Antimonopoly Law* (James Sameth & John Owen Haley, trans.), 12 LAW IN JAPAN 118–49 (1979).

187. *Id.* at 125–29.

188. *Id.* at 143–49.





provisions decreased.<sup>189</sup> From 1973 to 1977 there were ninety-four formal actions initiated by the JFTC against cartels, while there were only thirty-two actions against cartels from 1978 to 1987.<sup>190</sup> Structurally depressed industries became an important policy issue in 1978 and laws were passed in that year, and reworked in 1983, to allow for extensive coordination of business activities of firms (short of overt price-fixing) towards restructuring depressed industries.<sup>191</sup> Few horizontal agreements were exempted under these laws, but the policy imperative of aiding structurally depressed industries was an important factor in the decreased enforcement activity of cartel provisions.<sup>192</sup>

During the 1970s and 1980s, foreign regulatory norms respecting cartels were selectively adapted in Japan. When local norms, in this case the bureaucratic regulatory regime, failed to deliver prosperity (i.e., lost legitimacy), the public and the bureaucrats responsible for enforcement were willing to accept a policy more in line with foreign regulatory norms. With the return to prosperity, there was less enthusiasm for a strict anti-cartel policy, and local regulatory norms were once again favored.

*c. Enhancement: 1989–present*

Since the late 1980s, two forces have been at play to erode faith in the bureaucratic regulatory model and to enhance support for a stronger competition policy. First, the Japanese “bubble economy” burst, and partial responsibility was attached to the bureaucratic regulatory regime and the “crony-capitalism” it enabled. Second, the United States, suffering from a substantial trade deficit with Japan and believing its exports had been impeded by restrictive practices in Japan, put pressure on Japanese policy makers to more strictly enforce antitrust policy.

The bursting of the “bubble economy” in the early 1990s had a significant impact on anti-cartel policy in Japan because it affected the perceived legitimacy of the bureaucratic regulatory model. As was true in earlier periods, the model was extolled when the economy worked well and questioned during periods of poor performance. There was, however, a deeper criticism insofar as many believed the extant regulatory norms had not only failed to prevent the downturn, but were partially responsible

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189. BEEMAN, *supra* note 51, at 131.

190. Waldenberger, *supra* note 149, at 198. These laws were the Depressed Industries Law (1978) and the Structurally Depressed Industries Law (1983).

191. *Id.* at 215–17.

192. BEEMAN, *supra* note 51, at 96–112.





for it. Critics claimed that the network system, pejoratively called “crony capitalism,” was behind a number of economic ills ranging “from complacency and uncompetitiveness rooted in inbred trade and investment practices to the protection of the corporate unfit and the spread of moral hazard due to widespread subsidies and easy bailouts.”<sup>193</sup> Emerging evidence suggested that Japan’s post-war recovery, and its export success in particular, could be explained by high levels of domestic competition in specific industries rather than by administrative guidance. In describing the rekindled interest in competition policy in the 1990s, a JFTC official claimed that the government had come to recognize the positive relationship between competition policy and economic growth.<sup>194</sup> This recognition was apparently based on studies exploring the competitive advantage of Japan.<sup>195</sup> Perceived complementarities between competition policy and local regulatory imperatives significantly altered the state of adaptation in Japan.

During the 1980s the relationship between the United States and Japan became strained. By the mid-1970s the United States began to run a chronic trade deficit in goods (between 1960 and 1975 it had, on average, experienced a modest surplus), and by the mid-1980s the deficits reached very high levels (see Figure 3). A significant portion of this deficit was attributable to trade with Japan (see Figure 3). Many Americans believed that one source of the trade imbalance was the restrictive practices of Japanese firms that impeded imports from the United States. To remedy this concern, the United States strongly encouraged the Japanese to strengthen enforcement of their antitrust laws.<sup>196</sup>

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193. JAMES R. LINCOLN & MICHAEL L. GERLACH, *JAPAN’S NETWORK ECONOMY: STRUCTURE, PERSISTENCE AND CHANGE* 3 (2004).

194. Sadaaki Suwazono, The Features of the Newly Revised Anti-Monopoly Act—Japan’s Experience of Making Competition Policy Stronger 2–3, 13 (May 24, 2005, Jeju, Korea), *available at* <http://www.jftc.go.jp/e-page/policyupdates/speeches/050524suwazono.pdf>.

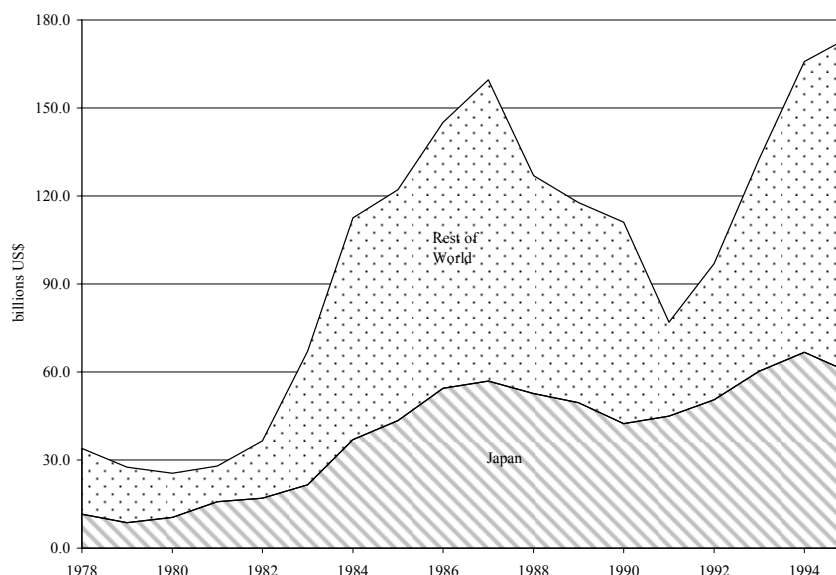
195. Suwazono, the Director of the Competition Policy Planning Office of the JFTC, identified two such studies—Sakakibara and Porter (2001) and an OECD (2003) economic survey. *Id.* at 6.

196. Porter & Sakakibara, *supra* note 160, at 45–47.





FIGURE 2  
U.S. TRADE DEFICITS (GOODS)<sup>197</sup>  
(BILLIONS OF CURRENT DOLLARS (USD))



Evidence of a changed power relationship can be found in the establishment of the Structural Impediments Initiative (SII) during 1989-1990. This marked a turning point in the enforcement of competition policy, credited by some sources as “creating an anti-monopoly renaissance” in Japan in the 1990s.<sup>198</sup> These bilateral trade negotiations between Japan and the United States devoted significant focus to the role of the AML, and its enforcement, as a means to improve the competitive environment facing American firms in Japan. Under threat from the application of retaliatory protectionist measures, Japan made concessions to the *gaiatsu* (foreign pressure) in some areas of concern, although there was lingering resistance regarding competition policy issues.<sup>199</sup> That said,

197. Calculated by authors using data from: BUREAU OF ECONOMIC ANALYSIS, U.S. DEPARTMENT OF COMMERCE, U.S. INTERNATIONAL TRANSACTIONS ACCOUNTS DATA, [http://www.bea.gov/bea/international/bp\\_web/simple.cfm?anon=71&table\\_id=10&area\\_id=11](http://www.bea.gov/bea/international/bp_web/simple.cfm?anon=71&table_id=10&area_id=11) (last visited Feb. 2006).

198. Sanekata & Wilks, *supra* note 170, at 107.

199. Leonard J. Schoppa, *Two Level Games and Bargaining Outcomes: Why Gaiatsu Succeeds in Japan in Some Cases but not Others*, 47 INT’L ORGAN 353, 362-64 (1993).





the SII played an important role in changing the Japanese public's attitude regarding the regulatory regime.<sup>200</sup>

Responding to American demands articulated in the SII, the cartel penalties were increased (to six percent of sales over the period of cartelization) in a 1991 amendment to the AML.<sup>201</sup> In addition, the JFTC pressed to reduce the number of explicitly exempted cartels. By 1995, the number of legal cartels had declined to a "negligible level."<sup>202</sup> The laws permitting these legal cartels were all but repealed in the 1997 Omnibus Act, which accommodated the 1997 amendment to the AML. The JFTC significantly increased its enforcement action beginning in 1990. The first criminal charges brought after the oil cartel cases of the 1970s were filed against a plastics cartel in 1991.<sup>203</sup> The JFTC issued New Trade Association Guidelines in 1995, attempting to clarify what constituted acceptable "self-regulation [by a trade association]" and what would offend the AML.<sup>204</sup>

Japanese competition policy is getting stronger. In April 2005, the AML was again amended. Penalties were raised to ten percent of sales during the period of cartelization and to fifteen percent of sales for repeat offenders. A leniency program was introduced to encourage whistleblowing by cartel members, an accepted method to destabilize such arrangements. There has also been an increase in private suits for damages, particularly by municipal governments that have been the victims of bid-rigging.<sup>205</sup>

#### 4. *The Selective Adaptation of Anti-Cartel Policy*

The selective adaptation framework illustrates the evolution of cartel policy in Japan. The AML was imposed on Japan in the mid-1940s. At that time, respective regulatory norms, horizontal agreements and trade association activities diverged markedly between the source of the foreign rules (the United States) and the local jurisdiction (Japan). This was reflected in perceptions of the intent and anticipated effects of the rules, the legitimacy of the rules and views as to whether the rules were consistent with local policy goals. The power imbalance between foreign and local entities was so great that it trumped the incompatibility of the

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200. *Id.* at 379–82, 383–86.

201. BEEMAN, *supra* note 51, at 141–43.

202. *Id.* at 148.

203. Sanekata & Wilks, *supra* note 170, at 118.

204. SCHAEDE, *supra* note 64, at 126.

205. *See* Uesugi, *supra* note 6.





regulatory norms, and Japan reluctantly legislated a strong anti-cartel law. When the power relationship changed, the anti-cartel provisions of the AML were diluted and enforcement was largely abandoned.

A bureaucratic regulatory culture led to bureaucratic guidance of the economy. Government bureaus actively encouraged the establishment of cartels and then used them to implement economic policy. As long as there was an apparent complementarity between bureaucratic guidance and strong, stable economic performance, the Japanese public viewed its government's encouragement and use of horizontal agreements amongst competitors as legitimate. When the economy faltered, the Japanese public questioned the relationship between bureaucratic guidance and economic performance, and policymakers moved to align local rules with the letter and spirit of the foreign rules that condemned anti-competitive horizontal agreements. Succinctly, Japan came to accept anti-cartel policy when policymakers came to believe that a pro-competition policy would facilitate attainment of local economic goals, namely: growth, price stability, and societal harmony.

#### *D. Application: Mergers and Acquisitions*

An analysis of Japanese merger control through the selective adaptation lens involves a more complex narrative than that of anti-cartel policy. Again, the recognition that Japanese economic regulatory norms value harmony in society, and operate within a bureaucratic regulatory culture, is central to the analysis. As these norms shaped the evolution of merger control in Japan, it is important to emphasize their institutional manifestations. These include the lifetime employment system, cross shareholding, and the main bank system.

##### *1. Impediments to Merger*

The pursuit of full employment has been a central goal of policymakers during the last fifty years and is arguably part of Japan's social contract.<sup>206</sup> The lifetime employment system that developed in post-war Japan reflected the norm of harmony, as social stability was enhanced when the economy was at near full employment.<sup>207</sup> The practice of lifetime

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206. Ulrike Schaede, *What Happened to the Japanese Model?*, 12 REV. INT'L ECON. 277, 280–84 (2004).

207. Curtis J. Milhaupt, *Creative Norm Destruction: The Evolution of Non-Legal Rules in Japanese Corporate Governance*, 149 U. PA. L. REV. 2083, 2093 (2001).





employment commitments, and the strong, almost familial relationship between management and employees of a firm created a negative perception of mergers and acquisitions (hostile or otherwise),<sup>208</sup> due to potential workforce rationalization accompanying a change in ownership. This social disapproval of hostile takeovers,<sup>209</sup> and to a lesser extent mergers and acquisitions in general, is well noted in the literature, although it has not prevented amalgamations from occurring.

In order to deter potential acquisitions, groups of friendly firms (and their banks) developed extensive inter-corporate cross-shareholding relationships to provide a practical defense against takeover bids. Cross-shareholding was bolstered by the main bank system, whereby corporate groupings owned a bank, which in turn was the principal shareholder in the group's firms. This type of arrangement provided a substitute for a legalistic corporate governance framework familiar to Western observers, and allowed firms the flexibility to pursue goals beyond profit maximization. Instead, firms provided output stability and secure lifetime employment (as desired by economic bureaucrats), knowing that in the case of financial difficulty their main bank would bail them out. It can be argued that the main bank system was based on a "social presumption" that the bank would support declining and failing firms, and would promote "survival of the weakest."<sup>210</sup> This normative interpretation of the institution's role is clearly in line with perceived Japanese social values of harmony and stability. Within this economic setting, shareholder rights were severely limited, firms were typically not governed with profit maximization in mind, and firms rarely went bankrupt.<sup>211</sup>

Seen from this local perspective, mergers and acquisitions presented either an opportunity or a threat. On the one hand, a friendly merger could help a company in trouble maintain social harmony by avoiding layoffs.<sup>212</sup> A merger could also serve to reduce excessive competition in a sector, solving a problem that often arose in the eyes of economic bureaucrats. On the other hand, a hostile merger or acquisition attempt could threaten the Japanese social fabric. Layoffs resulting from restructuring under new ownership could de-legitimize the main bank system (and the practice of lifetime employment), which was conceived to avoid such an eventuality.

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208. KANJI ISHIZUMI, *ACQUIRING JAPANESE COMPANIES* 13 (1990).

209. Kelly Charles Crabb, *The Reality of Extralegal Barriers to Mergers and Acquisitions in Japan*, 21 INT'L LAW. 97, 116 (1987).

210. Milhaupt, *supra* note 207, at 2088.

211. *Id.* at 2091–92, 2098–99.

212. Ishizumi, *supra* note 208, at 15–17.







Even friendly mergers could threaten local norms by, for example, displacing an individual firm's seniority system in the process of combining with the other company.<sup>213</sup>

As a result of local economic, regulatory, and social norms, Japanese policymakers perceived some mergers in a positive light, but perceived many others negatively. Consequently, the history of Japanese merger policy displays a tendency to neither encourage nor discourage mergers through the selective adaptation process. Instead, the government attempted to control mergers and acquisitions such that their outcomes were complementary to local norms. Through a "bureaucratic regulatory culture,"<sup>214</sup> government bureaus promoted defenses against hostile bids and avoided profit-seeking shareholders dampening the market for corporate control. These regulatory norms also encouraged bureaucrats to become directly involved in merger regulation, so that mergers or acquisitions perceived as beneficial (e.g., the rescue of a failing firm via merger) could be achieved through informal guidance and consultations (bypassing potential defense mechanisms). Hence, the selective adaptation of merger control was not reflected in the merger legislation itself, but rather in policies designed to control behaviors associated with undesirable mergers.

## 2. The Adaptation of Merger Policy

### a. 1947–1952

The legacy of wartime mergers and economic concentration contributed to the negative perception of business amalgamations among the occupying Americans.<sup>215</sup> As a result, Article 15 of the 1947 AML forbade all mergers between potential competitors.<sup>216</sup> American negotiators were also able to include prohibitions on holding companies and strict limitations on stockholding by non-financial firms in the AML.<sup>217</sup> It was hoped that these provisions would inhibit the restoration of the pre-war *zaibatsu*, a central goal of the economic reform program.<sup>218</sup> As

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213. Hiroyuki Odagiri, *Mergers and Acquisitions In Japan and the Anti-Monopoly Policy*, in 4 COMPETITION POLICY IN THE GLOBAL ECONOMY: MODALITIES FOR COOPERATION 69–88, 75 (Leonard Waverman et al. eds., 1997).

214. First, *supra* note 36, at 5–6.

215. Kanazawa, *supra* note 36, at 482.

216. *Id.* at 486.

217. HADLEY, *supra* note 36, at 164.

218. *Id.* at 61–124.





was the case with anti-cartel legislation, power relationships in place when the law was drafted dictated that a largely American-imposed merger policy would prevail based on their aim of democratization of the economy.<sup>219</sup>

Shortly thereafter, calls by the Japanese elite for the AML's amendment and the prospect of a conflict on the Korean peninsula resulted in a changed policy environment. At the recommendation of the U.S. business community,<sup>220</sup> occupation authorities approved slight amendments to the AML in 1949 to expedite Japan's economic recovery. Most notably, constraints on mergers and cross-shareholding by non-financial enterprises were relaxed.<sup>221</sup> Policymakers believed that this change in legislation would encourage foreign investment and allow the government to divest stock it had acquired in the *zaibatsu* dissolution efforts, revitalizing the Japanese economy.<sup>222</sup> However, it was this initial amendment in 1949 that allowed the reemergence of the pre-war cross-shareholding and the emergence of the main bank system, as friendly firms purchased each other's stock in the equity market.<sup>223</sup> In contrast to non-financial firms, financial enterprises survived the Occupation dissolution program with their assets intact and were able to hold up to five percent of competitor's stock.<sup>224</sup> Given the AML's prohibition of holding companies, banks in the emerging *keiretsu* groups replaced the holding companies at the core of these business groups as a next-best alternative. Ongoing efforts to rebuild shareholding alliances were accelerated by a rash of "greenmail" takeover attempts in the early 1950s, leading firms to further strengthen their shareholding defences as a result.<sup>225</sup>

[C]ross-shareholding arrangements in the post-war era operated as tacit mutual pacts designed to insulate the management of both sides from any market threat of hostile takeover. The purpose of most cross-shareholding is to avoid rather than confer shareholder rights, so stable shareholding relationships function as a strategy of

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219. First, *supra* note 36, at 67–70.

220. BEEMAN, *supra* note 51, at 16.

221. Kanazawa, *supra* note 36, at 487.

222. *Id.* at 487.

223. Mark Scher, *Bank Cross-Shareholding in Japan: What is it, Why Does it Matter, is it Winding Down?* 4, United Nations Economic and Social Affairs, DESA Discussion Paper No. 15 (Feb. 2001), available at <http://www.un.org/esa/desa/papers/2001/esa01dp15.pdf>.

224. HADLEY, *supra* note 36, at 163.

225. Scher, *supra* note 223, at 5.





corporate management to limit shareholder governance of the firm.<sup>226</sup>

Rather than face shareholders' discipline, majority shares of firms were held by the main bank, which monitored firm management and provided a guarantee against failures, both managerial and financial.<sup>227</sup> However, new laws clearly at odds with the main bank system were passed during the late stages of the Occupation. In 1948 the Occupation authorities passed the Securities Exchange Law, and in 1950 the Japanese Commercial Code was revamped. Both actions reflected American notions of shareholder rights. It is instructive that both laws were significantly amended or circumvented following the end of the American occupation; indeed, Commercial Code reform had no effect on Japanese corporate practice for several decades following the War.<sup>228</sup> The American corporate governance framework conflicted with local economic and social norms due to the potential for disruptive layoffs and restructuring under a more profit minded approach. Adaptation of this legislation to local norms allowed the main bank system to flourish. In summary, the changed power balance and resultant resurgence of local regulatory norms led to adaptation of the AML merger and stockholding policies, providing firms the means to defend against unwanted takeovers or amalgamations.

Although this discussion has concentrated on domestic merger and acquisition policy, it is important to note that during this period, an international dimension of these policies surfaced. While mergers and acquisitions among Japanese firms posed threats to social stability, similar actions from foreign sources caused even greater apprehension among the Japanese elite. Consequently, in the later stages of the Occupation two laws were passed: the Foreign Exchange and Trade Control Law (1949), and the Foreign Investment Law (1950).<sup>229</sup> These laws placed all foreign investment, including acquisitions, at the discretion of the bureaucracy. If government bureaus deemed a foreign bid undesirable, it was simply barred. For all intents and purposes, hostile bids from foreign sources were impossible.<sup>230</sup>

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226. *Id.*

227. Milhaupt, *supra* note 207, at 2087.

228. *Id.* at 2105.

229. Crabb, *supra* note 209, at 108.

230. *Id.*





*b. 1953–1970*

For the first twenty years of the post-war period, merger and acquisition activity in Japan was rather limited, especially prior to the mid-1960s. “[I]t seems reasonably accurate to say that in Japan, first, mergers and acquisitions involving large firms are not many; second, hostile acquisitions are infrequent; and third, at least among large firms, looser forms of combination are preferred.”<sup>231</sup>

As Table 3 shows, the number of mergers increased steadily over the period from 1950 to 1970. Yet, most of these mergers were among small-scale enterprises. Acquisitions in Japan remained steady at nearly 200 per year between 1950 and 1964. They increased sharply to 300, and then to 400 per year between 1965 and 1970.<sup>232</sup> Compared to the merger and acquisition activity in the United States over a comparable period, there was far less activity in Japan.<sup>233</sup> “Lest one conclude that these disparities simply reflect[ed] the oversized U.S. market for corporate control, data indicate that Japan’s M&A activity is extremely low by any international measure.”<sup>234</sup> The question is: Why were there so few significant mergers and acquisitions in Japan between 1950 and 1970?

TABLE 3: MERGERS IN JAPAN 1950–1970, BY COMBINED CAPITAL OF MERGED ENTITY<sup>235</sup>

Year	number of mergers by size of merged entity (billions of ¥)				
	Under 0.1	0.1–1	1–10	Over 10	Total
1950–1952	1,089	44	3	0	1,136
1953–1955	919	71	17	0	1,007
1956–1958	1,074	62	24	0	1,160
1959–1961	1,272	140	33	3	1,448
1962–1964	2,136	336	80	24	2,576
1965–1967	2,386	290	69	15	2,760
1968–1970	2,766	457	92	15	3,330

231. Odagiri, *supra* note 213, at 71.

232. *Id.* at 70.

233. Hiroyuki Odagiri & Tatsuo Hase, *Are Mergers and Acquisitions Going to be Popular in Japan Too?*, 7 INT’L J. INDUS. ORG. 49, 49–50 (1989).

234. Curtis J. Milhaupt & Mark D. West, *Institutional Change and M&A in Japan: Diversity Through Deals* 15 (Columbia Law School, The Center For Law and Economic Studies, Working Paper No. 193, 2001), available at <http://papers.ssrn.com/abstract=290744>.

235. See Caves & Uekusa, *supra* note 72, at 29 (Japan Fair Trade Commission, Corporate Mergers in Japan, 1971. Adapted from graphic representation in Caves & Uekusa 29, 1976. Data is 1970 values of Yen).





There were two principal reasons for this lack of large horizontal mergers and acquisitions. First, the motivation for these deals was not present, and second, their implementation was difficult. In a Western context, horizontal mergers are pursued in an effort to improve efficiency or to increase market power. As will be seen, neither of these merger incentives was particularly compelling in the Japanese economy of the 1950s and 1960s.

Potential efficiency gains are often a driving force behind horizontal mergers. Following a merger, such gains are often achieved through rationalization of the two workforces into one smaller and more efficient unit. In Japan, increased efficiency was extremely difficult to achieve through rationalization due to lifetime employment, rigid seniority systems, and strong firm-employee bonds.<sup>236</sup> If a firm hoped to increase efficiency, it would do so by internal redistribution of its existing employees and resources, rather than through merger, since lifetime employment implies an increase in employees following a merger.<sup>237</sup> Furthermore, the necessity of adhering to existing seniority systems within firms following a merger would pose a complex puzzle that would likely result in conflict and inefficiencies. The bond between firms and their employees meant that any merger faced significant opposition from employees and management, and this opposition would harm the firm by exacerbating inefficiencies in addition to creating a negative social stigma.<sup>238</sup>

The pursuit of market power provided little motivation for horizontal mergers due to the prevalence of horizontal agreements in the Japanese economy over the years in question (see Part C, *supra*). As a result of permissive regulation, horizontal agreements provided a more expedient method of gaining market power and circumvented any potential conflicts with labor norms.

Beyond a lack of motivation, it was difficult for any large merger or acquisition to come to fruition due to the prevalence of the main bank system and the complex cross-shareholding arrangements that had developed among the *keiretsu* business (formerly *zaibatsu*) groups following the war. The 1953 amendment to the AML allowed stockholding by financial institutions to increase from five to ten percent

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236. Odagiri, *supra* note 213, at 74.

237. *Id.* at 77.

238. *Id.* at 74–75.





of a firm's stock.<sup>239</sup> This had two important impacts on the ability of firms to merge.

First, it facilitated and legitimized the expansion of the main bank system. Banks were able to hold larger percentages of a firm's stock as stable shareholders, dampening the market for corporate control.<sup>240</sup> A potentially profitable merger that was not in the interest of the *keiretsu* (perhaps due to the necessity of guarding jobs or perhaps due to an aversion to amalgamation with entities outside the *keiretsu*) did not come to pass because the bank and other stable shareholders would simply block it. Despite the existence of the Commercial Code, a viable market for corporate control did not develop in Japan until at least the 1980s.<sup>241</sup>

Second, the amendment increased cross-shareholding by friendly (non-bank) shareholders further inhibiting any merger or acquisition. Part of the motivation behind this change in legislation was an increase in hostile takeover bids and greenmail in the wake of the Korean War, and Japan's associated economic slowdown.<sup>242</sup> Without other mechanisms of defense against unsolicited takeovers, due to underdeveloped legislation (Japanese law did not require disclosure of private shareholding interests until 1990), cross-stockholding between Japanese firms became widespread through the 1950s.<sup>243</sup> As a result of the 1953 amendment, cross-shareholding increased between banks and firms, and amongst firms, thereby making unfriendly acquisitions even more difficult.<sup>244</sup>

As noted earlier, mergers and acquisitions were both an opportunity and a threat to economic bureaucrats and the policymaking elite in Japan. Consequently, the Japanese government adapted merger policy such that it adhered to local norms through sponsorship of the main bank system.<sup>245</sup> Due to the "stable shareholders" within this corporate governance framework, firms could avoid mergers or acquisitions (even when they could be profitable) if doing so would endanger fulfillment of labor norms.<sup>246</sup> The acute lack of a market for corporate control under the main bank system played a key role in protecting these norms.<sup>247</sup> Also,

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239. Scher, *supra* note 223, at 7.

240. Milhaupt, *supra* note 207, at 2087–88, 2097.

241. *Id.* at 2112.

242. Scher, *supra* note 223, at 4.

243. Milhaupt, *supra* note 207, at 2100.

244. Scher, *supra* note 223, at 4.

245. Milhaupt, *supra* note 207.

246. Odagiri, *supra* note 213, at 75.

247. See Milhaupt & West, *supra* note 234, at 16; Milhaupt, *supra* note 207, at 2095–99.





government encouragement of horizontal agreements (see Part C, *supra*) inadvertently removed a major motivation for horizontal mergers.

Furthermore, the Japanese government provided regulatory support for cross-shareholding. A common extension of the cross-shareholding takeover defense was the offer of new shares to stable shareholders (at a discounted rate) in an attempt to thwart an unwanted suitor. Despite the fact that this practice contradicted the Commercial Code and impaired shareholder rights, Supreme Court decisions confirmed its legality until the late 1980s.<sup>248</sup> Direct government encouragement of this practice came during the Yamaichi Crisis of 1963, when one of Japan's larger securities firms was facing insolvency due to a precipitous fall in stock prices. Japanese policymakers felt particularly vulnerable during this crisis, as recent ascension to the Organization for Economic Co-operation and Development (OECD) had meant greater openness of capital markets, increasing the potential for foreign hostile takeovers. In response, a government securities trust was set up by the Ministry of Finance to purchase shares and prevent a complete collapse of prices. The trust later proceeded to sell the shares to "group-linked companies and their banks," which enhanced cross-shareholding and curbed unfriendly acquisitions.<sup>249</sup>

It is important to recognize that minority and majority shareholding acquisitions were essentially unregulated.<sup>250</sup> The AML (Articles 9.2 and 10.1) states that stockholding must not hinder the workings of the competitive market.<sup>251</sup> However, since the JFTC did not require any prior notification of stock purchases, it could not determine anti-competitive effects and, in essence, did not regulate them.<sup>252</sup> Stock acquisitions went largely unchallenged by the JFTC,<sup>253</sup> despite the potential for anti-competitive effects.<sup>254</sup> By not regulating these stockholding combinations, the government allowed firms to accommodate social norms within their business practices.

Japan's implementation of foreign rules governing merger policy resulted in a roundabout selective adaptation process, whereby associated rules and institutions (e.g., the main bank system, the structure of

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248. Todd S. Huckaby, *Defensive Action to Hostile Takeover Efforts in Japan: The Shuwa Decisions*, 29 COLUM. J. TRANSNAT'L. L. 439, 440-42 (1991).

249. See Scher, *supra* note 223, at 4-5; Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102(4) YALE L.J. 871, 897 (1993).

250. Odagiri, *supra* note 213, at 74.

251. *Id.* at 79.

252. *Id.* at 86.

253. MATSUSHITA, *supra* note 109, at 127.

254. Odagiri, *supra* note 213, at 86.







shareholder rights, and stockholding regulations) were modified so that mergers and acquisitions would occur only when they conformed to local norms.

In light of a lack of motivation, the existence of impediments, and antagonistic government regulatory behavior towards mergers and acquisitions, it can be argued that Japanese firms preferred to grow internally rather than use an external growth strategy based on mergers and acquisitions.<sup>255</sup> If external growth was absolutely necessary, “looser combinations,” such as capital integration or partial acquisitions, prevailed, since these methods avoided contentious labor issues.<sup>256</sup>

Despite the lack of large horizontal mergers, mergers were prevalent among smaller firms (see Table 3, *supra*). These small mergers were almost exclusively of a “rehabilitative” nature.<sup>257</sup> If a firm was faced with insolvency (or other troubles), another firm within the same *keiretsu* business grouping would typically merge with or acquire that company.<sup>258</sup> Often, the acquiring firm already held a large portion of the failing company’s stock, meaning that an acquisition or merger was simply a deepening of a pre-existing relationship.<sup>259</sup> In this way, firms were able to rationalize their operations within their business groupings and ease the pain felt in declining industries.<sup>260</sup> Since small firms were involved, the human resource constraints mentioned above<sup>261</sup> were more easily reconciled. Indeed, these types of purchases were welcomed by Japanese society, and were consistent with societal norms and avoided abrupt structural adjustment.<sup>262</sup>

In the mid-1960s a small number of very large mergers occurred.<sup>263</sup> Although the JFTC was able to prevent some early anti-competitive mergers, such as the proposed paper merger of 1968, several mergers were approved that created conditions detrimental to competition, most notably the Yawata-Fuji Steel merger of 1969.<sup>264</sup> Although there were some post-merger divestitures, the reformed Nippon Steel held a nearly 100% market

255. *Id.* at 70–71.

256. *Id.* at 75.

257. Dan F. Henderson, *Foreign Takeovers and Acquisitions in Japan*, 39 ST. LOUIS U. L.J. 897, 902–03 (1994–1995).

258. Mitsuru Misawa, *Mergers and Acquisitions in Japan: The Present and the Future*, 19 VAND. J. TRANSNAT’L L. 785, 786 (1986).

259. *Id.* at 791.

260. Henderson, *supra* note 257, at 902–03.

261. See *supra* notes 237–39.

262. ISHIZUMI, *supra* note 208, at 15–17.

263. BEEMAN, *supra* note 51, at 23–24.

264. *Id.*





share in several sectors.<sup>265</sup> Apparently, a bargain between the JFTC and MITI allowed for some of these mergers to pass: MITI would stop trying to dismantle the AML and the JFTC would take a permissive attitude towards mergers.<sup>266</sup> The JFTC seemed to take this agreement to heart as it rarely opposed large mergers or acquisitions prior to the 1990s.<sup>267</sup>

Most of the large mergers in Japan's history have occurred under heavy bureaucratic guidance.<sup>268</sup> Prior to any merger or acquisition activity, the companies involved would pay a visit to the relevant ministries, which solidified bureaucratic control over mergers and acquisitions through informal consultations and recommendations.<sup>269</sup> Formal decisions in these consultation cases were unusual prior to the 1990s (and records of informal consultations were not published), maximizing bureaucratic discretion in future cases.<sup>270</sup> Also, government guidance aided firms in bypassing some of the potential obstacles to mergers mentioned above.

Foreign merger and acquisition attempts faced nearly insurmountable bureaucratic obstacles through the 1970s, as foreign firms still had to contend with the provisions contained in the Foreign Exchange and Trade Control Law and the Foreign Investment Law, which both remained in place until the 1980s.<sup>271</sup>

### *c. 1970–Present*

In 1971 a tender offer system was introduced. Although this was a step towards a competitive market for corporate control, hostile takeovers remained nearly impossible within this system because approvals were still at the discretion of the Ministry of Finance.<sup>272</sup> The regulations served as a “structural impediment” to takeovers from 1971 until 1990, when they were amended.<sup>273</sup> As a result, only three tender offers were initiated during these thirty years.<sup>274</sup> Nevertheless, the mere introduction of this system signified a first step towards a more competitive, market-oriented merger policy.

265. MATSUSHITA, *supra* note 109, at 129–30.

266. CAVES & UEKUSA, *supra* note 72, at 151.

267. ISHIZUMI, *supra* note 208, at 118–21.

268. SCHAEDE, *supra* note 64, at 59.

269. *Id.* at 119; Ishizumi, *supra* note 209, at 120.

270. Odagiri, *supra* note 213, at 85.

271. Crabb, *supra* note 209, at 108.

272. Huckaby, *supra* note 248, at 462.

273. *Id.*

274. Milhaupt & West, *supra* note 234, at 19.





In 1977 the AML was again amended, including changes to merger policy. The permitted stockholding ratio of financial institutions was reduced from ten percent of a firm's stock back to five percent, although it took over ten years to implement this change.<sup>275</sup> Public concern over inflation and the Oil Cartel scandal provided a policy environment conducive to pro-competitive policies, and it was hoped this new legislation would help combat the influence of large business groupings and banks over individual enterprises and consumers as a whole.<sup>276</sup> At the very least, this reduction began to limit firms' defenses against takeovers and to remove insulation against structural adjustment for the benefit of the competitive market.

By the 1980s, the characteristics of mergers in Japan also began to change. Rather than simply indicating a "company in trouble," mergers became a growth strategy for firms.<sup>277</sup> A study of Japanese mergers and acquisitions in the 1980s suggests that they were usually a means towards "product and market extension."<sup>278</sup> As the complexion of mergers changed, government policy slowly adapted. Support for the main bank system and resistance to unsolicited takeovers gradually waned. The reduction of stockholding ratios put a constraint on this corporate governance system, while several policy changes altered the hostile takeover norm and associated shareholding practices. In 1980 the JFTC published merger guidelines, specifying market share levels (twenty-five percent for the new entity) at which mergers would likely be challenged in line with levels in other jurisdictions.<sup>279</sup> A year later, the JFTC announced another set of guidelines, stipulating disclosure of private stockholding interests on both a yearly basis and following any acquisition, in order to establish whether "a joint relationship due to stockholding" existed.<sup>280</sup> While the threat of prosecution under the AML curtailed the practice of cross-shareholding, it was a Supreme Court decision condemning the issue of discounted shares for sale to friendly shareholders (to block takeovers) that constituted the major blow to cross-shareholding.<sup>281</sup>

Following the onset of a recession in the early 1990s, the Japanese merger environment changed even further.

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275. Scher, *supra* note 223, at 8–9.

276. BEEMAN, *supra* note 51, at 75.

277. Misawa, *supra* note 258, at 786.

278. Odagiri & Hase, *supra* note 233, at 56.

279. Odagiri, *supra* note 213, at 78–85.

280. *Id.* at 80.

281. Huckaby, *supra* note 248, at 451–52.





The interesting feature of the new wave of Japanese M&A during the 1990s is that the nature of M&As has changed in face of the current micro- and macroeconomic situation in Japan. The economic conditions facing many firms today have fostered a climate where M&As based on due diligence and future strategic advantage, rather than based on network affiliations, have become common. In addition, the resistance towards takeovers by competitors and especially foreign firms seeking a foothold in Japan through M&As has started to diminish. In other words, the changing pattern of Japanese M&As is mirrored on multiple levels, including purely economic considerations and perceptions among individuals in the organizations.<sup>282</sup>

The steady increase of merger activity in Japan beginning in the early 1990s can be attributed to economic stagnation and the institutional change it produced. The old economic system of stable shareholders and lifetime employment led Japan to a recession, and both economic actors and policymakers recognized the need for changes. Main banks could no longer play the role they had in the economy, and so began the disintegration of the cross-shareholding system. Firms faced with increasing losses and greater pressure from shareholders saw mergers and acquisitions as a route to revitalization. The Japanese government recognized the need to facilitate corporate reorganization with new legislation. In essence, these changes reflected the de-legitimization of previously ingrained economic norms, such as “cross-ownership, main bank system, and employee-centered corporate governance.”<sup>283</sup>

For the purpose of understanding the onset of the merger boom, the first point to consider is the impact of the economic downturn on the main bank system, and by consequence on the cross-shareholding system. The main banks were adversely impacted by the stock market crash due to the large amounts of unprofitable investment readily offered to members of the banks’ corporate groups. This new economic reality meant that these banks were unable to play their accustomed role at the center of their business groups. Banks were forced to call in outstanding loans and decrease their cross-shareholding to avoid failure.<sup>284</sup> As the cross-shareholding system began to unwind, another impediment to mergers and

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282. H. Richard Nakamura, Attitudes, Structure and the Partner Selection of Japanese M&As 2–3, presented at the First Nordic Association for the Study of Contemporary Japanese Society, Gothenburg University (Apr. 2004) (on file with author).

283. *Id.* at 6.

284. Scher, *supra* note 223, at 6.





acquisitions was removed when several major Japanese banks merged in 1998.<sup>285</sup> These mergers confirmed the decline of the old system, as the new banks rapidly decreased their cross-shareholding commitments.<sup>286</sup> With the influx of foreign capital following the financial deregulation of the same year, the role of the main banks further faded, as did the government guarantee against bank failure implicit in the system.<sup>287</sup>

It should be noted that foreign institutional investors purchased the vast majority of the stock sold by the main banks. These shareholders were very different from those of the previous stable shareholders, in that they demanded a reasonable rate of return on their investment.<sup>288</sup> As losses mounted in conjunction with pressure from shareholders, firms found that corporate reorganization (through mergers and acquisitions) was an effective way of adapting to the demand for profits.

Japanese policymakers understood that legislative changes were needed in light of economic stagnation. Beginning in 1997, the prohibition on holding companies was lifted from the AML to facilitate corporate reorganization.<sup>289</sup> A year later, the “Big Bang” financial deregulation dramatically increased merger activity<sup>290</sup> by introducing the reality of financial sector reform.<sup>291</sup> Revision of corporate law began in earnest in 1999, when the Commercial Code was changed to allow share-for-share swaps between firms for the first time, enabling reorganization through holding companies or “stock swap” mergers and acquisitions.<sup>292</sup> In 2001, further amendments to commercial legislation permitted “corporate division,” enabling firms to better manage subsidiaries and joint ventures.<sup>293</sup> Another revision was introduced in 2002 that provided firms with two options for the structure of their board of governors and their system of corporate governance.<sup>294</sup> More recently, corporate law changes have allowed “triangular mergers” between Japanese and foreign firms. The new legislation allows foreign firms to acquire Japanese firms through

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285. *Id.*

286. *Id.* at 13.

287. See M. Diana Helweg, *Japan: A Rising Sun?*, 79(4) FOREIGN AFF. 26, 30–31 (2000); Milhaupt, *supra* note 207, at 2088.

288. Hiroyuki Itami, *Revision of the Commercial Code and Reform of the Japanese Corporate Governance* (The Japan Institute for Labour Policy and Training Working Paper), available at [http://www.jil.go.jp/english/documents/JLR05\\_itami.pdf](http://www.jil.go.jp/english/documents/JLR05_itami.pdf).

289. Nakamura, *supra* note 282, at 5.

290. *Id.*

291. Helweg, *supra* note 287, at 30.

292. Milhaupt & West, *supra* note 234, at 23.

293. *Id.*

294. *Id.*





formation of a Japanese subsidiary, followed by a stock swap between the subsidiary and the target firm, whereby the Japanese subsidiary trades shares of the foreign parent company. However, implementation was delayed due to a series of hostile takeover attempts that worried policymakers and business people. In particular, the attempted hostile acquisition of Fuji TV by Livedoor (a Japanese firm backed by American capital) in 2005 struck the public consciousness and created widespread alarm over unsolicited foreign acquisitions.<sup>295</sup> Nonetheless, the new triangular merger law came into effect in May 2007, forming part of Japan's strategy for attracting foreign investment and promoting growth.<sup>296</sup>

The increasing number of mergers through the 1990s prompted the JFTC to issue a series of merger guidelines. In 1998 the JFTC passed a new set of merger guidelines that introduced the factors regulators would consider when evaluating a merger.<sup>297</sup> The guidelines added transparency to the process, but uncertainty still remained about how the JFTC would weigh the various factors in a decision.<sup>298</sup> In this regard the 1998 guidelines still preserved elements of the previous approach to merger regulation, which had thrived in a bureaucratic regulatory culture, and relied heavily on informal consultations between business and bureaucrats.

The JFTC further revised the merger guidelines in 2004, increasing transparency by clarifying exactly how decisions will be reached based on gathered information and economic measures.<sup>299</sup> These guidelines seem to greatly limit bureaucratic discretion and the practice of industrial policy through merger policy.

The guidelines were revised again in March 2007.<sup>300</sup> The process for defining the relevant market was sharpened, safe and unsafe harbors were stipulated in terms of concentration levels, the efficiency exemption was more clearly defined and thereby constrained, and the roles of foreign

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295. See William R. Huss, Mariko Osawa and Yuji Iwanaga, *Japan: Japan's New Triangular Merger Rules—Acquisition of Japanese Companies Through Share Exchanges*, PILLSBURY WINTHROP SHAW PITTMAN CLIENT ALERT (Apr. 27, 2007), available at <http://www.mondaq.com/article.asp?articleid=48012> (last visited Nov. 10, 2007).

296. *Id.*

297. Salil K. Mehra, *Same Plant, Different Soil: Japan's New Merger Guidelines*, 26(3) NW. J. INT'L L. & BUS. 515, 516–17 (2006).

298. *Id.* at 523.

299. Mehra, *supra* note 298, at 523.

300. Fair Trade Commission of Japan, Guidelines to the Application of the Antimonopoly Act Concerning Review of Business Combination (amended Mar. 28, 2007), available at <http://www.jftc.go.jp/e-page/legislation/ama/RevisedMergerGuidelines.pdf> (last visited Nov. 10, 2007).







competition and the condition of market entry in the evaluation were set out. Policy today, insofar as it is reflected in these guidelines, is strikingly similar to merger control in the United States.

### *3. The Selective Adaptation of Merger Policy*

The development of merger policy within the context of a competition policy in Japan is markedly different from the evolution of anti-cartel policy. At war's end, regulatory norms as reflected in bureaucratic guidance, viewed horizontal agreements positively. Foreign rules hostile to such agreements were perceived as misguided and illegitimate. Consequently, adoption of the foreign rules was resisted and adaptation in the early years was significant. Foreign rules hostile to horizontal mergers were not seen in the same light because local norms were also hostile to disruptive takeovers. In effect, there was little need for the authorities to deal with anti-competitive mergers because there were so few of them.

Over time, policies that insulated firms from takeovers came into disrepute. Most importantly, the prolonged recession of the 1990s was blamed in part on crony capitalism, which was supported by the main bank system and extensive cross-shareholding. Public policies that protected firms from unwanted takeovers were reversed or moderated, opening the door to an upsurge in merger and acquisition activity. In effect the prevailing "anti-merger" rules were seen to be impairing economic performance. As was the case with horizontal agreements, change came because of a perceived lack of complementarity between two social goals, harmony (as manifested by an absence of disruptive mergers) and economic performance.

Japan is only recently experiencing the type of merger activity seen in North America and Western Europe. It appears that policy makers have accepted the legitimacy of merger controls that focus on the protection of competition, as opposed to controls focused on the maintenance of the status quo.

## V. CONCLUSIONS

As global economic integration proceeds, developing and transitional economies are implementing Western style economic policies. Sometimes adoption of specific policies is the price of admission to a trade group or organization and is, in a sense, forced on the recipient. In other cases, the policies are willingly and voluntarily adopted as they are seen as a necessary condition for a well functioning market economy. In many







instances, regardless of whether adoption is voluntary or non-voluntary, the adopting country is unfamiliar with the liberal economic norms that underlie the policy. There can be conflict when foreign rules or policies are incompatible with local economic and social norms and practices. Identification of the causes of such conflicts is a step towards their resolution.

Selective adaptation theory reasons that local norms will play a central role in the manner in which foreign ideas are integrated into the local context. Rather than blindly accepting foreign norms and practices (and the rules accompanying them), nations will adapt the foreign practices to serve local policy imperatives. Through this adaptation process, the dominant foreign practices are subject to modification by local norms. This modification and adaptation depends upon the local perspective of the foreign practice, the legitimacy of the foreign practice in the local context, and the extent to which the foreign practice complements local norms. Conflicts emerge when foreign and local perceptions as to the purpose and effects of the policy diverge, when local stakeholders view the policy as illegitimate, and when the foreign practice is seen to be at odds with local economic norms and goals.

This Article has employed the selective adaptation framework to explain the development of Japan's Antimonopoly Law. Application of that theory provides an evolutionary case study of a foreign policy that underwent adaptation according to local norms and priorities. Japan's Antimonopoly Law was imposed by an occupying power, and the law was a reflection of that power's economic and social values. American belief in freedom from concentrations of economic power and anti-statism were the basis for the installation of antitrust norms in the United States, and they were also at the core of the imposed Antimonopoly Law. When the law came into being, Japan's sole concern was post-war recovery. Based on its pre-war experience with rapid development and bureaucratic guidance that relied upon cooperation, and sometimes outright cartelization among competing firms, it is unsurprising that Japanese policymakers looked to these methods to rebuild post-war Japan. For many Japanese the AML was perceived as illegitimate and inconsistent with extant regulatory norms and economic goals and thus, when the opportunity arose, Japan amended its competition laws to better reflect local norms and priorities. In effect, adaptation (of both the law and the enforcement process) was such that Japan had no real competition policy for thirty years following passage of the AML. This adaptation process only began to change direction during the period of high inflation in the late 1970s when the need for stronger





competition policy became apparent. It was not until the onset of recession in the 1990s that the policy was made truly effective.

Based upon this review of the evolution of Japan's competition policy, it is our view that the selective adaptation model shows considerable promise as a tool to explain the speed of adoption and the extent of adaptation of foreign regulatory norms in local environments.

From the perspective of capacity building, it seems to us that the power relationship between the source of the foreign regulatory norms and the recipient, while important, is not the overriding consideration. Similarly, the written rule and the structure of the enforcement agency are important but not paramount. The critical factors are perception, legitimacy, and complementarity. The acceptance of the regulatory norms underlying an effective competition policy can require a wholesale change in business and regulatory cultures, and this does not happen quickly.

[The] "Harmonization culture" that dominated Japanese business thinking need[s] to experience culture shock in order to concede to the new one, "competition culture." Needless to say, any culture requires a long time to change, and [the] Japanese business community is in the midst of such cultural changes.<sup>301</sup>

The lesson from the Japanese experience is that capacity builders should focus on perception, legitimacy, and complementarity issues. Of these, complementarity is the key. In Japan it was only when stakeholders became convinced that competitive markets would deliver economic prosperity that competition policy became effective.

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301. Akinori Usegi, Recent Developments in Japanese Competition Policy—Prospect and Reality 5, Address Before the International Antitrust Forum, Antitrust Section, American Bar Association (Jan. 24, 2005), *available at* <http://www.jftc.go.jp/e-page/policyupdates/speeches/050124uesugi.pdf>.

