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2 Market Opening in Japan: Deregulation, Reregulation, and Cross-Sectoral Variation

Robert W. Bullock

DESPITE THE HISTORIC STRENGTH OF THE U.S. ECONOMY and the chronic recession and "deregulation fever" in Japan today, many American analysts have never been more pessimistic about the prospects for opening Japan's markets. In a 1998 position paper for the Council on Foreign Relations, Edward Lincoln, former special economic advisor to the U.S. Ambassador to Japan, concludes that we should simply lower our expectations for opening Japanese markets. Progress has been slow and difficult and there are few signs that things will improve.[1] In some ways, trade expert Leonard Schoppa is even more pessimistic. He argues that the prospects for the United States to win trade concessions from Japan sharply deteriorated with the change in Japanese "social context" in the early 1990s. With the end of the cold war, the establishment of the World Trade Organization (WTO), and a new generation of bureaucrats who "can say no" to unilateral U.S. demands, American trade negotiators face tougher conditions than ever (Schoppa 1999).

Recent works by American scholars on deregulation in Japan offer similarly pessimistic assessments. In the Brookings study *Is Japan Really Changing Its Ways?*, contributors stress the slow pace of reform, the persistence of industry cartels and bureaucratic governance of markets, and limited market opening. As coeditor Mark Tilton remarks, "The regulatory reform movement must be understood as a corrective and complement to Japan's system of developmentalist capitalism rather than an attempt to overthrow it" (Carlile and Tilton 1998). Even the "Big Bang" of financial-market reform, Elizabeth Norville tells us, is "mostly cosmetic," with little impact on traditional policy-making practices

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(Norville 1998). Steven Vogel's recent article takes a similar line, stressing continuity in national regulatory style: "Japan's distinctive approach to liberalization has been characterized by slow and incremental change; elaborate political bargains, typically involving compensation for the potential losers from reform; considerable efforts to prepare industry for competition; and continued bureaucratic monitoring and manipulation of the terms of competition" (1999a).

This caution is understandable. It is undoubtedly true that the Japanese economy—especially manufacturing—remains dominated by well-organized, oligopolistic industries that are ambivalent at best about deregulation and market opening. Tilton, Lincoln, and others document enduring domestic-overseas price differentials (*naigai kakusa*) and the persistence of formal or informal market barriers in a range of important markets. Japan's trade negotiating strategy is still mostly one of, as Lincoln puts it, "deflect, delay, and diminish" (Lincoln 1999, 141; Tilton 1996). And government claims of success in deregulating the overall economy are suspect when the total number of regulations continues to increase.[2]

And yet, we cannot let these macro-oriented reservations obscure striking variation across Japanese markets. The fact is that we have already seen substantial regulatory change and market opening in some of Japan's most notoriously protected industries. It is striking that some of the most influential voices in Japanese studies and trade policy exhibit such skepticism at a time when the Japanese economy (or parts of it) is opening up at record speed. The Japanese economy is not, and probably never was, a united front. Japan can no longer be characterized as a "reactive state" where domestic actors merely respond, usually defensively, to external challenges (see Calder 1988b).

The first objective of this chapter is thus to document that in certain sectors, regulatory change—both deregulation and reregulation—has already been substantial and has facilitated market opening, while in other sectors it has not. We find "successes" among even the sectors most politically and economically central to Japanese politics and industrial policy, those which we would expect to be the toughest markets to crack. Among the politically central sectors, we have seen the relaxation and then abolition of the notorious Large Scale Retail Store Law and the subsequent explosion of new retail investment. Among the economically central sectors, we have seen substantial regulatory and market changes in telecommunications—in long-distance and cellular phone service in particular—and the Big Bang in financial services, which, while not quite a revolution, is the most important set of financial deregulatory measures of the postwar era.

The second, more ambitious objective of the chapter is to attempt to explain this variation. Clearly, what is occurring in Japan is neither across-the-board change, as convergence theory would have it, nor a unified resistance to change, as some historical institutionalists or developmental-state theorists might claim.

We must develop a more nuanced approach, moving beyond case-specific explanations. This chapter argues that the critical formula for market opening is external pressure (*gaiatsu*) plus internal, intra-sectoral conflict: more specifically, the existence of a substantial domestic constituency for reform that is composed of producer groups seeking strategic advantage via regulatory reform, with the support of at least some elements of the state bureaucracy as well.[3] This is perhaps most striking in the case of finance, where the more competitive elements of the sector, backed by elements of the Ministry of Finance (MOF) and Prime Minister Hashimoto Ryūtarō's Administrative Reform Council, have driven wide-ranging deregulation.

Of course, one might argue that the enormity of the banking crisis made financial reform, if anything, overdetermined. But we find significant regulatory change and market opening elsewhere, in sectors untouched by crisis: in telecommunications, where the divide is between the mammoth Nippon Telegraph and Telephone Corporation (NTT) and comparatively small, up-and-coming firms (often joint ventures or foreign firms) that are backed by the Ministry of Posts and Telecommunications (MPT) in its efforts to contain NTT dominance and encourage competition; and in retail, where competitive elements of the sector, backed in the end by the Ministry of International Trade and Industry (MITI), have aggressively pushed for regulatory change and liberalization, with U.S. *gaiatsu* playing an important supporting role.

The chapter explores four sectors in pairs—rice and retail, finance and telecommunications—and puts each paired comparison to slightly different use. In rice versus retail, the most interesting variation is in terms of market opening, which is significant in retail but token in rice. In retail, as noted above, business interests, with the support of American pressure and ultimately of MITI itself, drove significant regulatory change and market opening. In rice, by contrast, the Liberal Democratic Party (LDP), the Ministry of Agriculture, Forestry and Fisheries (MAFF), and organized agriculture—notably, the Japan Agricultural Co-operatives (JA), formerly known as Nōkyō—have presented a united front of resistance. To be sure, there is domestic dissent—particularly from competitive, large-scale farmers and (to a lesser degree) from big business—but it is disorganized and muted. The only major force for change has been American *gaiatsu*. Lacking domestic allies, American trade negotiators have won only minimal concessions and only by dint of concerted political pressure.

In finance versus telecommunications, regulatory change and market opening are important in both, but there is significant variation in the *style* of regulatory reform. In finance, reform is now primarily deregulatory, as a weakened MOF is losing control over the sector. In telecommunications, regulatory change remains primarily reregulatory, and the MPT as yet retains undiminished control of the sector. In short, internal market splits plus external pressure drive market opening, while the decline of bureaucratic power favors deregulation.

These outcomes are broadly consistent with the argument made by Leonard Schoppa in his 1997 book: *gaiatsu* fails without the support of domestic interests (which help also to legitimize policy change and to monitor results). But at the same time, it is difficult to argue that the United States did more than complement these actors. In other words, Schoppa's emphasis on "synergistic strategies"—that is, where the actions of one player shape the behavior and even the preferences of the other—is intellectually interesting but difficult to verify empirically, at least in the cases discussed here. Take, for example, "participation expansion," the main such tactic explored in Schoppa's study of the Bush administration's trade negotiations with Japan.[4] Consumers were one of the primary targets of this tactic, but in Japan (as elsewhere), the problems inherent to collective action render consumers ineffective as political actors.[5] Further, what consumer groups do exist in Japan tend to be just as protectionist as producer groups (Vogel 1999b).[6] While a consumerist strategy may help to legitimize market-opening demands, much more central to explaining market opening and regulatory change are the preferences and capabilities of producer interests. Among them, there may be mavericks—low-cost producers who believe that they will do better with more open markets or greater deregulation. Mavericks may exist even among the "insiders" who dominate the sector. But these producers were not *created* by U.S. pressure, nor did their preferences suddenly shift from protectionism to free trade. These actors were present all along, and they were far from silent in advocating regulatory change and market opening.

In short, the effectiveness of *gaiatsu* depends not only on tactics but also—and perhaps even more importantly—on the domestic political economy. Simply put, some markets are easier to crack than others. Each side's "win sets" (i.e., the range of acceptable agreements) can be tweaked only so far. And the bigger the gap between them, the less likely are tactics of any sort to close it. However, where win sets do not overlap but are nonetheless close, international pressure may help to move them together and to tip the balance in favor of market opening. External forces like the U.S. government or American firms may form, implicitly or explicitly, transnational alliances with domestic mavericks.[7] Needless to say, the domestic approach developed here does not contradict the emphasis on international tactics but complements it. Nonetheless, it makes sense to think first about which sectors are vulnerable to market-opening pressures before deliberating on the tactics most likely to work.

What is more, much of the new trade with Japan is coming in the form of foreign direct investment (FDI), not simply merchandise or service trade. While we cannot be sure whether or how long the influx will continue, there are already powerful new players in the Japanese market—Trojan horses, as it were—with a vested interest in continued opening. And as Dennis Encarnation (1992) argues, additional trade tends to follow investment. Related to this point, Helen Milner (1988) argues that as a national industry becomes more internationalized, it is likely to reduce its political demand for protection and, indeed, to pursue liberalization.

This chapter has several implications for U.S. policy. The most important recent successes for U.S. exporters have come less via bruising, bilateral conflict than through regulatory change, where *gaiatsu* was but one of a host of pressures. These successes demonstrate that market opening need not come from managed trade alone. While numbers-based managed trade deals have been more successful than detractors claim, the approach is deeply unpopular in Japan today and remains controversial in Washington.[8] In the current atmosphere of deregulation fever in Japan, the United States would do well to focus its attention on regulatory change and to consider managed-trade demands only in those sectors that appear impossible to crack otherwise—that is, where sectoral divides are weak or absent, where actors on the American side are relatively unified, and where the United States is sufficiently competitive to benefit.

Rice Agriculture and Small Retail

Rice agriculture and small retail served as the chief social bases of postwar conservative rule for some forty years—from the 1950s into the 1990s. The two sectors survived decades of double-digit, industry-led growth, demographic change that was nearly as rapid, and international liberalization pressures that only mounted with time. In the economic recession of the 1990s, however, small business began to be squeezed out of the coalition, while agriculture's place in conservative politics became ever more secure.

First, the political bottom line: together, the two sectors supplied some three-quarters of the LDP vote in the 1950s and nearly one-half in the late 1980s. The relative contributions of each sector have been roughly comparable over time. The two sectors owe their electoral clout not only to their numbers but also to their high turnout, stable conservative support over time, organizational strength, and bloc-like voting behavior. On all counts, they stand in contrast to the urban majorities, who are less likely to vote, less interested in or involved in organized politics, and whose party/candidate preferences are weak and volatile over time.

There are additional similarities between the two sectors. First, each has a powerful ministry advocate—MAFF in the case of agriculture, and MITI's Small and Medium Enterprise Agency (SMEA) for small business. Both are major players in bureaucratic politics. The SMEA is on equal terms with other MITI bureaus that are more devoted to developmental policies (i.e., it is not outclassed by divisions that oversee high-growth/high-tech sectors).[9] Second, each is politically well organized. Organizational structure is not perfectly analogous—that of agriculture is highly concentrated and pro-LDP, while that of small business is more fragmented and politically split—but there is no reason to believe that the small-business split would make the LDP less sensitive to the sector's demands. (Indeed, one could well argue the opposite.) Third, each sector has strong, entrenched public support, not least among urban consumers; this support is strongest and most obvious for rice agriculture, given the importance of rice as Japan's staple food and as a locus of the country's cultural identity, but holds also for small retail and its importance in everyday neighborhood life.[10] Fourth, in terms of international pressure, the United States was at least as aggressive in demanding rice-market liberalization as in pursuing retail reform. I describe each sector in more detail below.

Agriculture

To an overwhelming extent, Japanese agriculture remains predominantly rice agriculture. Even today, rice is grown by more than 80 percent of Japan's four million farm households, occupies half of Japan's farmland, and provides one-third of its agricultural income. Agriculture has been rationalized largely through the spread of part-time farming (now 90 percent of the total), rather than through the exit of inefficient farmers. The average farm size in Japan today is just over two acres—virtually the same as in the 1930s. The logic is both economic and political: small-scale rice farming remains economically rational for individual farmers (if not for the sector or economy as a whole), and farmland consolidation would erode the political base of the LDP and the jurisdictional base of MAFF.

Ninety-nine percent of farmers are members of the agricultural cooperatives, the JA. Total JA membership, more than nine million today, is increasing despite agricultural decline, making it the largest mass-membership organization in Japan. Rice farmers have profited from two state policies in particular: a virtual ban on rice imports (partly lifted in 1993, as will be explained below) and a state-set rice price that is some seven to twelve times comparable prices on the world markets.

Small Retail

Small retail constitutes by far the largest and most politically active subcategory of small business. Like agriculture, small retail engages about 8 percent–9 percent of the labor force today, with about four million workers in each. Of the 1.3 million retail businesses in Japan in 1987, small businesses accounted for 970,000, including 704,000 single-shop operations (Patrick and Rohlen 1987, 339). In 1982, the number of retail stores per capita was 75 percent higher in Japan than in the United States, while the value-added per employee was 28 percent less. Stores with one or two employees accounted for just 14 percent of sales but 60 percent of all stores (Upham 1996, 278–279; see also Riethmuller 1994a, 131–143). Small-retail numbers have expanded over the postwar era, particularly from the early 1970s. The primary reason for this growth is state protection, and the primary reason for protection is the sector's electoral importance for the LDP.

Small-business organizations, unlike those of farmers, are not combined under a single peak association. Instead, hundreds, even thousands, have proliferated. Minshu Shōkōkai (or Minshō, for short), an organization for small businesses that has close ties to the Japan Communist Party (JCP), has enjoyed particular success, notably in undergirding decades of Communist Party dominance of Kyoto city politics (see Krauss 1980, 383–424; see also Calder 1988a, 200, 344–345). Local chambers of commerce and shopping-district (*shōtengai*) associations tend to be much closer to the LDP.

Small retail has been served by a range of subsidies—mostly in the form of low-interest loans—that expanded over the rapid-growth period even as similar loans to big business rapidly declined.[11] The centerpiece of small-retail support, however, has been the Large Scale Retail Store Law (Daikibo kouri tenpo hō), which created entry barriers for large retailers seeking to open new shops.

The Large Scale Retail Store Law was introduced in 1973 to replace the Department Store Law (Hyakkaten hō) of 1956 (originally passed in 1937). According to Kusano Atsushi (1992, 228), MITI had no plans of its own to introduce new legislation, but the Socialists and Communists had picked up new small-retail support in the 1972 election. The LDP therefore stepped up its efforts to win back the sector by demanding that the Department Store Law be enhanced or replaced. The new law was entirely political in intent.[12]

Under the Large Scale Retail Store Law, local retailers themselves held the power to grant or deny permission for the construction of large retail stores ("large" being defined as 500 square meters or more).[13] Typically small shopkeepers, these local interests tended to be unsympathetic to large-store proposals, and many localities imposed effective bans on the establishment of new large stores. With no time limits set for the process, even successful applicants could be forced to wait ten years or more for approval.

Under the new law, the number of new large- and medium-sized stores dropped to a trickle. In 1974, retail shops with one or two employees accounted for 62.5 percent of the total number of retail stores. By 1988, their share had fallen by just 5 percentage points. Over the same period, large stores (with more than twenty employees) increased their share of the total by just 1.1 percentage points (Schoppa 1997, 236).

In sum, there are strong similarities across rice agriculture and small retail and thus reason to expect policy change to be similar for each. Indeed, if anything, there are a number of factors that might lead one to predict that agriculture, not small retail, would be the more likely to be sacrificed: the Uruguay Round (concluded in December 1993) was regarded by many in Japan, and notably by the media, as virtually synonymous with rice-market liberalization, whereas in the 1989–1990 Structural Impediments Initiative (SII), where the United States sought Large Scale Retail Store Law reform, retail was just one of a host of issues[14]; farmers' political power was a central target of the 1994 electoral reforms (which substantially reduced the malapportionment favoring rural districts); the policy payoff in agriculture depends more heavily on budget outlays than does small-business payoff, which depends more on entry barriers, making agriculture more vulnerable to attack amidst the ongoing recession and rapidly increasing state budget deficits; and, finally, small retail is largely a full-time occupation whereas farming is overwhelmingly part-time, meaning that retail cuts would hit constituents harder than equivalent cuts in agriculture. Nonetheless, the Japanese government has increased supports for rice even as it has cut those for small retail.

Policy Change in Agriculture

Subsidies for rice have continued to climb through the 1990s and liberalization efforts under the Uruguay Round resulted in "minimum access" rice imports—a "minimal" concession where imports are controlled by MAFF, which buys them at cheap international prices, sells them at expensive domestic prices, and uses the proceeds to fund additional farm subsidies (as will be discussed below).

Since the Uruguay Round's 1993 conclusion, moreover, the conservative commitment to agriculture has only increased. Returning to power in the spring of 1994, the LDP's first priority was to push through a massive ¥6.01 trillion (US$60 billion) farm subsidy package, which even MAFF found excessive.[15] Soon afterward, the party and the JA co-ops won a ¥685 billion bailout for JA losses in the housing-loan companies (*jūsen*) debacle, Japan's version of the U.S. savings and loan crisis. They were even able to mask the political motivations behind the bailout somewhat by having it labeled a "contribution" (*zōyo*) (*Nihon Keizai Shimbun* 20 February 1996, 1).[16] In 1997, the Ministry of Finance organized a study group to consider ways to reduce the growing state budget deficit. Although the ¥6.01 trillion in post-Uruguay Round farm subsidies was one of the reasons the group was formed in the first place, in the end it recommended cuts in defense and official development assistance (ODA) rather than touching the farm grants (*Nihon Nōgyō Shimbun* 23 February 1997, 1).

Some analysts argue that the 1995 scrapping of the old Food Control Law

(Shokuryō kanri hō), which had been in place since 1942, and the introduction of the new Staple Food Law (Shokuryō hō, or Shin shokuryō hō) promise at last to free up the farm sector. The new law has won praise as "drastic deregulation" and an important step toward rehabilitating Japanese agriculture (*Nihon Keizai Shimbun* 30 October 1995, 2).[17] This author, however, takes a slightly different view. Although recent agricultural policy reforms are important and have achieved a great deal, their nature has often been mischaracterized and overstated. Specifically, market liberalization has progressed domestically, but not internationally. Domestic market liberalization does not mean deregulation. MAFF has redefined its control over the rice economy (via reregulation) but it has reduced that control only marginally.

The new Food Supply Law has five main features:

1. MAFF's role as a direct participant in the rice economy has been reduced. Government purchase of rice is now limited to foreign rice imported under the Uruguay Round minimum-access arrangement and domestic rice for stockpiling (food security) purposes.
2. In place of the old system of "government-controlled rice" (*seifu mai*) and "semi-controlled rice" (*jishu ryūtsū mai*) distribution routes, under which 20 percent–30 percent of rice ended up being sold through an illegal black market (*yami-gome*), the new law established a new set of routes. The first is for "government rice" (*keikaku ryūtsū mai*), including both the government-controlled rice, which the government itself buys from the farmers, and semi-controlled rice, which licensed buyers purchase from the farmers. The second is for "voluntary-marketed rice" (*keikaku-gai mai*), which farmers and the JA cooperatives are now permitted to sell directly to retailers and wholesalers. The major significance of this shift is that, after deciding it could not eliminate the black market, MAFF decided to "recognize" and legalize the market, thereby bringing it under ministerial oversight.
3. Japan's rice reserves are to be increased to 1.5 million tons. This change reflects, above all, the experience of 1993–1994. A 25 percent shortfall in the 1993 rice harvest led to shortages on the legal markets and spectacular price increases on the black market. The prices of the most popular varieties shot up nearly threefold, with would-be sellers withholding their stock in the hope of further increases, and with pundits describing the confusion as the "*Heisei kome sōdō*"—the "rice riots of Heisei (post-1989) Japan."
4. Rice-production control, formerly ad hoc in nature, has been incorporated into the legal framework. Coercive measures, such as withholding subsidies from areas that do not fulfill their reduction quotas, have been abolished. Concern remains, however, that the text of the law leaves room for informal pressure, particularly from JA.
5. Most significantly, the law provides for substantial deregulation of rice

retailing. This appears to be the single most consequential measure of the new law. Prospective retailers are no longer required to apply for permission to enter the market but need only register with the Food Agency. By all accounts, this is no small change. Registration applications are being approved almost automatically. The number of stores selling rice is projected to triple. By the end of 1996, the number of retail rice outlets had already reached 175,600, nearly twice the number in existence the previous year (*Japan Agrinfo Newsletter* August 1997, 2). Many analysts have remarked upon the new "warring states period" (*sengoku jidai*) in the rice trade and anticipate that the number of wholesalers and rice specialty shops will plummet (*Asahi Shimbun* 2 April 1996, 9).[18]

With the exception of retail, however, the new law is a clear case of reregulation. While the new Staple Food Law has significantly liberalized retail trade, in the areas of production and distribution, the *Shūkan Tōyō Keizai*, for example, dismisses the MAFF-proclaimed "deregulation" as a "big lie." Instead, the new law constitutes a "new form of control from above [. . .]. MAFF has introduced new, clever mechanisms" ("Nōkyō to nōsei" 1996). Price controls remain on rice. With domestic rice prices that are at least ten times higher than international prices, production control to limit rice supplies remains essential. MAFF withdrawal from production control has been matched by JA's advance. Indeed, one common criticism of the new law is that it simply represents a shift "from government food management to JA food management" (Nōsei Jānarisuto no Kai 1996, 14; Ouchi and Saeki 1995). Again, 99 percent of Japan's farmers are members of the JA (which is closely involved in national agricultural policy making and implementation), and its co-ops overwhelmingly dominate rice distribution and marketing. Overall, the new law represents far more an accommodation to long-term changes in the agricultural economy than a positive program for reshaping it.[19]

MAFF handling of rice imports since 1993 is also best characterized as reregulatory and of limited significance for market opening. In December 1993, under the auspices of the Uruguay Round negotiations, Japan agreed to a U.S. offer of a "minimum access" formula for rice imports: Japan would import 4 percent of its rice demand in 1995, increasing the share to 8 percent by the year 2000, with renegotiation to follow. Although the market-opening deal is a clear case of managed trade both in terms of who sells to Japan and how the imports are handled (i.e., via state trading), the United States and GATT (General Agreement on Tariffs and Trade) accepted this as a step toward complete liberalization. The results, however, have proven disappointing for would-be rice exporters.

MAFF's Food Agency holds the responsibility for importing rice, and the import system will remain "state trade until the very end" (*aku made kokka bōeki*) in the words of one agency bureaucrat (Saitō 1995). And while the agency is required to buy rice from abroad, it is not required to sell it to Japanese consumers. The problem is that selling foreign rice (*gaimai*) at anywhere near international prices would mean stiff new competition for domestic producers. Instead, the government decided to set artificially high prices on imported rice, at just under the prices for domestic rice. It is no surprise, then, that very little foreign rice has appeared in the table-rice market. Consumer preferences may be one problem, but the more immediate issue is that wholesalers earn little profit in the foreign-rice trade and thus have no incentive to expand their operations. As a result, although rice imports are mostly of table-rice quality, they are being diverted into processing (e.g., rice crackers), food aid for developing countries, and even animal feed. Of the 940,000 tons imported in the 1995–1996 fiscal year, for instance, 38 percent was used for processing, 31 percent for animal feed, and 13 percent for overseas food aid. Just 7 percent was sold as table rice. The remainder (11 percent) lies in storage.[20] Thus, imported rice is rarely available in retail establishments, even as rice retail is booming in a newly liberalized environment.

Under the minimum-access agreement, Japan has had to import increasing shares of foreign rice even as domestic production (the 1993 shortfall excepted) has continued to exceed demand, leading to mounting rice surpluses. An increasing share of the backlog is of foreign origin. Between 1995 and 1997, Japan imported 920,000 tons of rice; just 200,000 tons of this had been sold by May 1997. Over 700,000 tons of this rice (about half from the United States) remains in government warehouses. Between the fall of 1996 and the summer of 1998, Japan's total rice stock jumped 40 percent to 3.7 million tons, with imports constituting at least 1 million tons (*Asahi Shimbun* 26 July 1998). The new Staple Food Law was billed as introducing market principles into rice agriculture—that is, to allow prices to reflect the laws of supply and demand. These numbers make it clear that, as yet, the attempt has failed.[21]

In early 1999, Japan converted its rice import policy from minimum access to tariffication, which was the original U.S./GATT demand. It did so not because the United States demanded it, but because MAFF bureaucrats determined that tariffication would allow Japan to import even less rice. In effect since April 1, 1999, the tariff amounts to ¥351.17 per kilogram. On the basis of current import prices, this translates to a tariff of 300 percent–400 percent.[22] The new policy has drawn little opposition from Japanese farm interests, who cite consumer loyalty to high-quality domestic rice. They are doubtless also calmed by the high tariff rates. The price of rice imports ranges from ¥60 to ¥100 per kilogram, but with the tariffs added it costs more than every "brand rice" in Japan except one—Uonuma Koshihikari, which is grown in a single village in northern Niigata prefecture and is the most expensive rice in Japan. This means that for the time being there is a virtual ban on imports (*Nikkei Ryūtsū Shimbun* 6 April 1999; *Nikkei Weekly* 21 April 1999).

The United States has protested the high rates and the methods used to calculate them. It has not, however, lodged a formal complaint with the WTO, perhaps for fear of jeopardizing its current market share. Rumors abound that the United States has negotiated a secret market-share agreement under the new arrangement, just as it allegedly did in 1993, for half of the minimum-access market.[23]

Policy Change in Retail

If the Big Bang is the most dramatic expression of the new deregulation movement, regulatory change in retail is perhaps the most surprising. Protection of small retail, in contrast to that of agriculture, has declined dramatically as a result of the reform, and then abolition, of the Large Scale Retail Store Law over the past decade. The 1990 reforms to the law returned the authority to grant large-store operating permits from localities to MITI and the application approval process was limited to a maximum of eighteen months.[24] As a result, the number of large-store openings jumped from 132 in 1989 to 617 in 1990. Subsequent openings declined somewhat (following an initial burst of pent-up demand), but exceeded 2,000 in 1995 and 1996, falling to 1,928 in 1997 (*Sankei Shimbun* 15 April 1997, 1; unpublished MITI data 1998). Meanwhile, the number of small retailers fell by 6.6 percent between 1991 and 1994, with the 1994–1997 drop expected to be similar (*Nihon Keizai Shimbun* 27 February 1998). The Japan Retailers Association (Nihon Kourigyō Kyōkai) predicts that small retail numbers will drop 30 percent by 2010 (*Nikkei Ryūtsū Shimbun* 10 March 1998).

No major new subsidies were introduced to compensate for the Large Scale Retail Store Law relaxation. The only new package—for shopping-district revitalization, computers, parking facilities, and other physical improvements—provided just ¥10 billion per year (Ministry of International Trade and Industry 1997, 50). In a 1997 interview, a MITI official specializing in small business agreed that the amount was both minuscule and insufficient compared with what rice farmers received (again, US$60 billion over six years) in compensation for a far less significant market opening.[25]

The reforms have provoked cries of distress from small retailers that "our neighborhood stores will collapse" (*Yomiuri Shimbun* 15 March 1997, 1). Surveys show declines in small-business numbers and growing vacancy rates in small-business districts.[26] Contemplating these changes, even the *Nihon Keizai Shimbun* felt moved to quote from Karl Polanyi's *The Great Transformation* on the destructive forces of the market and the need for society to set limits on its power (*Nihon Keizai Shimbun* 12 May 1997, evening edition).[27]

As MITI moved toward further relaxation of the Large Scale Retail Store Law with new reforms in 1992 and 1994, even some big-business beneficiaries thought this was adding insult to injury. In late 1993, when the abolition of the law was being considered by a study group reporting to Prime Minister Hosokawa Morihiro, leading chain stores and supermarkets made no calls whatsoever in support of that policy. One large retailer was quoted as saying, "It would be unwise to provoke small- and medium-sized retailers by touching the Large Scale Retail Store Law, which [now] has little impact" (*Nihon Keizai Shimbun* 15 December 1993, evening edition). And despite its early enthusiasm for reforming the law, MITI itself grew ambivalent about further relaxation, given that changes to date seemed to be working (*Shūkan Daiyamondo* 11 October 1997, 40–42).

Not surprisingly, small retailers have defected from the LDP in droves. An *Asahi* survey on party preferences by sector, conducted just after the October 1996 House of Representatives (Lower House) election, found that on a preference scale ranging from −6 to +12, the LDP's scores were as follows: farmers, 6.0; small business, 3.8; commercial labor, −1.8; industrial labor, −0.5; and office/administrative workers, −4.5. The only score that was higher than the farmers' support for the LDP was a 6.5 given by office/administrative workers to the newly formed Democratic Party (*Asahi Shimbun* 24 October 1996, 9).[28] While small-business support for the LDP remained positive, in previous elections it had been approximately equal to farmers' support. Meanwhile, membership in the Communist-affiliated Minshu Shōkōkai is said to be surging.[29]

What do these changes mean for foreign exports? Needless to say, neither regulatory change nor market opening necessarily benefits U.S. interests. And there is concern that recent regulatory tightening will hurt U.S. exports.[30] Even so, Toys "R" Us—the very symbol of the U.S. market-opening drive in 1990—has become Japan's largest toy retailer. After opening its first store in Japan in 1991, it had established sixty-four branches by the end of 1997, with sales topping ¥100 billion (Tilton 1998, 166).[31] Gap, after opening its first branch in 1995, now has thirty-eight outlets nationwide. Starbucks is spreading faster in downtown Tokyo than in Manhattan. Eddie Bauer now has thirty outlets in Japan, while L.L. Bean has twenty (*Focus Japan* November 1998). Mail-order business is also booming, with foreign firms now holding 10 percent of that market. Major retailers like WalMart are also gearing up to enter the Japanese market. In office supplies, Office Depot and Office Max are rapidly expanding, having entered the Japanese market in 1997. They are staging aggressive discounting drives to break into a sector long dominated by Kokuyo Co., which controls more than sixty wholesalers and some twenty thousand outlets (*Nikkei Weekly* 3 May 1999).

For the overall economy, it appears that regulatory change in retail has had positive, if unspectacular, effects. The Organization for Economic Cooperation and Development (OECD) finds that Japan's retail prices have dropped around 1 percent annually since 1990. The Economic Planning Agency (EPA) finds that price declines have been appreciably stronger in sectors undergoing regulatory change than in those which are not (Organization for Economic Cooperation and Development [OECD] 1999, 38). As Lincoln and Tilton observe, *naigai* (domestic versus foreign) price disparities are a good indicator of protection, whether formal or informal. This slow, steady decline is a sign of progressive change—even if the decline starts from high levels even by Japanese standards (OECD 1999, 38; Tilton 1998, 163–164).

Explaining Change in the Two Sectors

How do we account for this new divergence between agricultural and small-retail policy? As summarized above, the sectors are similar in political clout, ministry representation, public attitudes, and external challenges.

The most striking difference between the two sectors lies elsewhere: their position in the overall economy, particularly vis-à-vis big business. From the perspective of big business, small-retail protection is considerably more zero-sum than that of agriculture. In the latter, concentrated producer gains from protection are balanced by diffused losses, born by millions of poorly organized, politically weak consumers. There are no Japanese agribusinesses scheming to enter the agricultural sector, and no foreign powers have ever threatened to target Japanese industrial exports in retaliation for agricultural protection. Food processing, the only significant agriculture-related industry, is highly concentrated, low in productivity by manufacturing standards, and the most protected of all manufacturing sectors in Japan.[32] Due to border protection and oligopolistic organization of the industry, this sector has easily passed on high input costs to consumers. In this way, food processing resembles Japanese industries that tolerate the protection of intermediate goods industries, such as concrete, steel, and petrochemicals, despite the fact that this protection substantially increases their production costs (see especially Tilton 1996).

By contrast, Japanese small retail has come under direct assault from powerful domestic retail interests, particularly from the late 1980s. The timing can be attributed in part to economic slowdown, and in part to the emergence of chain stores as the most dynamic force in Japanese retail. Significantly, these pressures *predate* the 1990 U.S. demand for Large Scale Retail Store Law change. In other words, Japan's inefficient distribution system was not an issue for the United States alone; it represented a huge opportunity for aggressive Japanese retailers—one that was all the more attractive in a time of increased competition and sluggish overall sales. This new generation of retailers was anxious to win new markets. While small retail gained or retained benefits under the old Large Scale Retail Store Law, the chain stores (especially mid- and large-sized stores) were bearing the costs of the law and were thus pressing for its reform. Convenience-store and supermarket chains like Seven-Eleven Japan, Lawson, and Itō-Yōkadō have been among the most dynamic and aggressive Japanese firms of the 1980s and 1990s (see Kawabe 1994; Yahagi 1994).

Convenience-store chains are owned by large corporations like Itō-Yōkadō and Daiei, the largest retail concerns in Japan (far outpacing the traditional leaders such as Mitsukoshi, Takashimaya, and Seibu). They have used their market power as leverage over wholesalers and are seen as the principal force behind the modernization of Japanese retail.[33] Recent retail innovations—driven especially by computerization—include the JIT (just in time) delivery system, high-tech distribution networks, VANS (value-added networks), EOS (electronic ordering system), and POS (point of sales) systems record-keeping.[34] As the number of mom and pop stores decline, they are replaced less by huge "super-stores" than by mid-sized stores, convenience stores, and specialty stores.

A supporting reason for change is that MITI itself was pressing for Large Scale Retail Store Law reforms from the late 1980s, again predating U.S. demands. In the summer of 1989, MITI proposed the abolition of all local regulations on retail-shop opening, but backed down in the face of opposition from prefectural governments. Around the same time, the EPA and the Administrative Reform Council also issued reports critical of the law. In 1989, two MITI advisory councils, the Industrial Structure Council and the Small and Medium Enterprise Policy Making Council, prepared for the ministry its "Vision for Distribution in the 1990s," which also called for a relaxation of the law's provisions. MITI initially planned to make a number of the regulatory changes in the fall of 1989, but after releasing the report to the LDP government, MITI took no action on the proposed revisions. For the first time since 1955, the LDP had lost control of the Upper House in the 1989 election and it was not anxious to risk making any changes to the Large Scale Retail Store Law. In light of the Lower House election scheduled for February 1990, LDP leaders intervened and asked MITI to hold off. MITI agreed and delayed its announcement of the reforms until three days after the elections (Kusano 1992, 161–194).

By 1990, however, Kusano Atsushi finds that the LDP was no longer mounting any resistance to these reforms, and that in the late stages of negotiations, party figures simply refused to meet with any small-business representatives. Business *zoku* (members of the so-called "policy tribes") within the party were divided between supporting small shops and supporting supermarkets and convenience stores. The more powerful among them, including Noda Takeshi, Watanabe Hideo, Mutō Kabun, and Tahara Takashi, tended to back the latter. While evidence concerning LDP preferences at this time is thin, it is clear that the LDP offered little defense of small-business interests against the attacks of big business, MITI, and the United States (Kusano 1992, chap. 5). Nor did LDP members publicly object to further Large Scale Retail Store Law changes by MITI in 1992 (see below, however, on the recent "backlash").

Finally, while the *timing* of the 1990s reforms can be partly attributed to U.S. pressure, which was considerable during SII, it was domestic pressure that made the reforms inevitable. Within the conservative coalition, LDP ambivalence was overpowered by MITI and large-retail commitment to reform. The latter enthusiastically, if tacitly, supported American pressure. After 1990, the United States put the Large Scale Retail Store Law on the back burner (although it still favored further relaxation), but the reforms to the law continued nonetheless. (Changes in 1992 and 1994 limited the application-processing period to one year, increased the floor-space definition of "large stores" from 500 to 1,000 square meters, etc.)

In the spring of 1998, retail reform went a step further—or backward, critics would say—with the abolition of the Large Scale Retail Store Law and the introduction of the new Law Concerning the Measures by Large Scale Retail Stores for Preservation of the Living Environment (Daikibo kouri tenpo ricchi hō). The new law, dubbed the "crown jewel of deregulation" by the *Sankei Shimbun*, was passed by the Diet in May 1998, and took effect in June 2000. In addition to specifying transparent store-opening procedures and a one-year time limit on the application-approval process, the law sets new restrictions on large stores in terms of parking, noise, and garbage removal (*Sankei Shimbun* 28 May 1998). In conjunction with this, the Law on Improvement and Vitalization in City Centers (Chūshin shigaichi kasseika hō) was enacted in July, providing ¥1 trillion of small-retail funding to support downtown shopping districts. The Ministry of Construction also prepared a third law, the Revised City Planning Law (Kaisei toshi keikaku hō), to allow local governments to restrict areas in which large stores may be opened. Together, the stated intent of these "three laws for town-building" (*machi-zukuri kanren sanpō*) is to shift the emphasis from economic protection of small retailers to a positive program of community development—one that includes large retail.

Large retail interests worry that the new laws mean a return to the old days. In early 1998, the small-business-dominated Japan Chamber of Commerce and Industry had a "terrible reaction" to the proposed Large Store Location Law and stepped up its lobbying of the LDP and MITI. Small-retail pressure resulted in the devolution of regulatory authority from MITI back to the localities, where small-retail power is most potent. "With [the changes], the group's influence was clearly written into the final draft of the law as vested interests crept into the process" (*Nihon Keizai Shimbun* 28 February 1998; see also *Asahi Shimbun* 12 March 1998 and Tilton 1998, 168).[35] That devolution, along with the strict new regulations on parking lots, garbage removal, and noise restrictions represent new hurdles for large stores and constitute more, not less, regulation.[36] As one large retailer put it, "the details of the new law are more severe than we had expected" (*Nihon

Keizai Shimbun 27 February 1998, 13 May 1999).[37] Another observed that "the regulatory means have simply become more ingenious" (*Nihon Keizai Shimbun* 28 February 1998).[38] In support of this take on the law, the *Nihon Keizai Shimbun* quoted one local chamber of commerce member from Fukushima prefecture as saying, "Shifting authority to the localities is rather beneficial in that we can prevent disorderly store openings" (14 May 1999).

Still, it is easy to overstate the backlash. Despite the concessions they won, small retailers see the new law as a poor substitute for the old Large Scale Retail Store Law. They turned against the LDP in the July 1998 Upper House elections just as they had done in 1996. Although Prime Minister Hashimoto, along with the Japanese media, was confident of an LDP victory, in the end the party won just 25 percent of the vote. The loss came partly from small-business defection (one small-retail specialist at MITI believes this was the single most important cause of the LDP's poor showing) and more generally from dissatisfaction—especially among uncommitted voters who would be unlikely otherwise to turn out—with Hashimoto's weak, contradictory program for economic recovery.[39] And although the media has widely publicized the new (¥1 billion) funding to revitalize shopping districts, only 10 percent of the monies are in fact new. The remainder had already been appropriated. On balance, MITI officials seem to be committed to regulatory opening and claim to be more concerned about large-retail interests overpowering localities (with information, money, and so forth) than the converse.[40] More concretely, tens of thousands of large stores have opened over the 1990s, already making for a hugely changed balance of power in the sector. No regulatory tightening can reverse these changes.

Finance and Telecommunications Reform

We have seen even more rapid regulatory change and market opening in the economically central sectors of finance and telecommunications. In finance, most striking are the new policies for restructuring the banking sector, which constitute a sharp break with the old MOF-dominated regime, and the Big Bang financial reforms begun in 1998, which significantly liberalize financial services, are primarily deregulatory, and reduce MOF powers. In telecom, dramatic changes have occurred in the long-distance and mobile markets, and may potentially occur in the local telephone market as well. The long-distance and mobile markets are characterized by rapidly declining prices and service improvements as a result of regulatory change and increased competition, including an influx of foreign firms and joint ventures. Nonetheless, the MPT retains firm control of the sector, even as MOF appears to be losing control of finance.

Why has telecom reform proceeded differently from that of finance? First, this variance is not in the degree of market opening—which is significant in both—but in regulatory *style*, despite many reasons to expect reforms to proceed similarly in the two sectors. Each has been under heavy and increasing international market pressures. Indeed, the two are the very definition of high-growth, high-technology sectors, where globalization is driven by not only political pressure but also by rapid technological change and international firms looking for new markets. Both sectors have been targeted by heavy U.S. (and EU) political pressure as well. Indeed, the pressure focused on telecom is probably even stronger than that on finance, given that external political pressure had minimal influence on the Big Bang reforms. Both sectors, further, are critically important to the ruling LDP, though less in terms of votes than financial contributions. In addition, each sector is marked by increasing sectoral splits: in telecom, fierce competition between the mammoth NTT and aggressive new upstarts, and in finance, a gap between strong and weak financial institutions that became unbridgeable with the banking crisis.

In explaining the divergent style of regulatory change, perhaps the chief reason is simply this: unlike MOF, the MPT has not been tarred by scandal or by massive policy failure. Nor was it punished in Prime Minister Hashimoto's administrative reforms, in which MOF was perhaps the biggest single loser. And powerful ministries tend to prefer reregulation to deregulation because the latter means, by definition, less control of the sector. In short, Steven Vogel's (1996) characterization of telecom reforms as reregulatory remains apt in the late 1990s, whereas regulatory change in finance has become largely deregulatory in nature.[41] To repeat: sectoral splits, driven by the emergence of maverick, competitive firms, mean the emergence of a domestic constituency for market opening. This we have seen in both telecom and finance (with the latter crippled by the banking crisis as well). At the same time, the decline of bureaucratic dominance favors deregulation and, arguably, accelerates the pace of change as well. This we see in finance alone.[42]

At the same time, it is important to stress that as foreign firms and joint ventures take root in the Japanese market—in telecom no less than in finance—both sectors are likely to become increasingly difficult for the ministry, or anyone, to control. These rapidly changing and internationalizing sectors are likely to move increasingly beyond the control of national policymakers. As Frieden (1991) and many others contend, convergence theory works a lot better for some sectors than for others.

MOF, the Big Bang, and the Financial Crisis

Vogel (1996, 1999a) argues that, even in the most dynamic and globalizing industries, governments are not necessarily overwhelmed by international market pressures. To the contrary, he finds that Japan's "national regulatory regime" is to manage liberalization, resist devolution of regulatory power, protect ministry discretion, and implement necessary reforms in a smooth and coordinated fashion.

In finance, MOF prided itself until recently on a record of zero bank failures since 1945. The ministry arranged private mergers or bailouts on a case-by-case basis for any troubled financial institutions. It strove to protect all financial institutions from failure and to thereby maintain public confidence in the overall financial system. MOF closely managed the process of regulatory reform, deliberately opting for slower, smoother, and more coherent policy change than in the United States. Policy reform was kept slow in order to persuade any dissenters to accept the changes, to arrange compensation packages, and to enable firms to prepare for the new conditions. "The ministry has orchestrated political bargains between industry groups—with market segmentation keeping the industry economically protected but politically divided—filtered its own agenda into the reform legislation, and continued to redefine the reform at the stage of implementation. MOF officials have not only dictated the pace (slow) and the quality (tidy) of policy change, but they have been powerfully influential in its content" (Vogel 1994, 220).

MOF retained this approach for as long as it could, but the banking crisis of the 1990s marked the beginning of the end for the old regime. By the early 1990s, a combination of loose monetary policy, lax ministry oversight, and an explosion of risky, high-stakes investment (especially in real estate and equities) made for a bad-loan problem impossible even for optimists to ignore. MOF stonewalled, however, and resisted major policy change until 1997, when it at last allowed several major financial institutions to fail. Earlier that year, the ministry had managed to save the Nippon Credit Bank by arranging capital infusions from healthy banks. It then tried to save Hokkaido Takushoku Bank and the Long-Term Credit Bank of Japan (LTCB) in the same manner, by arranging for mergers and providing financial assistance from the Deposit Insurance Corporation and the Bank of Japan. But faced with growing opposition from comparatively healthy banks, growing alarm from international investors and MOF's fiscal arm, and the sheer volume of nonperforming loans—with current estimates running at US$1 trillion or more—the old system simply no longer worked. The ministry was forced to ask the Diet to pass bills allocating public monies to liquidate failing banks and support comparatively healthy ones. Enacted in February 1998, the Emergency Measures Law for Stabilization of Financial Functions (Kinyū kinō anteika kinkyū sochi hō) allocated ¥13 trillion to improve the capital adequacy of healthy financial institutions (those with capital-asset ratios of 8 percent or higher) and in part to enable them to absorb insolvent institutions, while the Revised Deposit Insurance Law (Kaisei yokin hoken hō) allocated ¥17 trillion to protect the depositors of failed banks. But because these monies were nowhere close to being enough to deal with the crisis, the ministry also began courting foreign firms. Simply in order to survive, the sector requires the infusion of foreign capital and best-practices talent to restructure the sector in an already internationalized, intensely competitive industry. This restructuring has begun in earnest.

A stream of bribery, *sōkaiya* (racketeer) payoffs, *tobashi* (the practice by brokerages of shifting losses from one client to another with the understanding that the paper losses would be covered), and other corruption scandals, together with MOF mismanagement, have undermined the ministry's reputation and credibility and have led to its worst nightmare: loss of jurisdiction, dismemberment, and even renaming. For the first time in fifty years, the Bank of Japan Law was revised in 1998, granting the bank new autonomy from MOF. A new, independent regulatory body, the Financial Supervisory Agency (FSA), was established in June 1998 to oversee financial institutions. It took over the Securities and Exchange Surveillance Commission (SESC), which had been established in 1992 within MOF to monitor the securities industry. At the beginning of the decade, with the financial sector already weakened and scandal-ridden, MOF had been able to resist the creation of an independent securities regulator, creating the SESC under its own jurisdiction. But by 1998, it was no longer able to resist. The crisis had worsened by orders of magnitude. Opposition parties (especially the Democratic Party of Japan), emboldened by the LDP's defeat in the 1998 Upper House election, pursued an aggressively anti-MOF line to distinguish themselves from the LDP and attempted to exploit public discontent. Opposition parties also proved instrumental in overcoming LDP ambivalence and MOF opposition to establish the Financial Reconstruction Commission (FRC) in the fall of 1998.[43] The Commission is charged with overseeing the resolution of failed loans, financial-crisis management, and other supervisory work with the support of the FSA (see Asahi Shimbun Keizaibu 1998).

While some observers have expressed concern that the FSA (and FRC) would function as a vehicle of old-guard MOF policy, especially as many of its staff are seconded MOF officials, early practices suggest not. The agency forcibly nationalized one bank in November 1998 and fired the management. In another case, it agreed to support the merger of two troubled institutions only after they committed to substantial downsizing. It has been hiring up financial experts from the private sector (especially foreign securities firms) and building, even among outside observers, a reputation for smart, creative sleuthing (*New York Times* 17 September 1999).[44] In early 1999, Minister of State and FRC Chair Yanagisawa Hakuo publicly stated that he would like to see LTCB or Nippon Credit Bank—both of which were nationalized due to their debt problems—sold off to foreign institutions, arguing that this would promote restructuring within the sector. (In September 1999, it was decided that U.S.-based Ripplewood Holdings would in fact buy out LTCB. The agreement, signed by the two parties in February 2000, became the first sell-off of a nationalized financial institution.) Yanagisawa also made clear that he would "show no mercy" to banks that fail to meet restructuring pledges they made in order to receive government funding (*Japan Digest* 29 March 1999, 8–9).[45]

To be sure, the story is hardly one of total defeat for the ministry. MOF retains sole authority over taxation and the budget. Even in terms of financial regulation, a compromise was reached. Although the FSA was established as an independent agency, MOF was to retain authority in policy planning for bank failures and crisis management. How this division of labor will work in practice remains unclear. A recent article in the *Nikkei Weekly* comments, "This marks a significant victory for Finance Ministry bureaucrats in that it keeps the ministry's old discretionary regulation powers alive even as it sows the seeds of serious confusion later on" (26 April 1999; see also Mabuchi 1997).

Nonetheless, overall policy changes amount to a radical shift in MOF authority and policy toward troubled banks. Failing banks are no longer to be propped up with cross-subsidization or public funds but are to be liquidated, with public funds used to support only those on sound footing. This marks a huge decline in MOF's discretionary authority and a corresponding increase in the importance of formal, juridical regulation.

The Big Bang reforms constitute a similar shift. In November 1996, Prime Minister Hashimoto ordered MOF and other relevant government bodies to begin discussion on the Japanese version of the United Kingdom's Big Bang financial reforms with the basic goal of establishing "free, fair, and global" financial markets. Not incidentally, the administration also hoped to make the Japanese market competitive with New York and London and to reestablish Tokyo as the financial center of Asia. Hashimoto stacked his Administrative Reform Council with reformists and chaired it himself. Past deregulation and administrative reform efforts have often been bold in rhetoric but weak in substance. Those under Hashimoto have been the most substantive since the Rinchō administrative reforms implemented under Prime Minister Nakasone Yasuhiro (see e.g., *Nihon Keizai Shimbun* 8 December 1995; *Yomiuri Shimbun* 8 December 1995; Carlile and Tilton 1998, 76–110).[46]

In June 1997, reports outlining the proposed reforms were published. Among the most important measures: removing entry restrictions between banking, securities, and insurance; liberalizing insurance premiums and stockbroker commissions; liberalizing securities derivatives; easing the registration process for new securities companies; promoting an asset-backed securities market; deregulating new financial products and reforming the financial supervisory system for financial institutions; legalizing financial holding companies; and establishing new rules for transparency, accounting, acceptable business practices, and investor protection.[47] The reforms mark a clear transition from MOF's old, informal, collusive practices to new, formal, codified regulations—reregulation—as well as substantial deregulation. The changes undermine MOF's traditional regime of informal oversight over a segmented financial market. Henceforth, the industry will become less divided, more powerful, and more internationalized, while MOF policy will be less discretionary and more legalistic.

The Big Bang began on April 1, 1998, with the liberalization of foreign exchange transactions. To date, measures are being implemented on schedule. In December 1998, banks and insurance firms were allowed to begin selling over-the-counter investment trusts (similar to mutual funds in the United States). In the past, investment trusts have accounted for just 2 percent–3 percent of personal financial assets (which totaled ¥1.2 trillion in 1998), with bank deposits and cash comprising about 50 percent (*Nihon Keizai Shimbun* 30 March 1998, 24 November 1998). But there has been a surge of new interest as consumers look for better returns. (A ¥1 million bank deposit yields a measly annual return of ¥500 today.) Some analysts predict that investment trusts will grow to account for 10 percent of personal financial assets. This growth is expected to disproportionately benefit foreign firms. Many customers believe that foreign asset-management firms, in addition to their proven record in money management, are more trustworthy in terms of information disclosure ("Investment Trusts" 1999).

To encourage increased competition and more diversified products, MOF has introduced a series of new regulations on transparency, accounting formulas, insider trading, investor protection, and capital adequacy. Henry Laurence has aptly described a "race to the bottom" in Japanese (and British) deregulation as international financial markets struggle to become more competitive. On the other hand, he finds a "race to the top"—reregulation—to tighten disclosure laws, protect investor rights, and so forth (Laurence 1996). In short, the rules governing the financial sector have become more transparent and formal, with implementation expected to be more juridical than in the past. However, this sort of reregulation, far from enhancing ministry authority, promises to reduce it.

Once described as the "world's most powerful bureaucratic institution" (Pempel 1998, 66), MOF is perhaps the biggest loser in the administrative reforms and, in some ways, in the Big Bang as well. Not only has it lost its exclusive jurisdiction over banking and securities, but it has suffered perhaps the ultimate insult: MOF is to be renamed as the Zaimushō (tentatively to be called the Ministry of Treasury in English) in January 2001. At the same time, the financial industry, once highly segmented, is on its way to becoming more unified, powerful, and foreign-penetrated, further undermining the old order.

Nonetheless, MOF as a whole has grudgingly supported the Big Bang reforms. The continuing stock-market slump persuaded the ministry, along with stronger players in the financial sector, that the only path to recovery was to make the Tokyo market more accessible and attractive internationally by reducing sectoral barriers and increasing competition. Moreover, the yen, stock market, and economy—all flagging—made MOF's fiscal arm acutely aware that the inability and unwillingness of the Financial Bureau to fix the banking crisis was dragging down the overall economy. In this way, we can say that MOF came to accept the rearrangement of the existing financial policy regime. The ministry certainly did not want to be broken up, but it did know that policy had to change.[48]

Healthier elements of the financial sector have been among the reforms' most enthusiastic supporters, correctly seeing them as a means to expand their market presence. And even as some in the industry undoubtedly still have their heads in the sand, the crisis has provoked a remarkable candor among others. Consider the remarks of Kanzaki Yasuo, chairman of Nikkō Research Center:

> Why is reform of the financial industry spearheading Hashimoto's grand [deregulation] scheme? I can think of several reasons, not very flattering to the industry. First of all, the financial industry is regarded as—indeed is—one of the most heavily protected and regulated in Japan. Secondly, due partly to various recent scandals, the financial industry is among the least popular and least likely to receive public sympathy. Third, the industry has fallen far behind foreign competitors and the public is demanding better service from their bankers and brokers. Fourth, to revitalize the Japanese economy, restoring confidence in the financial industry is absolutely crucial (1997).

What will Big Bang reforms mean for other Japanese financial institutions, already weak and struggling to compete in an even tougher market? Some observers, notably Alicia Ogawa, Edward Lincoln, and Robert Litan, are not optimistic (Ogawa 1998; Lincoln and Litan 1998). While it is much too early to predict the winners and losers of the reforms, it appears likely that foreign firms and joint ventures will be prominent among the winners. As Iwata Kazumasa observes, "Foreign institutions have now in fact taken over the leading role in the Japanese Big Bang, overshadowing their local counterparts. The so-called Wimbledon phenomenon, the dominance of foreign players in Britain's financial markets after its own Big Bang, is becoming evident in Japan as well" (1999, 56). This, obviously, has made for a significant change in market outcomes already.

To date, foreign institutions have focused on mutual funds, foreign-currency deposits, and entry into the securities business. Morgan Stanley Dean Witter, for one, is betting that asset-backed securitization (e.g., mortgage-backed securities) in Japan will show the fastest growth of any market in the world (*Nikkei Weekly* 19 April 1999). Citibank has excelled in attracting foreign-security deposits. The number of its customers for foreign currency deposits grew 50 percent in 1997, and 39 percent in 1998 (*Nikkei Weekly* 5 April 1999).

The combination of the continuing recession, declining property values, and financial-sector reform has led to a surge of FDI into Japan. For years, foreign companies complained that it was too expensive to invest in Japan and that Japanese authorities made it very difficult for them to do so. Today, foreign firms are actively wooed by Japanese interests seeking both foreign capital and market skills. In fiscal year 1998, FDI into Japan by foreign companies more than doubled to a record high of US$10.95 billion. That by U.S. companies increased more than fivefold to US$6.6 billion. As expected, these increases were concentrated in finance.[49] Foreign concerns now account for nearly half of trading on the Tokyo Stock Exchange and have been buying up problem loans in bulk.

One of the principal means for foreign entry into the Japanese market is through alliances with and acquisitions of Japanese financial institutions. Recent examples include Bankers Trust's joint venture with Nippon Credit Bank, GE Capital's de facto acquisition of Tōhō Mutual Life Insurance, Salomon Smith Barney's 25 percent purchase of Nikkō Securities, and Merrill Lynch's hiring of more than two thousand employees and absorption of offices from the bankrupt Yamaichi Securities. In this way, *gaiatsu* can become *naiatsu* (internal pressure), gaining strength and arguably legitimacy in the process, and serving as a Trojan horse on behalf of continuing reform.

Indeed, it is FDI, not calls for managed trade, that has become the chief American irritant (in economics, at least) for Japanese nationalists today. Many worry that the economy will become hopelessly penetrated by outsider interests (ignoring at the same time that it is these outsiders who are propping up troubled Japanese firms). In 1998, LDP Secretary-General Nonaka Hiromu notoriously referred to these trends as the "second invasion of Asia." The Ripplewood Holdings takeover of LTCB drew charges of a "Jewish conspiracy" from the *Shūkan Post* (15 October 1999).[50] A short decade ago, of course, American alarmists were making similar charges against Japan. How times—and especially the rhetoric—have changed.

Still, these shifts should not obscure the huge investment imbalances that remain. American FDI in Japan is growing, but from a very low starting point. In 1996, it totaled US$6.6 billion (0.08 percent of gross domestic product), as compared to Japan's US$84 billion (1.4 percent of GDP) of investments in the United States. As of 1998, total FDI in Japan remained less than 1 percent of GDP, the lowest in the OECD (OECD 1999; Department of Commerce 1998). The same must be said of mergers and acquisitions (M&A). There was just US$2 billion of M&A investment into Japan in 1996, comprised mostly of buyouts by American firms of their Japanese venture partners. Compare this to a figure of US$60 billion in the United States for the same year (American Chamber of Commerce in Japan 1999, 14).

Nonetheless, and in conclusion, the old MOF regime is being toppled.

Whether these policy changes will revitalize the financial industry is an open question, but they have already weakened MOF, brought significant deregulation to the industry, and enabled a dramatically increased foreign market presence. Reregulation has occurred as well, but in a manner that has constrained, not enhanced, ministry power.

Telecommunications Reform: Mobile, Long-Distance, and Local Services

Japan is the world's second largest telecommunications market, with annual revenues of US$110 billion in 1998. Far from being in crisis, telecom is one of the hottest, most dynamic industries in Japan today, projected to displace manufacturing as Japan's largest industry early in the next century. NTT overwhelmingly dominates the market, with 1997 revenues of US$77 billion (including those for NTT DoCoMo, the dominant cellular phone provider)—about eight times those of its nearest rival, DDI. Indeed, the NTT Group is the largest telecommunications company in the world, with 1997 revenues of US$7.6 billion—50 percent larger than AT&T ("The Global 500 Survey" 1998).[51] But its services are expensive and it is vulnerable to competition. High NTT usage fees have long been an irritant to foreign users, with the cost of leased lines as much as seven times higher than in the United States. Telecommunications equipment is typically 50 percent–400 percent more expensive in Japan than in the United States and telephone calls can be three times as expensive (Katz 1997).

Nonetheless, the market has seen important regulatory change and market opening in recent years as market segmentation has been eroded by technological and market changes, new providers have been allowed to enter, and NTT has been forced to scramble. The telecommunications market has come under strong international challenge from the United States (and the EU). For its part, the big-business federation Keidanren (Japan Federation of Economic Organizations) is said to be planning proposals modeled on the 1996 telecom deregulation in the United States, aimed at promoting competition and reducing NTT dominance.

What is probably the chief driving force, however, is the MPT's long and ongoing battle with NTT. Prior to its 1985 "privatization" (only one-third of the company's shares were sold off that year and the state retains majority control today), NTT was the dominant force in the sector as the monopoly carrier, the primary sponsor of research and development, and the de facto market regulator until the MPT won rights to the sector (see Vogel 1996). The two have been at odds ever since. The MPT has sought the breakup of NTT but the telephone giant managed to resist it for twelve years, until 1999. Moreover, the "breakup" deal that was finally worked out leaves the three new NTT entities under a single holding company. NTT "family consciousness," according to the *Nihon Keizai Shimbun*, is unlikely to diminish (24 June 1999).

But even as the MPT's effort to break up the giant has been thwarted, the ministry holds other levers, including licensing requirements, authority over price and service changes by NTT and its competitors (known as the new common carriers, or NCCs), and low-interest loans. The ministry has consistently used these levers to favor the NCCs, limit NTT power, and improve the sector's competitiveness overall. In doing so, it has both retained its regulatory authority over the sector and enabled the entry of new players, including foreign concerns.

Mobile Telephone Services

One example of this power game is in the mobile telephone market. In the market's infancy, the MPT itself arranged a consortium of private firms (IDO Corporation) to compete with NTT, but using already available NTTtechnology. Faced with U.S. pressure to use Motorola technology, it then put together a second consortium led by DDI Corporation, which used the Motorola format. At first, DDI was assigned to the Osaka region, while IDO was assigned to Tokyo. Under continued U.S. pressure, the MPT pushed IDO to make investments in Motorola technology as well. Doing so both placated the United States and helped to reduce NTT dominance, preserving an MPT-brokered balance in the sector.[52]

In recent years, the number of cellular phone subscribers has exploded, jumping from two million in 1993 to nearly forty million in 1998. In 1994, NTT DoCoMo abolished the ¥100,000 deposit requirement and allowed sales of cellular phones in retail stores. Following heavy U.S. pressure that year, tight government restrictions on transmission terminals lifted in 1995. As of May 1999, there were 42.5 million cellphones and 5.79 million Personal Handy Phone (PHS) subscriptions.[53] New cellphone competitors, notably J-Phone and TU-KA, have expanded aggressively and hold NTT DoCoMo to a 60 percent market share today.[54] Technological change has helped to drive the cellphone boom, with rapid improvements in miniaturization, battery life, and available functions, including e-mail capacity on the newest models (*Nihon Keizai Shimbun* 23 September 1998; *Japan Digest* 17 May 1999, 22). Perhaps even more importantly, rate wars between cellphone providers have driven prices down rapidly. Between 1994 and 1996 alone, consumer prices in cellphones fell by more than 80 percent (OECD 1999, 86).

Young single people are increasingly likely to subscribe to mobile telephone services rather than install expensive fixed-line telephones at home (which require deposits of some US$800) (*Yomiuri Shimbun* 12 March 1999). Indeed, the new phones have started to have substitution effects. Since 1994, mobile subscriber growth has outpaced that of fixed-line service and the number of fixed lines (now sixty million) actually began to decrease in 1997 (OECD 1999, 86).

In 1997, mobile phone services generated revenues of ¥5.28 trillion, up 29.9 percent from 1996. To keep up with soaring demand, 1997 telecom industry investment totaled 10 percent of Japan's total capital investment—second only to Japan's electric power companies—and will increase further as the industry prepares for the next generation of cellphones. New investment is estimated to run to ¥1 trillion (Asano 1999, 7; *Nihon Keizai Shimbun* 22–23 September 1998). Given these rapid advances, Japan appears to be moving into the position of market leader. Although Europe is currently leading the cellphone market with a 50 percent market share, the next generation of cellphones (capable of transmitting sound, pictures, and high-speed data) will be marketed first by Japan, indicating that Japan is quickly becoming the technological leader in the industry (see *Nihon Keizai Shimbun* 22–23 September 1998).

The Long-Distance Market

We also find this combination of MPT objectives—managing competition and managing NTT—in the long-distance market. Over the past ten years, the average long-distance rate has fallen from an average of ¥400 to ¥100 for a three-minute call (*Japan Digest* 16 February 1998, 21). The cost of long-distance calls between Tokyo and Osaka declined by 77.5 percent—from ¥400 to ¥90 for three minutes—between April 1985 and February 1998 (OECD 1999, 84). Long-distance service has been shaken up by a range of new upstarts—notably, Tokyo Telecommunication Network (TTNet), DDI, IDO, and Japan Telecom—and by rate wars as the new competitors fight it out. The MPT has consistently allowed the upstart NCCs a rate advantage over NTT, although the amount of this advantage has fallen over time.[55] The NCCs' share of the market has risen steadily with time and now amounts to about one-third of domestic long distance, and one-half of calls between Tokyo, Osaka, and Nagoya. But even this success has been difficult to achieve because of NTT reluctance to provide adequate and reasonably priced interconnections (Arthur D. Little, Japan 1998, unpublished report). And even today, the United States charges that interconnection fees are as much as eight times the charges in the United States and that they are well above NTT's actual costs (*Nihon Keizai Shimbun* 22 September 1999).

Local Markets

The MPT is now challenging NTT on its strongest ground: the local telephone market, in which it holds more than a 99 percent market share. Consider, for example, the MPT plans for wireless local-service networks. The wireless local service will connect homes and offices to relay bases and regional phone networks like cellphones but without being mobile. It will provide an alternative to NTT's hard-wired local phone service monopoly and is expected to be cheaper to install and maintain, and fast enough for Internet use. To give NCCs a head start on establishing service, the MPT will bar NTT from entering the wireless local phone market until April 2001. KDD, DDI, and Japan Telecom, in addition to several foreign firms, are expected to enter the market (*Nihon Keizai Shimbun* 16 September 1998; *Japan Digest* 21 September 1998, 21).

NCCs and other firms are also mounting a strong challenge to NTT in the Internet service market. Due to high NTT access charges and the difficulties of using Japanese-language computers (PC penetration is only 25 percent in Japan), Internet use in Japan remains low—perhaps 15 percent of the population. NTT currently charges ¥10,000 per month (plus ¥2,800 in line charges) for unlimited Internet access. The MPT had pushed for the giant to offer lower prices, but NTT refused and the ministry countered in July 1999 by allowing other providers direct connections to NTT's main distribution frames—bypassing NTT's metered (and costly) switchboards. This move is expected to cut the cost of the rivals' Internet connections by half. *The Japan Digest* concludes that the MPT's decision is "a major step toward breaking NTT's longtime monopoly on the so-called last mile—connections into homes and offices" (26 July 1999, 22).

NTT is facing a similar challenge in the fiber-optic market, aimed at servicing data transmission (projected to exceed voice-transmission traffic early in the next decade). Cross Wave Communications leases fiber-optic networks from KDD (the leading international-telephone-service provider, having had a monopoly until 1989) and offers data transmission services for half of the NTT rates. KDD itself plans to lay a new loop through the Tokyo business district. PowerNets Japan, an association of local telecom companies established by ten local electric utilities, has 160,000 kilometers (km) of local fiber-optic networks—more than NTT. The Tokyo Electric Power Company (TEPCO) is planning a 5,000-km fiber-optic network in Tokyo.[56] Among foreign firms, MCI WorldCom and British Telecommunications are laying their own fiber-optic lines in downtown Tokyo (*Japan Times* 3 July 1999; *Japan Digest* 20 August 1999, 24, and 30 August 1999, 24).

The battle between NTT and its competitors is raging in political circles as well, although as yet this battle is entirely underground—unlike the more visible political fights in agriculture and retail, where large, mobilized vote blocs are at stake and openly assert their interests. The NCCs argue in particular that NTT should be broken up because its monopoly control of local phone networks allows it to charge its competitors exorbitant access fees and to restrict interconnection. A new group of telecom *zoku* is emerging in the Diet that have allied themselves with newcomer firms against the older *zoku* who are tied to NTT. A great deal of money is said to be involved in the fierce political battle now being waged over this sector.[57] Just as we saw in retail, then, telecom's sectoral split has manifested itself inside party politics as well.

In addition to cash payoffs from the industry, some politicians also hope that the impressive price reductions that have resulted from market opening will win them new consumer support. While it is true that in cases like rice, imported rice may be cheaper (though not by much, after passing through MAFF's hands), rice accounts for a tiny and declining share of household budgets (about 1 percent today). Moreover, opinion surveys demonstrate that consumers *increasingly* support the protection and subsidization of domestic rice and strongly prefer Japanese rice to foreign varieties, whether short-grained or not.[58] In telecom markets, however, consumer services of different companies are more or less identical and there is little love lost between consumers and the reigning firms, NTT and KDD, which have long been known for their high prices. Everyone (as the line goes) may love a farmer, but the telephone company is an altogether different matter. And again, price declines in the market have already been substantial.

While the numbers are less dramatic than in finance, there have been surges of telecom FDI into Japan as well (*Nikkei Weekly* 17 May 1999). DDI has entered into a tie-up with the Canadian carrier Teleglobe to provide international services. In order to enter the domestic long-distance market, AT&T and British Telecommunications have each bought 15 percent stakes in Japan Telecom, the third-largest domestic long-distance carrier (see *Nikkei Weekly* 26 April 1999). At the same time, NTT has entered into a linkup with AT&T, and, in what some describe as a hostile takeover, the British firm Cable and Wireless plc defeated NTT in a bidding war for control of IDO. Last fall, MCI WoldCom began investing several tens of billions of yen to begin laying a 100-km fiber-optic network in Tokyo. Altogether, as of July 1999, there were thirty-two Type 1 telecommunication carriers (of some one hundred thirty-five total) in which foreign investors held stakes of 5 percent or higher. Eight of these were wholly foreign owned (*Look Japan* October 1999, 14).[59]

As in finance, transnational alliances in telecommunications are producing a new domestic constituency for continued market opening, both domestic and international (see Kusano 1999). Although not as quickly as in finance, market segmentation is breaking down and foreign firms are becoming players in the market. But as yet—and in contrast to MOF—the MPT remains in control of regulatory reform and market change. The ministry maintains an informal consultation process in allowing new business entrants. For instance, it continues to use "public interest" standards in evaluating applications of potential market entrants but refuses to provide clear information on the minimum requirements for receiving a license. While processing periods for license applications are limited to one to two months, the MPT's discretion can result in lengthy delays (OECD 1999, 88).

The ministry also allows favored firms advance access to new markets (e.g., the wireless local telephone market discussed above). Similarly, it has allowed these firms to cut rates below those of NTT (although this lever disappeared in 1998, when the MPT converted the approval system for rate changes into a notification system).[60] Finally, such firms have also been favored with low-interest loans channeled through the Japan Development Bank to fund R&D and infrastructure projects. The MPT, long a student of MITI and MOF administrative guidance and industrial policy, has learned its lessons well enough to outlast its teachers.

Conclusions—Implications for U.S. Policy

So, is Japan really "changing its ways"? This brief review has found that in certain sectors it is. One of these sectors has been a core support base for LDP rule. Others have been at the center of economic and industrial policy. Nonetheless, a combination of sectoral splits, foreign pressure, and, in finance, near collapse has combined to drive significant regulatory change and market opening.

Current trends in Japan mean unprecedented opportunities for further market opening and regulatory change. The prolonged recession has shaken people's faith in the old economic formulas and has prompted even some insiders to call for change. The LDP has survived the recession—despite the common belief that growth was a necessary condition for its rule—but it has lost its position of unassailable dominance. The bureaucracy has been tarred by scandals that have undermined its credibility and authority. Free-market economists like Nakatani Iwao and Takenaka Heizō are pressing for system-wide deregulation and the media has endorsed much of their agenda. In addition, maverick producers and retailers are exploiting the climate of deregulation fever, making them key constituents for continued change.

In this atmosphere, the United States is well advised to join in the chorus and call for continued regulatory change. Kusano (1999) argues that the United States has concentrated its efforts on sectoral, market-opening negotiations, viewing deregulation as an important but longer-term process. This chapter suggests that deregulation, and sometimes reregulation, have already brought trade gains in the short term. The U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy, begun in 1997, should most definitely be continued. In sharp contrast to managed trade, deregulation has become a fully legitimate policy option in Japan—and one endlessly discussed in the press today. Related to that point, U.S. advocacy of deregulation would seem less likely to provoke divisions on the home front as well. Divisions among the United States Trade Representative (USTR), Department of Commerce, State Department, and Congress remain a chronic weakness in U.S. trade policy. If anything, managed-trade tactics have exacerbated these divisions.

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And, as it happens, the United States is extremely competitive in the sectors subject to the greatest regulatory change and market-opening pressures today—finance and telecommunications. Moreover, ongoing FDI into Japanese markets promises to serve as a Trojan horse in support of continued change.

This chapter has focused on inter-sectoral differences because these differences, although often overlooked, are striking, and because variation facilitates the building and testing of theories. The "successes" reviewed here—finance, telecommunications, and retail—suggest that, above all, sectoral splits count. All are marked by weak or declining concentration or cartellization, accelerated by the crisis in the financial sector and by the emergence of new, competitive forces in retail and telecommunications. Seconding Schoppa, I think the general message for the United States is clear: look for domestic allies, but do so especially among low-cost producers dissatisfied with the status quo. Potential exporters to Japan would do well to look for interest-based conflicts among producers and to cultivate ties with maverick figures like Daiei's Nakauchi Iwao, Tokyo Steel's Iketani Masanari, Summit's Arai Shinya, Softbank's Son Masayoshi, or rice trader Kawasaki Isonobu. However, the importance of "participation expansion" and other "synergistic strategies" can be easily exaggerated. First, efforts to draw consumers into the process have failed or backfired. To the degree that they are organized at all, consumers have generally been as protectionist as producer groups. Second, maverick producers such as those mentioned above were not created by U.S. strategy. They were there all along, and they were far from silent. The international politics that matter most have centered on transnational alliances, not participation expansion per se. Ongoing restructuring, the emergence of upstart firms, and the increased presence of foreign firms and joint ventures mean new cracks in Japanese markets and new domestic support bases for further market opening.

Allies can sometimes be found in the ministries as well. They exist at the MPT, which seeks to counterbalance NTT dominance by encouraging rival firms, and at MOF, which has opted (with great reluctance) to back substantial reforms in a context of sheer economic necessity. At MITI, the fierce battles between the "internationalist" and "nationalist" factions ended a long time ago with the victory of the former (Johnson 1982, chaps. 7, 8). Today, the battle is over deregulation versus reregulation, with the line of division more generational than bureau- or personality-based. This divide is at least as important as the one Schoppa highlights: that between an older, more deferential generation of bureaucrats who began their careers in the early postwar era and a new generation that regards Japan as the United States' equal (Schoppa 1999).

At the same time, the rice case provides a cautionary example of what can go wrong and what the United States should not do. It reminds us that regulatory change does not always mean liberalization, and that partial market opening need not beget further market opening (i.e., by creating a constituency for further change). Interestingly, the case also suggests that Japan is not always averse to managed trade. Just as Japan was pronouncing its much-publicized rejection of Clinton's managed-trade demands in the automobile sector (1993–1994), it was in fact concluding a managed-trade deal for rice. Finally, the rice case shows that consumer preferences themselves may sometimes constitute Japan's ultimate "non-tariff barrier," where even complete liberalization would promise few gains for U.S. exporters. In sum, one is hard-pressed to find a trade issue where the United States has tried harder and achieved less. More careful analysis of Japanese politics and markets might help in avoiding such mistakes in the future.

Generally, managed trade is deeply unpopular in Japan today and has become harder to justify in the WTO era. Even successful managed-trade efforts may well cause more harm than good over the long term, undermining both Japanese trust in the United States and the credibility of the WTO (Schoppa 1997; Abels 1996). Given these dangers, any such demands should be made sparingly and be targeted at sectors where the potential benefits are great, where U.S. actors are unified, and where the market is unlikely to open otherwise (i.e., pronounced sectoral splits are absent). They should not be wasted on sectors like rice, which is of limited economic importance to the United States and politically central in Japan. Amazingly, the USTR continues to list rice as among the U.S. economy's "best export prospects."

To be sure, none of this is meant to deny what pluralists like E. E. Schattschneider and I. M. Destler have long argued: American trade politics is strongly shaped by the demands of domestic lobbies, not just the probability or significance of changes in trade outcomes. Similarly, one of the more elementary truths of political science is that reelection-minded politicians tend to want their results in the short term. Given this, concern over long-term credibility with Japan or the WTO may not rate high in Congress. Nonetheless, U.S. negotiators would be well advised to consider the "supply-side" factors this chapter has stressed—i.e., the sectoral conditions of Japanese markets—in addition to those on the demand side.

The approach developed in this chapter is incomplete. It is necessary to think more about how to measure sectoral splits, what causes them, and how much of a split is necessary to make a sector ripe for change. As a first effort, I have chosen to study sectors marked by extreme variations in sectoral split—virtually none in rice, large and growing splits in retail and telecom, and an enormous divide in finance—and where there are clear successes and clear failures with respect to regulatory change and market opening—successes in retail, telecom, and finance, and relative failure in rice. Likewise, successful regulatory change and market opening were seen in the case faced with the least external political pressure (the Big Bang in finance) and failure in the case with the most (rice). I have also focused on successes in parts of the economy that one would imagine to be most sacrosanct: core LDP support bases (small retail), and strategic sectors at the center of developmental/industrial policy (finance and telecom).

To refine the argument on market opening, the literatures on industrial organization and endogenous tariff theory may help. Obvious areas for exploration include the speed of technological change, production-cost spread within the sector, degree of market organization and cartellization, degree of product differentiation, and the strength of industry associations. Adding new cases to obtain further variation is also necessary to test these ideas.[61]

In addition, while this chapter has argued that consumers are too weak and poorly organized to have much influence on policy, the same cannot be said of intermediate (corporate) consumers. Some analysts claim, for instance, that large manufacturing firms, seeking cheaper and more flexible access to capital, have been a critical constituent for financial-sector change. Intermediate users are also likely to figure large in MITI's attempt to deregulate the electric power industry, mobilizing big users like the steel and auto industries against that powerful, highly-concentrated but high-cost sector.[62]

The domestic focus taken here should also be integrated with Schoppa's focus on international tactics. As argued above, market-opening tactics should target not the broad public but producer interests vulnerable to division. They can be used, for instance, to break united fronts and widen market splits—as the United States tried, for instance, in the 1986 semiconductor dispute, where it cited some Japanese firms but not others in anti-dumping complaints (see Krauss 1993, 272).[63] Japan, for its part, proved adept at exploiting American divisions over the Clinton administration's demands for managed trade (Schoppa 1997, chap. 9). Interesting new work focused primarily on U.S. trade policy has moved in this integrative direction.[64] This, indeed, was Putnam's prescription in his seminal 1988 article on two-level games, where he stressed that any two-level theory of international negotiations must be rooted in a theory of domestic politics.

Notes

1. Council on Foreign Relations position papers by Ira Wolff and Jim Southwick send much the same message as Lincoln's 1998 "Whither Trade Policy with Japan?" Lincoln amplifies this thesis in his *Troubled Times: U.S.-Japan Trade Relations in the 1990s*, in which, it should be noted, he identifies finance as "the one partial exception to the general thesis of weak deregulation and structural change" (1999, 199).

2. Lincoln (1999) notes that from 1996 to 1997, the number of regulations rose by 223, for a total of 10,983. As of March 1998, the Prime Minister's Office found that the number had increased to 11,117 (*Tokyo Shimbun* 2 March 1999).

3. An analogous argument is made by Anne Krueger (1996), who finds that the most effective defense against protection is division within the industry in question.

4. "Participation expansion" refers to attempts by one country to increase participation in the other's decision-making process and, more generally, to "increase public awareness of a problem and sometimes serve as a rallying point for the unorganized and ignored general public" (Schoppa 1993, 372). The other tactic Schoppa studies—alternative specification—is intended to influence domestic politics by linking and building on policy proposals already in existence. While participation expansion is attempted in four of the cases Schoppa studies, alternative specification is used in only one: U.S. demands for change in Japanese land laws (characterized by Schoppa as a partial success). Here, the United States linked proposals by Japanese scholars that had previously been considered only in isolation. In Schoppa's research on the Framework Initiative negotiations conducted by the Clinton administration, the main tactic under review is managed trade (Schoppa 1997, chap. 9; 1999).

5. As many political economists argue, consumers are many in number and tend to derive only small benefits from organizing to attack high prices, whereas the producers are relatively few in number, tend to be organized already, and derive considerable individual (not only collective) gains from protection.

6. Consumer-movement specialist Patricia Maclachlan confirms that consumer groups remain wary of deregulation and market-opening moves today (Personal communication, October 1999).

7. For an early, important analysis of transnational alliances in U.S.-Japan trade negotiations, see Kusano (1983).

8. In a 1997 study, the American Chamber of Commerce in Japan (ACCJ) finds that of forty-five major U.S.-Japan trade agreements since 1980, just thirteen were producing the intended results, while ten were judged a complete failure. "Numbers-based" deals are among the most highly rated. The 1986 and 1991 semiconductor agreements were scored 8 out of 10, as was the 1995 auto parts agreement. These sectors, like rice agriculture in this chapter, are marked by high producer organization and minimal sectoral divides.

9. Personal interviews with various MITI officials (Tokyo, 1996–1997).

10. For excellent survey data on public opinions on rice, see the Prime Minister's Office "Public opinion surveys concerning the roles of food and farm villages" (*Shokuseikatsu, nōson no yakuwari ni kansuru yoron chōsa*, various years). Among other things, the surveys show high and increasing shares of respondents saying they will buy expensive domestic rice even if cheaper foreign imports are available. On consumer attitudes toward retail stores, see the 1997 "Public opinion survey concerning small-retail shops" (*Kouri tempo tō ni kansuru yoron chōsa*, also from the Prime Minister's Office). In terms of small, independent stores, for instance, the most important qualities are, in descending order, a friendly atmosphere, good service, low prices, and good merchandise quality. (Elsewhere, consumers stress convenience, familiarity, and trustworthiness as important small-store qualities.) For superstores, price is most important, while for specialty stores, product quality is the critical factor. Sensibly, consumers have different preferences with respect to different kinds of stores. Consumer groups are neutral or opposed to retail deregulation in general. See, for example, the *Nikkei Ryūtsū Shimbun* interview with the secretary-general of Shufuren, the Housewives' Association (29 May 1997). A second source is Maclachlan (Personal communication, October 1999).

11. Most of these subsidies are funded by the Fiscal Investment and Loan Program, Japan's "second budget" (see Noguchi 1995).

12. MITI official Amaya Naohiro confirms that the Large Scale Retail Store Law had little to do with improving competitiveness in the sector: "The Large Scale Retail Store Law is the result of a compromise between supermarkets, which insist on free competition, and small retailers, who insist on the restriction of competition. It is impossible to find the consistency in such a law in terms of economic rationality. It is a product of a power balance between [existing] supermarkets and small retailers" (as quoted in Kusano 1992, 113).

13. The owner of a proposed store was required to submit documents detailing the proposed opening date, floor space, operating hours, required vacation days, and so forth to the local Commercial Activities Adjustment Boards. These boards were formed within local Chambers of Commerce, which are dominated by small-retail interests, and their purpose was to evaluate the proposals and to submit recommendations to MITI.

14. Schoppa (1993, 1997) identifies public investment, the distribution system (including the Large Scale Retail Store Law), land policy, exclusionary business practices, and *keiretsu* organization as the main U.S. targets in SII. By February 1990, the United States had made more than two hundred separate demands.

15. In the words of an *AERA* article, the agricultural budget is "overflowing" (*dabutsuki*). Twenty to 30 percent of the annual agricultural budget is being passed forward into the next fiscal year budget because there is more than can be used ("Hitori ichimanen" 1997, 24–27). The *Sankei Shimbun* reports that the ¥6.01 trillion figure was fixed via political pressure, without any needs-based calculations. It claims that ¥10 billion was added to the initial ¥6.01 trillion in order to give the appearance that the amount was worked out through such calculations (*Sankei Shimbun* 29 April 1997, 1).

16. No other financial institutions received state funds. The decision to bail out JA was of course politically motivated. Interestingly, the details were worked out by MAFF and MOF via administrative guidance (*kanryō shudō*), circumventing the LDP. One MAFF bureaucrat said, "If they learned of the figures beforehand, we thought they'd just get upset and make it difficult to resolve" (*Nihon Keizai Shimbun* 21 February 1996, 1).

17. For an English-language analysis that takes a similar line, see Francks (1998).

18. From March 1996 to March 1997 alone, the number of rice specialty shops fell from 30,000 to 20,000 (*Nihon Keizai Shimbun* 7 January 1998). The most enthusiastic entrants into rice retailing have been supermarkets and, in particular, convenience stores. The Japan Rice Market projects that the number of rice wholesalers will drop from three hundred down to seventy or eighty, with perhaps just ten active nationwide (*Nikkei Ryūtsū Shimbun* 3 November 1998).

19. Personal interviews with MAFF officials (May 1997) confirm this assessment.

20. For details, see *Nihon no kome shijō* (8 April 1998) on the website of the Japan Rice Data Bank <http://www.japan-rice.com>. Storage costs for rice are expensive—an annual cost of ¥12,000–¥14,000 per ton.

21. The emphasis on farmer protection and local production continue today. Although even MAFF calls their goals unrealistic, JA and the LDP are now pushing for new farm-income supplements to increase Japan's overall food self-sufficiency, which is now 42 percent, to 50 percent by 2010 (*Nihon Keizai Shimbun* 18 December 1998).

22. Japan calculated the tariff on the basis of the price differences between imported

and domestic rice during 1986–1989. The main imports at that time were low-cost Thai rice used for processing, hence the high tariff. Tariffs will remain at the same level for 2000 (*Nikkei Weekly* 22 February 1999). One Democratic Party member charges, "While there was no debate in the Diet or among the Japanese people, the tariff levels were forced through by an agreement between the ruling party, the bureaucracy, and some of the agricultural organizations [i.e., JA]." The MAFF vice-minister agrees, saying, "Public debate was insufficient" (*Yomiuri Shimbun* 28 March 1999).

23. While no Japanese government member has been willing to confirm this agreement (illegal under GATT/WTO), an official at South Korea's Ministry of Agriculture and Forestry openly acknowledged that the United States forced exactly the same deal on Seoul. But unlike Japan, South Korea subsequently said, in essence, "What deal?" and bought the cheapest foreign rice it could find (from China and India) to fulfill its minimum-access obligations (Personal interview, Seoul, November 1997). By contrast, the United States has consistently held a 50 percent share of Japan's rice imports, despite the fact that American rice is neither the cheapest (Indian, Thai, and Chinese rice being the least expensive) nor the most highly regarded foreign rice in Japan (Australian *koshihikari* is according to the *Nihon Keizai Shimbun* 2 June 1999). All of these details add credence to the allegation. (On rumors of the 1999 renewal, see *Mainichi Shimbun* 24 March 1999).

24. The reforms also increased permissible hours and days of operations for large stores and improved the transparency of the approval process.

25. Personal interview with a MITI official (Tokyo, August 1997).

26. The *Yomiuri* article summarizes a survey by the Japan Chamber of Commerce and Industry that found that in the mean *shōtengai* (small-business district) of 57 stores, 5 are now vacant. The vacancy rate has risen fairly steadily over the 1990s—from 4 percent of stores in 1990 to 8.1 percent in 1997 (*Asahi Shimbun* 30 May 1998). In one-third of the *shōtengai* today, 10 percent or more of the shops are vacant ("Shōtengai hōkai" 1998).

27. The article continued to say, "Before a further relaxation of Large Scale Retail Store Law restrictions results in only large-scale retail stores and the destruction of local shopping districts, Japan must prepare a system that can function as a self-defense mechanism for society."

28. Note that the survey measures support for parties, not particular candidates; in Japan, party support tends to lie below candidate support, especially for the "hard vote" of farmers and retailers. Finally, regarding the Democratic Party's high level of support, note that new parties in Japan often undergo booms in their early days, doing particularly well among the "floating vote"—those voters unattached to particular parties or candidates.

29. Personal interview with MITI officials (Tokyo, June 1997); Personal interview with Kikkawa Takeo, Professor, Tokyo University (Tokyo, June 1997).

30. Personal interview with representative of the American Chamber of Commerce in Japan (ACCJ) (Tokyo, May 1999).

31. In fiscal year 1998, despite the recession and the shrinking number of Japanese children, the chain registered a 17 percent sales increase (*Japan Digest* 10 May 1999, 15).

32. At the close of the Tokyo Round, the effective rate of protection for agriculture as a whole was 20 percent; that for food processing was 50 percent (Riethmuller 1994b, 3–6).

33. In 1998, Lawson (owned by Daiei) was raided by the Fair Trade Commission of Japan for violating the Antimonopoly Law. Reportedly, the chain has used its market

power to wrest concessions from wholesalers. Daiei itself was targeted for squeezing Suntory on beer prices (*Asahi Shimbun* 18 August 1998).

34. The Japanese press has been full of reports on the "convenience store wars" and "*kakaku hakai*" (price destruction) in the 1990s (see, e.g., *Shūkan Tōyō Keizai* 27 March 1996, 13 April 1996, and 31 August 1996). The latest conflict (fall 1999) is a "beer war" provoked by 9 percent price cuts at Seven-Eleven, with other chains following suit. Despite such conflicts, and in contrast to department stores and supermarkets, convenience stores have increased profits and sales throughout the 1990s and earned a reputation for being "recession-proof." In fiscal year 1998, all convenience-store chains posted sales gains of 4 percent–6 percent and all except Lawson posted record pretax profits (*Japan Digest* 27 April 1998, 10; *Asahi Evening News* 12 April 1999). For background, see Kawabe (1994) and Yahagi (1994).

35. In the House of Representatives, since the 1994 introduction of the single-member district system (*shō senkyoku sei*), politicians have become even more beholden to local interests, including the well-organized small retailers (*Nihon Keizai Shimbun* 14 May 1999). In the House of Councillors (Upper House), too, backbenchers are wary. As one put it in early 1998, "We're facing [Upper House] elections this summer and it is taboo to oppose the views of the large vote base of the small retailers" (*Nihon Keizai Shimbun* 28 February 1998).

36. The United States has publicly complained about the new law for these reasons (*Japan Digest* 31 May 1999, 24).

37. Some chains are racing to open currently planned stores before the new laws take effect (e.g., Toys "R" Us and Itō-Yōkadō). In recent years, the Life Supermarket chain has been opening around twenty large supermarkets annually but expects the figure to fall to around five under the new law (*Sankei Shimbun* 28 May 1998).

38. Daiei's Chairman Nakauchi Isao similarly comments: "We demand the creation of transparent and fair procedures that will keep the new law, which scatters authority among the local governments, from becoming as restrictive as the Large Scale Retail Store Law" (*Sankei Shimbun* 28 May 1998).

39. Personal interviews with MITI officials (Tokyo, July 1998 and November 1999). Still, it is unclear, stated the same MITI official a year later, that the LDP made the wrong choice in pushing through the law. "If the LDP had failed to pass the law, that would have been damaging, too." See also Curtis (1999, 208–210).

40. But even MITI bureaucrats are unsure what the new law will mean. When I asked another official whether he thinks the Law Concerning the Measures by Large Scale Retail Stores for Preservation of the Living Environment (Daikibo kouri tenpo ricchi hō) marks a return to the old Large Scale Retail Store Law, he replied, "As a MITI bureaucrat, no, but as a political scientist, yes." Personal interviews with MITI officials (Tokyo, June and November 1999).

41. For a related argument focused on television broadcasting, especially the emerging cable and satellite markets, see Noble (2000). Like Japan's telephone markets, broadcasting is marked by rapid technological change, market desegmentation, and internationalization pressures, but the MPT nonetheless remains the gatekeeper mediating the impact of these forces on Japanese markets.

42. Jennifer Holt Dwyer suggests that asset-specificity—higher in telecom than

finance—is likely also relevant. This hypothesis deserves more attention but is beyond the scope of this paper (Personal communication, July 1999).

43. On the centrality of opposition parties in driving MOF restructuring, see Hiwatari (2000).

44. Moreover, there is at least an informal understanding that seconded MOF bureaucrats will remain at the FSA rather than be returned to the ministry (Personal interviews with MITI and MOF officials, Tokyo, June and August 1999).

45. On the other hand, Yanagisawa was succeeded in the fall of 1999 by Ochi Michio, who has distanced himself from Yanagisawa and appears likely to take a more moderate approach.

46. Beginning in 1981, the Second Provisional Commission on Administrative Reform, known as the Second Rinchō (Rinji gyōsei chōsakai), and subsequent administrative reform efforts succeeded in introducing a program to reduce Japan's growing budget deficit without tax increases as well as to privatize a range of government-owned corporations. See especially Carlile (1998, 77–85).

47. Note that the "Big Bang" moniker is something of a misnomer. Regulatory changes do not occur all at once but are spaced out over three years (1998–2000). More importantly, they constitute only the latest—although much more thoroughgoing—measures in a series of financial reforms that date back two decades. Desegmentation and internationalization of the industry began in the 1970s, foreign ownership of bank shares has been increasing since the early 1990s, and by some accounts, financial reforms have been largely deregulatory since the early 1980s.

48. Personal interview with MOF official (Tokyo, June 1999).

49. While inward foreign direct investment in fiscal 1998 was double that of fiscal 1997, at the same time, outgoing investment by Japanese firms fell to US$42.6 billion in fiscal 1998, representing a 20 percent drop from the previous year (*Journal of Commerce* 28 May 1999).

50. At the same time, a 1999 editorial in the *Nikkan Kōgyō Shimbun* observed that Japanese firms in the United States now employ 2.9 million workers, almost as many as are unemployed in Japan. "It's time for foreign capital to help create jobs [in Japan too]" (as quoted in Doi 1999).

51. At the time of the *Fortune* survey, NTT and NTT DoCoMo were a single company. For more on NTT's reorganization, see the *Nihon Keizai Shimbun* series "NTT saihen" (24–26 June 1999).

52. Note that today, Motorola is focusing less on hardware, where its competitive advantage has eroded, than on phone units (*Japan Digest* 16 November 1998, 23).

53. PHS initially boomed when introduced in 1995, but is being eclipsed by advances in cellphone technology, price drops, and density/coverage of transmitter stations. Unlike PHS, cellphones can also be used in moving cars or trains. Japan's Telecommunication Technology Committee forecasts that by 2010, the number of mobile phone subscribers will reach eighty-one million—two of every three Japanese people. That is double the current total, with a majority likely to use a new generation of digital phone service that will become available in 2000. The council predicts that the total mobile phone market will reach ¥9.3 trillion a year and employ 563,000 people (*Japan Digest* 4 October 1999, 24).

54. This is the smallest advantage NTT holds in the different telephone markets (NTT

market share is about two-thirds of the domestic long-distance market and virtually the entire local market). Even with cellphone rates deregulated today, competitors offer lower rates, although DoCoMo continues to lead in the provision of new services.

55. The ministry has used selective access to cheap capital as an additional lever. As Vogel observes, "Ironically, at a time when MITI was publicly renouncing industrial policy, the MPT was just getting started" (1996, 138).

56. TEPCO also plans to develop a low-cost Internet service using transmitters mounted on its utility poles, with prices again one-half those of NTT for unlimited access.

57. Personal interview with MITI official (Tokyo, June 1999).

58. See the Prime Minster's Office surveys cited previously.

59. Type 1 licenses are for facilities-based carriers; Type 2 licenses allow carriers to use Type 1 carriers' facilities.

60. Although the notification system is more lenient, it still leaves room for MPT discretion. Almost immediately following the regulatory change, for instance, the ministry intervened against DoCoMo rate-setting on behalf of competitors (*Asahi Shimbun* 6 January 1999).

61. On industrial organization, see especially Tilton (1996) and Uriu (1996). Unrelated to Japan but conceptually rich is Bowman (1989). On endogenous tariff theory, see especially Nelson (1988) and Magee, Brock, and Young (1989).

62. Personal interview with MITI official (Tokyo, October 1999).

63. In 1995, the United States used a similar tactic, threatening to target Japanese luxury-car exports with punitive tariffs. That time, MITI and the industry remained united and denounced the Clinton administration's heavy-handedness and managed-trade agenda.

64. For several recent efforts to combine two-level game analysis with models of domestic politics (drawn heavily from collective action and endogenous tariff theory), see Milner (1997); Gilligan (1997); and O'Halloran (1994).

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