POLICY BRIEF

OECD

September 2004

Competition Law and Policy in Japan

What are the basic rules against anti-competitive restraints and abuses?

How can Sanctions be set to deter hard-core violations?

Is criminal enforcement working?

Can a leniency program improve enforcement?

How have reforms strengthened competition policy?

Does competition policy clearly support consumers?

For further information

For further reading

Introduction

Japan's Fair Trade Commission, created in 1947, is one of the oldest and largest competition law enforcement agencies in the world. Before the 1990s, though, competition had usually played a subordinate role in Japan's regulatory policies, while aspects of Japan's traditional approach to regulation had contradicted principles of modern competition policy. Over the past decade of reform in Japan, this attitude toward competition policy has been changing.

In 1999, the OECD examined Japan's competition policy and enforcement institutions in detail. The 1999 Report found that the legal foundation for competition policy was sound and that resources applied to enforcement were increasing despite belt-tightening elsewhere.

The OECD reviewed the situation again in 2004 and found that Japan has made substantial progress, notably the removal of regulatory entry controls and the elimination of most exemptions from the competition law. The FTC can now take more enforcement actions in regulated network industries. The FTC's independence was underlined by moving it to the Cabinet office in 2003. The FTC has some new powers to deal with official involvement in bid-rigging, a new economic unit, the Competition Policy Research Centre, and substantially more resources, most of them dedicated to investigation and enforcement.

Improving the enforcement of competition law is now a high priority. The FTC's principal target has been bid rigging, one of the most serious problems in the domestic political economy. Increasing the maximum fine made sanctions look stronger, yet there are few prosecutions. Repeat offences show that deterrence still falls short, despite the efforts to strengthen the system. A Study Group on the Antimonopoly Act in 2003 recommended major reforms, and the FTC in April 2004 announced its plans to implement many of them. The most important would be to revise the system of financial penalties. ■

OECD Observer

© OECD 2004

What are the basic rules against anti-competitive restraints and abuses?

Japan's Antimonopoly Act (AMA) has several means to deal with anticompetitive conduct. Its general prohibition against restraints of trade is the strongest law the FTC can apply against horizontal price fixing and bid rigging agreements. Enforcement can involve not only an order to stop the violation, but also financial penalties and even criminal prosecution. A special rule in the AMA prohibits restraints imposed by trade associations, because they are a common setting for horizontal restraints. A section of the AMA that prohibits unfair practices is applied to most other kinds of competition issues. Under that section, the burden of proof is lower, but the only remedy the FTC can impose is an order.

The AMA's prohibition of "private monopolisation" is aimed at harm to competition due to firms with market power. There have been only 15 of these cases in more than 50 years, though, because it appears that the FTC typically deals with large-firm abuses as unfair practices rather than as private monopolisation. Proving private monopolisation is complex and costly, and it may be difficult to apply an effective remedy at the end of the process. Treating the problems instead as unfair practices preserves enforcement resources for horizontal matters. But this approach, ending only with an order to stop the offending conduct, may be less effective at curbing monopolising practices than the prospect of fines or divestiture would be.

The Study Group Report proposed some changes to the AMA about dominant firms and concentrated industries. The AMA's rules about parallel pricing have not proven to be useful, and these should be eliminated, as the Study Group proposed. A static, formalistic provision of the AMA about restructuring and divestiture in "monopolistic situations" has never been used, and the Study Group recommended repealing it.

Nonetheless, authorising structural remedies in appropriate cases should be considered, as the Study Group recommended

The proposal for new powers to order access to "essential facilities" needs further study. One common setting for these controversies is traditional network monopolies such as energy, telecoms and transport, but issues in many other industries, from financial services to software, can also be framed in these terms. In principle, the FTC could already deal with them in terms of "private monopolisation". The complexity of the issues and remedies are reasons to proceed carefully in designing new law in this area. Indeed, if the FTC brought more Sec. 3 cases against monopolizing conduct, there would be a broader base of experience on which to draw for that purpose. The FTC might facilitate the process by developing guidelines about the interpretation of "private monopolisation" in these circumstances.

The FTC has concentrated its enforcement attention on horizontal cartels and bid rigging. The FTC has tried to keep abreast of novel issues, in sectors undergoing deregulation, problems of high technology and intellectual property rights, and areas subject to social regulation. But traditional topics remain the mainstays of its enforcement practice. The most common complaint that the FTC receives is about excessive discounts (that is, competitors complaining about "too much competition"), while the most frequent target of the FTC's enforcement action is bid-rigging in construction. ■

How can sanctions be set to deter hard-core violations?

Many kinds of sanctions are possible in Japan's enforcement system. The FTC can impose a financial penalty, termed a "surcharge", for violations involving effects on price (as well as issue orders to correct behaviour). The surcharge is computed as a percentage of the firm's sales of the product affected by the restraint. The rate is fixed by statute, and the FTC has no discretion to vary it. The current rate, of 6% of affected sales, looks low by international standards. Deterrence is weakened further by reductions in the rate for violations by small business and in retail and wholesale trade. Moreover, since 1999-2000, the annual total of surcharges imposed has dropped substantially – from JPY 18 433 million to only JPY 2 700 million in 2002.

Criminal penalties are also possible, but the courts' reluctance actually to impose substantial criminal sanctions means that deterrence is weaker than would appear. The highest possible fine for a company, JPY 500 million, is substantially lower than fines being imposed in many other jurisdictions now against price fixing conspiracies. Individual violators might also be punished by up to 3 years in prison and a JPY 5 million fine. Prison sentences are rare, and execution of sentence has always been suspended. No one has ever gone to jail for violating the AMA.

The practical deterrent effect of these theoretical punishments is hard to identify, because there are few criminal cases, so fines of any magnitude, against companies or individuals, are rarely imposed. Since 1990, 7 cases have resulted in fines. The highest total imposed in a single case, against all defendants, was JPY 460 million; the highest against a single defendant was JPY 130 million. These fines, imposed against rigging bids for jet fuel, were less than 1% of the JPY 49 billion in estimated losses that this cartel imposed. Surcharges are a more substantial financial deterrent than criminal penalties of this magnitude, because surcharges can be much larger than fines, even at a rate of only 6%.

Sanctions actually applied must be effective to deter hard-core violations: surcharges must be much higher, especially if criminal prosecution remains rare

The FTC's April announcement proposes that the current surcharge rates be approximately doubled. The rate would still be applied only to the commerce affected by the violation. Rates applied to small businesses and to wholesale and retail trade would also be increased, but they would remain below the basic rate. The FTC also proposes to add about 50% to the surcharge for repeat violators. The proposals to change the surcharge system have revived questions about the system's rationale and jurisprudential foundations. Extended debate over these issues should not delay necessary strengthening of the sanction system. The Study Group Report argued that the existing rate collects the benefit to the party, that is, the unreasonable profits, and that raising the percentage will improve deterrence by making the surcharge higher than the party's gain from the violation. A financial imposition that is greater than the gain to the violator is consistent with economic theory about deterrence, to correct for the possibility that the violator could avoid detection. To reach a level that deters effectively, the rate needs to be much higher than 6%.

A rate about double the present level would still be lower than the cap on fines in most other jurisdictions. In the systems commonly found in Europe, administrative fines can be as high as 10% of total firm turnover, not just of the commerce affected. In the UK, fines can be up to 10% of turnover over the period of the violation (up to 3 years). In several countries, sanctions may be based on the gain from the violation or the harm it caused. In the US, the fine may be up to 2 times the gain or the loss (and the maximum basic fine, which does not depend on actual gain or loss, has just been raised to USD 100 million); in Germany and New Zealand, the fine may be up to 3 times the gain.

Proposals to double the surcharge level would bring Japan closer to the emerging international consensus about the need for strong action against the most serious abuses. (The OECD's 1998 *Recommendation* and subsequent reports on enforcement against hard-core cartels are available at *www.oecd.org/competition*, law enforcement and co-operation.) A figure well above 10% of covered commerce could be justified, given the difficulties of detection and proof as well as the likelihood that gains and losses due to hard-core conduct are significantly greater. If the gain to the violators from hard core cartels is typically at least 10-15% of turnover (an estimate that is supported by OECD surveys of its members' experiences), then a sanction fixed at about 10-12% of commerce affected by the cartel would be on the low side. Adding only 50% to the surcharge for repeat offenders might not be enough to get their attention; that percentage probably should be significantly higher. Retaining distinctions in the surcharge system for different violators is problematic. The rationale for maintaining these distinctions for small business and for wholesale and retail trade is not that there is less need for enforcement in those settings, but that because margins are smaller, smaller sanctions would still have adequate deterrent effect. Even if that were true, retaining these special lower rates preserves a loophole that weakens enforcement.

Amendments may also apply surcharges to a wider range of AMA violations. The FTC proposes that surcharges would be applied to restraints about price, volume, market share or customer allocation, to purchasing cartels, and to acts of "private monopolisation" that, by controlling other firms, had the same price-related effect as a hard-core cartel. Fines or surcharges could be appropriate for especially egregious restrictions or exclusionary tactics. It seems clear from the Study Group Report and the FTC's proposals that surcharges are not being considered as a remedy for simple exploitation of market power by charging supra-competitive prices. ■

Is criminal enforcement working?

The threat of criminal penalties does not yet deter effectively. After a 40 year period in which there had been only 6 criminal cases, in 1990 the FTC announced it would crack down on hard-core price

fixing by seeking more criminal prosecutions. Yet despite the higher priority, there have been only 7 more since then. In those 7 cases, over 90 individuals were prosecuted, but execution of their sentences has always been suspended. The courts have never imposed a fine as high as the statutory maximum. Ineffective deterrence invites repeated violations. Firms that were recently convicted of rigging bids for municipal water meters had previous convictions.

Capacity to prosecute should be expanded, if the AMA's criminal penalties against horizontal cartels and bid rigging are to be applied credibly

The capacity to prosecute price-fixing violations of the AMA appears constrained. The FTC is now pursuing dozens of bid rigging matters every year, but the prosecutors evidently can only handle one AMA case at a time. The case about jet fuel bid rigging was filed in 1999, and it was not decided until March 2004; one other criminal case was filed and decided during that period. (There have been many more prosecutions under the special provisions of the Penal Code about obstruction and collusion in bidding, though.)

The FTC needs stronger investigative powers and closer co-operation with the prosecutors

The FTC has sole discretion to refer a matter to the Public Prosecutor General, but it cannot prosecute itself. The FTC's evidence is usually the core of the case, although the prosecutor and its investigators must re-assemble much of that evidence in order to meet procedural requirements. Prosecutors appear to have been wary of the risks of competition cases, and the FTC has difficulty obtaining the kind of evidence that could overcome scepticism. Notably, the FTC cannot prosecute refusal to comply with its investigative demands. Despite the problems, the possibility of criminal prosecution is likely to be retained, and the Study Group Report recommended several technical legal changes to make the criminal enforcement process more flexible. The FTC's proposals call for authorising compulsory investigative measures for criminal investigations and for expanding venues so criminal cases could be tried in district courts, rather than the Tokyo High Court.

The relationships among the surcharge system, criminal penalties and private damages recoveries have drawn attention. The Study Group Report contrasted a "sanctions" system, involving discretion in setting the level of the sanction, with the "administrative" fixed-rate surcharge system, which is intended to have the same practical effect of economic deterrence of violations but is simpler and more certain. The Study Group called for changing the conceptual basis of the surcharge, from taking back unjust profits to recovering the losses inflicted on society, as a means of distinguishing the surcharge from the criminal penalty. Objections to imposing sanctions and criminal fines in the same case could be overcome by making an appropriate adjustment, such as applying one amount as a credit against the other. The FTC's April proposals call for deducting half of any criminal fines from the surcharge imposed in the same matter. ■

Can a leniency program improve enforcement?

The FTC has been considering the adoption of a formal leniency program. Promising a reduction in the sanction to a violator who provides evidence early can make enforcement against secret price fixing conspiracies much more effective. Leniency might in theory take the form of reducing or forgoing surcharges for one company. A prerequisite for such a program is provision for varying the sanction, so that the enforcer can be lenient in appropriate cases. This is more difficult to do if the surcharge is conceived as a fixed, administrative charge. The AMA does not provide for a true "administrative fine", similar to sanctions applied in some other areas such as tax law, and Japan's criminal law does not usually countenance the use of leniency in this fashion. Thus, for now a leniency program would have to be adapted to the surcharge system.

The Study Group's recommendations on this issue included some of the key elements of an effective leniency program. The law would set a lower surcharge rate (even 0) for a company that voluntarily informed the FTC of its conduct before the FTC was investigating and that voluntarily ceased that conduct. Consistent with aspects of effective leniency programs that have developed in other jurisdictions, it would be clear that total immunity from the surcharge could go only to the first party to come in, while those who come in later could get some reduction for co-operation. To ensure that leniency concerning surcharges is not inconsistent with the potential to apply criminal penalties, it may be necessary to make clarifications about criminal liability in the AMA too, although that result might be achieved by an FTC promise not to refer for prosecution. Extending

leniency to individuals, by not recommending prosecution, could be a tool for obtaining evidence about corporate violations. (A general measure to protect such "whistleblowers" against retribution from their employers was recently approved in the Diet.)

A leniency program is needed, to detect and deter cartels

The FTC's April announcement includes plans for immunity or reduction in surcharges under conditions to be defined in the AMA. A leniency system would make Japanese enforcement more effective and may facilitate co-operation with other enforcers to deal with wide-ranging cartels that harm Japanese consumers. Experience in other member countries shows that where there is a very clear advantage to being the first party to come forward (and thus, a very substantial risk in not being the first), and there is some advantage to coming forward even after an investigation has started, some cartels have broken down in a race to confess. Proper attention to matters of process and design of an effective leniency program, such as the relationship between the surcharge system and criminal prosecution, is important, and the FTC's plans show that this issue has received considerable attention. The most important consideration, though, is the enforcement climate: the promise of leniency is an effective enforcement tool only if the threatened sanction that is avoided is substantial and credible. ■

How have reforms strengthened competition policy?

The 1999 Report made a number of recommendations to make competition policy more effective, in regulation and in law enforcement. The 2004 review showed that most of these have been implemented. Most importantly, regulations setting prices and controlling entry based on ministerial assessment of the balance between supply and demand in the market have been removed from trucking, airlines, ports, petroleum, housing, banking, securities and telecoms. A few pockets of resistance remain, though, where administrative measures may be used to protect incumbents against unwelcome competition. Reduction in the number of statutory exemptions from the AMA represents a substantial reform of competition policy. Comprehensive legislation enacted in 1999 abolished the system for depression and rationalisation cartels and a long list of other exemption systems, while limiting the scope of many others. Compliance with the terms of the remaining exemptions, particularly concerning SMEs, should be monitored. Problems due to reduced competition and hence higher costs remain in some sectors, due to industry and regulatory habits that are resistant to change. Issues in particular sectors are described in more detail in the special chapter on product market competition in the 2004 OECD *Economic Survey* of Japan.

The FTC's 1994 Guidelines about anti-competitive administrative guidance are still in place, and a Cabinet Decision in March 2003 reminded Ministries of their obligations to consult with the FTC. The FTC does not report any new, significant cases raising this issue. Perhaps because of reforms there have been fewer problems. Or, perhaps it is still too difficult to take these problems on through enforcement action, because ministries that interfere with markets are still powerful and the firms affected by the interference are still reluctant to complain. In telecoms, "promoting competition" is now one of the purposes of regulation. In electric power, by contrast, the principle of promoting competition was not included among the purposes of sectoral regulation. Making the responsibility to support competition explicit concerning transport and energy would also be valuable.

Merger standards have been revised, with new guidelines published in May 2004, and the FTC has clarified its informal process of merger review by setting a timeline for advising the parties whether a proposed merger requires more serious investigation and possibly relief. This commitment aims for greater transparency, because the FTC also undertakes to explain its action publicly at the end of the process. In 2002, for the first time, the FTC issued a release in connection with a consultation in which it told the parties that it had concerns which caused the parties to abandon their plans.

The FTC's visibility and independence have been enhanced. The FTC's 2003 move to the Cabinet Office implies a potentially stronger role in government-wide reform. Stronger ties with the formal regulatory reform process, promised in 1999, would still be valuable. The FTC's independent image could be improved further by appointing commissioners from a broader range of backgrounds. Its resources have continued to increase; the staff level in 2004 is 672, up about 10% since 2002, and it has added some legal expertise. The FTC contends that it still needs several

hundred more for enforcement, though, and the FTC still has only a few graduate-degree economists.

Supplementing public enforcement, a new kind of private relief is now possible under the AMA, enabling consumers or businesses to challenge unfair practices and restraints imposed by trade associations. The number new lawyers admitted through examination is increasing; from 1 500 in 2004, the plan is to reach 3 000 by 2010. A new legal education system will make an alternative path to entry available. ■

Does competition policy clearly support consumers?

The 1999 Report recommended that competition policy be connected more clearly to consumer policy. This could be built on the FTC's responsibility for special statutes, such as those concerning premiums and representations. Unfair competition is an important part of the FTC's work; some, but not all, of this enforcement agenda is related to consumer protection. Under the AMA, the FTC has many cases about sales at prices that are "unjustly" low, which are typically competitor complaints about their rivals' price-cutting. The surprisingly large number of FTC actions about price cutting would not inspire confidence in consumers that competition enforcement is promoting their interests.

Strengthen consumer protection and its relationship to competition policy

Japanese consumers still need a stronger voice in the policy process and stronger protections in the law. Japan does not yet have a comprehensive consumer protection law or enforcement authority, other than these functions of the FTC. To the extent there are agencies and NGOs with interests in consumer issues, there has been some effort to recognise common interests and co-ordinate actions. Laws and institutions protecting consumers in Japan need to be strengthened. Giving that responsibility to the FTC could help to focus competition law enforcement on consumer interests, too.

Consumers have clearly benefited from the pro-competitive reforms to date. The Cabinet Office has tried to estimate the benefits to consumers of implementing some of the major changes in the 3 year regulatory reform programs. The latest estimate, in 2003, dealt with the effects of reforms in mobile telephony, trucking, domestic airlines, car inspections, electric power, gas, oil, securities commissions, insurance, beverages and food, and products where resale prices had been designated such as cosmetics and pharmaceuticals. In total, the Cabinet Office estimated that these reforms increased consumer surplus by JPY 13.4 trillion annually, or JPY 112 000 per capita: this amounts to about 4% of GDP. Nearly a third of this total, JPY 3.9 trillion, resulted from ending rate and entry regulation in trucking, a reform recommended in the 1999 OECD Report. ■

For further information

For further information about the OECD's work on competition policy, please see our website at *www.oecd.org/competition* or contact us at *dafcomp.contact@oecd.org*.

For further information about this policy brief, please contact:
Michael Wise,
tel.: 33 (0) 1 45 24 89 78
e-mail: *michael.wise@oecd.org*.

For further reading

- 2004 OECD Economic Survey of Japan;
- Regulatory Reform in Japan (1999);
- Japan: progress in implementing Regulatory Reform (2004);
- OECD Journal of Competition Law and Policy
  ISSN: 1560-7771, Subscription (3 issues per year) € 189.

OECD publications can be securely purchased from the OECD Online Bookshop
www.oecd.org/bookshop

The OECD Policy Briefs are prepared by the Public Affairs Division, Public Affairs and Communications Directorate.
They are published under the responsibility of the Secretary-General.

Where to contact us?

FRANCE
OECD Headquarters
2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 67
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: *www.oecd.org*

GERMANY
OECD BERLIN Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail:
berlin.contact@oecd.org
Internet:
www.oecd.org/deutschland

JAPAN
OECD TOKYO Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0035
E-mail: center@oecdtokyo.org
Internet: *www.oecdtokyo.org*

MEXICO
OECD MEXICO Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560
MEXICO, D.F
Tel.: (00.52.55) 9138 6233
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet:
www.ocdemexico.org.mx

UNITED STATES
OECD WASHINGTON Center
2001 L Street N.W.,
Suite 650
WASHINGTON D.C. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: *www.oecdwash.org*
Toll free: (1-800) 456 6323

00 2004 4 J 1