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Permeable Policymaking: Foreign Firms in the Japanese Political Economy

By

Kristi Elaine Govella

A dissertation submitted in partial satisfaction of the

requirements for the degree of

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of the

University of California, Berkeley

Committee in charge:

Professor T.J. Pempel, Chair

Professor Steven Vogel

Professor Vinod Aggarwal

Professor Thomas Gold

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Permeable Policymaking: Foreign Firms in the Japanese Political Economy

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## Abstract

Permeable Policymaking: Foreign Firms in the Japanese Political Economy

by

Kristi Elaine Govella

Doctor of Philosophy in Political Science

University of California, Berkeley

Professor T.J. Pempel, Chair

This dissertation examines the consequences of globalization and trade liberalization for government-business relations in advanced industrial economies. How do the early stages of trade liberalization affect the opportunities for multinational firms to influence the policies of a target country? What factors explain the varying patterns of corporate political activity that we see across different sectors in an economy? In order to answer these questions, I conduct a cross-sectoral analysis of Japan, a country that has historically been notoriously closed to foreign business and investment. Drawing on archival material, market data, newspaper articles, direct observation, and interviews, I examine the influence of foreign firms on the Japanese policymaking process from the immediate post-World War II period to the present. In particular, I focus on case studies of four sectors in which distinctly different patterns of corporate political activity manifest: agriculture, pharmaceuticals, insurance, and information and communications technology.

I find that while foreign firms were initially dependent on their home governments to influence Japanese policy, opportunities for these firms to employ political strategies both independently and in coalition with Japanese partners have increased with the opening of the Japanese economy and society. Furthermore, the manner in which the Japanese market opened has had important consequences for politics; the pattern of internationalization in each sector has shaped foreign firms' political strategies by defining the scope of potential coalitions and tactics available. In sectors such as agriculture where internationalization in Japan has been minimal, foreign actors' political strategies remain focused on lobbying their respective home governments, which continue to be the primary conduit for private sector demands. However, in other more internationalized sectors, understanding the precise mix of political strategies used by foreign firms requires investigating the cleavages that internationalization creates in both the home and target countries. In some cases, these cleavages favor the formation of cross-national coalitions, alliances between Japanese and foreign actors who consciously coordinate strategies and pool resources in pursuit of mutual aims. When Japanese actors are divided, foreign firms may be able to form cross-national coalitions and increase their political influence. However, divisions among foreign firms may also complicate the policymaking process, resulting in competing cross-national coalitions or in situations in which foreign firms who have achieved market success in Japan try to shut out all new market entrants, both foreign and Japanese alike.

To my father

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## Abbreviations

ACCJ	American Chamber of Commerce in Japan
ASCS	Agricultural Stabilization and Conservation Service (US)
BSA	Business Software Alliance
DPJ	Democratic Party of Japan
EBC	European Business Council
EC	European Community
EFPIA	European Federation of Pharmaceutical Industries and Associations
EMA	European Medicines Agency
EMEA	European Medicines Evaluation Agency
ERS	Economic Research Service (US)
EC	European Community
EU	European Union
FDA	Food and Drug Administration (US)
FDI	Foreign direct investment
FECL	Foreign Exchange Control Law (Japan)
FIL	Foreign Investment Law (Japan)
FILP	Fiscal Investment Loan Program (Japan)
FPMAJ	Federation of Pharmaceutical Manufacturers' Associations of Japan
FSA	Financial Services Agency (Japan)
GATT	General Agreement on Tariffs and Trade
HPV	Human papillomavirus
ICH	International Conference on Harmonization of Pharmaceuticals for Human Use
ICT	Information and communications technology
IETF	Internet Economy Task Force
IP	Intellectual property
JA	Japan Agricultural Cooperatives
JAAME	Japan Association for the Advancement of Medical Equipment
JASRAC	Japanese Society for the Rights of Authors, Composers and Publishers
JETRO	Japan External Trade Organization
JPSPMA	Japan Direct-Selling Pharmaceutical Manufacturers Association
JMA	Japan Medical Association
JPMA	Japan Pharmaceutical Manufacturers Association
LDP	Liberal Democratic Party
LIAJ	Life Insurance Association of Japan
M&A	Mergers and acquisitions
MAFF	Ministry of Agriculture, Forestry and Fisheries (Japan)
METI	Ministry of Economy, Trade and Industry (Japan)
MEXT	Ministry of Education, Culture, Sports, Science and Technology (Japan)
MITI	Ministry of International Trade and Industry (Japan)
MHLW	Ministry of Health, Labor and Welfare (Japan)
MHW	Ministry of Health and Welfare (Japan)
MIC	Ministry of Internal Affairs and Communications (Japan)
MOF	Ministry of Finance (Japan)
MOSS	Market-Oriented Sector-Selective [talks]

MPPAJ	Motion Picture Producers Association of Japan
MPT	Ministry of Posts and Telecommunications (Japan)
NHI	National Health Insurance (Japan)
NPO	Non-profit organization
NTT	Nippon Telegraph and Telephone
OECD	Organization for Economic Cooperation and Development
OPSR/KIKO	Organization for Pharmaceutical Safety and Research
PhRMA	Pharmaceutical Researchers and Manufacturers Association (US)
PMA	Pharmaceutical Manufacturers Association (US)
PMDA	Pharmaceuticals and Medical Devices Agency (Japan)
PMDEC	Pharmaceuticals and Medical Devices Evaluation Center (Japan)
RIAJ	Recording Industry Association of Japan
RCEP	Regional Comprehensive Economic Partnership
RMA	Rice Millers Association (US)
SII	Structural Impediments Initiative
TPP	Trans-Pacific Partnership
TRIPS	Trade Related Aspects of Intellectual Property Rights Agreement
USTR	United States Trade Representative
VERs	Voluntary export restraints
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

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Kristi Govella  
Berkeley, California  
August 2016

# **1 Multinational Firms and the Domestic-International Nexus in Political Economy**

Governments and firms are developing connections beyond national borders in ways that were previously unimaginable. As governments have taken steps to remove formal trade barriers, they have created room for foreign firms to enter their borders, opening up a rift between an increasingly internationalized economic sphere and a political arena still largely national in orientation. As time goes on, the deepening internationalization of the economic sphere has had intensifying consequences for the political arena. As a result, policymaking is no longer the exclusive preserve of a unitary state or “domestic” actors. Despite increasing recognition of this fact, however, scholars still have a limited understanding of the ways that transnational relationships interact with domestic politics to influence the policymaking processes of individual nations.

This dissertation examines the evolution of politics in an era of deepening globalization and economic interdependence. In the early stages of trade liberalization, governments often play a leading role in bringing down trade barriers through bilateral, regional, and global agreements. State action is usually necessary to compel protectionist countries to accept foreign direct investment and to treat foreign firms fairly. This state action is often guided by the preferences and influence of major multinational firms looking to penetrate markets abroad. Although these firms cannot open markets on their own, they can provide information that informs the content of trade negotiations, influencing which countries are targeted for increased investment and the specific form that agreements eventually take.

Once initial restrictions on foreign investment are removed, these foreign firms are then able to enter a country and act independently on their own behalves. In some cases, they may continue to call on their home governments to pressure a target country for more favorable terms or to bring cases of trade discrimination to the World Trade Organization. But in other cases, these firms may choose not to bother with their home governments at all. By virtue of their initial entry into the target country, multinational firms are increasingly able to act through other “insider” channels of influence that were previously only available to firms native to the target country. These “foreign” firms may even be able to cooperate with actors in the target country to accomplish their aims, altering the domestic political outcomes of that country.

In these ways, the initial entry of firms into a target country transforms them into micro forces of globalization that influence that country from the inside out; foreign pressure becomes internalized through the market entry of these firms, with their economic activities often resulting in political consequences. However, these firms’ interests are sometimes difficult to fathom; they are not necessarily synonymous with the interests of their home countries. In many cases, firms may share their home government’s desire to increase liberalization in a target country, but in other cases, they may act to keep other foreign firms out of the market in which they have recently gained a foothold.

Understanding the aims and strategies of these firms is akin to understanding the new politics of the international political economy. States are still important actors in international relations, and in many cases, their action is required in order to facilitate the early stages of trade liberalization. States also play a key role in defining the way that policies are implemented within their borders. However, the ways that this liberalization is implemented and the ways that

it manifests in each individual country is often also dependent on the firms actually attempting to do business internationally using the newly negotiated rules. The early stages of trade liberalization thus have important and lasting consequences for both the economic and political future of a country. Moreover, as more countries embrace deepening levels of economic interdependence, this interaction between states and firms on increasingly equal ground is likely to become more prevalent and more important to understand. We are in the midst of an important shift away from a time when governments were the leading actors in policymaking and toward a period where multinational firms are also becoming agents of globalization in their own right.

In this dissertation, I analyze variation in the political strategies of firms in order to shed light on this transition and to better understand how globalization and liberalization alter the political dynamics of advanced industrial countries. I tackle two related questions. First, how do the early stages of trade liberalization affect the opportunities for multinational firms to influence the policies of a target country? Second, what factors explain the varying patterns of corporate political activity that we often see across different sectors in a country?

In order to answer these questions, I conduct a cross-sectoral analysis of Japan, a country that was notoriously closed to foreign business and investment in many sectors until the 1990s. Focusing on a cross-sectoral comparison within Japan has several distinct advantages. First, examining the behavior of foreign firms and associations in a single country allows the analyst to control for a host of domestic institutional, historical, and cultural variables that might otherwise confound the study. Sectors represent distinct configurations of more basic economic characteristics; as a result, a sectoral approach enables researchers to tease out the ways that these economic variables shape firms' incentives for how they interact with one another and the state. Recent studies have challenged the scholarly tendency to characterize "national" systems of capitalism, arguing that there is evidence for the existence of more differentiated "sectoral varieties of capitalism" or sector-specific political economies within the same national system.<sup>1</sup> Importantly, by conducting research at the sectoral level, the key concepts developed in this research can be readily deployed and explored in other national contexts. In this sense, Japan acts as an arena in which to examine the political and economic dynamics of different sectors, which will help us to understand how these industries function in countries around the world.

Second, despite the variation in sectors, Japan as a whole can be conceptualized as an extreme case of trade protectionism among advanced industrial countries. As will be further discussed in Chapter 2, Japan has had the lowest levels of inward foreign direct investment of all OECD countries and has encountered much international criticism for its maintenance of trade barriers over the post-World War II period. The relatively closed orientation of Japan until recently makes it easier to trace the ways that changes in trade policy have created opportunities for multinational firms and to pinpoint the mechanisms by which these firms have in turn influenced the domestic politics of Japan. The identification of these causal mechanisms is an essential step in building theory that can be subsequently tested in a variety of contexts.

Drawing on data from two years of field research in Japan, including archival material, market data, newspaper articles, direct observation, and interviews, I examine the influence of

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<sup>1</sup> For an example of a prominent framework characterizing national-level models of political economy, see Peter Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundation of Comparative Advantage* (Oxford: Oxford University Press, 2001). For works arguing in favor of a sector-differentiated approach, see Scott Kennedy, *The Business of Lobbying in China* (Cambridge, MA: Harvard University Press, 2005); Colin Crouch, Martin Schroder, and Helmut Voelzkow, "Regional and Sectoral Varieties of Capitalism," *Economy and Society* 38, no. 4 (2009).

foreign multinational corporations on the Japanese policymaking process across sectors and across time. In particular, I focus on case studies of four sectors in which distinctly different patterns of corporate political activity manifest: agriculture, pharmaceuticals, insurance, and information and communications technology. I analyze these sectors from after World War II to the present, with particular attention to shifts in the 1990s and 2000s.

In terms of changes over time, I find that while the role of foreign firms was limited by formal and informal barriers during the high-growth era, options increased with the removal of trade barriers, regulatory reform, institutional changes and shifts in the political environment that began in the 1970s and accelerated in the 1990s. In the early period, these changes were largely driven by overt governmental pressure, particularly from the United States. Over time, drivers of change internal to Japan also began to play a more important role in the country's transformation. In particular, Japan's economic stagnation in the 1990s led to the decline of the major institutions of the postwar Japanese model, to public dissatisfaction with the handling of economic affairs, and eventually, to economic reform. All of these changes opened up room for foreign firms first to enter to Japan and then to play a more active role in the Japanese political economy once inside.

However, the manner in which the Japanese market opened had consequences for politics; the cross-sectoral portion of the analysis reveals that the pattern of internationalization in a sector shapes firms' political strategies by defining the scope of potential coalitions and tactics available. In sectors such as agriculture where internationalization in Japan has been minimal, foreign actors' political strategies still focus on lobbying their respective home governments; thus, foreign business interests are embedded in the two-level game of classic trade politics; the private sector relies on its home government to act as a conduit for their demands. In sectors that have experienced significant internationalization in Japan, understanding the precise mix of political strategies used by foreign firms requires investigating the cleavages that internationalization creates in both the home and target countries. It is necessary to look beyond traditional variables such as factor endowment or factor mobility in determining political cleavages because many political battles are now not about if countries should liberalize but how they should liberalize. The cases of pharmaceuticals, insurance, and information and communications technology offer three different examples of sectors where a distinct pattern of internationalization led to very different political strategies for foreign firms in Japan.

Although corporate political strategy comes in many forms, the analysis here focuses specifically on patterns in the formation of political coalitions between foreign firms and Japanese actors, both public and private. The key concept I employ is that of a *cross-national coalition*, which I define as an alliance between Japanese and foreign actors who consciously coordinate strategies and pool resources in pursuit of mutual aims. These coalitions can increase the influence of foreign firms by allowing them to utilize strategies that were previously open to insiders in the Japanese system. However, not all patterns of internationalization in a sector allow for the formation of cross-national coalitions. When Japanese actors are divided, foreign firms may be able to form cross-national coalitions, but divisions among foreign firms may also complicate the policymaking process, creating situations that produce competing cross-national coalitions or situations in which foreign firms who have achieved market success in Japan try to shut out all new market entrants, both foreign and Japanese alike. These varying configurations of coalitional formation will be examined in detail in the body of this dissertation.

This chapter begins with a brief discussion of the evolution of models of interstate relations in political science before proceeding to a discussion of the literature on multinational

firms and government-business relations. The subsequent section of the chapter delves into conceptualizations of firm strategy, distinguishing between market strategy and political strategy. I then present the theoretical framework that I use to blend the study of corporate strategy with the literature on transnational interactions, introducing the concept of the cross-national coalition in further detail. The final sections of the chapter describe the rationale for selection of the four sectors that provide the bulk of the analysis in this dissertation. I close with a brief overview of the chapters.

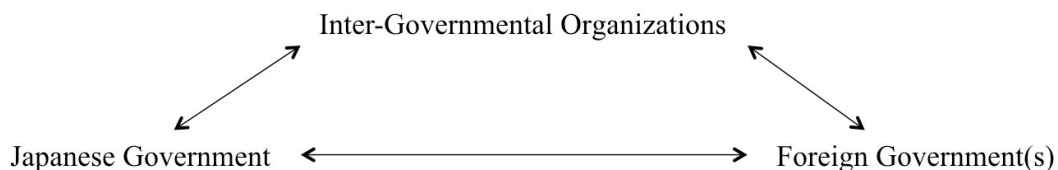
It is my hope that this research will shed new light on the complexities of government-business relations in an increasingly globalized world. As economic globalization has led to the proliferation and diffusion of foreign multinational corporations across the globe, the domestic-international nexus of policymaking has also grown more complex. At the same time that trade liberalization has progressed and interdependence has deepened, the nature of trade politics has also shifted from a focus on manufacturing to a very different world of services. As technology and issues become more complex, firms and governments now find themselves increasingly intertwined with one another. These interconnections blur the distinctions between comparative politics and international relations; they call for a synthesis of not only political science scholarship but also of relevant literature from economics, sociology, business, and area studies.

## 1.1 Models of Inter-State, Transnational, and Cross-National Politics

Although few would deny that globalization and interdependence have changed world politics, it is difficult to precisely pin down the ways that they have done so. The scholarly literature on this topic has gone through a gradual evolution from conceptualizing domestic politics and international relations as separate spheres to recognizing the increasing importance of domestic-international nexus in economic policymaking. The lines between the “domestic” and the “international” have become progressively blurrier, creating a need for new frameworks to accommodate this changing reality.

The classic paradigm of interstate politics focuses on governments as the agencies through which societies deal politically with each other. Interstate politics is conceptually distinguished from domestic politics, and it is often analyzed as if states are unitary actors with well-defined national interests. International institutions are easily accommodated within this framework, and do not seriously challenge the assumption that states are unitary. Figure 1.1 illustrates this view of interstate politics with specific reference to Japan:

Figure 1.1 The Classic View of Interstate Politics

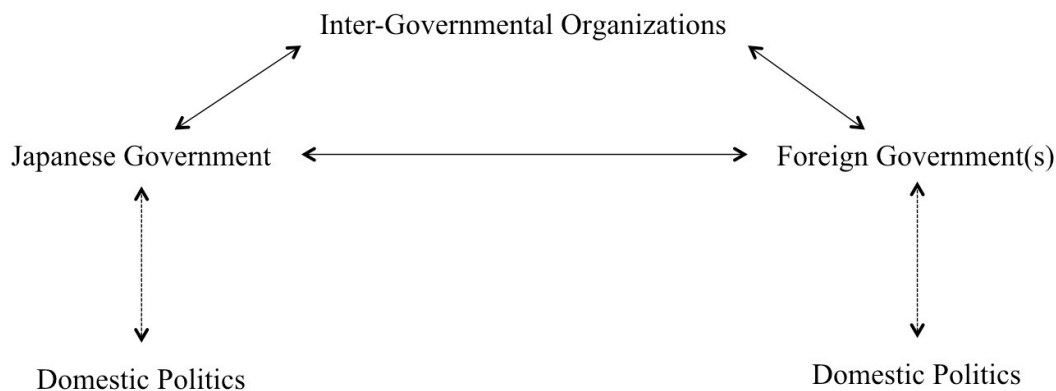




This kind of framework was prevalent in early international relations scholarship, and it is still employed in some contemporary research, although the assumption of the state as a unitary actor has come under intensifying criticism over time.

In recognition of the increasing importance of the interaction between the domestic and international arenas, subsequent scholarly frameworks attempted to enhance the classic view of interstate relations by modeling the interaction of the two arenas. As aptly described by Robert Putnam, the field needed "...to move beyond the mere observation that domestic factors influence international affairs and vice versa, and beyond simple catalogs of such influence, to seek theories that integrate both spheres, accounting for the areas of entanglement between them."<sup>2</sup> Putnam's solution is the "two-level games" framework, in which government leaders are simultaneously playing games on two separate fronts. Domestically, they must satisfy constituents who have specific policy preferences, and internationally, they must maximize their own ability to satisfy these domestic pressures while also minimizing the adverse consequences of foreign developments. Consequently, the negotiating behavior of these government leaders reflects the dual imperatives of both the domestic and international political games, as depicted in Figure 1.2:

Figure 1.2 Interstate Politics as a Two-Level Game



Putnam's framework offers useful insights into the domestic-international nexus of politics and has subsequently been built upon by scholars working across a wide array of subject matter.<sup>3</sup> However, it is fundamentally based upon the state-centered paradigm of international relations; in short, it underemphasizes the way that the domestic political games of various countries are linked by actors who are fundamentally transnational.

This concept of the transnational has been explored by a different school of research established by Joseph Nye and Robert Keohane, who draw attention to the slew of international activity taking place outside official government-to-government contact.<sup>4</sup> In contrast to both the

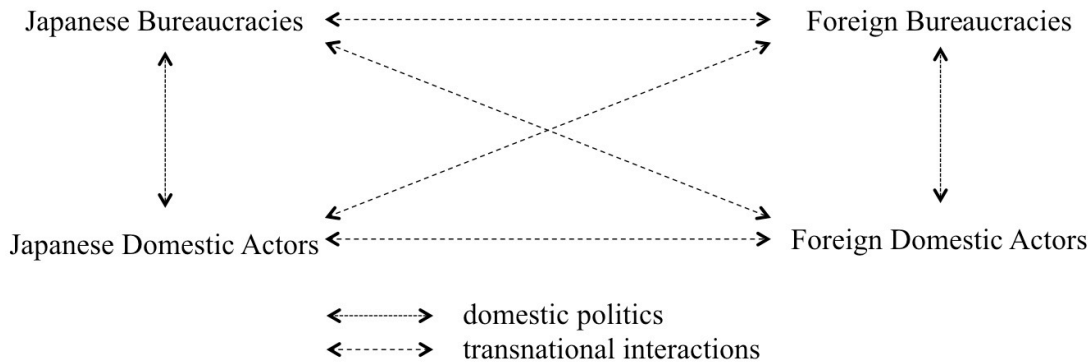
<sup>2</sup> Robert Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," *International Organization* 42, no. 3 (1988): 433.

<sup>3</sup> Peter Evans, Harold Jacobson, and Robert Putnam, eds., *Double-Edged Diplomacy: International Bargaining and Domestic Politics* (Berkeley: University of California Press, 1993); Leonard Schoppa, *Bargaining with Japan: What American Pressure Can and Cannot Do* (New York: Columbia University Press, 1997).

<sup>4</sup> Joseph Nye and Robert Keohane, "Transnational Relations and World Politics: An Introduction," *International Organization* 25, no. 3 (1971).

classic view of interstate relations and the two-level games model, scholars of transnational interactions disaggregate the unitary “state” into its constituent bureaucracies, which possess separate roles and capacities and may often have competing interests with one another. Thinking about states in this way reveals a new international landscape filled with mezzo-level connections between bureaucracies and domestic actors such as businesses or civil society groups, the latter of which are also capable of engaging in transnational interactions. An adaptation of their approach is illustrated in Figure 1.3:

Figure 1.3 International Politics as Patterns of Transnational Interactions



This framework captures the horizontal connections that firms have formed with one another in the form of inter-firm networks.<sup>5</sup> Disaggregating the state into individual bureaucracies also allows scholars to incorporate the lessons of organizational behavior literature and recognize the ways that “national” policy decisions are closely related to the interests of specific bureaucracies in increasing their influence and discretionary power.<sup>6</sup>

In this dissertation, I build upon each of these frameworks and analyze the conditions under which each can be most appropriately applied to the dynamics of a sector. In general, international politics have moved away from the simple model described by the classic view of interstate relations, but the two-level games framework still aptly describes some sectors that has experienced very limited liberalization, as will be seen in the discussion of Japanese agriculture in Chapter 3. In many other sectors, the model of transnational interactions is much more apt and enables analysts to recognize dynamics that have been underemphasized in studies of international relations. For example, cases of multinational firms engaging in joint lobbying of a government fall into the transnational interactions framework, and are explored in Chapters 4, 5, and 6 of this dissertation. The transnational interactions framework also allows analysts to examine the ways that the organizational interests of government bureaucracies may lead them to find more common ground with foreign actors than their traditional domestic allies.<sup>7</sup>

<sup>5</sup> Walter W. Powell, "Neither Market nor Hierarchy: Network Forms of Organization," *Research in Organizational Behavior* 12 (1990); Ranjay Gulati, "Alliances and Networks," *Strategic Management Journal* 19 (1998).

<sup>6</sup> See for example, Junko Kato, *The Problem of Bureaucratic Rationality: Tax Politics in Japan* (Princeton: Princeton University Press, 1994), 35; John Campbell, "Policy Conflict and Its Resolution within the Governmental System," in *Conflict in Japan*, ed. Ellis Krauss, Thomas Rohlen, and Patricia Steinhoff (Honolulu: University of Hawaii Press, 1984).

<sup>7</sup> See Glenn S. Fukushima, "No Double View of Japan," *Japan Policy Research Institute (JPRI) Critique* 3, no. 6 (1996).

While Nye and Keohane's concept of the transnational is often a useful tool, in this dissertation, I introduce a different concept of a cross-national coalition in order to gain more analytical traction over the ways that international politics and domestic politics interact. I intentionally use the term cross-national instead of transnational because I consider the two terms to be conceptually distinct. While the term transnational suggests an alliance or network that is more global in scope, cross-national in my usage indicates the involvement of actors from a smaller number of countries and allows for the examination of bilateral cases.<sup>8</sup> Examination of cross-national coalitions and networks can help us to gain insight into global dynamics, not only by generating generalizable hypotheses but by illustrating ways that the processes of globalization may be concentrated more heavily in certain bilateral or regional relationships. In this sense, these relationships are not truly "global" and this limitation of scope must be recognized.

This definition differentiates coalitions from more ubiquitous transnational "networks" that have been identified as important parts of policymaking and governance.<sup>9</sup> Coalitions might be thought of as "networks in action."<sup>10</sup> In contrast to networks that seem to exist everywhere all the time, cross-national coalitions occur where these cross-border networks collide and intersect with the domestic policymaking process. Compared to networks, coalitions involve more routine communications, more clearly defined expectations and efforts at mutual support, and more explicit commitment to specific campaigns. Coalitions tend to be defined around very specific and limited objectives, with few long-term commitments to sustained transnational cooperation.<sup>11</sup> In this dissertation, a cross-national coalition occurs when Japanese domestic actors join with foreign counterparts to consciously coordinate strategy and to pool resources in pursuit of mutual aims. While my project focuses primarily on coalitions between government actors and firms, the concept of a cross-national coalition could include any configuration of actors from different countries. Coalitions will be discussed in greater detail in the subsequent discussion of corporate strategy in this chapter.

The multinational firm is an ideal vehicle through which to study the nexus of domestic politics and international relations because it so often finds itself operating at this very crossroads. However, the role that firms play within the greater political economy is often ambiguous. The next section provides a brief overview of the literature on government-business relations in order to contextualize the role of multinational firms in debates about international and comparative political economy.

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<sup>8</sup> For a similar use of the term "binational" see, Jonathan Fox, "Assessing Binational Civil Society Coalitions: Lessons from the Mexico-U.S. Experience," in *Cross-Border Dialogues: U.S.-Mexico Social Movement Networking*, ed. D. Brooks and Jonathan Fox (La Jolla: Center for U.S.-Mexican Studies, University of California, San Diego, 2002).

<sup>9</sup> Margaret Keck and Kathryn Sikkink, *Activists Beyond Borders: Advocacy Networks in International Politics* (Ithaca: Cornell University Press, 1998); Anne-Marie Slaughter, *A New World Order* (Princeton: Princeton University Press, 2005); Jackie Smith, *Social Movements for Global Democracy* (Baltimore: The Johns Hopkins University Press, 2007).

<sup>10</sup> Keck and Sikkink, *Activists Beyond Borders: Advocacy Networks in International Politics*.

<sup>11</sup> Smith, *Social Movements for Global Democracy*; Fox, "Assessing Binational Civil Society Coalitions: Lessons from the Mexico-U.S. Experience."

## 1.2 The Multinational Firm and Government-Business Relations

The influence of business on government (and vice versa) has long been of interest to scholars of political science, across essentially all of the subfields of the discipline. Government-business relations have been an important part of the debates on interest representation in comparative politics. Theories of pluralism became popular in the 1950s and 1960s, depicting the state as an arena in which multiple pressure groups compete for political influence; in extreme versions of pluralism, these battles between businesses and other societal groups determined outcomes with little direct involvement from the state. Theories of corporatism took a different approach, emphasizing the role of business and other key groups in working closely with the state to formulate policy.<sup>12</sup> These schools of thought later led to the emergence of theories regarding different national models of political economy, wherein firms structure their relationships differently depending on distinct configurations of national institutions. For example, the Varieties of Capitalism literature characterized national economies as Coordinated Market Economies or Liberal Market Economies based on whether firms solved their coordination problems primarily through relational or market mechanisms.<sup>13</sup>

The multinational firm presents an interesting puzzle for these differing analytical perspectives, each of which is to some extent concerned about how national models of interest representation and government-business relations are and will be affected by processes of increasing globalization and deepening interdependence.<sup>14</sup> On one hand, foreign multinational firms have been seen as a force for the transmission of foreign norms, practices and interests into host countries, raising questions about the ways that they might affect domestic patterns of interest representation or negotiation. The growth of foreign direct investment is thought to diminish the power of states to control economic events, and increased economic interdependence is generally seen as leading to the development of domestic constituencies that support further liberalization of trade policies. This has allowed some analysts to predict the retreat of the state, arguing that "...the impersonal forces of world markets, integrated over the postwar period more by private enterprises in finance, industry and trade than by the cooperative decisions of governments, are now more powerful than the states to whom ultimate political authority over society and economy is supposed to belong."<sup>15</sup> In this view, when combined with the forces of interdependence and globalization, business power has grown so large as to disrupt national models and overpower states.

On the other hand, many studies have pointed out the demise of the state has not yet occurred and that national governments still retain a large degree of influence over their domestic economies. Differing models of capitalism have not converged; existing institutional arrangements remain powerful in shaping political interests and the conflicts between them, even

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<sup>12</sup> Philippe Schmitter, "Still the Century of Corporatism?," *The Review of Politics* 36, no. 1 (1974), pp. 93-94.

<sup>13</sup> Hall and Soskice, *Varieties of Capitalism: The Institutional Foundation of Comparative Advantage*.

<sup>14</sup> Although it is not the focus of this analysis, it is useful to distinguish between the concepts of interdependence and globalization. The term interdependence captures the shared vulnerability and sensitivity that now characterizes the international political economy, while globalization refers to the gradual movement toward one integrated world market or global society. See Michael Zurn, "Globalization and Governance," in *Sage Handbook of International Relations*, ed. Walter Carlsnaes, Thomas Risse, and Beth Simmons (Los Angeles: Sage, 2012).

<sup>15</sup> Susan Strange, *The Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: Cambridge University Press, 1996).

in the case of multinational firms.<sup>16</sup> Instead of firms simply eclipsing states in importance, the very nature of international diplomacy has changed. Governments and firms now find themselves negotiating with one another on much more equal footing than before.<sup>17</sup> Both governments and firms find themselves with many more policy tools; however, they are also presented with complex problems in which political and economic factors are intertwined. They can work together as potential partners to achieve shared aims or sabotage one another.

Moving away from characterizing the relationship between business and the state as a zero-sum battle requires a more nuanced understanding of what each set of private and public actors want and how these interests interact. Business preferences are often treated as a key determinant of trade policy by the literature on international political economy. In many theories, business preferences are largely related to material interests. Some scholars have drawn on the Stolper-Samuelson theorem to argue that business preferences are essentially determined by whether a party owns factors of production that are scarce or abundant; if this is true, debates over trade policy should result in the formation of class-based coalitions, with holders of abundant and/or globally competitive factors supporting trade liberalization and holders of scarce or uncompetitive factors favoring protectionism.<sup>18</sup> Other scholars employing the specific-factors or Ricardo Viner model have pointed out that some factors of production are more mobile between different industries than others, arguing that the real divides are sectoral and not class-based.<sup>19</sup> Drawing on these and other similar theories, most trade policy scholars follow an analytical model in which material interests drive firms and other societal actors to put pressure on politicians.<sup>20</sup>

However, this type of approach often underplays the ways that governments and private actors form their interests and preferences in interaction with one another, each sometimes shaping the other. For example, Cornelia Woll compellingly argues that the traditional IPE literature was better suited to an examination of tariff negotiations in the trade of goods than for the study of new trade issues such as service trade or regulatory harmonization. When the issue is no longer whether to liberalize but how to liberalize, firms and governments must base their relationships more on information exchange than on simple exertion of pressure.<sup>21</sup> These and similar innovations in the existing scholarship are moving the study of government-business relations to a place where the interplay between these actors is multi-directional and increasingly complex; firms may influence policy outcomes, but policies and politics in turn influence

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<sup>16</sup> See John Zysman, "How Institutions Create Historically Rooted Trajectories of Growth," *Industrial and Corporate Change* 3, no. 1 (1994); Steven Vogel, *Japan Remodeled: How Government and Industry Are Reforming Japanese Capitalism* (Ithaca: Cornell University Press, 2006).

<sup>17</sup> See for example, John Stopford, Susan Strange, and John Henley, *Rival States, Rival Firms: Competition for World Market Shares* (Cambridge: Cambridge University Press, 1991).

<sup>18</sup> Jeffrey Frieden and Ronald Rogowski, "The Impact of the International Economy on National Policies: An Analytical Overview," in *Internationalization and Domestic Politics*, ed. Robert Keohane and Helen Milner (Cambridge: Cambridge University Press, 1996).

<sup>19</sup> James Alt et al., "The Political Economy of International Trade: Enduring Puzzles and an Agenda for Inquiry," *Comparative Political Studies* 29, no. 6 (1996). Hiscox (2002) bridged these two perspectives by arguing that class coalitions are more likely where factor mobility is high, while sectoral coalitions predominate in cases of low factor mobility. See Michael Hiscox, *International Trade and Political Conflict: Commerce, Coalitions, and Mobility* (Princeton: Princeton University Press, 2002).

<sup>20</sup> Jeffrey Frieden and Lisa Martin, "International Political Economy: Global and Domestic Interactions," in *Political Science: The State of the Discipline*, ed. Ira Katznelson and Helen Milner (New York: Norton, 2002).

<sup>21</sup> Cornelia Woll, *Firm Interests: How Governments Shape Business Lobbying in Global Trade* (Ithaca: Cornell University Press, 2008).

business demands. This becomes even more complex when one considers the interplay of shifting interests between domestic firms and foreign firms, the latter of which are increasingly difficult to distinguish from the former. Consequently, a more differentiated and nuanced analysis of firms' preference formation process is necessary.

My argument is that firms' preferences and their corresponding market and political strategies are shaped by the path-dependent processes of trade liberalization that occur in a country. If a sector is completely liberalized all at once, this shapes firms' preferences and strategies in a very different manner than if a sector is only partially opened. Moreover, sectors that are partially opened may develop different political dynamics depending on the exact manner in which that partial opening occurred. The pattern of internationalization in a sector shapes the opportunities for firms to employ political strategies, interacting with their material interests and their relationships with other actors.

In addition, further analytical benefit can be derived from breaking down the idea of a national model of political economy into a more nuanced and specific sectoral analysis. If firms' interests are not reliably inferred through simple models based on factor endowment and factor mobility, and if analysts need to account for complex patterns of interaction between government and business, then it is difficult to form generalizations on a national basis. "Business" cannot be treated as a single coherent interest group; sectoral and even individual differences are empirically and normatively significant and must be taken into consideration.<sup>22</sup> Moreover, the relative political influence of firms and industries may vary over time.<sup>23</sup> Understanding these factors can help us understand counterintuitive outcomes in which firms seem to lobby against their apparent material interests. There is a need to look more at the sectoral and firm-level differences that exist within the business community, as well as a need to bridge the literatures of business, economics and political economy.

### 1.3 Conceptualizing Firm Strategy

The next step in understanding the complexities of government-business relations is to delve more deeply into the activities of firms themselves in order to define the primary dependent variable of this study: firms' political strategy, and in particular, firms' propensity to form cross-national coalitions. This section provides a brief overview of the existing business literature on market and non-market environments and associated strategies.

Much of the existing business literature describes firms as embedded in both "market" and "non-market" environments. The market environment is commonly defined as interactions between firms and other parties that take place through markets or private agreements such as contracts.<sup>24</sup> Interactions are typically voluntary and involve economic transactions and the exchange of property. In contrast, the non-market environment includes the social, political and legal arrangements that structure interactions outside of but in conjunction with markets and private agreements; this term is often used to describe all aspects of a firm's environment that are not explicitly related to its core business. For example, Baron argues that the non-market

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<sup>22</sup> See David M. Hart, "'Business' Is Not an Interest Group: On the Study of Companies in American National Politics," *Annual Review of Political Science* 7 (2004).

<sup>23</sup> See David Vogel, *Kindred Strangers: The Uneasy Relationship between Politics and Business in America* (Princeton: Princeton University Press, 1996), 298-322.

<sup>24</sup> David Baron, *Business and Its Environment*, 7th ed. (Prentice Hall, 2012).

environment of a firm or industry is characterized by four factors: issues, interests, institutions, and information.<sup>25</sup> Governments represent major sources of uncertainty for firms because they often control critical resources and opportunities that shape firms' industry and competitive environments.<sup>26</sup> Activities may be voluntary, as when a firm cooperates with government requests, or involuntary, as when a government regulates an activity or an activist group organizes a boycott.

The market and non-market environments of a firm are strongly interrelated. The market environment determines the significance of non-market issues to a firm, while the non-market environment shapes business opportunities in the marketplace. In theory, firms need separate strategies to deal with the market environment (i.e., market strategies) and the non-market environment (i.e., non-market strategies); in practice, however, firm strategy must integrate both market and non-market considerations.<sup>27</sup> Market strategies are generally focused on increasing profits, market share, or other aspects of the firm's performance through produce marketing, research and development, or other activities. Non-market strategy is often targeted toward the government through lobbying or toward the public through public relations or philanthropic activities designed to increase goodwill toward the firm.

In this project, I embrace the term political strategy instead of non-market strategy. The reasons for this are twofold. First, the term non-market often creates the false impression that firm strategy can be reliably classified as either market or non-market in nature.<sup>28</sup> In practice, this is often not the case; while some strategies may be clearly characterized, but many others occupy a murky middle territory. For example, if a foreign firm acquires a Japanese firm in order to gain access to its political resources, is this a market or a non-market strategy? It is unclear. I therefore conceptualize firm strategy as a continuum between market strategy and political strategy rather than as a simple dichotomy. Second, the term non-market is often used as a catchall term to refer to a host of different activities. As mentioned above, non-market strategies can include activities such as philanthropy; however, in this study, I focus on political strategies intended to influence regulations and laws.

Corporate political strategies are likely to be more important the more opportunities are controlled by the government, as in the case of highly regulated industries or in countries where the government plays a more direct role in industry; public opinion and ethical considerations can also be important factors. Political issues also have a life cycle that affects business strategy.<sup>29</sup> The firm has greater flexibility and a wider range of alternatives the earlier it catches an issue. For example, if an issue is identified early, strategies can be directed at affecting the development and framing of this issue, preempting the formation of interest groups around divisive points. At later stages in the issue life cycle, firms must shift their focus to adaptation, compliance, and damage control.

Since successful companies are likely to integrate their market and political strategies, it is nearly impossible for an observer to disentangle the two and to attribute a particular

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<sup>25</sup> Ibid.

<sup>26</sup> See Amy Hillman and William Wan, "The Determinants of MNE Subsidiaries' Political Strategies: Evidence of Institutional Duality," *Journal of International Business Studies* 36, no. 3 (2005).

<sup>27</sup> See for example, Vinod Aggarwal, "Analyzing American Firms' Market and Nonmarket Strategies in Asia," in *Winning in Asia, U.S. Style: Market and Nonmarket Strategies for Success*, ed. Vinod Aggarwal (New York: Palgrave Macmillan, 2003).

<sup>28</sup> For a strong critique of the false dichotomy between states and markets, see Steven Vogel, "Marketcraft: How Governments Make Markets Work (or Not)," (University of California, Berkeley, 2016).

<sup>29</sup> See Baron, *Business and Its Environment*.

company's success or failure to solely a market or political variable. However, looking at the interplay of these factors is essential to understanding the complex interrelationship between business and government. Instead of trying to explain success or failure of a specific company or industry, this project instead focuses primarily on political strategies and the factors that lead firms and industries to choose one kind of political strategy over another. The business literature on firm strategy provides a useful set of tools, but these tools are often employed in isolation from larger discussions of international politics. The next section attempts to address this by incorporating some of the ideas of firm strategy with models of international relations through the concept of the cross-national coalition.

#### 1.4 Corporate Political Strategy in a Globalizing World

While the international business literature has often discussed the complexities of market and political strategies prior to a multinational firm's initial entry into a target country, much less research has been directed toward post-entry corporate political strategies.<sup>30</sup> This is important because once firms are inside a target country, they gain the ability to act more independently with less assistance from their home governments. Multinational firms operating around the world today have a large number of potential political strategies and pathways at their disposals, some of which may be focused in their home country and others of which may take place in a host country. Still other political strategies may be employed outside any particular domestic arena in the realm of purely international politics.

In some cases, firms may be acting within their own home domestic arena, engaging in what some might characterize as their own national model of political economy and interest representation. They might fight it out with other domestic interests in order to convince their home government to lobby on their behalf in international negotiations. If they do so, firms have a role to play in what Putnam calls the "two-level game" of international negotiations; business interests are an important part of the domestic constituency that international negotiators must satisfy while also trying to strike a deal with their counterparts from other countries.<sup>31</sup> If this is true, firms' corporate strategies are embedded in the classic view of interstate relations described at the beginning of this chapter. Figure 1.5 illustrates the potential political strategies available to firms under the classic view of interstate relations and in the two-level games model. In cases where liberalization is limited, foreign firms have a menu of options that looks very similar to this model.

But in many cases, the classic view of interstate relations and trade politics no longer encompasses the full range of corporate political strategies. In addition to lobbying their home governments as shown in Figure 1.5, multinational firms may be independently and simultaneously 1) trying to influence the domestic politics of another negotiating state and 2) forming cross-national connections with other economic and political actors outside of the context of a specific negotiation. Consequently, understanding the complex interplay of corporate political strategy involves examining the intersection of comparative politics and international relations, as these firms are operating in a blur of what scholars have traditionally characterized as "international" or "domestic" contexts. A savvy firm will employ all of the tools

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<sup>30</sup> See Raymond Vernon, *Sovereignty at Bay* (New York: Basic Books, 1971); John Dunning, *Multinational Enterprises and the Global Economy* (Wokingham: Addison-Wesley, 1992).

<sup>31</sup> Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games."



at its disposal, pursuing its interests through domestic, international and transnational pathways. An expanded model of these political strategies is provided in Figure 1.6. This figure shows how trade liberalization and initial market entry create many more strategic opportunities for firms seeking to influence the politics of a target country. Multinational firms are no longer restricted to their domestic political arena; instead, they can seek a wider variety of allies and partners abroad.

Figure 1.4 Political Strategies Available to Firms in Classic Trade Politics

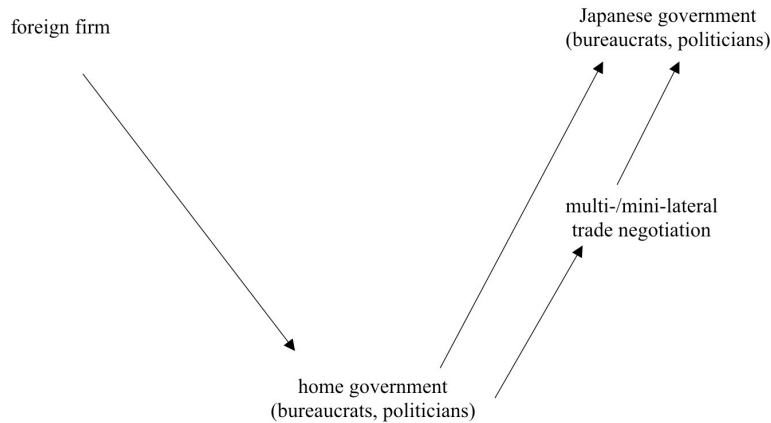
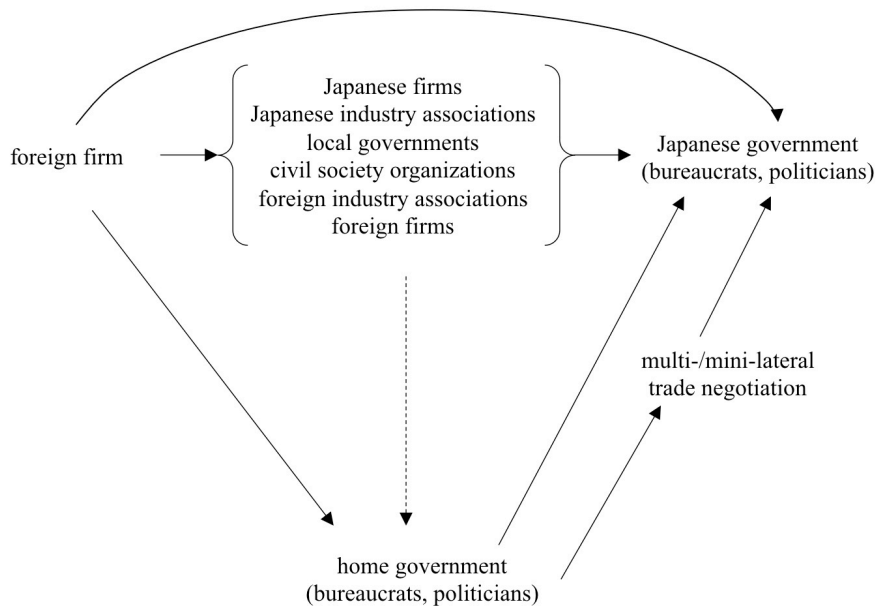


Figure 1.5 Political Strategies Available to Firms After Trade Liberalization



We can think of these different political pathways broadly as outsider and insider approaches, although as in the case of market and non-market strategy, the terms outsider and insider can be thought of on a continuum, with many strategies falling somewhere in the middle.

The strategies listed here are not exhaustive, but they provide a representative list of common political tactics employed by foreign firms seeking to influence political outcomes in a target country.

The most traditional outside approach is for a foreign firm to lobby its home government and request pressure toward a target country. This is an option that is available to firms regardless of whether a sector has been liberalized or not; it is fundamentally compatible with the classic view of interstate relations in which states are the primary actors in international relations. Slightly less outsider approaches involve partnering with other foreign firms or foreign industry associations operating in the target country; the dynamic is still fundamentally a conflict between foreign and domestic firms, but the lines are blurrier since some of these “foreign” firms are operating within the borders of the target country.

In contrast, insider approaches are usually employed within the target country and involve some type of collaboration between foreign firms and domestic actors such as firms, industry associations, local governments, civil society organizations, and government entities in the target country. In short, the majority of these insider strategies involve the formation of a cross-national coalition between a foreign actor and a domestic actor in the target country.

When defining a cross-national coalition, I consider issues of duration and coordination. How long does an alliance need to persist in order to be classified as a coalition, and how much coordination is required for a coalition to exist? In this dissertation, I am not necessarily interested in coalitions that last for decades or even years; rather, I am interested in alliances formed during the course of a particular policy debate or negotiation, whether they persist beyond that specific episode or not. Consequently, situations in which a single issue has been the topic of multiple negotiations can be conceptualized as different cases with potentially different associated cross-national coalitions. By forming coalitions with domestic actors, foreign firms are able to behave as insiders would and access channels of influence that were formerly closed to them. However, it is often difficult for foreign firms to access these insider strategies and form cross-national coalitions with partners in a target country, as will be discussed throughout the dissertation.

Table 1.1 provides a summary of the outsider and insider strategies discussed previously with specific reference to the Japanese case:

Figure 1.6 Sample Political Strategies of Foreign Firms in Japan

<b>Outsider Strategies:</b>	<b>Insider Strategies via Cross-National Coalitions with...</b>
<ul style="list-style-type: none"> <li>• Lobbying home government for pressure</li> <li>• Acting through foreign chambers of commerce</li> <li>• Acting through foreign industry associations</li> <li>• Partnering with other foreign firms</li> </ul>	<ul style="list-style-type: none"> <li>• Japanese firms</li> <li>• Japanese industry associations</li> <li>• Japanese civil society organizations</li> <li>• Japanese local governments</li> <li>• Japanese government officials or ministries</li> </ul>

In the remainder of this section, I attempt to make these strategies less abstract and to provide context for the case studies to follow through a discussion of each of these strategic pathways as seen in Japan. This helps to provide a sense of the tactical diversity employed by foreign multinational firms. There are four main outsider strategies discussed in the body of this dissertation:

1. Lobbying the Home Government to Pressure Japan: This outsider strategy was a common political strategy employed by foreign, particularly American firms, toward Japan. Foreign pressure from the US government played an important role in encouraging the Japanese government to liberalize many sectors such as textiles during the post-World War II period. However, this political strategy has declined in prevalence as issues of market access were resolved and superseded by more complex regulatory issues. Many firms seeking access to the Japanese market actually achieved their goals via government pressure in the 1980s and 1990s; they subsequently found other, less obtrusive ways to pursue their goals or gone on to focus primarily on market strategies. In addition, for those companies who wish to bring government pressure to bear on Japan, the process is generally now much more complicated than it was before. Complex regulatory issues often divide foreign industry, making it more difficult for a national government can face in trying to advocate for the benefit of its companies. There are, however, some areas in which companies are still actively lobbying their home governments, often in sectors where market access is still an important issue.
2. Acting through Foreign Chambers of Commerce: The two most influential foreign chambers of commerce in Japan are the American Chamber of Commerce (ACCJ) and the European Business Council (EBC). These organizations perform a variety of functions to assist foreign firms and sometimes cooperate across national lines if an issue warrants it. They provide “cover” when foreign firms are reluctant to approach the Japanese government on their own. They issue periodic policy reports outlining issues of concern to foreign business and proposing solutions, as well as organizing annual interactions with Japanese politicians. Their subcommittees also provide a venue in which foreign firms can coordinate their interests; however, in some sectors, there are deep industry divides that limit the potential scope of cooperation. Unlike in previous periods, these chambers of commerce are no longer seen as representing invaders; instead of market access, these organizations now seek goals such as better bureaucratic coordination and a “level playing field” that would provide fair conditions for all new market entrants, both foreign and Japanese alike.
3. Acting through Foreign Industry Associations: As in the case of chambers of commerce, foreign firms go to foreign industry associations when they need to do things they cannot easily accomplish alone, such as make broad policy proposals or deal with the Diet. Industry associations tend to play a coordinating role in industry lobbying efforts and in developing an industry consensus. They may help create a division of labor in lobbying efforts that allows each company to reach out to their best allies and extend the influence of the entire industry.<sup>32</sup> Firms can broaden the scope of support for their particular policy objectives and create a more positive image for their policy interests.<sup>33</sup> Foreign industry associations are often perceived by government to be useful sources of information, particularly when complex regulatory issues are concerned.

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<sup>32</sup> See Lee Drutman, *The Business of America Is Lobbying: How Corporations Became Politicized and Politics Became More Corporate* (Oxford: Oxford University Press, 2015).

<sup>33</sup> See Marie Hojnacki, "Interest Groups' Decisions to Join Alliances or Work Alone," *American Journal of Political Science* 41, no. 1 (1997).

4. Partnering with Other Foreign Firms: Foreign firms sometimes find it in their interests to cooperate with one another, but at other times they go to great lengths to shut other foreign competitors out of the market. The cooperative side is often facilitated through organizations like chambers of commerce or industry associations, but there are also alliances on specific issues, and if the problem is seen as one for “US business” or “foreign business” at large, firms may jointly request pressure from their home governments. On the competitive side, it is sometimes the case that foreign firms are deeply divided and in fierce competition with one another. Foreign firms who have been successful in Japan have sometimes been known to make moves to shut out competitors from their home countries, regardless of their shared nationality. Moreover, when industry is divided, it is difficult for a home government to take action on its behalf.

In contrast to these outsider strategies, foreign firms operating in Japan also have the opportunity to utilize insider channels of influence by building cross-national coalitions with domestic actors in Japan. By doing so, foreign firms can leverage increased political resources in order to accomplish their policy goals. This dissertation deals with cross-national coalitions between foreign firms and five main types of actors:

1. Japanese Firms: Foreign firms can form coalitions with Japanese firms as a market strategy, as a political strategy, or as a hybrid of the two. As mentioned previously, a foreign firm may acquire or partner with a Japanese firm that can then act as the “Japanese face” of a foreign company and advocate for the latter’s interests. This could be thought of as a market strategy, but it also has potential political ramifications. While some such partnerships may be pursued explicitly for their political benefits, others may be initially approached as part of a market strategy and may only later be seen as a means through which to achieve goals in the political environment. Coalitions between foreign and Japanese firms can also be entirely political without any market aspect to the coalition such as joint investment. In either case, partnering with Japanese companies can often be unsuccessful. Choosing the wrong joint venture partner can be a major factor in the failure of a foreign firm’s attempt to enter the Japanese market. In more strictly political coalitions, Japanese firms may try to use foreign firms to push for policy change without sacrificing their close relationships to the Japanese government.
2. Japanese Industry Associations: In some cases, foreign firms are able to participate directly in the domestic industry associations of a host country as members. However, foreign firms often have their own separate industry associations, and there is sometimes a complex interplay between these organizations. In some cases, working through a domestic industry association can be beneficial when there are shared interests between both domestic and foreign firms. At other times, domestic industry associations seem happy to let the foreign companies take the lead on certain issues; although the Japanese side shares the same concerns, they prefer to let the foreign companies spearhead lobbying efforts in order to avoid attracting the ire of Japanese regulators or tax authorities.

3. **Civil Society Organizations:** Japan has been notable in the post-World War II period for its relatively low levels of protests and civil society mobilization; most Japanese citizens' groups do not fit the strict definition of civil society because they are not very independent from the state, nor do they position themselves in opposition to the state.<sup>34</sup> Labor unions, consumer organizations, religious organizations, political advocacy groups and the media are all relatively weak. However, this is showing signs of changing due to changes in rules and due to declining public confidence in the Japanese government.<sup>35</sup> These shifts have created room for foreign firms to form coalitions with Japanese civil society organizations on issues of shared concern.
4. **Local Governments:** Another possibility for foreign firms is to form coalitions with local governments in the target country. In the case of Japan, the government is highly centralized, but over time, some responsibilities have been devolved to local governments in order to increase responsiveness, which has created an additional political opportunity for foreign firms. For example, local governments have the ability to decide which drugs to subsidize, even though the Ministry of Health, Labor and Welfare (MHLW) sets overall policy. However, in most cases, partnering with local governments is too labor and time intensive for foreign firms, which are overwhelmingly centered physically and economically in the Tokyo area.
5. **Government Officials and Ministries:** Foreign firms with the greatest political resources may try to form coalitions with government officials and ministries in a target country directly. However, it can be very difficult for foreign entities to cultivate and leverage these kinds of relationships with elites in a host country where the government tends to favor the interests of its own domestic business interests. Explicit or implicit exchange relationships develop wherein domestic firms provide political actors with information, financial resources, and sociopolitical support in exchange for enhanced legitimacy and competitive positions through a variety of policy tools and resources. These ties are particularly strong between domestic firms and the government in Japan, which has been characterized as a corporatist system or coordinated market economy; it can be difficult for foreign firms to gain access to these institutions and individuals due to the long-term relationships characteristic of this system.<sup>36</sup> Politicians also tend to be wary of meeting with representatives of foreign firms due to fears of being accused of wrongdoing.<sup>37</sup> However, in some cases, it is possible for foreign firms to form coalitions with Japanese government actors, particularly if the former can claim that they share the interests of the Japanese public.

This brief examination of the menu of political strategies available to foreign multinational firms illustrates that the latter operate in a very complex environment. A firm's choice of political

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<sup>34</sup> See Frank Schwartz and Susan Pharr, *The State of Civil Society in Japan* (Cambridge: Cambridge University Press, 2003).

<sup>35</sup> See Robert Pekkanen, *Japan's Dual Civil Society: Members without Advocates* (Stanford: Stanford University Press, 2006); Jeff Kingston, *Japan's Quiet Transformation: Social Change and Civil Society in the Twenty-First Century* (New York: RoutledgeCurzon, 2004).

<sup>36</sup> See Yoshito Ishio, "Interest Groups' Lobbying Tactics in Japan and in the US: The Influence of Political Structures and Conflict on Tactical Choice," *Southeastern Political Review* 27, no. 2 (1999).

<sup>37</sup> See Kingston, *Japan's Quiet Transformation: Social Change and Civil Society in the Twenty-First Century*.

strategy is therefore strongly related to the specific issue at hand. There is no one strategy that suits all problems; experienced government relations professionals seek to use all channels of influence at their disposal and to cultivate new sources of influence whenever possible. Therefore, to understand these strategies and the dynamics of government-business interaction, we must engage in systematic analysis of the factors that drive differing patterns of coalitional formation. In this dissertation, this is accomplished by conducting case studies of four key sectors in Japan, which will be described in the next section.

## 1.5 Case Selection and Theoretical Framework

In order to examine corporate political activity over time and across sectors, I chose sectors in which 1) foreign multinational firms are engaged in significant political activity directed toward Japan but 2) differing patterns of corporate political strategy manifest. Four sectors—agriculture, pharmaceuticals, insurance, and information and communications technology—were selected on the basis of this variation in firms’ political strategy. In this section, I explain the rationale for my selection of these four sectors in greater detail and introduce the theoretical framework that serves as a basis for this dissertation.

The aim of this dissertation is to examine the mechanisms whereby foreign firms influence the policy of a target country; in particular, I am interested in varying patterns of coalitional formation that pit foreign and domestic actors against one another or potentially against themselves, depending on the issue at hand. Therefore, I selected my cases based on variation on the dependent variable, coalitional configuration. Table 1.1 illustrates the differing patterns of coalitional configuration that manifest in the agricultural, pharmaceuticals, insurance, and ICT sectors in Japan.

Table 1.1 Coalitional Configurations and Political Dynamics

Sector	Coalitional Configuration	Type
Agriculture	foreign firms vs. Japanese firms	Classic trade politics
Pharmaceuticals	Japanese firms vs. cross-national coalition	Gradual globalization
Insurance	foreign firms vs. cross-national coalition	Selective deregulation
Information technology	cross-national coalition vs. cross-national coalition	Regulatory competition

In the case of agriculture, the coalitional configuration pits foreign agriculture against Japanese agriculture in the style of classic trade politics. Foreign agricultural interests pressure their home governments to pressure Japan to liberalize, while Japanese agricultural interests pressure their own home government to protect them from the vagaries of global competition. Domestic interest groups in each respective country are united. National governments face off against one another in bilateral or multilateral negotiations over agricultural policy.

The pharmaceutical sector, in contrast, is characterized by alliances between globally competitive Japanese firms and foreign firms against smaller, less competitive Japanese firms. This cross-national coalition has pushed the Japanese government to harmonize its regulations,

reduce its drug approval times, and maintain drug prices. The result is gradual globalization, with globally competitive firms pushing the Japanese government to embrace policies closer to international standards. The insurance sector also provides an example of a potential cross-national coalition between foreign and Japanese firms seeking to liberalize the Japanese insurance market, but in this case, their opponents are foreign insurers. The result is selective deregulation, with foreign incumbent firms fighting to slow the pace of deregulation in order to maintain their market share.

In the final sector, information and communications technology, cross-national coalitions are operating on both sides of the issues, leading to a situation of regulatory competition. The battles are fought over global issues, but these global battles are played out in the Japanese domestic arena. Foreign firms are divided on the issues, and they recruit Japanese firms as their allies in these contests to win a favorable regulatory structure.

I argue that this variation in coalitional formation can be explained by differing patterns of internationalization in each sector. In sectors that are not internationalized, such as agriculture, business actors' political strategies focus on lobbying their respective home governments; thus, business interests are embedded in a two-level game, in which the private sector relies on government to act as a conduit for their demands. In other sectors, globalization and trade liberalization have created opportunities for firms to enter Japan and to employ political strategies target toward the Japanese government and private actors. However, the exact nature of these strategies is determined by the manner in which the sector was internationalized. Table 1.2 presents a summary of my argument connecting the pattern of internationalization with the firms' political strategies.

Table 1.2 Connecting the Pattern of Internationalization with Firms' Political Strategy

Sector	Pattern of Internationalization	Firms' Political Strategy
Agriculture	Lack of internationalization	No opportunities for cross-national coalitions; political strategies are focused on lobbying the home government, which advocates on behalf of firms
Pharmaceuticals	Globally competitive companies (both foreign and Japanese) vs. small, non-competitive Japanese companies	Foreign firms form cross-national coalitions with globally competitive Japanese firms to pursue mutual interests
Insurance	Selective market entry by a few politically-backed foreign companies into a specific segment of the market	Foreign firms try to protect their market share by excluding both foreign and domestic firms
Information technology	Global firms determine the regulatory structure and big picture issues; Japanese firms are largely peripheral	Competing cross-national coalitions; Japanese firms recruited as allies in global policy battles between major foreign firms

Understanding the precise mix of strategies that foreign firms use requires investigating the cleavages that globalization creates in both the host and target countries. Determining the type of cleavages at work in a sector allows us to predict the strategic profile that firms will pursue,

which in turn strongly influences their potential for success. The next section lays out the structure of the dissertation and summarizes the main arguments.

## 1.6 Overview of Chapters

In order to understand the ways in which the Japanese political economy has changed and to develop a better sense of the differing dynamics of government-business relations across industries, this dissertation proceeds as follows. In Chapter 2, I trace the major political, institutional and regulatory developments in Japan, arguing that these changes have created greater opportunities for foreign multinational firms to enter the Japanese market. I briefly address the pre-war roots of foreign involvement in the Japanese industrialization process before moving on to a more detailed examination of the post-World War II period. While the involvement of foreign firms was limited in a number of ways initially, options increased with removal of trade barriers, regulatory reform, institutional changes and shifts in the political environment, which began in the 1970s and accelerated in the 1990s. In the early period, these changes were largely driven by overt international pressure, particularly from the United States. However, as time went on, other internal drivers of change began to play a more important role in Japan's transformation, which will be discussed in greater detail.

This general treatment of trade liberalization in Japan sets the stage for the four sectoral case studies. Chapters 3 through 6 explore four sectors with different patterns of industrialization in order to demonstrate the ways that the early stages of trade liberalization affected the strategies of foreign firms and the politics of regulation in these sectors. In Chapter 3, I turn to an examination of the agricultural sector. In order to appreciate the ways that the political strategies of foreign firms have evolved over the course of the post-World War II period, it is instructive to first examine a sector in which government-business relations are still firmly embedded in a two-level games model. In this chapter, I argue that due to the low level of internationalization in the sector and the diffuse nature of potential coalition partners, foreign agricultural interest groups have been extremely constrained in their ability to form cross-national coalitions with Japanese actors in order to pursue their policy goals. Instead, foreign agricultural interest groups have focused their attention on their home governments, channeling their demands through their home government officials, who in turn have sought to influence Japan through both bilateral and regional negotiations.

This discussion of the agricultural sector serves as an important reference point for the discussion in Chapters 4 through 6 because it typifies the politics of most industrial sectors in the days before significant trade liberalization. The politics of agriculture follow the model of classic trade politics in which domestic interest groups are united against foreign interest groups, and state actors play the most important roles in defining the policies that govern the sector. As time has passed and many governments have chosen to open up their economies to some degree, however, the openings created by these policy changes have created opportunities for foreign firms to enter a target country and to form alliances with domestic firms and government actors in order to accomplish their goals. However, the *manner* of this trade liberalization was very important in defining the opportunities available to these foreign firms. Some sectors still resemble agriculture in their politics, but many others function in fundamentally different ways. Chapters 4 through 6 examine three sectors where the pattern of internationalization in a sector looked very different, resulting in different patterns of coalitional formation.



In Chapter 4, I explore the case of the pharmaceutical sector. While initially dependent on home government pressure to open Japanese markets, the foreign pharmaceutical industry became a standout success in terms of cultivating close relationships with the Japanese government, particularly in the 1990s and 2000s. Firms in this sector utilize the full range of insider and outsider corporate political strategies both within Japan and in their home countries and have had a number of major policy successes over the last 20 years. In this chapter, I argue that the pattern of internationalization in the pharmaceutical sector has led to a distinct coalitional configuration that pits the globally competitive players, both foreign and Japanese, against the weaker, smaller players. This distinct pattern has opened up possibilities for foreign firms to cooperate with Japanese firms, industry associations, and government ministries. The opening up of Japanese politics to include greater participation by civil society organizations has also created an opportunity for the industry to leverage issue salience to ally itself with patient groups.

The inverse situation is the case of the Japanese insurance sector, which is the topic of Chapter 5. While Chapter 4 demonstrates how foreign pharmaceutical firms have acted as drivers of deeper liberalization and deregulation, Chapter 5 shows that foreign insurance firms have actually worked to impede or slow regulation of the Japanese insurance sector. I argue that this can be explained by the selective deregulation of the insurance market, which enabled a small number of foreign insurance firms to gain an early privileged position in the Japanese market. In insurance, the pattern of internationalization was characterized by early market penetration by two American companies, Aflac and AIG, which were able to win the support of their home government in order to make sure that further deregulation of the Japanese insurance market worked in their favor. As a result, a dynamic was created in which these first-mover foreign firms attempted to defend their turn from all competitors, both Japanese and foreign alike. Moreover, as early market entrants, they were able to use market strategies to shore up their dominance in preparation for the eventual full deregulation of the Japanese insurance market.

In Chapter 6, I shift to the information and communications technology sector. I argue that the pattern of internationalization has led to a political environment of competing cross-national coalitions. Japanese ICT firms matured in relative isolation from some major global developments, the latter of which were pioneered primarily by American firms. Due to the government-led strategy of development in this sector, Japanese ICT firms tended to cater to their own domestic market, leading them to become somewhat peripheral and reactive to major global debates over policies such as intellectual property and privacy, which are vital for the ICT sector. However, because the dominant foreign firms are divided and engaged in heated battles with one another in multiple national jurisdictions to define laws and regulations, Japanese firms have been drawn into the fray as allies with the potential to tip the political scales. Foreign and Japanese firms have partnered with one another against competing coalitions of other foreign and Japanese actors, each side advocating a different regulatory outcome than the other. This situation is the most different from classic trade politics scenario where domestic actors often presented a united front against foreign influence, as described in the analysis of agriculture in Chapter 3.

Chapter 7 summarizes the main findings from the preceding chapters and offers some extensions of the theoretical framework to other sectors of the Japanese economy such as retail, soft drinks, luxury goods, automobiles, and civil aviation. It also discusses the implications of this research for other advanced industrial countries and for scholarship on the domestic-international nexus of policymaking.

The shift from a world where policy battles were fought between fairly cohesive sets of national actors toward one where policy issues cut across national lines has resulted in a much more complex set of political dynamics than before. Earlier theories of cleavages between importers and exporters are no longer sufficient to capture the complexity of government-business relations; instead, analysts must look at the specific issue at hand in order to discern the cleavages that matter. This dissertation attempts to connect the literature on corporate political strategy and government-business relations with more fundamental debates in political science about the interaction between domestic and international politics. As such, it builds on a wealth of research that has attempted to not only connect these two realms but also to specify under what conditions they intersect.

Globalization is not a uniform force leading to worldwide convergence. It permeates individual countries in distinct ways that are conditioned by existing national institutions. This dissertation also seeks to relate liberalization and market opening with what happens next, offering insights about how liberalization shapes the forces that will later come to impact domestic institutions. The early days of liberalization have important consequences for political cleavages that emerge, creating different opportunities for firms to act, but those cleavages really only structure the potential strategies; firms ultimately exercise the agency to choose their political strategies and further shape the politics of the sector. Understanding the interrelationship between these political and economic variables and the way that they unfold over time is an essential first step toward greater understanding of government-business relations in a globalizing world.

## **2 Gaining Access: The Evolving Role of Foreign Firms in Japan**

No industrialized country has worked as adamantly as Japan to keep foreign firms out of its domestic markets. In order to understand this phenomenon, it is necessary to examine the history of Japan's industrialization and the imperatives driving this process. In this chapter, I trace the major political, institutional and regulatory developments in Japan, arguing that these changes have fundamentally altered the environment in which foreign multinational corporations operate. I briefly address the early roots of foreign involvement in the Japanese industrialization process before moving on to a more detailed examination of the post-World War II period. While the role of foreign firms was limited in a number of ways during the high-growth era, options for their entry into and activity within Japan increased with removal of trade barriers, regulatory reform, institutional changes and shifts in the political environment, which began in the 1970s and 1980s and accelerated in the 1990s and 2000s.

In the early period, these changes were largely driven by overt international pressure, particularly from the United States. However, as time went on, other internal drivers of change began to play a more important role in Japan's transformation. In particular, Japan's economic stagnation in the 1990s led to the decline of the major institutions of the postwar Japanese model, public dissatisfaction with the handling of economic affairs, and eventually, economic reform. All of these changes opened up room for foreign firms to enter to Japan and to play a more active role in the Japanese political economy once inside.

This chapter sets the stage for the sectoral case studies in Chapters 3 through 7. It establishes Japan as an extreme case of trade protectionism among advanced industrial countries and introduces the domestic political and economic institutions that structure interaction across all sectors in Japan. It also demonstrates the piecemeal, gradual liberalization of the Japanese economy, which is essential to understanding the subsequent variation observed in coalitional formation patterns across different sectors.

### **2.1 From Expelling the Barbarians to Embracing Western Technology (1600-1930s)**

Foreign capital controls have a long history in Japan dating back to the isolationist policies of the shogun-led Tokugawa government in the 1600s, which closed Japan to most trade and investment from abroad. Western influence was perceived by the shogunate to be a dangerous source of instability. Concerns over the potential spread of Christianity led to the expulsion of Spanish and Portuguese traders, limiting trade with the West largely to the Dutch, who were closely confined to their trading post of Dejima at Nagasaki.

While Japan maintained some contact with its Asian neighbors during this time, its era of relative isolation from the West continued for more than 200 years until American Commodore Matthew Perry arrived in 1853 and demanded that Japan open itself to foreign trade. In 1854, a reluctant shogunate signed the Treaty of Kanagawa permitting access to US ships and the installation of a consul, the terms of which were extended to other countries due to most favored nation guarantees among Western powers. In 1858, Japan signed the Harris Treaty with the US, opening eight ports to foreign trade, surrendering tariff autonomy, and permitting extraterritoriality for foreign residents. Japan later signed similar agreements with other Western powers, and these agreements came to be known as the "unequal treaties," which Japan would

seek to revise for the next nearly four decades. The “foreign threat” posed by the arrival of Perry’s ships and the subsequent foreign incursions exacerbated the internal legitimacy crisis that the Tokugawa government was already facing due to budgetary failings and social discontent over a lack of social mobility. As a result of these combined internal and external tensions, rebel lords rallying under the banner of “honor the emperor and expel the barbarians” eventually overthrew the shogunate in the Meiji Restoration of 1868.

After the Meiji Restoration, Japan embraced modernization and Westernization as a means of national survival, with the goal of ridding itself of the unequal treaties and achieving equal footing with the advanced nations of the world. The government took steps to centralize national power and to build state capacity. The adoption of a Prussian-style constitution centered on the emperor allowed a small group of elites to exercise relatively strong control over the economy and society, though some moves toward political liberalization were gradually made in recognition of growing popular movements.

In an attempt to modernize while still maintaining political control of the industrialization process, the Japanese government sought the knowledge of foreigners while also continuing to limit their direct involvement in the Japanese economy to the greatest extent possible. The government actively called in foreign experts to help provide Japan with the infrastructure and technology necessary to catapult it into the modern age in areas such as manufacturing, textiles, shipping, and mining.<sup>38</sup> There were a number of foreign traders operating in Japan in the early Meiji period, since their domestic counterparts lacked the skills and capacities to trade directly abroad at the time.<sup>39</sup> Foreign enterprises were also essential to Japan’s early growth in areas such as banking and shipping. The Japanese government discouraged foreign ownership of industry. It purchased the few foreign facilities that existed at the time, forbade local entities to borrow from abroad, and repaid the foreign debts of local lords in order to avoid the risk of foreign control resulting from defaults.<sup>40</sup> National control over capital was of paramount importance to the Japanese government, and over time, domestic Japanese industry came to surpass the early dominance of foreign firms in Japan.

As Japan’s development progressed and it began to gain more confidence on the international stage through its victories in the Sino-Japanese War (1894-95) and the Russo-Japanese War (1904-05), its overall policy against foreign loans was somewhat relaxed, but restrictions on foreign investment remained. By the end of World War I, Japan had not only maintained virtually 100 percent control of its trade, banking and shipping, but had actually for the first time become a net capital exporter while avoiding substantial direct foreign investment.<sup>41</sup> From 1868 to 1941, throughout the period from the Meiji Restoration to World War II, there were fewer than 100 foreign-affiliated companies in existence at any one time.<sup>42</sup>

That being said, foreign investment did grow over this period, reaching \$50 million by 1913. Japan’s entry into World War I led to extensive buying of Japanese exports by its allies and an accompanying increase in foreign direct investment, which more than doubled to \$122

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<sup>38</sup> G.C. Allen and Audrey Donnithorne, *Western Enterprise in Far Eastern Economic Development* (London: George Allen & Unwin, Ltd, 1954).

<sup>39</sup> Ibid.

<sup>40</sup> Dan Fenno Henderson, *Foreign Enterprise in Japan: Laws and Policies* (Chapel Hill: University of North Carolina Press, 1973).

<sup>41</sup> Ibid.

<sup>42</sup> Tomoko Hamada, *American Enterprise in Japan* (Albany: State University of New York Press, 1991).

million by 1929 as Japan's demand for foreign capital and technology accelerated.<sup>43</sup> In manufacturing, direct participation by Western firms increased in importance after WWI, particularly in areas that were closely dependent on advanced Western technology. Firm-specific assets led Ford, General Motors, Dunlop, General Electric, and a few other American enterprises to establish control over roughly half of all foreign investment in Japan. For example, in the 1920s, almost all of the cars sold in Japan were made by Ford or General Motors and assembled in new plants in Japan.<sup>44</sup> A number of firms became interested in establishing operations in Japan when the government increased import duties in the 1920s; this period could be considered Japan's first golden age of FDI.<sup>45</sup>

These early foreign investments had a huge impact on Japan's industrial development. Foreign firms were directly involved in the establishment of some of Japan's most successful companies in the electrical machinery and electronics industry, such as NEC, Toshiba, Mitsubishi Electric, and Fuji Electric.<sup>46</sup> They also provided the patents, experience, skill and knowledge that enabled these firms to help close the existing gap vis-à-vis Western firms.<sup>47</sup> Foreign electrical machinery and auto firms introduced production technology that laid the foundation for Japan's machine tool industry, which would become another leading export sector in the post-WWII era.<sup>48</sup>

Even though Japan's political environment opened up somewhat as it moved from the Meiji period into the era of "Taisho Democracy" (1912-1926), relatively strong state control remained a continuous feature throughout this entire period. Economically, the government supported huge family-owned corporate conglomerates known as *zaibatsu* that were essential to the country's development. The *zaibatsu* actually welcomed foreign direct investment and tie-ups with foreign firms in the 1920s, but they eventually encountered opposition on this front from the strongly anti-Western military elements that were gaining power in Japan during this time.<sup>49</sup> As militarism and nationalism began to take hold of the country during the 1930s, the Japanese government once again tightened its control over access to its domestic market, and foreign investment suffered. What few investments remained were eventually expropriated by the Japanese government at the beginning of World War II.

## 2.2 The Post-World War II Pre-Liberalization Period (1945-1960s)

From the end of World War II until the early 1960s, the Japanese government tightly controlled foreign investment on the grounds that its economy was fragile; it was low in capital inputs and technology and required protection for the sake of the national interest. The Allied Occupation did little to reverse Japan's restrictive policies on FDI, fearing that FDI would needlessly

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<sup>43</sup> Mark Mason, "Foreign Direct Investment and Japanese Economic Development," *Business and Economic History* 16 (1987).

<sup>44</sup> Mira Wilkins, *The Maturing of Multinational Enterprise: American Business Abroad from 1914 to 1970* (Cambridge: Harvard University Press, 1974).

<sup>45</sup> Ralph Paprzycki and Kyoji Fukao, *Foreign Direct Investment in Japan: Multinationals' Role in Growth and Globalization* (Cambridge, UK: Cambridge University Press, 2008).

<sup>46</sup> Hamada, *American Enterprise in Japan*.

<sup>47</sup> Paprzycki and Fukao, *Foreign Direct Investment in Japan: Multinationals' Role in Growth and Globalization*.

<sup>48</sup> Kozo Yamamura, "Japan's Deus Ex Machina: Western Technology in the 1920s," *Journal of Japanese Studies* 12, no. 1 (1986).

<sup>49</sup> Hamada, *American Enterprise in Japan*.

complicate the reconstruction process and allow foreign companies to take over weakened and vulnerable Japanese companies.<sup>50</sup> Early Occupation reformers had lofty goals of demilitarizing and democratizing Japan that included key economic reforms such as dismantling of the *zaibatsu*, but many of these policies were stymied or reversed as American leaders began to see Japan as a much-needed bulwark against communism in Asia. The signing of the US-Japan Security Treaty in 1950 marked the beginning of an era where Japan's importance to the US in terms of security granted it concrete economic advantages: namely, access to US markets and the ability to maintain protectionist policies at home. The Japanese state combined these protectionist policies with active promotion of its domestic industry; the Ministry of International Trade and Industry (MITI) took the lead in working closely with domestic firms to nurture specific sectors and prevent "excess" competition.<sup>51</sup> This interventionist approach to economic development has led many to characterize Japan as a "developmental state."<sup>52</sup> Protection and promotion of export-oriented industries was combined with a system of side payments to agriculture and small business, creating a unique coalition that sustained industrial world's longest dominance by a single political party.<sup>53</sup> Under what came to be known as the 1955 system, the Liberal Democratic Party presided over Japan from 1955 until 1993.

As Japan began to reestablish itself after WWII, it witnessed the solidification of several other distinctive structural features of the Japanese political economy that helped to promote close coordination between government and business and within the Japanese business community itself.<sup>54</sup> The financial system centered on bank lending, with the government actively directing the allocation of credit; firms often maintained closed relationships with their "main bank" through their association with an industrial group (*keiretsu*). These industrial groups linked companies horizontally across sectors in long-term relationships with one another, with cross-shareholding often cementing these ties; *keiretsu* also linked firms vertically through extensive supply and distribution networks. The labor relations system combined a grand bargain of wage moderation and few strikes in exchange for what became known as "lifetime employment" for workers. The cooperation and coordination promoted by these complementary institutions naturally worked to exclude foreign economic actors, who had difficulty penetrating Japanese elite networks or accessing resources without the help of the state.

From the perspective of the developmental state, cross-border enterprise mobility threatened the cultivation of domestic industry and the effective implementation of government policies. In short, foreign influence had the potential to disrupt the smooth functioning of the interdependent institutions described above. Therefore, the government tried to influence both the pace at which Japanese firms went multinational and the entry of powerful foreign firms into the Japanese market.<sup>55</sup> The adoption in 1949 of the Foreign Exchange Control Law (FECL) and

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<sup>50</sup> Mark Mason, *American Multinationals and Japan: The Political Economy of Japanese Capital Controls, 1899-1980* (Cambridge: Council on East Asian Studies, Harvard University, 1992).

<sup>51</sup> Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Stanford: Stanford University Press, 1982). For an analysis of how the Japanese government chose which sectors to favor, see Saadia Pekkanen, *Picking Winners?: From Technology Catch-up to the Space Race in Japan* (Stanford: Stanford University Press, 2003).

<sup>52</sup> Meredith Woo-Cummings, ed. *The Developmental State* (Ithaca: Cornell University Press, 1999).

<sup>53</sup> T.J. Pempel, *Regime Shift: Comparative Dynamics of the Japanese Political Economy* (Ithaca: Cornell University Press, 1998).

<sup>54</sup> Vogel, *Japan Remodeled: How Government and Industry Are Reforming Japanese Capitalism*.

<sup>55</sup> Mireya Solis, "From Iron Doors to Paper Screens: The Japanese State and Multinational Investment," in *Japan and China in the World Political Economy*, ed. Saadia Pekkanen and Kellee Tsai (New York: Routledge, 2005).

in 1950 of the Foreign Investment Law (FIL) served to formalize exclusionary rules. These two statutes became the pillars of Japan's postwar regime of capital controls, granting broad discretionary powers to the Ministry of Finance (MOF) over foreign exchange transactions and to MITI over technology transfer, equity ownership and numerous other international transactions.

The only foreigners exempt from these conditions were prewar investors who sought to resume their earlier operations (strictly defined) and who did not seek foreign exchange for the repatriation of yen-denominated profits or the payment of various foreign fees. Only about thirty foreign-affiliated enterprises survived the war to reemerge in the post-WWII period.<sup>56</sup> Such investors could create a "yen-based company" that could grow through the reinvestment of domestically acquired yen in existing businesses. From 1957 to 1963, foreign firms opened 289 yen-based companies for a total investment of US \$500 million; among the high-profile entrants under this scheme were Coca-Cola and IBM.<sup>57</sup> Several prewar investors returned to their earlier operations and managed to secure FIL licenses in exchange for bringing scarce technology and related assets to Japan. Most investors returned to the same industries they were operating in before the war, particularly petroleum, energy, chemicals, and other sectors requiring sophisticated technologies unavailable either locally or on the open market. However, companies such as Ford and GM were actually prevented by the Occupation from reinvesting in Japanese assembly plants in their settlement of company claims to nationalized assets, leading them to resume sales to Japan under license agreements instead.

As for newcomers with no prior experience in the Japanese market, their entry typically remained limited and seldom extended beyond minority equity shareholdings in joint ventures operating in the few industries open to foreigners. From the start of the Occupation in 1945 until 1952, only 90 foreign-affiliated (mostly American) projects were approved under the FIL, totaling roughly \$20 million.<sup>58</sup> During the 1950s as a whole, only 101 new investment permits, totaling no more than \$59.7 million, were approved under the FIL. Between 1950 and 1970, Japan pursued very restrictive policies toward foreign entities. In general, Japan permitted foreign direct investment only when it seemed necessary in order to obtain certain essential foreign technology not available via licensing contracts. While approval was formally decided by the Foreign Investment Deliberation Council (*gaishi shingikai*), MITI and other ministries played a major role in deciding which foreign investors would enter an industry, often imposing numerous restrictions on the Japanese operations of the foreign company. In direct investments, Japan favored joint-venture corporations; as a rule, only minority interests were allowed for foreigners in manufacturing joint ventures.<sup>59</sup> Other stipulations prohibited foreign-affiliated ventures from entering related or new industries, augmenting their capitalization, and remanding abroad more than a specified amount of currency. Moreover, foreign firms had to gain repeated authorization from government ministries whenever they sought to remit capital, import machinery and raw materials, raise capital locally, or otherwise do business. These conditions stymied expansion, even in industries dominated by foreigners before WWII.<sup>60</sup>

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<sup>56</sup> Hamada, *American Enterprise in Japan*.

<sup>57</sup> Dennis Encarnation and Mark Mason, "Neither MITI nor America: The Political Economy of Capital Liberalization in Japan," *International Organization* 44, no. 1 (1990).

<sup>58</sup> *Ibid.*

<sup>59</sup> Henderson, *Foreign Enterprise in Japan: Laws and Policies*.

<sup>60</sup> Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*.

### 2.3 Increasing International Pressure, Liberalization, and Reregulation (1960s-1980s)

As time went on and Japan began to recover and prosper economically, it began to confront both international and domestic pressures for change. This eventually led to gradual loosening of some of the formal restrictions faced by foreign firms, though often these changes were more akin to reorganization of government control over private sector behavior rather than an outright reduction in regulation.<sup>61</sup> Japan committed to the principles of deregulation and liberalization as part of its accession to international economic institutions, and as its accelerating economic growth began to concern its major trade partners in Europe and the United States. Domestically, foreign firms seeking market access found willing allies in Japanese oligopolists eager to make use of the former's technology. In addition, the administrative reform process pushed the government to deregulate. In response to these pressures, the government took steps to change the formal institutions and rules related to inward FDI and foreign firm participation in the Japanese economy; however, due to the strong role of Japanese ministries in this process, the results often ended up being less liberalization and more "reregulation" in ways that enhanced bureaucratic power. Nonetheless, over the course of several decades, Japan took significant steps toward opening up its economy to foreign firms.

As Japan's economic success began to alarm its trading partners and allies, international criticism of its protectionist policies increased. For about twenty years after World War II, the dominant conceptions of security and economic interests in Japan and the US were remarkably conducive to a strong alliance. The US pushed to have Japan admitted to institutions such as the GATT, despite opposition from European countries, for example. However, this changed in the 1960s; Japanese exports suddenly exceeded imports, upending the US-Japan trade balance, and these exports shifted toward high-quality, technologically sophisticated products. Figure 2.1 illustrates this change. At a time when the US was experiencing a crisis in its overall trade and payments balance, Japan's growth soared, making it the second largest economic power in the world. Japan began to be seen as the primary economic rival to the US and a source of worldwide trade and monetary disruption. Consequently, the US and Japan entered into a series of trade disputes that would escalate over the next three decades. These disputes resulted in a series of bilateral agreements, beginning with issues such as textiles (1971, 1972), beef and oranges (1978), and telecommunications equipment (1979).<sup>62</sup>

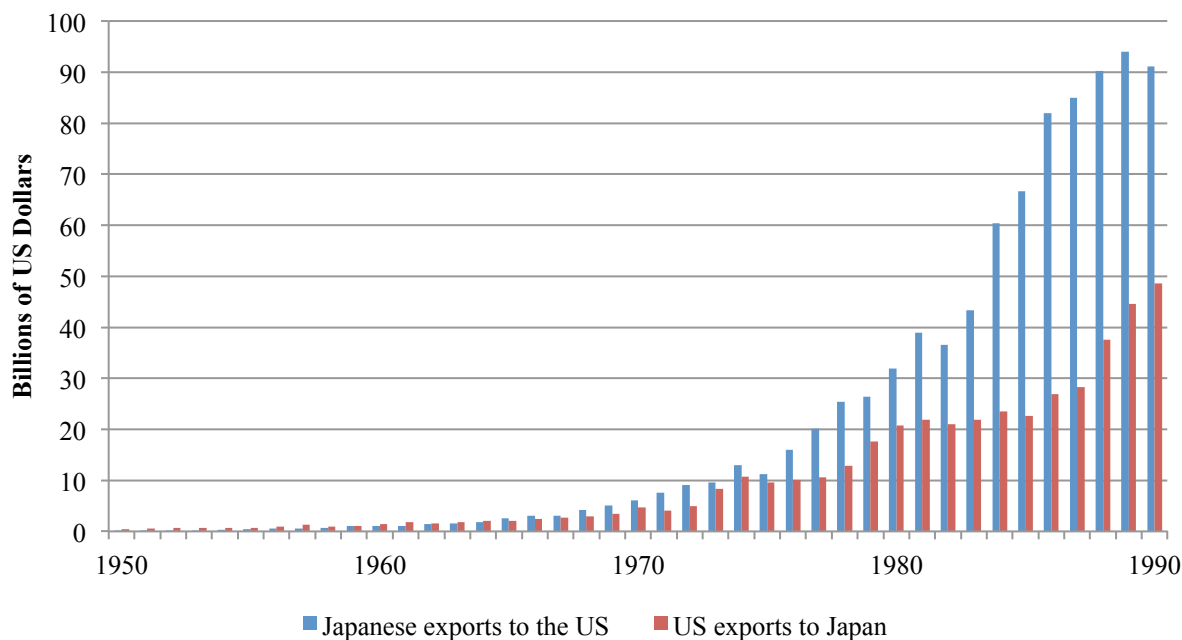
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<sup>61</sup> See Steven Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Ithaca: Cornell University Press, 1997).

<sup>62</sup> See I.M. Destler, Haruhiro Fukui, and Hideo Sato, eds., *The Textile Wrangle: Conflict in Japanese-American Relations, 1969-1971* (Ithaca: Cornell University Press, 1979). For a discussion of the evolution of bilateral and global agreements on textiles, see Vinod Aggarwal, *Liberal Protectionism: The International Politics of Organized Textile Trade* (Berkeley: University of California Press, 1985).



Figure 2.1 The Shifting Balance of US-Japan Trade (1950-1990)<sup>63</sup>



Through the Kennedy and Tokyo rounds of the GATT negotiations and as a result of bilateral negotiations with the US, Japan agreed to substantially eliminate trade quotas and lower tariffs in the 1960s and the 1970s. Japan also made commitments to deepening liberalization as part of its admittance to organizations such as the International Monetary Fund and the Organization for Economic Cooperation and Development. The Japanese government carried out five rounds of liberalization of outward and inward FDI between 1967 and 1978. The government eventually phased in liberalization measures in 17 industries and permitted majority foreign ownership in all but five restricted industries (agriculture, fishery, mining, oil and leather). However, some of these liberalization efforts, such as the 1963 elimination of the yen-based company, actually curtailed foreign firm access for a time, and case-by-case screenings of investments in specially designated sectors continued.

Tensions between Japan and Europe, which had been present since the 1950s in sectors such as textiles, were also building during this period. In the 1970s and 1980s, the EC provided a substitute market for Japanese exports in markets where Japan faced American export restrictions. Consequently, rather than exporting a wide range of goods to Europe, Japan targeted selected industrial sectors where Japanese exports were blocked by the US government such as automobiles, machine tools, ball-bearings, office equipment, and VCRs. Therefore, Japanese exports to the EC until the 1980s were controversial not only due the total amount of the EC trade deficit but also due to the concentration levels of such Japanese exports.<sup>64</sup> In contrast, European exports to Japan remained low. Table 2.1 shows the growth of European imports from Japan and the persistence trade deficits that European countries ran during this period. Similarly, European FDI to Japan was very limited during this period, although Japanese FDI to Europe had increased dramatically.

<sup>63</sup> Compiled from International Monetary Fund, "Direction of Trade Statistics," <http://data.imf.org/DOT>.

<sup>64</sup> Atsuko Abe, *Japan and the European Union: Domestic Politics and Transnational Relations* (London: The Athlone Press, 1999).

Table 2.1 Euro-Japanese Trade by Country (1970-1980, \$US Millions)<sup>65</sup>

	Imports from Japan			Exports to Japan		
	1970	1975	1980	1970	1975	1980
Germany	550.2	1,659.8	5,786.1	535.0	956.0	2,186.2
UK	479.9	1,472.1	3,803.6	354.8	685.3	1,387.8
France	127.4	700.0	2,035.5	153.8	380.3	1090.9
Italy	192.1	333.5	960.1	127.8	298.3	705.7
Netherlands	277.5	726.1	2,069.6	85.1	151.1	331.7
Belgium	156.1	509.9	1,433.0	85.3	152.4	316.9
Denmark	64.2	214.2	430.7	26.9	121.5	298.0
Ireland	14.7	58.0	222.0	9.7	20.3	40.1
EC Total	1,862.1	5,673.6	35,056.6	1,378.4	2,765.2	6,357.3
EC Deficit	-483.7	-2,908.4	-28,699.3			

This combination of multilateral and bilateral pressure led to the elimination of most *de jure* capital controls in 1980, though the actual content of the liberalization was strongly influenced by bureaucratic politics and support from local oligopolists. MOF and MITI consistently sought to deliver on Japan's international commitments to the principle of capital liberalization by offering deregulation in the other's area of jurisdiction while preserving its own.<sup>66</sup> Bureaucrats and politicians strove to protect politically important industries from competition with foreign firms while making moves toward liberalization in other sectors. In addition, although Japanese oligopolists often pressed the government to regulate foreign operations, they sometimes chose to lobby on behalf of foreign firms in order to obtain coveted proprietary technology from foreign firms.<sup>67</sup> These two dynamics interacted with international pressure and the efforts of foreign firms acting within Japan to produce varying patterns of liberalization and internationalization across sectors.

The most far-reaching changes in the 1980 FECL were the adoption of freedom in principle for foreign exchange transactions and the introduction of a prior notification system for FDI. However, as was the case in many examples of Japanese reform, the formal rules left considerable scope for bureaucratic discretion and informal control through administrative guidance over FDI. The prior notification system granted ministries 20 days to examine a proposed investment project and to suspend anything that affected domestic or international financial markets or harmed the business activities of certain industrial sectors or the smooth performance of the national economy. While no applications for foreign investment were formally rejected, foreign investors would be "advised" by ministries to withdraw applications or to make amendments.

By the 1980s, tensions had reached new heights. American firms had lost billions of dollars in sales at home and abroad to Japanese competitors; factories were shut down and workers were laid off. Japanese investment to Europe also increased sharply due to the European Single Market integration effort, which made the EC the largest single market and increased European competitiveness, and the strong yen, which enabled Japanese firms to launch additional FDI in Europe. European countries responded to this Japanese trade surplus by intensifying their criticism of Japan's closed market to European products and services.

<sup>65</sup> Compiled from International Monetary Fund, "Direction of Trade Statistics".

<sup>66</sup> Encarnation and Mason, "Neither MITI nor America: The Political Economy of Capital Liberalization in Japan."

<sup>67</sup> Solis, "From Iron Doors to Paper Screens: The Japanese State and Multinational Investment."

The US and Europe accused Japan of being a mercantilist state, and Japan became the target of trade negotiations in a number of sectors. US-Japan negotiations on semiconductors began in the early 1980s and produced two major bilateral agreements in 1986 and 1990. In 1981, the US pressured Japan to adopt Voluntary Export Restraints (VERs) on its auto exports. In 1985, the Reagan administration initiated a set of Market-Oriented Sector-Specific (MOSS) talks to remove barriers to foreign access in telecommunications equipment and services, medical equipment and pharmaceuticals, forest products, and electronics. Unsatisfied with the results of these talks, Congress passed the Trade Act of 1988 with Japan in mind; it required the administration to identify countries that were “unfair traders” and then engage in negotiations to address problems through a provision known as Super 301. The subsequent Super 301 investigations in 1989-1990 targeted the Japanese satellite, supercomputer and forest product industries. The European Community also brought a dispute against Japan in the GATT concerning its liquor tax, resulting in major but incomplete reform of the tax in 1989.<sup>68</sup>

During this time, international criticism began to shift in focus to what were termed “structural” barriers to foreign investment in Japan; the problem was not only formal rules and regulations but also the basic structure of the postwar Japanese system itself. Critics argued that many of the distinct institutions that formed the basis for the Japanese economic model worked to exclude or disadvantage foreign firms in concrete ways. For example, the main bank and convoy system prevented bankruptcies and rescued troubled firms, reducing potential targets for foreign acquisition. *Keiretsu* industrial groups made it difficult for newcomers to enter production networks and to offer services to firms in these groups. Cross-shareholding among firms in these groups was designed to thwart hostile takeovers, making it difficult for foreign firms to purchase majority shares of foreign firms. Long-term employment stymied foreign firms’ efforts to find highly qualified employees.

Critics claimed that addressing these barriers would require serious reform on the part of the Japanese government, which the US had in mind when it initiated the bilateral Structural Impediments Initiative (SII) in 1989. The American government began the SII with the goal of reforming Japanese structural barriers in five areas: public investment, the distribution system, land policy, exclusionary business concessions, and *keiretsu* business groups. Japan made some concessions on the first two issues. It increased its government spending in order to offset its high savings rate, which the US saw as contributing to Japan’s growing trade surplus. It also abolished the Large Store Law, which protected small local businesses by impeding the construction of large establishments by foreign companies such as Toys ‘R’ Us and by Japanese department stores as well. The concessions on these issues were enabled by strong support from Japanese domestic constituencies within the government and business communities.<sup>69</sup>

However, little progress was made on the remaining three issues. The US called for changes in tax and regulatory policies to increase the supply of land and allow more efficient use, arguing that high land prices discouraged foreign firms from establishing operations in Japan. The US also argued that lax Japanese enforcement of antitrust policy enabled a host of exclusionary business practices such as bid rigging, cartels, manipulation of the slow Japanese patent process to disadvantage foreign projects, and use of manufacturer-controlled distribution networks to exclude foreign products. Finally, the US claimed that the cross-shareholding,

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<sup>68</sup> Dimitri Vanoverbeke, "The Dynamics in the EU-Japan Relationship," in *EU-Japan Relations, 1970-2012: From Confrontation to Global Partnership*, ed. Jorn Keck, Dimitri Vanoverbeke, and Franz Waldenberger (New York: Routledge, 2013).

<sup>69</sup> Schoppa, *Bargaining with Japan: What American Pressure Can and Cannot Do*.

interlocking boards of directors, and stable business arrangements that characterized the *keiretsu* fostered preferential trade and deterred foreign direct investment.<sup>70</sup> However, due to the complexity of these issues and lack of support from within Japan for making major changes, not much change took place as a result of negotiations. Critics maintain that the SII talks were not particularly successful in making Japanese markets more open to foreign investment; at best, SII "...chipped away a bit at the problem of market access and structural distortions."<sup>71</sup>

Concurrent with this onslaught of foreign pressure, Japan was also facing internal pressures for reform as part of an administrative reform movement that sought to emulate the neoliberal deregulation initiatives being undertaken in places like the US and the UK. Reform became seen as a way to decentralize authority, reduce government spending, and ensure economic growth. However, Japan's pattern of regulatory reform was to selectively introduce competition in specific markets while simultaneously ensuring that domestic firms were able to operate and succeed with minimal disruption.<sup>72</sup> Some changes were made that opened up space for competition from foreign firms, but the government continued to retain a great deal of authority and discretion over the Japanese economy.

The Japanese economy reached a turning point in the early 1990s, though it would take some time for the parties involved to realize it. A factor in Japan's remarkable economic boom had been the revaluation of the yen that took place as part of the 1985 Plaza Accord; the intended goal of the exchange rate adjustment was to address the US trade imbalance with Japan, and while that goal was not achieved in the end, the policy had a dramatic impact on the Japanese economy. As the 1980s drew to a close, worries mounted that the yen revaluation combined with efforts by the Ministry of Finance and the Bank of Japan to limit the rise of the yen through low interest rates had actually set off an asset bubble, and the Bank of Japan finally took steps to raise interest rates. The bubble suddenly burst in 1990. The Japanese stock market hit its peak on December 31, 1989 and then plunged, losing 50 percent of its value by October 1990. Land values collapsed, and the number of non-performing loans sharply increased. These events marked the end of Japan's economic ascendance and the beginning of its first "lost decade."

Despite these troubles, however, Japan continued to face strong criticism that it wasn't playing fair economically and that it was not taking responsibility commensurate with its global economic power. Pressure continued to mount from its American and European trading partners. In addition to the SII talks, the Bush administration continued the US sector-specific approach by negotiating 13 bilateral industry or sectoral agreements with Japan in four years on: cellular phones and radio communications (1989), digital network channel termination equipment (1990), amorphous metals (1990), wood products (1990), government procurement of satellites (1990), international value-added network services (1990 and 1991), public works construction contracting (1991), semiconductors (1991), supercomputers (1992), paper (1992), flat glass (1992), automobiles and auto parts (1992) and corn and dairy products (1992).<sup>73</sup>

In response to pressure from the US and Europe, the Japanese government also adopted several measures to encourage FDI, including preferential loans offered by the Japan

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<sup>70</sup> Evidence is mixed on the mechanisms by which *keiretsu* may actually disadvantage foreign firms. For example, David Weinstein and Yishay Yafeh, "Japan's Corporate Groups: Collusive or Competitive? An Empirical Investigation of Keiretsu Behavior," *Journal of Industrial Economics* 18 (1995). find that *keiretsu* do not actually collude in product markets to prevent entry or raise prices in sectors.

<sup>71</sup> Edward Lincoln, *Troubled Times: U.S.-Japan Trade Relations in the 1990s* (Washington, DC: Brookings Institution, 1997).

<sup>72</sup> Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*.

<sup>73</sup> Lincoln, *Troubled Times: U.S.-Japan Trade Relations in the 1990s*.

Development Bank, tax benefits, and support for foreign enterprises from JETRO and the Foreign Investment in Japan Development Corporation. Since American firms and the American Chamber of Commerce in Japan (ACCJ) identified the pre-notification system as a source of discretionary power to deter investments, the Japanese government switched to a post-facto FDI notification system in 1992 for all areas except those that threatened national security, the public order, or the health of the Japanese economy.

In 1993, the politically unthinkable happened: for the first time since 1955, the Liberal Democratic Party of Japan lost power due to an internal split. Although the Socialist-led coalition government that followed lasted less than a year before the LDP's once again took the reins of power in 1994, the LDP was never the same after this loss, having to rule in coalition with small parties such as the Komeito from that point on.

This political transition introduced an element of unpredictability to the 1993 Framework Agreement that the Clinton administration signed with Japan to define a new set of bilateral negotiations. The agreement aimed at a reduction of Japan's current-account surplus and mandated negotiations to increase global access to Japanese markets in specific areas such as government procurement, financial services, insurance, competition policy, transparent government procedures, deregulation, distribution, the automotive industry, intellectual property rights, access to technology, and long-term buyer-supplier relationships. The negotiations encountered difficulties as the initial deadline passed and a set of proposed Japanese concessions was rejected by the US.

By the end of 1994, agreements had been reached on a number of major issues such as intellectual property rights, government procurement of medical and telecommunications equipment, and financial services. However, automobiles and auto parts, areas that were key parts of both countries' industrial machinery sectors, proved to be a sticking point. By mid-1995, there was still no agreement on access in Japan for foreign cars, the market for auto parts for new cars, and sales of parts into the replacement part market in Japan. In May 1995, President Clinton announced that the US would initiate a WTO case against Japan and retaliate against Japanese exports via a 100 percent punitive import duty on Japanese luxury cars. Japan in turn filed its own WTO trade case against the US citing the proposed import duty as a violation of WTO rules. Last-minute negotiations produced an agreement on automobiles and auto parts such that the tariff was never enacted. Some of the difficulties encountered by the Clinton administration could be attributed to short-term effects of the political shifts in Japan, which disrupted the typical pattern of relations that the US had enjoyed with the LDP.<sup>74</sup> Also with its economy now stagnant, the Japanese government was not inclined to further open up its economy, and it was more willing to mount a strong response to American pressure.

## **2.4 Japan's Second Golden Age of FDI (1990s-present)**

A combination of pull and push factors contributed to a boom in inward FDI to Japan in the late 1990s and 2000s. On the "pull" side, greater investment opportunities in Japan were spurred by the economic difficulties of the "lost decade," which eroded high prices and cross-shareholding, prompted government deregulation, exposed troubled companies ripe for potential takeovers, and generally shifted attitudes toward foreign firms in Japan. In addition to reforms specific to FDI, general deregulation measures undertaken during this period helped to open up opportunities for

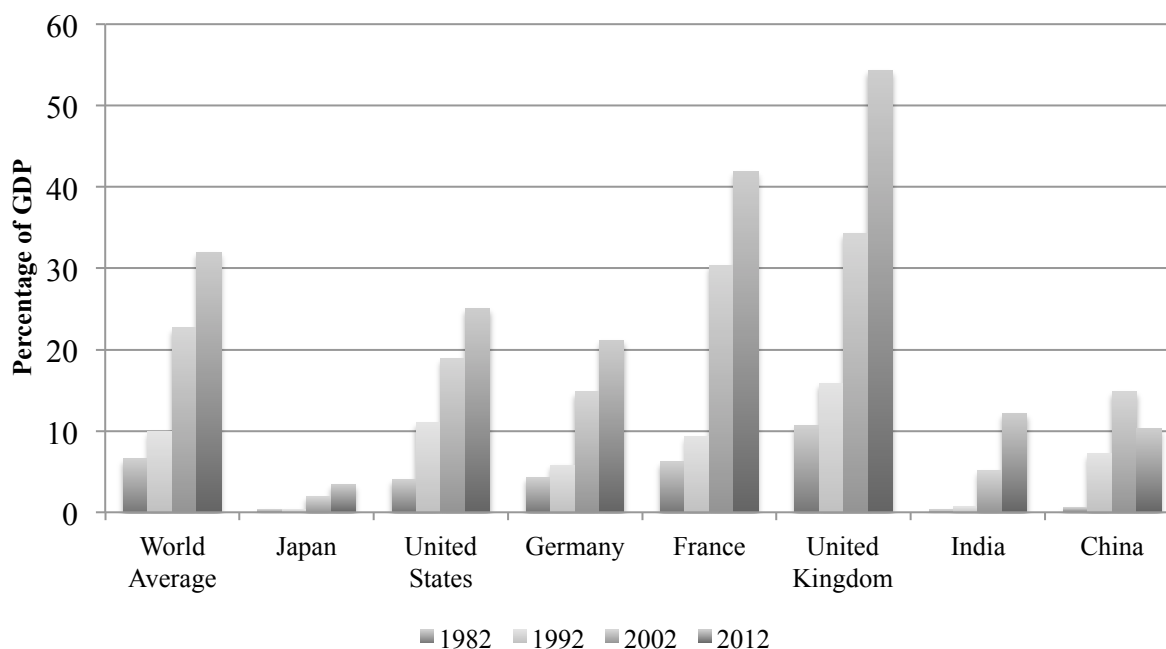
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<sup>74</sup> Schoppa, *Bargaining with Japan: What American Pressure Can and Cannot Do*.

foreign firms. As the recession dragged on, it became increasingly clear that high levels of regulation and the extensive presence of public corporations were harming the economy by restricting new market entrants, both foreign or domestic. The government took measures to make it easier for companies to spin off subsidiaries and to facilitate mergers and acquisitions. A range of service sectors was deregulated, including retail, finance and insurance, and telecommunications.

Meanwhile, on the “push” side, this surge in foreign investment coincided with a global boom in FDI and cross-border mergers and acquisitions.<sup>75</sup> As a result of these dynamics, the amount of foreign direct investment and the number of foreign firms in Japan increased rapidly in the late 1990s and 2000s. For example, if one looks at the 1999-2000 period, Japan attracted more FDI in those two years than it had in the entirety of the preceding three decades.<sup>76</sup> Figures 2.2 and 2.3 show Japan’s inward FDI position in international context, illustrating both its paucity in absolute terms and its relative growth during the 1990s and 2000s.

Figure 2.2 Japan’s Inward FDI position in International Context (1982-2012)<sup>77</sup>

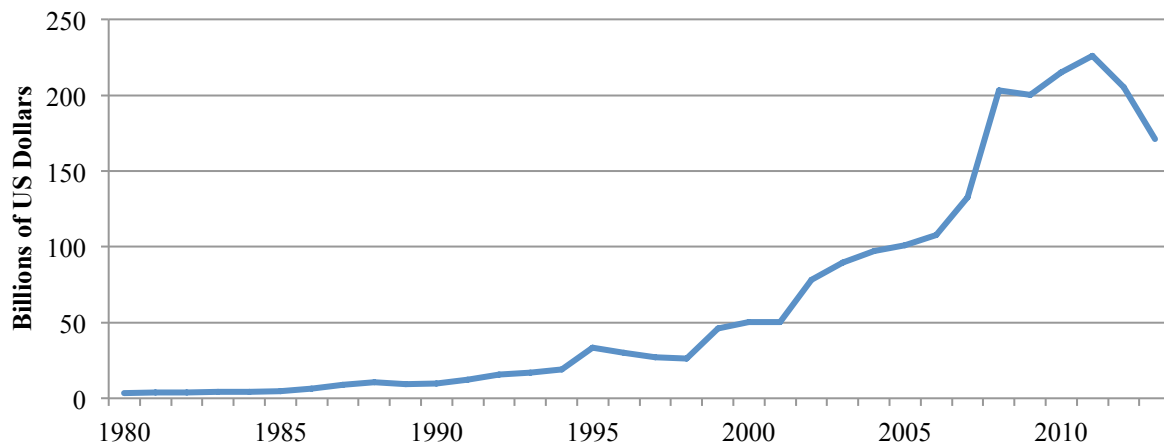


<sup>75</sup> Paprzycki and Fukao, *Foreign Direct Investment in Japan: Multinationals' Role in Growth and Globalization*.

<sup>76</sup> Ibid.

<sup>77</sup> Compiled from United Nations Conference on Trade and Development, "UNCTADStat," <http://unctadstat.unctad.org>.

Figure 2.3 Japan's Inward Foreign Investment Stock (1980-2013)<sup>78</sup>



A major part of this reform came in the form of the “Big Bang” financial liberalization initiated in the late 1990s by Prime Minister Hashimoto. The Japanese financial system had become increasingly unstable after the end of the bubble as a result of bank failures, policy failures, and scandals. In 1997, three large banks and securities companies went under, leading to a serious credit crunch. The government used public money to protect creditors of insolvent banks and to recapitalize some of the solvent ones. It was clear that the Japanese financial system was in need of change. The goal of the Big Bang was to make the Japanese financial system free, fair, and global by liberalizing financial markets, formulating transparent rules, and harmonizing Japanese domestic practice with global standards. The LDP and MOF played a key role in shaping these reforms, and they in part reflect an increased role for the Japanese public in policymaking, as loss of public trust was one of the motivations for structural reform.<sup>79</sup> As a result of the changes made as part of the Big Bang, a large part of the increase in FDI in the late 1990s and early 2000s went to the financial sector.<sup>80</sup>

Reforms like the Big Bang and Japan's ongoing economic stagnation led to a decline of some of the core features of the postwar Japanese economic system, though these institutions did not disappear entirely.<sup>81</sup> Changes to the main bank and convoy systems ended practices that had protected poorly performing banks and firms for decades, opening up acquisition opportunities for foreign firms. Cross-shareholding decreased as it became increasingly irrational for corporations to hold bank shares in the face of a looming banking crisis; moreover, managers of profitable firms with easy access to capital markets found little need to maintain these financial relationships.<sup>82</sup> *Keiretsu* ties weakened with a decline in bank financing and some dissipation of

<sup>78</sup> Ibid.

<sup>79</sup> Tetsuro Toya, *The Political Economy of the Japanese Financial Big Bang: Institutional Change in Finance and Public Policymaking* (Oxford: Oxford University Press, 2006).

<sup>80</sup> Solis, "From Iron Doors to Paper Screens: The Japanese State and Multinational Investment."

<sup>81</sup> Kenji Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Process" (Ph.D. Dissertation, University of California, Berkeley, 2010); Vogel, *Japan Remodeled: How Government and Industry Are Reforming Japanese Capitalism*.

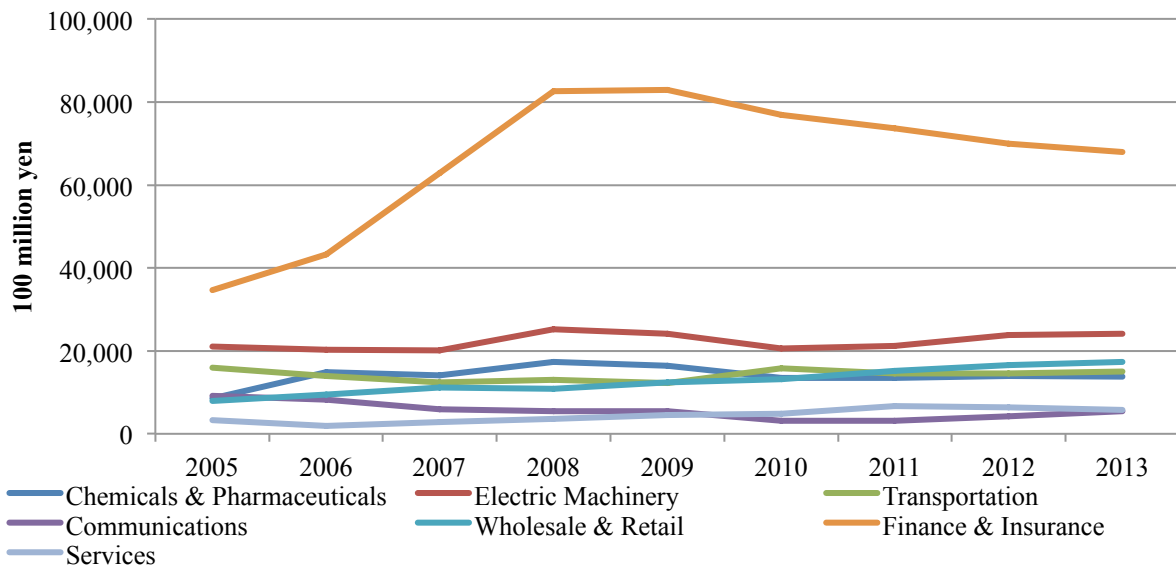
<sup>82</sup> Hideaki Miyajima and Fumiaki Kuroki, "The Unwinding of Cross-Shareholding: Causes, Effects, and Implications," in *Corporate Governance in Japan: Institutional Change and Organizational Diversity*, ed. Masahiko Aoki, Gregory Jackson, and Hideaki Miyajima (Oxford: Oxford University Press, 2007).

traditional buyer-supplier ties, opening up opportunities to enter production networks and provide services to related firms.<sup>83</sup>

These changes paved the way for a surge in inward FDI, most of which took the form of acquisitions. Mergers and acquisitions came to play a more significant role in inward FDI to Japan. Out-in M&As, where a foreign company acquires a stake in a domestic firm, jumped from an annual average of \$320 million during 1990-1995 to more than \$15 billion in 1999-2001.<sup>84</sup> Foreigners bought controlling shares in some of the country's largest and best-known companies, such as Nissan and Mitsubishi Motors.

In line with patterns in other developed countries, the majority of cumulative FDI inflows to Japan during the 1990s and 2000s were concentrated in the service sector. More than four-fifths of FDI inflows were concentrated in telecommunications, finance and insurance, retail and wholesale trade, business services, and the machinery industry led by the automotive sector (see Figure 2.4). Moreover, most foreign investment continued to come from Western countries, with the US and Europe accounting for about 75 percent of all inward FDI to Japan and the majority of foreign firms operating in Japan (see Figure 2.5 and Figure 2.6).

Figure 2.4 Inward Direct Investment Position in the Top 7 Sectors (2005-2013)<sup>85</sup>



<sup>83</sup> Jean McGuire and Sandra Dow, "Japanese Keiretsu: Past, Present, Future," *Asia Pacific Journal of Management* 26 (2009).

<sup>84</sup> Paprzycki and Fukao, *Foreign Direct Investment in Japan: Multinationals' Role in Growth and Globalization*.

<sup>85</sup> Compiled from Bank of Japan, "Chokusetsu Tousei Zandaka [Foreign Direct Investment Stocks]," <https://www.boj.or.jp/statistics/br/bop/index.htm>.



Figure 2.5 Inward Direct Investment Position by Home Region of Firm (1996-2013)<sup>86</sup>

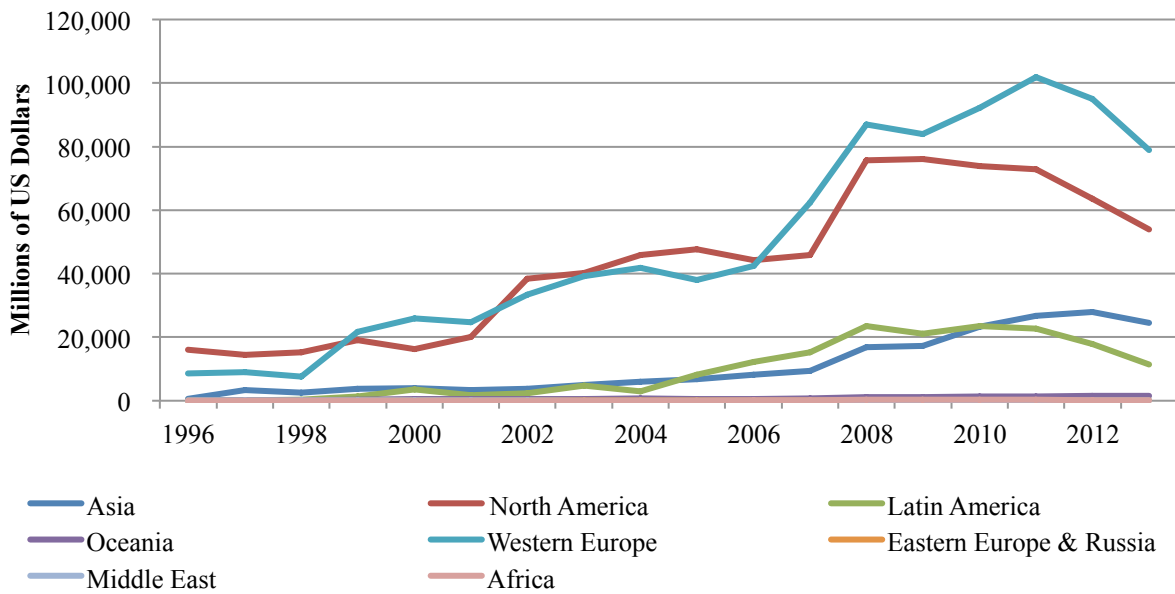
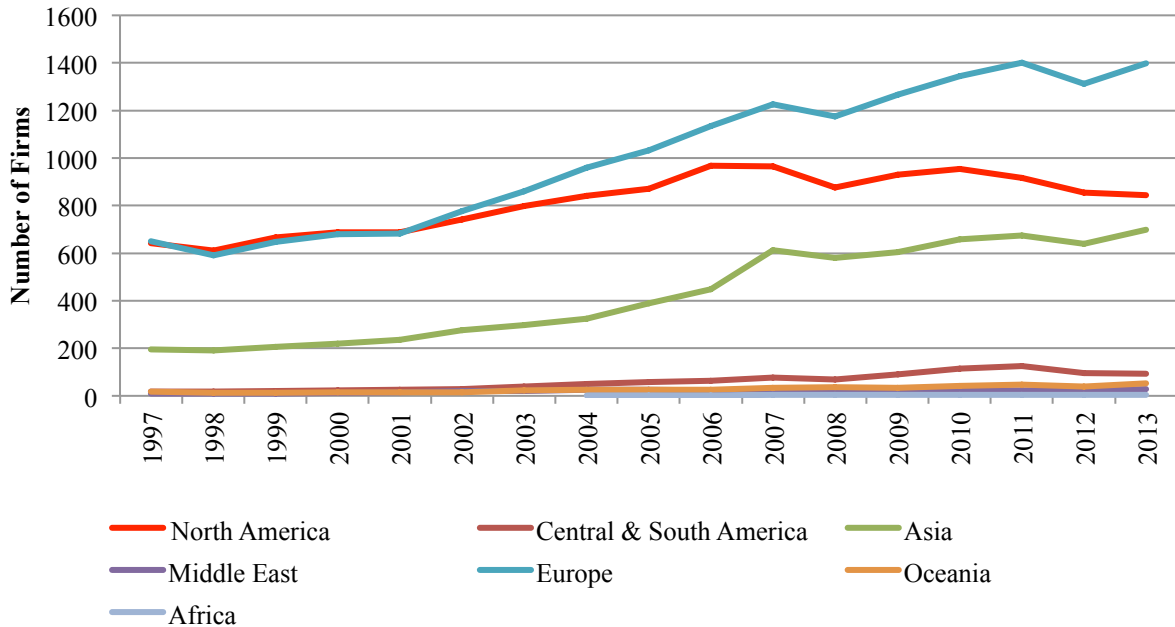


Figure 2.6 Foreign Firms Operating in Japan by Home Region of Firm (1997-2013)<sup>87</sup>



<sup>86</sup> Compiled from Japan External Trade Organization, "FDI Stock (Based on International Investment Position, Net)," <https://www.jetro.go.jp/en/reports/statistics>.

<sup>87</sup> Compiled from METI, "外資系企業動向調査 [Survey of Trends in Business Activities of Foreign Affiliates]," <http://www.meti.go.jp/statistics/tyo/gaisikei>.

Another concurrent change that took place during the 1990s was an increase in public scrutiny of the Japanese political process. A series of bureaucratic scandals in the 1980s and 1990s and the general sense that the government had mismanaged the economy led to a loss of confidence in the bureaucracy and increased citizen interest and involvement in politics. Changes in rules made it easier for non-profit organizations (NPOs) to form, giving citizens an easier path to civic participation.<sup>88</sup> Growing transparency of government resulting from information disclosure and judicial reform also helped to foster greater citizen involvement.<sup>89</sup> Although these broader social changes are not directly related to FDI, they resulted in a parallel opening up of the Japanese political system that created new avenues for foreign firms to influence the government. Increased citizen and NPO activism meant that foreign firms had more potential allies in influencing policy outcomes, another way of circumventing the tightly controlled circle of elites that had run the Japanese business and political community for decades. Foreign firms in sectors such as pharmaceuticals and information and communications technology were able to take advantage of this new strategic pathway, as will be further discussed in Chapters 4 and 6. The institutions of not only the Japanese economy but also the Japanese government were becoming more permeable to diverse interests.

There was also a shift in official attitudes toward foreign firms, as reflected by a series of ambitious government goals to increase inward FDI in the 2000s. The Japanese government changed course, deciding that it needed foreign direct investment to save Japanese firms and to revitalize the economy. In 2003, Prime Minister Koizumi announced a target to double the amount of inward FDI stock in five years, from ¥6.6 trillion in 2001 to ¥13.2 trillion in 2006. In 2006, he revised this goal to reach an inward FDI stock equivalent to five percent of GDP by the end of 2011. However, in 2011, Japan's inward FDI stood at only 3.9 percent of GDP, still well below the average figure of 30.1 percent for developed countries.<sup>90</sup> Prime Minister Shinzo Abe once again emphasized the importance of increasing FDI as part of his "Abenomics" growth strategy in 2013, hoping that an influx of foreign investment would help to rejuvenate the Japanese economy. He announced the goal of doubling inward FDI stocks to 35 trillion yen by 2020, improving JETRO consultation services for foreign firms, and creating national strategic zones where foreign firms would be able to take advantage of tax breaks and bold regulatory reforms. However, many observers are skeptical that these plans will result in meaningful change.

Challenges to inward FDI remain, but nonetheless, current FDI inflows represent a marked increase from the period prior to the 1990s. Although absolute levels of FDI remain low compared to other countries, it is certain that Japan has never been more open to foreign investment than it is today. Moreover, some foreign firms have managed to very successfully navigate the Japanese political economy, which will be the subject of subsequent chapters.

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<sup>88</sup> Pekkanen, *Japan's Dual Civil Society: Members without Advocates*.

<sup>89</sup> Kingston, *Japan's Quiet Transformation: Social Change and Civil Society in the Twenty-First Century*.

<sup>90</sup> Eurobiz Japan, "FDI-Led Revitalisation: Quality Means Much More Than Quantity," <http://eurobiz.jp/2013/03/fdi-led-revitalisation/>.

## 2.5 Understanding the Current Situation of Foreign Firms in Japan

This chapter has examined the history of foreign investment and trade in Japan in order to show the policy continuities over a remarkably long span of time ranging from 1600 to the present. Japan has employed a number of different tools to try to keep foreign firms out of its market and to control the few that managed to gain access. However, internal and external pressures have gradually led Japan to undertake a number of liberalization and deregulation initiatives that have created more room for foreign firms to enter and operate in Japan. The pace of change accelerated in the 1990s, as economic difficulties and political change created new opportunities for foreign acquisition prompted the Japanese government to further advance its deregulation initiatives. Although the absolute amount of foreign investment in Japan remains strikingly low compared to other advanced industrial economies, it is undeniable that Japan experienced a dramatic increase in FDI in the late 1990s and 2000s. Moreover, the opening up of Japanese society and politics has given foreign firms more options to choose from when attempting to influence government policy.

Interestingly, the most recent period of increased FDI has coincided with a decrease in international pressure, at least of the dramatic type characteristic of the 1980s and early 1990s. By the late 1990s, foreign attitudes toward Japan had shifted substantially in light of the latter's relative economic decline, and bilateral trade no longer commanded attention for many countries. Some of this may be attributable to the fact that many formal barriers to trade and investment have been removed, and many of the foreign firms most enthusiastic about entering the Japanese market have been able to do so. This has coincided with a shift in foreign direct investment to countries such as China that offer cheaper labor and other more favorable business conditions than Japan. This has reduced the demand for government-level pressure directed toward Japan in many sectors and issue areas.

As foreign firms gained access to Japan through the many reforms described in this chapter, the act of gaining market access changed their behavior, shifting their focus away from non-market or political strategies and toward market strategies, actions taken in the market environment to create value by improving the economic performance of the firm.<sup>91</sup> For example, in stark contrast to the 1980s, there is relatively little demand for home government intervention on the part of foreign retail and wholesale firms operating in Japan today. Interviews with companies from sectors such as retail, food, and soft drinks suggest that much of these firms' interaction with the Japanese government is purely public relations or part of their corporate social responsibility efforts to preserve the environment, improve public health or promote educational exchanges between Japan and their home country. This is predictable given that the market environment determines the significance of political issues to the firm. Occasionally, unforeseen events might create a situation that necessitated lobbying for or against a government policy, but this tends to be the exception to the rule in many sectors today.

This does not mean, however, that Japan no longer possesses barriers to foreign investment or that foreign firms have no complaints about Japanese practices. The US, Europe and other countries continue to actively press Japan on trade issues across multiple sectors. In particular, political strategies continue to be important for two groups of foreign firms: those still dealing with restricted access to the Japanese market and those operating in highly regulated sectors in Japan.

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<sup>91</sup> Baron, *Business and Its Environment*.

The first group is addressed in Chapter 3 through an examination of agriculture, a sector in which foreign business interests still face significant barriers. The relatively lack of internationalization in Japan's agricultural sector has meant that foreign business has been unable to successfully permeate Japanese politics. Foreign agricultural interests are largely unable to directly enter Japan to form coalitions with like-minded actors. In addition, the ability of foreign farmers to collaborate with pro-liberalization forces in Japan is limited by the diffuse nature of its potential partners; even if coalitions could be formed with Japanese consumers or food importers, foreign governments has often had to act as the broker of these connections. As a result, foreign actors' political strategies still resemble those frequently seen in the early postwar period through the 1980s; they focus on lobbying their respective home governments, relying on the latter to act as a conduit for their demands in bilateral or multilateral negotiations.

Chapters 4 through 7 tackle the second group of foreign firms, those operating in highly regulated sectors in Japan. Foreign firms have managed to enter the Japanese market and attain a significant degree of economic success in sectors such as pharmaceuticals, insurance, information technology, and defense. However, political strategies remain an important part of these firms' business strategies. Once inside the Japanese market, many foreign firms continue to draw on assistance from their home governments, but they are additionally able to begin to behave as insiders in some important ways. The pattern of internationalization in each sector has shaped firms' political strategies by defining the scope of potential coalitions and tactics available to them. In particular, the process of internationalization creates cleavages among both foreign and Japanese actors. In some cases when Japanese actors are divided, foreign firms are able to form cross-national coalitions to pursue mutual aims, taking advantage of the ways that the Japanese political economy has become increasingly permeable to foreign firms over the course of the post-World War II period.

As a result of the political, institutional and regulatory changes that have taken place in Japan, foreign firms are increasingly able to develop their own channels of influence in addition to or as substitutes for intervention by their home government. These new channels of influence might include partnerships with Japanese firms, participation in domestic industry associations setting standards for industrial products, partnerships with Japanese civil society groups, or direct lobbying of Japanese politicians and bureaucrats. These strategies will be explored in greater detail in the chapters to follow.

### 3 Agriculture: Private Sector Political Strategy Embedded in a Two-Level Game

In order to appreciate the ways that the political strategies of foreign firms have evolved over the course of the post-World War II period, it is instructive to first examine a sector in which the primary political strategy available to foreign firms is still to lobby their home governments. Government-business relations are firmly embedded in a two-level games model in the sense that firms must rely on their home states to facilitate their market entry via bilateral and multilateral trade agreements. In accordance with Putnam's theory described in Chapter 1, domestic business actors play a strategic game in their home political arena, pursuing their interests in interaction with politicians courting the support of these business groups. Meanwhile, the second international-level game consists of government officials, who negotiate in an attempt to find a deal acceptable to their international counterparts. The key is that any agreement must be both acceptable to the partner government and lie within the "win-set" of agreements acceptable to their own domestic constituency. This two-level process can be iterative; the negotiators may go back and forth between trying out possible agreements and reassessing their constituents' positions.<sup>92</sup>

In this chapter, I argue that due to low levels of internationalization in the agricultural sector, foreign economic actors interested in increasing their business in Japan tend to focus their political strategies predominantly on influencing their home governments. Foreign pressure has been channeled primarily through the government officials who have served as the key link between domestic groups and the target country. These government actors have tried to influence Japan both through bilateral, country-to-country negotiations and through multilateral channels such as negotiations on the General Agreement on Tariffs and Trade (GATT). This is in stark contrast to other sectors that will be examined in later chapters, in which foreign actors have developed much more varied patterns of political strategies aimed not only toward their home governments but also directly toward government and private actors in the target country.

Why are foreign agricultural actors restricted in their political strategies? First and foremost, agriculture is a sector with very low levels of foreign participation. Inward foreign direct investment is minimal and requires approval from the Japanese government. This means that foreign agricultural interests are unable to directly enter Japan to form coalitions with like-minded actors through strategies such as mergers and acquisitions or joint ventures. Second, the ability of foreign farmers and agricultural industry groups to collaborate with pro-liberalization forces in Japan is limited by the diffuse nature of its potential partners; even if coalitions could

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<sup>92</sup> Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games." A number of authors have used some version of Putnam's concept of linked games to account for the influence of autonomous international organizations on countries' domestic agricultural policies. See for example: Herve Guyomard et al., "Agriculture in the Uruguay Round: Ambitions and Realities," *Journal of Agricultural Economics* 44 (1993); William Coleman, Grace Skogstad, and Michael Atkinson, "Paradigm Shifts and Policy Networks: Cumulative Change in Agriculture," *Journal of Public Policy* 16, no. 3 (1996); Lee Ann Patterson, "Agricultural Policy Reform in the European Community: A Three-Level Game Analysis," *International Organization* 51, no. 1 (1997); Giovanni Anania, "Policy Choices and Interdependence of Country Decisions in the Implementation of the 1994 GATT Agreement on Agriculture," *European Review of Agricultural Economics* 24 (1997); Robert Paarlberg, "Agricultural Policy Reform and the Uruguay Round: Synergistic Linkage in a Two-Level Game?," *International Organization* 51 (1997).

be formed with Japanese consumers or food importers, foreign governments often had to act as the broker of these connections.

I examine these dynamics by using process tracing to analyze the liberalization of rice, one of Japan's most protected agricultural commodities. I focus specifically on the interaction between Japan and the United States because the American business community and government played a major role in Japan to change its agricultural policies. Japan's high level of regulation of rice and the consequent high prices charged to Japanese consumers drove private agricultural interests in the US to spearhead this issue, convinced that a more open Japanese market would be highly lucrative. However, due to the difficulty of directly advocating for their own interests in Japan, the rice industry was compelled to embed their political strategy in a two-level game. The US rice industry had to rely on its home government to advocate on its behalf, but in doing so, its demands became just one part of a larger US government agenda with respect to Japanese liberalization. The case of the rice industry also demonstrates the role that the private sector can play in affecting the course of intergovernmental negotiations; constant pressure from the US Rice Millers' Association allowed the US government to credibly claim that lack of progress on rice liberalization was unacceptable to its domestic constituency. This case illustrates corporate political strategy in a situation where industry cannot advocate effectively for itself in the target country.

The chapter begins with a discussion of the internal politics of agriculture in Japan and the US to give context for the domestic political game that takes place between the governments of these countries and their own respective domestic interest groups. The subsequent section illustrates the interplay of domestic agricultural interest group strategies, government action, and international negotiations through a detailed case study of the politics of rice liberalization.

### **3.1 Understanding the Domestic Political Games**

Despite the notoriety of Japanese restrictions on imports of items such as beef and rice, agricultural protection is by no means unique to Japan. Among OECD countries, the most costly and market-distorting policies have always been found within the agricultural sector.<sup>93</sup> Table 3.1 compares protection levels in the industrialized world using estimates of producer subsidy equivalents for selected agricultural commodities, which measures the payment that would be required to compensate agricultural producers for the loss in income that would result from the removal of existing policy. The advantage of this measure is that it captures the effects of a broad range of assistance policies, including administered prices, direct payments, input subsidies, and the provision of general services by the government at below cost. The numbers shown are from 1991, in the midst of a period when Japan was undergoing heated negotiations over agriculture in the Uruguay Round of the GATT. They demonstrate the relatively high levels of protection in Japan in comparison to Australia, Canada, Europe, and the United States.

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<sup>93</sup> "Agricultural Policy Reform and the Uruguay Round: Synergistic Linkage in a Two-Level Game?."

Table 3.1 Agricultural Producer Subsidy Equivalents in Industrialized Countries (1991)<sup>94</sup>

	Wheat	Coarse Grains	Beef & Veal	Pork	Mutton & Lamb	Milk	Oil-seeds	Sugar	Poultry	Average
Australia	1.19	1.09	1.11	1.05	1.09	1.36	1.11	1.15	1.05	1.15
Canada	1.42	1.37	1.41	1.16	0.00	1.83	1.28	1.22	1.45	1.45
EU	1.61	1.55	1.54	1.08	1.68	1.69	1.67	1.41	1.18	1.49
Japan	2.03	1.98	1.40	1.47	--	1.88	1.76	1.67	1.12	1.66
USA	1.50	1.26	1.34	1.06	1.07	1.58	1.07	1.56	1.10	1.30

A large body of scholarship has used both qualitative and quantitative techniques to analyze the determinants of agricultural protection among countries, over time, and across different agricultural products.<sup>95</sup> Research has shown that levels of agricultural protection tend to increase with industrialization; as comparative advantage shifts from agriculture to industry, the focus of public policy protection shifts from industry to agriculture.<sup>96</sup> Moreover, current levels of protection are often the result of social contracts struck with farmers at key points in time that subsequently become difficult to alter or revoke.<sup>97</sup> As a result, advanced industrial countries often wage difficult battles with one another and with developing countries over agricultural issues, with the battle lines being drawn between net exporters and net importers.

Beginning in the 1950s, Japan engaged in significant agricultural liberalization at the behest of the international community, led by the United States. Negotiations over specific commodities continue to the present day, as evidenced by the recently concluded negotiations on the Trans-Pacific Partnership (TPP). In order to examine the dynamics of negotiations in this sector, it is necessary to understand the domestic political context of the major players involved. This section provides a brief overview of agricultural lobbying in Japan and in the United States, the latter of which has been a major force in promoting international agricultural liberalization in the post-World War II period.

### 3.1.1 Agricultural Politics in Japan

Agriculture occupies a privileged position in Japanese politics. Land reform during the American Occupation eviscerated the power of the prewar landlord class and redistributed land to Japanese farmers, thereby establishing a pattern of small-scale farming that continues today. Highly mechanized farming of large plots is limited. Low productivity and inability to compete in free markets drive Japanese farmers to seek protection, and farmers have traditionally formed a well-organized voting bloc with strong influence over policymakers in both the Ministry of Agriculture, Forestry, and Fisheries (MAFF) and the dominant Liberal Democratic Party (LDP)

<sup>94</sup> OECD, *Agricultural Policies, Marketing and Trade* (Paris 1992).

<sup>95</sup> Harry de Gorter and Johan Swinnen, "Political Economy of Agricultural Policy," in *Handbook of Agricultural Economics, Volume 2*, ed. Bruce Gardner and Gordon Rausser (Elsevier Science B.V., 2002).

<sup>96</sup> Kym Anderson and Yujiro Hayami, *The Political Economy of Agricultural Protection* (Sydney: Allen & Unwin, 1986); Masayoshi Honma and Yujiro Hayami, "The Determinants of Agricultural Protection Levels," in *The Political Economy of Agricultural Protection*, ed. Kym Anderson and Yujiro Hayami (Boston: Unwin and Unwin, 1986).

<sup>97</sup> Robert Paarlberg, "The Political Economy of American Agricultural Policy: Three Approaches," *American Journal of Agricultural Economics* 71, no. 5 (1989).

Farmers are a key electoral base of the LDP, which has dominated Japanese politics since 1955. As discussed in Chapter 2, the long rule of the LDP rested on an unusual coalition of both competitive and protected sectors. In short, the party found ways to appease both the winners of trade liberalization (e.g., big business) and the losers (e.g., small business and agriculture).<sup>98</sup> Farmers were overrepresented by an electoral system that gave rural votes as much as three times the weight of urban votes; although reforms attempted to partially correct this in 1994, the ratio of difference in the voting value between the most populous and least populous districts was still almost 5 to 1 post-reform.<sup>99</sup> Opposition parties have also sometimes tried to win farmers' favor by supporting higher producer prices and opposing liberalization.<sup>100</sup> The existence of multiple political parties eager to win rural support mean that farmers can credibly threaten to shift their vote if politicians do not deliver on promises.

The farm lobby in Japan is highly organized within a single dominant grouping, Japan Agriculture (JA, formerly Nokyo). JA consists of a three-tiered organization of national, prefectural, and local-level agricultural cooperative groups. JA's membership covers the vast majority of farmers and is strongly cemented by the fact that it plays broad economic, social, and community roles in farming areas. JA is engaged in banking, insurance, agricultural wholesaling and retailing, and supply of farming materials. The relationship between the LDP, MAFF bureaucrats, and JA has been characterized as an "agricultural policy triangle" based on mutual exchange of favors.<sup>101</sup> MAFF intervenes in the agricultural sector with the help of JA. JA also functions as the largest electoral support organization for the LDP through its national political organization, the National Farmers' League (Zenkoku Noseiren). Through these political groups, JA was able to deliver bloc votes to candidates incredibly effectively. Moreover, strong community solidarity and social hierarchies in rural districts have produced higher voter turnout in rural areas than in cities and more predictable voting patterns because local leaders have traditionally been effective in directing the vote to favor particular candidates.<sup>102</sup> JA also performs lobbying functions through Zenchu, which formulates and publicizes agricultural policy demands.

Moreover, the strength of the Japanese agricultural lobby is intensified by the fact that few in Japan speak out against agricultural protection; hypothetical opposition groups such as consumers, big business, and the food industry are often silent or even sympathetic to continued protection. Despite the small number of farmers, the share of "pro-agriculture" voters is large because there is wide identification with agricultural interests by extended family and non-farmer residents in rural districts. Furthermore, while consumers in Japan would benefit from the lower cost of agricultural imports, opinion polls have consistently revealed a lack of support for agricultural liberalization. To the contrary, consumer organizations have actively opposed agricultural liberalization due to concerns about undermining food self-sufficiency, increasing the risk of contamination or disease, and threatening the livelihood of farmers.<sup>103</sup> Part of this can

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<sup>98</sup> Pempel, *Regime Shift: Comparative Dynamics of the Japanese Political Economy*; Steven Vogel, "Can Japan Disengage? Winners and Losers in Japan's Political Economy, and the Ties That Bind Them," *Social Science Japan Journal* 2, no. 1 (1999).

<sup>99</sup> Aurelia George Mulgan, *The Politics of Agriculture in Japan* (London: Routledge, 2000), 329.

<sup>100</sup> Ibid.

<sup>101</sup> Gerald Curtis, *The Logic of Japanese Politics: Leaders, Institutions, and the Limits of Change* (New York: Columbia University Press, 1999).

<sup>102</sup> Albrecht Rothacher, *Japan's Agro-Food Sector* (London: Macmillan, 1989).

<sup>103</sup> Aurelia George Mulgan, "The Farm Lobby," in *Japanese Politics Today: From Karaoke to Kabuki Democracy*, ed. Takashi Inoguchi and Purnendra Jain (New York: Palgrave Macmillan, 2011).



be explained by Japan's historical experience as a late developer. The government actively sought to shape consumer preferences to increase savings (suppressing consumption) and to buy only domestic products to assist with the goals of first war mobilization and then economic development; consumer groups were active participants in this process.<sup>104</sup> In addition, consumer organizations see "weak" groups such as small retailers or farmers as their allies and "strong" groups such as big businesses and foreign governments as their enemies.<sup>105</sup> Consumer groups feel bound by mutual ties of obligation to farmer groups, and their identities as consumers are closely tied to their roles as producers.<sup>106</sup>

For the business community, another potential advocate of agricultural liberalization, the latter could hypothetically be a way to reduce trade tensions and the internal costs of protection, such as high costs of food, inflated land prices and government expenditures. Industrial groups, especially in the food-processing industry, lose international competitiveness when they have to pay high input costs to purchase domestic raw materials and simultaneously compete with cheap imports. However, for decades these pro-liberalization interests remained largely passive while agricultural protection programs expanded. Keidanren has generally restrained its demands for agricultural liberalization for fear of antagonizing farmers or hurting the LDP politically. Large firms in the food processing industry have chosen to exit and move operations overseas in order to keep costs down, depriving domestic pro-liberalization forces of their voices for change.<sup>107</sup>

These patterns have meant that there are few allies in Japan for foreign agricultural interests; in addition, the closed nature of the sector makes it difficult for foreign actors to operate in the Japanese domestic arena. Foreign direct investment flows in agriculture tend to be very small around the world, and this is especially the case in Japan.<sup>108</sup> Inward FDI in areas such as food, forestry and fisheries is minimal; these sectors consistently rank among the lowest recipients of FDI in Japan. Investment of foreign capital in agriculture must first be examined and approved by the Japanese government. These factors put important limits on the ability of foreign agricultural interests to influence Japanese politics directly.

Some important shifts in the power of Japanese agricultural interests have occurred over the last 20 years. The 1994 electoral redistricting dramatically reduced the overrepresentation of the rural vote; combined with continued rural to urban migration, this has made political parties less willing to court farmers at the risk of alienating the urban residents who make up the majority of the Japanese population. The political and economic standing of JA has also declined as numbers of farmer-members and local cooperatives continue to drop, and the number of

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<sup>104</sup> Steven Vogel, "When Interests Are Not Preferences: The Cautionary Tale of Japanese Consumers," *Comparative Politics* 31, no. 2 (1999).

<sup>105</sup> Sheldon Garon, *Molding Japanese Minds: The State in Everyday Life* (Princeton: Princeton University Press, 1997).

<sup>106</sup> Vogel, "When Interests Are Not Preferences: The Cautionary Tale of Japanese Consumers." This finding of a "coalition of losers" has been confirmed by recent survey experiment research, which shows that those who fear future job insecurity and loss of income become more supportive of agricultural protectionism when primed with photographs intended to activate respondents' consciousness as producers. In contrast, visual stimuli intended to activate respondents' identities as consumers have no systematic effect on respondents' attitudes toward food imports, which suggests that it is difficult to change individuals' minds on the basis of appeals to their interests as consumers. See Megumi Naoi and Ikuo Kume, "Explaining Mass Support for Agricultural Protectionism: Evidence from a Survey Experiment During the Global Recession," *International Organization* 65 (2011).

<sup>107</sup> Leonard Schoppa, *Race for the Exits: The Unraveling of Japan's System of Social Protection* (Ithaca: Cornell University Press, 2006).

<sup>108</sup> Astrit Sulstarova, "FDI Data on Agriculture," (Rome: United Nations Conference on Trade and Development, 2012).

politicians linked to farming interests has decreased. The LDP ceded power to the Democratic Party of Japan (DPJ) from 2009 to 2013, which left the farm lobby in a less certain position; however, in the end, this did not result in substantial agricultural reform, as the DPJ also eventually found itself courting agricultural interests. Overall, agricultural interests still possess a great deal of influence in Japan. In 2004, Japan's total government transfers to agriculture amounted to 1.3 percent of GDP, which was almost equal to agriculture's 1.4 percent share of GDP; this overall level of government assistance is well above the OECD average.<sup>109</sup> The LDP as a whole remains disproportionately strong in rural districts, consumers still tend to identify with farmers, and farmers remain one of the best organized voting blocs in the country.

### 3.1.2 Agricultural Politics in the United States

Like Japan, the United States also provides extensive assistance to its agricultural sector. Over 80 percent of growers of program crops (e.g., wheat, cotton, corn, rice) collect federal subsidies, and government payments account for nearly a third of net farm income. Government program payments to American farms totaled \$12.3 billion in 2009.<sup>110</sup> Since the US is a net exporter of agriculture, taxpayers (not consumers) foot most of the bill, paying about \$20 billion per year to support subsidies.<sup>111</sup> In contrast to the Japanese agricultural sector, which is dominated by small-scale farming, large establishments dominate the agricultural sector in the US; the "family farmer" ideal no longer reflects the realities of modern American agriculture. For example, today most cropland is on farms with at least 1,100 acres, and many farms are 5-10 times that size.<sup>112</sup> Although mid- and large size farms account for just 8 percent of US farms, they generate 60 percent of the value of production.<sup>113</sup>

Current American farm policy is a complex layering of over 80 years of legislation beginning with the Agricultural Adjustment Act of 1933, which first extended New Deal policies to agriculture during the Great Depression. The goal was to restore the purchasing power of farm commodities to their 1910-14 level, a concept referred to as "parity," through a mix of supply controls and processing taxes. The laws of the 1930s established the basic price support and production control system that remains today. In this way, current levels of protection can be understood as the result of a social contract struck with the agricultural industry at a key point in time. Price guarantees were appropriate in the 1930s, but the structure of the US farming industry subsequently became increasingly skewed toward a few large farms, allowing a small number of actors to capture the majority of all support benefits.<sup>114</sup>

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<sup>109</sup> Aurelia George Mulgan, "Farm Reform Shell Game," *The Oriental Economist*, December 2013.

<sup>110</sup> WTO Secretariat, "Trade Policy Review Japan," (2006).

<sup>111</sup> T. Kirk White and Robert Hoppe, *Changing Farm Structure and the Distribution of Farm Payments and Federal Crop Insurance* (Economic Research Service, US Department of Agriculture, 2012).

<sup>112</sup> James MacDonald, Penni Korb, and Robert Hoppe, *Farm Size and the Organization of US Crop Farming* (Economic Research Service, United States Department of Agriculture, 2013). Paarlberg, "The Political Economy of American Agricultural Policy: Three Approaches."

<sup>113</sup> Robert Hoppe, *Structure and Finances of US Farms: Family Farm Report, 2014 Edition* (Economic Research Service, US Department of Agriculture, 2014). MacDonald, Korb, and Hoppe, *Farm Size and the Organization of US Crop Farming*.

<sup>114</sup> "Farm Subsidies: Milking Taxpayers," *The Economist*, 14 February 2015.

Farmers represent a smaller share of the US population today than in the 1930s, but the farm lobby remains a powerful political force.<sup>115</sup> The lobby is composed of a mix of producer groups (general farm groups, commodity producers, cooperatives), agribusinesses (both wholesalers and retailers), agricultural facilitators (such as chemical companies), and public interest groups.<sup>116</sup> Beginning with producer groups, the American Farm Bureau Federation reflects the interests of large-scale farmers, so it seeks to promote a free market economy through the elimination of protection globally. At the other end of the ideological spectrum, groups such as the National Farmers' Union have a family farmer focus that lead them to pursue parity and the maintenance of government price support policies to maintain farm incomes. The membership of these general farm organizations cuts across commodities, making it difficult for them to define their position with respect to legislation.

Since the 1960s, commodity groups have tended to replace the dominant position previously occupied by general farm organizations; they have an inherent advantage over the latter because commodity organizations can more clearly express the concerns of their constituencies and deliver information to politicians.<sup>117</sup> Most commodity organizations also have access to federal- and/or state-mandated producer checkoff funds to help fund their activities. Groups such as the National Association of Wheat Growers or the Rice Millers' Association that represent export-oriented commodities often lobby for the reduction of trade barriers in other countries; for example, the Rice Millers' Association filed over 300 complaints against Japan and Taiwan between 1989 and 1994 in an attempt to gain access to their rice markets.<sup>118</sup> However, there are some clashes between producer and agribusiness interests within commodity organizations; this leads to a complicated price-volume tradeoff, since guaranteed high prices are not a clear advantage for all parties involved. The increasingly vigorous representation of agribusiness interests has led to much greater complexity and ambiguity in the agricultural lobby; wholesalers generally prefer to increase sales volume, whereas retailers prefer to purchase commodities at the lowest possible price. Public interest groups typically popularize key agricultural issues in order to transform the nature of the policy debate.

Despite the diversity of the agricultural lobby and the complexity of the US policy process, Congress is the target for most agricultural interest groups, particularly members of the agricultural committee in either chamber. Increasing policy complexity has made expertise on specific issues increasingly important, leading commodity organizations with their own research departments to become partners with Congress and the US Department of Agriculture (USDA) in the policy process. The most natural lobbying targets within the American government are the Agricultural Stabilization and Conservation Service (ASCS) and the Economic Research Service (ERS) of the USDA. The ASCS administers most of the farm price and income programs, while the ERS conducts research and monitors the global food and agriculture system. The older, more established groups in particular benefit from being incorporated into the process whereas newer entities such as public interest groups are outsiders. The latter often consider themselves shut out of the inner circle of congressional committees and the USDA and are thus more inclined to target other departments such as the Treasury, the State Department, the Department of

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<sup>115</sup> For a discussion of how migration of farmers affected agricultural access to Congress, particularly from the 1960s on, see Hoppe, *Structure and Finances of US Farms: Family Farm Report, 2014 Edition*.

<sup>116</sup> John Hansen, *Gaining Access: Congress and the Farm Lobby, 1919-1981* (Chicago: The University of Chicago Press, 1991).

<sup>117</sup> Jonathan Brooks and Colin Carter, *The Political Economy of US Agriculture* (Canberra: Australian Bureau of Agricultural and Resource Economics, 1994).

<sup>118</sup> Hansen, *Gaining Access: Congress and the Farm Lobby, 1919-1981*.

Commerce, the Environmental Protection Agency, and the Food and Drug Administration. Farm interests also try to lobby the White House directly, but their success varies from administration to administration. Thus, whereas Japanese agricultural groups lobby directly through the party system, and historically through their support of the LDP, American agricultural groups target both parties through Congress and committees.

Lobbying techniques vary depending on the target but include campaign donations, provision of information, testimonies at committee hearings, and instigating grassroots action. The concentration of US farming in certain regions of the country means that farm products constitute a significant portion of the GDP of specific states; this makes political representatives of these states highly sensitive to pressure from farmers. Studies have shown that campaign donations are correlated with a strong influence over agricultural protection.<sup>119</sup> In particular, contributions tend to be directed toward incumbents that already have demonstrated support for agricultural programs.<sup>120</sup> Voting outcomes on the floor of Congress are further influenced by vote trading, or log rolling. For example, some studies have found evidence of vote trading coalitions among sugar, dairy, peanut, and tobacco interests.<sup>121</sup> Also, farm-state legislators are sometimes able to gain the support of urban legislators who seek increase subsidies in agriculture bills for programs such as food stamps.

When it comes to foreign agricultural policy, the US has a very aggressive set of trade policies in the Export Enhancement Program, targeted export assistance, and import quotas. Powerful agricultural interests and the US government seek to maintain international market share. Agribusinesses also support export subsidies because of their volume increasing effects. The US government generally supports the export promotion program because any improvement in the trade balance is politically attractive. The Office of the US Trade Representative (USTR) has prime responsibility for the American negotiating position.

As in Japan, foreign agricultural interests have little independent input into American domestic policy formation. Although foreign investment is openly permitted in agriculture, the sector accounted for less than one percent of inward FDI to the United States in 2009.<sup>122</sup> Instead, foreign actors generally seek representation through their own governments, hoping that the latter will successfully negotiate favorable trade agreements on behalf of industry. If foreign agricultural interests do attempt to influence the US government, it is often through different channels than domestic actors. For example, while domestic farm lobbying activity tends to be directly heavily toward Congress and the USDA, foreign interests tend to consider the White House a more sympathetic and accessible contact.<sup>123</sup> However, these channels are very limited

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<sup>119</sup> Brooks and Carter, *The Political Economy of US Agriculture*.

<sup>120</sup> Kishore Gawande, "The Structure of Lobbying and Protection in US Agriculture," in *World Bank Policy Research Working Paper Series* (World Bank, 2005).

<sup>121</sup> David Abler, "Campaign Contributions and House Voting on Sugar and Dairy Legislation," *American Journal of Agricultural Economics* 73, no. 1 (1991).

<sup>122</sup> US Governmental Accountability Office, "Sovereign Wealth Funds: Laws Limiting Foreign Investment Affect Certain US Assets and Agencies Have Various Enforcement Processes," (2009). Although foreign investment is permitted, foreign investors in agricultural land holdings must file a disclosure report. This is a result of the Agricultural Foreign Investment Disclosure Act of 1978, which was enacted partly in response to concerns of US rural constituencies that foreign investment was causing an escalation in the price of agricultural land in the US and threatening rural communities.

<sup>123</sup> David Abler, "Vote Trading on Farm Legislation in the US House," *American Journal of Agricultural Economics* 71, no. 3 (1989); Thomas Stratmann, "The Effects of Logrolling on Congressional Voting," *American Economic Review* 82, no. 1162-1176 (1992).

because foreign agricultural interests have little ability to build coalitions with American domestic actors that might help to give them more weight in appealing to politicians.

Opposition to agricultural protection is muted. Few voters realize how much of their money is given to farmers and agricultural protection is underpinned by public support, which still reflects the notion that agriculture is an important profession deeply intertwined with American national identity. Moreover, as in the Japanese case, agricultural policymaking is more complicated than a simple three-way contest between producers, consumers, and taxpayers. Agricultural interests extend across the food chain from input suppliers of chemicals, machinery, and raw materials to producers, importers, food distributors, food exporters, grocers, food preparers, and consumers. Across the economy, facilitator or supplier industries such as transport, finance, communications, research and consulting also have an interest in agriculture, as do unions, public interest groups, and the government itself. This means that a broad array of actors have an incentive to maintain some type of government support for agriculture.

### **3.2 The Domestic-International Nexus of Rice Liberalization**

Rice has been one of the biggest stumbling blocks to Japanese agricultural liberalization, and as such, it makes for an excellent case through which to examine the strategies of foreign actors interested in the Japanese market. Rice is an important staple of the Japanese diet and holds a special place in Japanese culture, which, combined with the political muscularity of agricultural organizations, have all contributed to the difficulty of negotiating its liberalization. In this section, I demonstrate that due to its limited ability to target Japanese actors or the Japanese government directly, the US Rice Millers' Association (RMA) took dramatic US domestic political action to get the issue on the US trade agenda. They were unable, however, to get the issue taken up at the bilateral level, as they so desired; instead, the US decided to discuss rice within the context of the GATT for political reasons of its own. The RMA's reliance on government channels meant that it lost control of the issue. Once the matter was taken up in multilateral talks, the vocal opposition of the RMA served to provide the US government with an important bargaining tool at the GATT; in essence, US negotiators were able to use continued RMA threats to demonstrate to Japan that the American win-set—the set of possible agreements acceptable to American business—was quite small and that a breakdown of the GATT negotiations would result in more trouble for Japan. The strategies of the rice industry were targeted primarily at actors within the US government, which represented American agricultural interests in multilateral talks.

Medium-grain japonica rice is the preferred rice in Japan and South Korea; the US competes with Australia, Spain and Italy for the japonica markets. Rice is among the most heavily protected crops produced in the US, which reflects the extensive political clout of producer's organizations such as the RMA and the dependence of the industry upon government subsidies.<sup>124</sup> US government support ensured that rice producers would not incur losses even when world prices were low. Although it produces less than two percent of the world rice crop, the US averaged 17.5 percent of annual world rice exports in the early 1990s.<sup>125</sup> Thus, while the US rice crop makes up a small portion of world production, it is globally competitive and thus has a large impact on trade. The export side of the world rice market is fairly concentrated and

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<sup>124</sup> Brooks and Carter, *The Political Economy of US Agriculture*.

<sup>125</sup> Yasuhiko Kishi, "Subsidies Keep US Rice Farmers Competitive," *The Japan Economic Journal*, 13 August 1988.

somewhat stable, but the import side is much more fragmented with relative positions among countries changing. Trade barriers, especially those instituted by the South Korean government in the early 1980s, had dramatic negative effects on US rice growers, which made them eager to secure new export markets.<sup>126</sup> Developments in Japan, therefore, had important consequences for American rice producers.

After the much-publicized liberalization of beef and oranges in the late 1970s, rice became the focal point of American pressure to relax restrictions on Japanese agricultural imports. Japan's relatively inefficient rice producers had long been protected by an outright prohibition on the sale of imported rice, authorized by Japan's Staple Food Control Law. Under the Japanese food control system established in 1942, the government purchased almost all rice grown in the country at eight to ten times the world price with the logistical assistance of JA and then resold it to consumers at prices five to six times higher than the cost of US or other imported rice. Consumers shouldered the majority of the financial burden through high retail prices. Japanese politicians, many of whom were deeply dependent on agricultural votes for their positions, staunchly opposed rice liberalization; the Diet passed unanimous resolutions in 1980 and 1984 calling for greater self-sufficiency in agriculture and opposing liberalization.

The US Rice Millers' Association played a central role in unifying the voices of the American rice industry and spearheading action against Japanese protectionism. At the time, the 27 members of the Rice Millers' Association consisted of farmer-owned cooperatives and independently-owned rice milling companies located in Arkansas, California, Louisiana, Mississippi, Texas, and Florida. Members of the farmer-owned cooperatives belonging to the RMA grew approximately 65 percent of the rough rice produced in the US and included over 12,000 rice farmers. The independent rice milling companies in the RMA, together with the farmer-owned cooperatives, accounted for virtually all of the rice milled in the US. In addition, there were 23 associate members of the RMA, including the major US exporters of rice. Consequently, the RMA spoke on behalf of the entire US rice industry, which was united in its desire to obtain access to the Japanese rice market.<sup>127</sup>

Frustrated by the high level of regulation and Japan's persistent refusal to open its market, the RMA and the USA Rice Council brought the issue to US Trade Representative Clayton Yeutter in September 1986. They requested the application of the Section 301 provisions of the 1974 US Trade Act that empowered the president to take retaliatory action against countries that practice unfair trade. Up until this petition, rice had never been on the list of agricultural commodities to be negotiated between Japan and the US. The entire California congressional delegation urged Yeutter to take the case, and House agricultural subcommittee hearings also demonstrated support.<sup>128</sup> The Japanese side was outraged. The Diet passed another resolution opposing the liberalization of rice, and a senior executive for Zenchu responded that the petition "...both amazed and infuriated Japanese farmers and agricultural organizations..." and was "...a selfish bid for profit completely ignoring the social, economic, cultural and political importance of rice in Japan."<sup>129</sup>

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<sup>126</sup> Parveen Setia et al., "The US Rice Industry," (Commodity Economics Division, US Department of Agriculture, Economic Research Service, 1994).

<sup>127</sup> Debbie Stone, "Rice Growers Gaze Longingly at Japan," *Journal of Commerce*, 27 August 1991.

<sup>128</sup> Stephen Gabbert, "Inflated Rice Cost Half U.S.-Japan Trade Deficit," *The Japan Economic Journal*, 27 September 1986.

<sup>129</sup> Christina Davis, *Food Fights over Free Trade: How International Institutions Promote Agricultural Trade Liberalization* (Princeton: Princeton University Press, 2003).

The RMA was adamant that USTR address the rice issue in bilateral talks, but its petition was rejected by Yeutter in October 1986 in favor of putting rice (and agriculture more generally) on the negotiating table at the Uruguay Round talks of the GATT. J. Stephen Gabbert, executive vice president of the RMA, denounced the administration's decision, saying, "We think that basically what the United States has done is thrown away a very big bargaining chip. We had aces in our hand and gave them away... We walked away, and the Reagan administration is trying to make it sound as if it's a great big deal to be put in the new round of trade talks."<sup>130</sup> The RMA wanted rice to be addressed in bilateral talks because it felt that the latter would be a more expedient venue in which it could exercise more influence than it could in multilateral talks. Discussing rice in the Uruguay Round would involve a much larger number of actors, slowing the pace of progress and diluting the power of the US rice industry.

A key problem for the RMA was that it lacked the ability to lobby on its own in Japan; therefore, it had little choice but to wait for the US government to act on its behalf. A June 1987 article commented on this lack of action and criticized the RMA among other American industries for not going abroad to directly promote the opening of foreign markets, asking, "Where is the US private sector?"<sup>131</sup> A logical step for the RMA might have been to cultivate goodwill among the Japanese consumers who stood to save money through the importation of cheap American rice; however, the RMA actually took the opposite tack by offending consumers. In August 1987, Gabbert gave an interview in which he implied that Japanese consumer groups were taking bribes from Japan Agriculture. Naokazu Takeuchi, president of the Consumers Union of Japan, demanded an apology for the "defamatory remarks."<sup>132</sup> This provides evidence that the RMA clearly saw Japanese consumer groups more as adversaries than as allies with whom it could form a political coalition.

In April 1987, the Japanese government publically announced that it would consider the US demand for rice liberalization as part of the agricultural reform talks at the Uruguay Round. The US rice industry was unhappy about the placement of rice issues in the multilateral negotiations and their slow pace; the RMA continually raised the threat of filing another petition. In August 1988, the "Super 301" provision of the Omnibus Trade and Competitiveness Act was signed into law, requiring the US Executive to establish trade liberalization priorities and negotiate with foreign governments to achieve them during 1989-1990. It required USTR to identify priority practices, the elimination of which would have the most significant potential to increase US exports, and priority countries that demonstrated a large number of these identified barriers. It was widely believed that Japan was the unstated target of this provision. On September 14, the RMA and the USA Rice Council filed another complaint asking for an investigation into Japan's barriers against rice imports and for the US to bring charges against Japan before an international trade tribunal if Japan refused to lower them. Specifically, the rice industry requested that Japan ease import quotas to allow rice imports equal to 10 percent of the country's domestic rice needs within four years.

The timing of this petition gave the Reagan administration just 11 days before the November 8 presidential election to make a decision; the rice growers hoped to use election year political pressure to push the US government into action. "If the USTR rejects the petition, Republican candidate George Bush will lose votes in California in the presidential election,"

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<sup>130</sup> Robert Weigand, "No Open Door for Foreign Rice in Japan," *Food Policy* (1988).

<sup>131</sup> Stuart Auerbach, "U.S. Holds Off Challenge of Japanese Rice Policy," *The Washington Post*, 24 October 1986.

<sup>132</sup> Helen Ericson, "Rice Millers' Plea Fails Yeutter Rejects Retaliation Petition," *Journal of Commerce*, 24 October 1986.

Gabbert warned.<sup>133</sup> There were divides within the US government about the petition; while the State Department favored rejecting the request to preserve US-Japan relations, White House trade officials privately agreed with the rice industry and Vice President George Bush urged USTR to take action during a campaign stop. By law, the decision was solely in the hands of USTR, but the political pressure was evident. Yeutter said, "Clearly, I am a supporter of Vice President Bush and will do whatever I can to insure that he becomes the next President...But totally aside from that, I have to look at this in the context of what is in the best interest of the United States. Clearly, this is a very difficult decision. I have to look at the long-term US-Japan relationship."<sup>134</sup> Because the rice industry had to rely exclusively on government channels, its interests were mediated by intergovernmental battles and conflicting priorities.

On October 28, Yeutter rejected the RMA's petition, saying that said he was prepared to reconsider his decision if Japan did not show a willingness to open its markets at the upcoming Montreal meeting; this was essentially a restatement of the stance he had taken two years earlier. The RMA was "shocked, disappointed, and dismayed."<sup>135</sup> Gabbert said that Republicans had "failed the test" of whether they would take firm action against unfair foreign trade barriers, urging rice farmers to "think about which political party protects their interests" when voting.<sup>136</sup> The RMA also threatened to ask Congress to amend the new trade law, under which the petition was filed, to eliminate the discretion Yeutter had used in rejecting the petition.

Two factors were critical in the administration's decision not to target rice. First, there was a concern about deliverability; US officials found it difficult to imagine the Japanese government making concessions in this area of domestic sensitivity, especially under the blatant coercive pressure of Super 301. Second, US officials agreed to forego the use of Super 301 and to take up the issue of rice in the Uruguay Round in exchange for a Japanese pledge to support the US in pursuit of its overall Uruguay Round objectives.<sup>137</sup> Japan's support was critical in light of the EC's intransigence on agriculture, and the reluctance of many developing countries to liberalize trade in services and investment. Both the US and Japan anticipated that the Uruguay Round might play out in their favor; Japan hoped rice would be ignored in the midst of a broad negotiation on many issues, while the US hoped that Japan would yield to pressure to concede on rice once all countries had put their sensitive issues on the table.<sup>138</sup>

When US officials decided to make farm policy reform a centerpiece of the Uruguay Round, they thought that they were gaining at least two practical advantages. First, they knew that an international sharing of the policy reform burden among farm producers in all countries would reduce the actual burden that producers in any one country would have to bear, thus presumably reducing farm-sector resistance to reform. Second, putting farm policy reform into a multi-sector international negotiation would take the farm policy initiative away from illiberal domestic agricultural-sector coalitions and would also dilute any veto power those coalitions might seek to exercise over the final outcome.<sup>139</sup> For the US rice industry, the upshot of this deal

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<sup>133</sup> Associated Press, "Japanese Criticize Rice Millers," *ibid.*, 21 August 1987.

<sup>134</sup> "USTR Cannot Avoid RMA Appeal: Gabbert," *The Japan Economic Journal*, 9 October 1988.

<sup>135</sup> Clyde Farnsworth, "The Nation: The Politics of Protectionism; When Running for President, It's Hard to Be Free on Trade," *The New York Times*, 9 October 1988.

<sup>136</sup> "US Rejects Action on Japan's Rice Imports," *The New York Times*, 29 October 1988.

<sup>137</sup> AP-Dow Jones, "Yeutter's Rice Ruling under Fire," *Australian Financial Review*, 1 November 1988.

<sup>138</sup> Michael Mastanduno, "Setting Market Access Priorities: The Use of Super 301 in US Trade with Japan," *The World Economy* 15 (1992).

<sup>139</sup> Davis, *Food Fights over Free Trade: How International Institutions Promote Agricultural Trade Liberalization*.



was that rice would become one part of a complex and protracted multilateral negotiating process, rather than the focus of one of several priority bilateral negotiations.

Despite the decision to take rice to the GATT, USTR continued to use the threat of another RMA petition as negotiating leverage with the Japanese government; the implication was that US industry was eager for a chance to politicize the rice issue, and that the US government would not be able to hold it at bay forever. RMA officials continued to be frustrated with the slow pace of negotiations and periodically reiterated their intent to refile their complaint if progress was not made. They also continued to use their connections to Congress to put pressure on USTR and the Bush administration. For example, in August 1989, the president of the RMA said that his organization would "...keep working with our friends in Congress to...make sure that the administration doesn't get weak on rice."<sup>140</sup> In Putnam's terms, US negotiators could credibly claim that the size of their win-set, or set of possible agreements that could possibly be approved, was restricted by the demands of the rice industry; total lack of progress on the rice issue was simply unacceptable. Moreover, if the desired outcome could not be achieved through the GATT, the US would have to resort to bilateral talks. To the frustration of the Japanese side, the US Secretary of Agriculture Richard Lyng emphasized that, "Now, it's better in the long run to do this in the Uruguay Round, but we have not closed the door to bilateral negotiations."<sup>141</sup>

From the start, the Uruguay Round set a broad agenda that laid the foundation for cross-sector issue linkage. Christina Davis convincingly argues that when the agenda and procedures of a negotiation bind together negotiations for market opening across multiple sectors into a single package deal, as in the case of the Uruguay Round, this broadens the economic stakes of the negotiation, creating a balance of gains and losses for domestic interests that politicians may find easier to accept.<sup>142</sup> Fifteen negotiation groups were formed to address topics ranging from traditional issues like tariffs for trade in goods to new issues such as services and investment rules.<sup>143</sup> All participating nations agreed that failure of any negotiation group would stop the entire process. The broad agenda helped persuade Japanese leaders to discuss rice policy since all countries would be putting their sensitive topics on the negotiating table. When the collapse of agricultural talks at the 1990 Brussels ministerial led to a suspension of the entire conference, it demonstrated that failure on agriculture could scuttle the entire round, emphasizing that this was indeed a single undertaking. Another important development was the generation of the Dunkel draft in late 1991, which outlined a final agreement on all negotiation groups including agriculture. This put even more pressure on countries like Japan to justify their need for any exception that might sabotage the negotiations.

As the GATT negotiations progressed, they increased the size of the Japanese win-set by bolstering the position of pro-liberalization forces in Japan. Gradually, the voices of consumers and business became more prominent in challenging the agricultural status quo. In Putnam's language, international pressure "reverberated" within Japanese domestic politics, tipping the

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<sup>140</sup> Stuart Auerbach, "Bush Faces Decision on Rice Imports; Trade Issue Tops Agenda of Meeting with Japanese Prime Minister," *The Washington Post*, 31 August 1989.

<sup>141</sup> Ikuo Hirata, "US Farm Chief Presses for Rice Market Opening," *The Japan Economic Journal*, 3 December 1988.

<sup>142</sup> Davis, *Food Fights over Free Trade: How International Institutions Promote Agricultural Trade Liberalization*.

<sup>143</sup> The fifteen groups were: tariffs, nontariff measures, natural resource base products, textiles, agriculture, tropical products, subsidies, safeguards, GATT articles, dispute settlement, multilateral trade negotiation arrangements, functioning of the GATT system, trade-related aspects of intellectual property, trade-related investment procedures, and services.

domestic balance and thus influencing the international negotiation.<sup>144</sup> The restarting of the Uruguay Round in 1991 seemed to be a turning point for Japanese domestic sentiment. The 1990 talks had been dominated by disagreements between the US and the EC over reducing agricultural subsidies; once the EC agreed to make concessions on agriculture, Japanese government officials concluded that they could no longer dodge the issue of rice.<sup>145</sup> In May 1991, Keidanren pushed past fears that rice liberalization would lead to farm boycotts against its members, passing a resolution urging the Japanese government to show leadership in the round and specifically calling for rice market opening. Within the time frame of just a few weeks, a number of Japanese political leaders called for at least partial opening of the rice market in a series of public statements. These political leaders included Prime Minister Toshiki Kaifu, former Prime Minister Noboru Takeshita, former Deputy Prime Minister Shin Kanemaru, LDP General Council Chairman Takeo Nishioka, Chief Cabinet Secretary Misoji Sakamoto, and LDP Secretary General Keizo Obuchi.<sup>146</sup> Public opinion also began to move slightly in the direction of support for limited liberalization of rice.<sup>147</sup>

Debate over if and how Japan would liberalize its rice market continued throughout 1991 and 1992, with the RMA continuing to play an active role in putting pressure on the American and Japanese governments. In March 1991, the Japanese agricultural ministry forced US rice industry representatives to remove samples of American rice during a food show under threat of arrest for violating Japan's Food Control Law.<sup>148</sup> The RMA issued a press release publicizing the incident and interpreted it as evidence of continued Japanese resistance. RMA President David Graves commented, "This is a very clear signal that Japan has no intention of negotiating seriously in the GATT negotiations. We intend to return to Washington and appeal directly to the administration and to Congress for help."<sup>149</sup> In terms of how rice should be liberalized, the RMA supported the US government's proposal that all bans or quotas be eliminated in favor of imposing tariffs that would be eliminated over a 10-year period.<sup>150</sup> Japan preferred a "minimal import access" approach that would allow it to open 3-5 percent of Japan's rice market to imports. With the transition to the new administration in 1993, the RMA expected support from President Bill Clinton, whose home state of Arkansas was the largest rice-growing state in the US; they continued to threaten to file another petition with USTR.<sup>151</sup>

When the LDP lost power and a new seven-party coalition government took the reins of government in August 1993, many expected the Uruguay Round negotiations to proceed more smoothly, since the refusal to open the rice market had been a pillar of LDP policy. Yet, immediately after it was formed, the new government agreed to refuse the tariffication of rice due to strong opposition by the Japan Socialist Party, illustrating the tendency of opposition parties to court the rural farm vote, just as the LDP had done for so long. However, pro-

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<sup>144</sup> Davis, *Food Fights over Free Trade: How International Institutions Promote Agricultural Trade Liberalization*.

<sup>145</sup> Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games."

<sup>146</sup> "Japan Faces June High Noon on Rice Issue; GATT Concessions Look Inevitable, Policy Shift Anticipated," *Nihon Keizai Shimbun*, 26 January 1991.

<sup>147</sup> Satoshi Isaka, "International Stakes Prompt Japanese Leaders to Shift; Successive Calls Voiced for Partial Lifting of Ban on Rice Imports," *The Nikkei Weekly*, 8 June 1991.

<sup>148</sup> Davis, *Food Fights over Free Trade: How International Institutions Promote Agricultural Trade Liberalization*.

<sup>149</sup> David Sanger, "Japan Shuts US Rice Exhibition," *The New York Times*, 18 March 1991; Paul Blustein, "At Tokyo Fair, US Booth Sparks Rift over Rice," *The Washington Post*, 16 March 1991.

<sup>150</sup> "Tempest in a Rice Bowl Japan," *The Toronto Star*, 17 March 1991.

<sup>151</sup> Richard Katz, "Rice Market Seen as Test for US Global Policy; Controversial Memo Aimed at Blocking Partial Opening," *The Nikkei Weekly*, 10 August 1991.

liberalization forces continued to press the government to reconsider its position as negotiations neared their conclusion in 1993. Keidanren and Nikkeiren both released reports calling for agricultural reform and liberalization, and a group of former bureaucrats, scholars, and journalists issued a declaration recommending that Japan accept tariffication.<sup>152</sup> The pro-liberalization side was also bolstered by a terrible harvest in 1993 that required Japan to import huge amounts of foreign rice, demonstrating the disadvantages of existing Japanese rice policy. Much of this emergency rice came from the United States.

Negotiators reached an agreement at the end of 1993. On December 13, the Japanese government announced that it would accept a compromise proposal for liberalization. Japan agreed to end the rice import ban, but tariffication of rice would be postponed for six years in exchange for raising the minimum access import quota to four and then eight percent. Japanese political leaders justified this concession by saying that it had to be viewed in terms of the importance of the Uruguay Round as a whole, demonstrating the power of issue linkage to help them shift the balance of domestic interests.<sup>153</sup>

Although the final outcome of an import quota was at odds with the RMA's demands for more substantial opening of the Japanese rice market, the RMA reportedly came around to this deal because it felt that it would be able to secure a certain amount of the market during the six-year grace period. The thinking was that US rice could gain a larger market share in a bureaucracy-managed system than in a more competitive market situation where it would have to compete with low-cost producers. The US government unofficially requested that Japan promise US rice exporters a 40-60 percent share in imports beginning in 1995.<sup>154</sup>

In the context of Japanese politics, the agreement for partial opening of the rice market represented a major political step. The import of rice required the overhaul of the entire food control system and large budget outlays for compensation payments to rural regions. The deal transformed Japan from a closed market into the top US rice export market, though important limitations remained. Rice exports from the US to Japan significantly increased after the conclusion of Uruguay Round, but they remained within a range of about 300,000-400,000 metric tons annually. Figure 3.1 illustrates the spike in imports in 1994 due to Japan's bad harvest and the relatively flat level of rice exports to Japan after the GATT agreement.

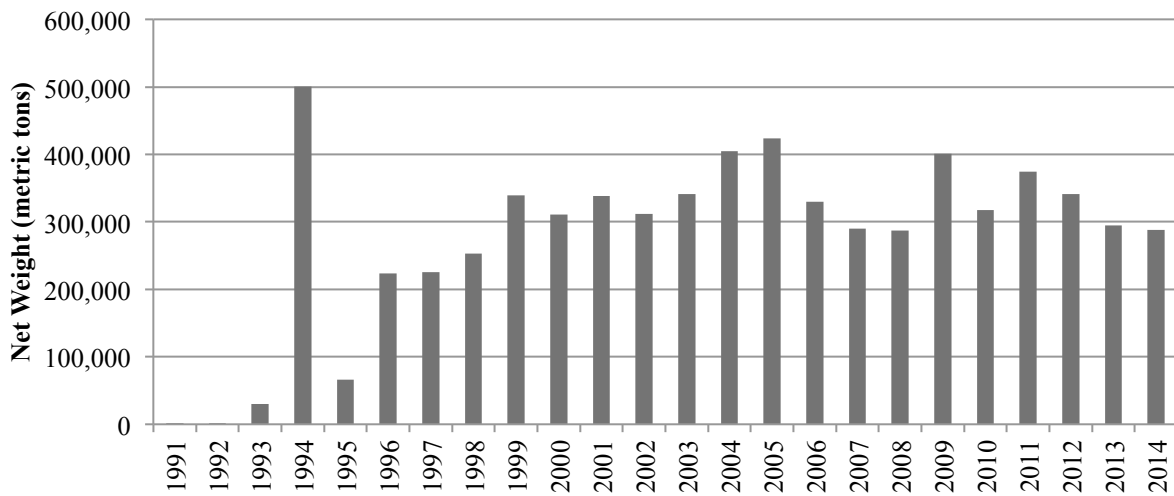
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<sup>152</sup> Reuters, "Apples, Rice Scarce at Osaka Food Show," 15 April 1993.

<sup>153</sup> Davis, *Food Fights over Free Trade: How International Institutions Promote Agricultural Trade Liberalization*.

<sup>154</sup> "US Seeks 40-60% Share of Japan's Rice Imports," *The Daily Yomiuri*, 4 January 1994.

Figure 3.1 US Rice Exports to Japan (1991-2014)<sup>155</sup>



Although Japan has generally met the commitments that it made during the Uruguay Round and subsequent negotiations in terms of import volumes, its highly regulated distribution system for imported rice continues to limit market access for the rice industry in the US and other foreign countries. A 2003 report estimated that less than one-half of one percent of rice imported from the US reached Japanese consumers as an identifiable product of the United States.<sup>156</sup> Japan established a tariff-rate quota assuring imports of 682,000 tons annually; however, since Japan tariffed rice imports in 1999, no rice has been imported outside of the import quota because it would be subject to duty equivalent to about a 400-1,000 percent ad valorem tariff. Of the total amount of rice imported under the tariff quota, 582,000 tons is imported under the minimum access system operated by MAFF. The US rice industry has been disappointed by MAFF's record of buying medium quality rice for industrial use, food aid, and blending, rather than top quality rice for table use, despite industry research showing Japanese consumers would buy high quality American rice if it were more readily available. The remaining 100,000 tons of rice which Japan imports goes through a complex Simultaneous-Buy-Sell (SBS) system also administered by MAFF, which is very difficult to use because of lack of transparency. Strict residue testing requirements for rice imports have also served as an impediment. Overall, Japan's rice import regime significantly increases the cost of imported rice, which discourages consumption. Moreover, since the majority of US rice imports sit in warehouses, importers are denied the opportunity to establish direct relationships with Japanese consumers, to the detriment of the US rice industry.

No significant liberalization of the Japanese rice market has occurred since the conclusion of the Uruguay Round, although that is slated to change if the Trans-Pacific Partnership (TPP) is ratified. In the Doha round of the WTO, Japan sought to decrease its minimum access commitment, citing changing demographics and declining rice consumption. In the TPP negotiations concluded in 2015, Japan finally committed to further liberalization of its rice market. However, as seen in the Uruguay Round negotiations described previously, because American agricultural interests have had to continue to rely on the US government to represent

<sup>155</sup> Compiled from United Nations, "United Nations Commodity Trade Statistics Database," <http://comtrade.un.org/db/dqBasicQuery.aspx>.

<sup>156</sup> "US Seeks 40-60% Share of Japan's Rice Imports."

them in negotiations, their demands have been sacrificed to those of other interest groups in multilateral negotiations. Consequently, in TPP, the American and Japanese government struck a deal that allows Japan to continue to protect its agricultural interests for an extended period of time, while the US has been allowed to protect its auto industry. Japan agreed to increase quota for rice imports for the first time in 20 years under the TPP agreement, from 78,000 tons to 850,000 tons, which is about 10 percent of annual domestic consumption; however, it will still maintain a 778 percent tariff on imported rice. So, while this constitutes an important step for the American rice industry, it is still far short of complete liberalization, due to US government concerns for maintaining tariffs on Japanese automobiles.

### 3.3 Conclusion

Writing in 1990, a Japanese journalist responded to then-common criticisms that Japanese corporations were buying their way into American politics, saying:

If Japanese farmers were trying to open US rice markets as American agribusiness is now trying to crack Japan's Zenno, the national farm association, would have to spend millions of dollars on lobbyists to appeal to Congress and employ public relations firms to target public opinion. The American Rice Millers' Association didn't have to do any of this. They merely petitioned the trade representative's office and left the negotiations in the US trade representative's hands.<sup>157</sup>

The preceding case study shows that this journalist is wrong on several counts: First, it would have been very difficult, and likely impossible, for Japan's national farm association *or* for the US Rice Millers' Association to appeal to consumers or politicians in their target country. The lack of internationalization in the agricultural sector means that actors have a very difficult time advocating for themselves abroad. There was not much sympathy for American demands among Japanese actors, nor much support for Japanese demands in the US, at least when the RMA started lobbying for rice liberalization. Instead, agricultural political strategies were restricted to their respective home domestic arenas: industry has *had* to make use of the government as the key conduit for transmitting their interests and gaining concessions from foreign actors abroad.

Second, the process of petitioning the US government and leaving the negotiations in the hands of USTR was not easy nor even the optimal strategy from the perspective of the US rice industry. The necessity of relying on government as the conduit of their demands means that agricultural actors must contend with a great deal of uncertainty about how their issues will play out. When firms cannot lobby for themselves directly, they have to contend with the possibility that the government will prioritize other interests over their own. This seems particularly likely when a narrow trade issue is viewed in the context of a larger bilateral relationship; government entities such as the State Department may argue that it is folly to sacrifice diplomatic relations to satisfy private interests, even if Congress is in favor of such a move. Executive officials have carved out an important area of autonomy from Congress and society with regard to how and where to pursue unfair trade complaints.<sup>158</sup> By controlling a menu of institutional options,

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<sup>157</sup> USTR, "National Trade Estimate Report on Foreign Trade Barriers," (Washington, DC: Office of the US Trade Representative, 2003).

<sup>158</sup> Taro Kimura, "US Has 'Agents' in Japan, Too," *Journal of Commerce*, 28 December 1990.

executive officials can be responsive to congressional and societal demands but in a way that satisfies their own conceptualization and prioritization of foreign and trade policy objectives. In the case of rice, for example, this meant that rice would be one part of a complex and protracted multilateral negotiating process, rather than the focus of one of several priority bilateral negotiations. The multilateral approach proved to be a way of linking issues together and accomplishing some of the agricultural lobby's interests, but in a sense, without a way to influence the domestic games of the target countries, the industry lost substantial control over the process and was essentially at the mercy of a government tasked with weighing many competing objectives. The RMA could not effectively use political strategies independently of the US government or even control the venue in which the government pursued its demands.

Third, after the negotiations commenced, the RMA continued to play an important role; the RMA did not just simply hand off the issue to the US government. On the contrary, the US government used the RMA's continued threats as an important source of leverage. The US side could credibly claim that their win-set was restricted by the demands of the rice industry; total lack of progress on the rice issue was simply unacceptable for domestic political reasons in the US. If the desired outcome could not be achieved through the GATT, the US would have to resort to bilateral talks. As the negotiations progressed, they also increased the size of the Japanese win-set by bolstering the position of pro-liberalization forces in Japan. Gradually, the voices of consumers and business became more prominent in challenging the agricultural status quo. International pressure reverberated within Japanese domestic politics, tipping the domestic balance and thus influencing the international negotiation. The combination of a restricted US win-set and an enlarged Japanese win-set resulted in an agreement that was more favorable to US industry than it would have been prior to the negotiations. Again, this was not something that the US rice industry was able to accomplish on its own; it needed the US government, acting through the framework of the GATT, to make these indirect connections with Japanese domestic actors.

Since the relative liberalization of rice in Japan, foreign agricultural interest groups have started to focus somewhat more on market strategy, a pattern also seen in other sectors. In the case of the American rice industry, for example, the USA Rice Federation established a representative office in Tokyo in 1997 with the aim of expanding rice sales in Japan in partnership with Jusco, a major general merchandise store chain, and FamilyMart, a major convenience store chain.<sup>159</sup> In this way, initial market entry has opened up some possibilities for partnering with Japanese actors in even the area of agriculture. However, opportunities still remain extremely limited in comparison to other sectors. Because rice still remains subject to restrictive government regulations in important ways, political strategies will continue to be necessarily for the success of foreign industry.

This discussion of agriculture serves as an important departure point from which to view the sectoral case studies developed in the subsequent chapters. Firms in many sectors have political strategies that resemble that of agriculture; in cases where regulation is high but internationalization is low, firms will generally have to lobby their home governments to gain market access in Japan and or other economies with restricted trade. However, the remainder of this dissertation looks at sectors where foreign firms have been able to successfully enter Japan. As a result, their political strategies have become much more diverse, and in many cases, foreign firms have gained the ability to permeate the Japanese political process directly without the

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<sup>159</sup> In 1994, the Rice Millers' Association, the USA Rice Council, and the US Producers' Group merged to form an umbrella organization called the USA Rice Federation.

assistance of their home government. Understanding firms' political strategies in more globalized sectors requires an understanding of both their own domestic political context and their activities in the Japanese political arena, since strategies based in the target country have increased in importance over the course of the post-World War II period.

## 4 Pharmaceuticals: Insiders Within the Japanese System

Japan has the second largest market for pharmaceuticals in the world, behind that of only the United States. A 2013 article in the *The Economist* identified Japan as “the best market in the world right now” for foreign firms.<sup>160</sup> Sales growth for the top eight multinational drug firms in Japan in 2011 ranged from 12 to 31 percent, impressive rates more commonly seen in quickly growing emerging markets. For foreign firms, this market success has come hand in hand with notable achievements on the political front. The pharmaceutical industry is commonly recognized as the most successful foreign lobby in Japan in terms of forging strong relationships with Japanese public and private actors. Foreign firms in this sector have not relied exclusively on outsider political strategies such as lobbying their home governments; instead, they have actively attempted to form cross-national coalitions with Japanese actors in order to leverage insider political strategies and resources. This has translated into the ability to influence Japanese policy in a host of areas, particularly over the last 20 years. For example, the Health Care Committee of the American Chamber of Commerce in Japan (ACCJ) estimated that 37 percent of the recommendations from its 2011 white paper were acted upon by the Japanese government, and 31.2 percent of the recommendations from its 2013 white paper saw action.<sup>161</sup>

In this chapter, I argue that the pattern of internationalization in the Japanese pharmaceutical sector has led to a distinct coalitional configuration that pits the globally competitive players, both foreign and Japanese, against the weaker, smaller players. This distinct pattern has created opportunities for foreign firms to cooperate with Japanese firms, trade associations, and government ministries, which has helped to make the pharmaceutical industry one of the most influential foreign lobbies in Japan. While initially dependent on home government pressure, the foreign pharmaceutical industry has subsequently been able to develop close working relationships with bureaucrats, regulators, and politicians in Japan. The opening up of Japanese politics to include greater participation by civil society organizations has also created an opportunity for the industry to ally itself with Japanese patient groups in specific cases.

This chapter begins with a brief overview of the political economy of the global pharmaceutical industry to show how Japan fits into the larger landscape of a sector that has been strongly shaped by American and European multinational corporations. I then turn to the Japanese domestic context, explaining how Japan came to have its particular pattern of internationalization before turning to a brief outline of the key actors involved in policymaking. This is followed by two issue case studies that illustrate how the foreign pharmaceutical industry has been able to capitalize on the pattern of internationalization in the sector to form cross-border coalitions with Japanese actors. The first case illustrates the role that the foreign pharmaceutical industry played in reducing drug approval times in Japan. While Japan had a severe “drug lag” in the 1990s due to very long approval times, these approval times had become faster than the US Food and Drug Administration by 2015. I argue that the foreign pharmaceutical industry was able to use a wide variety of strategies to influence Japanese policy in this area, including engaging in coalitions with globally competitive Japanese firms and with Japanese patient groups. Similarly, the second case shows the influence of the foreign pharmaceutical industry on drug pricing policy in Japan and highlights its strong coalitions with globally competitive

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<sup>160</sup> “Regenerative Medicine,” *The Economist*, 23 February 2013.

<sup>161</sup> Interview with ACCJ Health Care Committee members, 16 July 2015.



Japanese firms. Both cases demonstrate a gradual transition from government-led foreign pressure to firm-led foreign pressure in the pharmaceutical sector.

#### 4.1 The Political Economy of the Global Pharmaceutical Industry

The pharmaceutical industry is highly globalized, dominated by multi-billion dollar firms that engage in significant business activity in many countries and whose products are distributed and marketed worldwide. The sector has the highest average profit rates of any major manufacturing sector in the world, and global pharmaceutical sales reached a milestone of \$1 trillion in 2014, with expectations for strong growth in the future.<sup>162</sup> While sales and manufacturing are highly geographically dispersed, however, innovative activity tends to be geographically concentrated in the advanced industrialized economies, reflecting the economic significance of factors such as localized knowledge spillovers and the strength of patent protection, as well as the influence of government policies such as price regulation, state procurement of drugs, and health and safety regulation. While Europe was the biggest player in the pharmaceutical market in the 1990s, American firms currently dominate the sector. Table 4.1 shows the ranking of the top 20 pharmaceutical firms in the world.

Table 4.1 Top 20 Global Pharmaceutical Firms (2015)<sup>163</sup>

Rank	Company Name	Country	Sales (billions)	Profits (billions)	Assets (billions)	Market Value (billions)
1	Pfizer	USA	\$49.6	\$9.1	\$169.3	\$211.7
2	Novartis	Switzerland	\$53.6	\$10.1	\$125.8	\$272.6
3	Merck & Co	USA	\$42.2	\$11.9	\$98.3	\$162.3
4	Roche Holding	Switzerland	\$51.8	\$10.2	\$76.1	\$240.4
5	Sanofi	France	\$44.8	\$5.8	\$117.8	\$136.0
6	GlaxoSmithKline	UK	\$37.9	\$4.5	\$63.4	\$114.1
7	McKesson	USA	\$174.0	\$1.7	\$55.1	\$52.3
8	Teva Pharmaceutical	Israel	\$20.3	\$3.0	\$46.4	\$54.5
9	AstraZeneca	UK	\$26.1	\$1.2	\$58.6	\$87.7
10	Abbott Laboratories	USA	\$21.3	\$2.3	\$41.3	\$69.9
11	Eli Lilly & Co	USA	\$19.6	\$2.4	\$37.2	\$79.2
12	Bristol-Meyers Squibb	USA	\$15.9	\$2.0	\$33.7	\$105.0
13	AbbVie	USA	\$20.0	\$1.8	\$27.5	\$91.7
14	Cardinal Health	USA	\$93.9	\$1.1	\$27.2	\$29.7
15	Merck	Germany	\$15.3	\$1.5	\$32.1	\$50.7
16	Takeda Pharmaceutical	Japan	\$16.9	\$1.1	\$38.8	\$39.3
17	Novo Nordisk	Denmark	\$15.8	\$4.7	\$12.5	\$147
18	Valeant Pharmaceuticals	Canada	\$8.3	\$923.0	\$26.4	\$67.5
19	Otsuka Holding	Japan	\$15.4	\$1.5	\$18.2	\$17.7
20	Astellas Pharma	Japan	\$11.4	\$907.0	\$15.4	\$37.1

<sup>162</sup> Thomson Reuters, *2015 CMR International Pharmaceutical R&D Factbook* (London: Thomson Reuters, 2015); Denis O'Hearn and Stephen McCloskey, "Globalisation and Pharmaceuticals: Where Is the Power? Where to Resist?," in *Power, Politics and Pharmaceuticals: Drug Regulation in Ireland in the Global Context*, ed. Orla O'Donovan and Kathy Glavanis-Grantham (Cork, Ireland: Cork University Press, 2008).

<sup>163</sup> Adapted from Forbes, "The World's Biggest Public Companies," [http://www.forbes.com/global2000/list/#header:position\\_industry:Pharmaceuticals](http://www.forbes.com/global2000/list/#header:position_industry:Pharmaceuticals).

There are only a handful of Japanese firms that are competitive globally; in 2015, Takeda Pharmaceuticals, Otsuka Holdings, and Astellas Pharma were the only three Japanese firms among the top 20 global pharmaceutical firms.

This relatively small number of large global firms coexists with a very large number of small firms that tend to focus on producing drugs for their respective domestic markets.<sup>164</sup> Whereas large, internationally oriented firms may manufacture “blockbuster” products that are sold to most middle- and high-income countries, smaller firms may focus on more “minor” drugs for sale in fewer countries or even for only their own domestic market.<sup>165</sup> Table 4.2 illustrates the distribution of firms in select advanced economies by size and ownership structure.

Table 4.2 The Structure of the Pharmaceutical Industry in Six Large Nations (1983)<sup>166</sup>

Country	Number of Firms	Number of Large Firms	Nationality of Ownership		
			Domestic	European	American
Germany	530	38	57%	24%	18%
France	320	40	57%	20%	22%
Italy	345	30	47%	47%	6%
Japan	400	81	83%	9%	8%
UK	212	24	46%	21%	33%
US	950	57	70%	30%	30%

Major Western pharmaceutical firms such as Eli Lilly and Merck began operating internationally as early as the 1870s. Several factors have contributed to the rapid degree of internationalization in the pharmaceutical industry.<sup>167</sup> First, development costs for new drugs are very high and increasing rapidly; these large costs have to be spread over the widest possible market. Second, product life cycles are fairly short, leading to a need to maximize global sales as quickly as possible. Third, the majority of profit comes from patented products, which encourages firms to look overseas wherever patent protection can be had in order to maximize sales.

The nature of the product development process, along with historically strong intellectual property rights, has allowed pharmaceutical firms to decouple manufacturing and marketing from R&D. Even from the earliest days of international expansion, major Western pharmaceutical firms often took the approach of trying to protect their valuable proprietary knowledge while also forming market partnerships with firms in target markets to facilitate sales and marketing. In order to gain market access in this early period, major Western firms might license a local company to manufacture drugs in a target country. Alternative strategies were to allow local firms to market a patented drug or enter into joint ventures to establish a jointly owned subsidiary for the purposes of R&D, manufacturing, and/or sales. To some extent, this patterns remains today; the bulk of all R&D expenditure occurs in advanced industrial economies, with the global firms conducting operations in the US, a few European countries, and

<sup>164</sup> Adapted from James Taggart, *The World Pharmaceutical Industry* (London: Routledge, 1993).

<sup>165</sup> Some countries are noticeably different in these respects; for example, Japan and Italy have much higher frequencies of single country drugs that are sold only domestically due to factors such as price regulation. See Patricia Danzon, Y. Richard Wang, and Liang Wang, "The Impact of Price Regulation on the Launch Delay of New Drugs: Evidence from Twenty-Five Major Markets in the 1990s," *Health Economics* 14, no. 3 (2005).

<sup>166</sup> Adapted from Taggart, *The World Pharmaceutical Industry*.

<sup>167</sup> *Ibid.*

Japan, although there have also been some moves to begin increasing R&D in developing countries.<sup>168</sup> In some cases, global firms have been able to move into manufacturing and marketing their own products in target markets, but in others there remains a division of activities between global and local firms.

The pharmaceutical industry is a highly regulated sector, subject to stringent market access rules to ensure safety and efficacy. Domestic regulatory institutions have shaped international regulation of the pharmaceutical industry.<sup>169</sup> The United States and its firms have long been the dominant force in establishing global market regulations for pharmaceuticals. It is only recently that it has seen its leadership on this front challenged by the European Union. Until the 1960s, there was very little international market regulation; firms seeking access to a foreign market had to comply with existing requirements in that market. Due to worries that weak foreign regulation might pose a risk to American consumers, the US FDA slowly became a global player, drawing on its reputation and authority to push US rules and standards internationally.

International pharmaceutical regulation began to evolve rapidly beginning in the 1980s. First, regulatory efficiency became a focus of policy. In the 1980s, the effect of the divergence in regulatory requirements became more important and functional interdependence between the US, EU, and Japan grew, requiring the regulatory authorities to cooperate internationally. Duplicate testing in multiple countries increased R&D costs for exporting firms, and in turn increased drug prices, which concerned governments providing health coverage. It also slowed down patient access to new drugs in different jurisdictions and raised ethical concerns of unnecessary tests on animals and clinical trials on humans. A wave of industry consolidation created a group of globally operating pharmaceutical firms who pushed for international harmonization, which would address these issues and allow for greater regulatory cooperation and sharing of data evaluation.<sup>170</sup> In parallel, industry globalization created competition between different countries with respect to the quality, speed, and cost of approval processes.<sup>171</sup>

Second, the pharmaceutical industry was an important force in calling for changes in international intellectual property rules, claiming that intellectual piracy was undermining its profits and R&D.<sup>172</sup> The American pharmaceutical industry, led by the Pharmaceutical Research and Manufacturers Association (PhRMA), saw the globalization of US intellectual property protection standards as the solution to piracy, and it attempted to link the perceived decline in US competitiveness throughout the 1980s with weakly enforced intellectual property rights in Japan and the Asian tigers.<sup>173</sup> The industry lobbied throughout the 1980s for the signing of the Trade Related Aspects of Intellectual Property Rights Agreement (TRIPs) by contracting parties of the

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<sup>168</sup> Iain Cockburn, "Pharmaceuticals," in *Innovation in Global Industries: US Firms Competing in a New World*, ed. Jeffrey Macher and David Mowery (Washington, DC: The National Academies Press, 2008).

<sup>169</sup> David Bach and Abraham Newman, "Governing Lipitor and Lipstick: Capacity, Sequencing, and Power in International Pharmaceutical and Cosmetics Regulation," *Review of International Political Economy* 17, no. 4 (2010).

<sup>170</sup> Ayelet Berman, "The Public-Private Nature of Harmonization Networks," (Geneva: Centre for Trade and Economic Integration, 2011).

<sup>171</sup> David Vogel, "The Globalization of Pharmaceutical Regulation," *Governance* 11, no. 1 (1998).

<sup>172</sup> Gerard Downes, "The Pharmaceutical Industry and the World Trade Organisation's Trips Agreement: Intellectual Property, Global Governance and Health," in *Power, Politics and Pharmaceuticals: Drug Regulation in Ireland in the Global Context*, ed. Orla O'Donovan and Kathy Glavanis-Grantham (Cork, Ireland: Cork University Press, 2008).

<sup>173</sup> Susan Sell and Aseem Prakash, "Using Ideas Strategically: The Content between Business and NGO Networks in Intellectual Property Rights," *International Studies Quarterly* 48 (2004).

GATT. TRIPs came into being with the establishment of the WTO in 1995, making intellectual property rights violations punishable by a penalty such as economic or trade sanctions in the WTO's Dispute Settlement Understanding.

Third, regulators began to initiate bilateral partnerships to promote technical information sharing and coordination. Around 1987, the EC pharmaceuticals unit started conducting bilateral discussions with Japan, seeking to open its relatively closed market and harmonize rules among them, in the context of and in parallel to GATT negotiations. The US FDA also began conducting similar harmonization discussions with Japan in parallel. The EC convinced its American and Japanese counterparts to meet as a group instead of concluding separate bilateral agreements, and the three parties began discussions in 1988.<sup>174</sup> European pharmaceutical harmonization raised competitiveness concerns for the FDA, whose standards enjoyed global dominance at the time. The FDA also hoped that harmonization could help ameliorate its long approval and overcome resource limitations within the bureaucracy.<sup>175</sup>

In 1990, Japan, the US and Europe formed the International Conference on Harmonization of Technical Requirements for Registration of Pharmaceuticals for Human Use (ICH) to reduce the costs and time involved in duplicating drug development across countries. Europe, the US and Japan accounted for 75 percent of the world's production of medicines and 90 percent of global pharmaceutical R&D at the time.<sup>176</sup> The ICH is essentially composed of the three major regulatory authorities of the US, Europe, and Japan, and the three corresponding associations of pharmaceutical manufacturers.<sup>177</sup> While the pharmaceutical industry was not the driving force behind the ICH process, industry players were included in the process due to dependence of regulatory authorities on industry for information and the preference of both the FDA and EC for inclusion of firms. Globally competitive pharmaceutical firms from Japan, the US, and Europe saw harmonization as being to their advantage, whereas smaller, less competitive firms benefited less or may have been negatively impacted by more stringent international regulations.<sup>178</sup>

While the main participants were not initially attempting to develop global regulatory standards, the ICH is "a network of pharmaceutical industry and government scientists, who have, in effect, become the international regulatory power in setting safety standards for new medical drugs."<sup>179</sup> This was facilitated by the dominant positions of the American, European and Japanese firms in the global pharmaceutical industry, which facilitated the transformation of ICH guidelines into de facto international standards. Many non-participant countries have adopted ICH guidelines, seeing a benefit to joining in a standard used in these dominant markets.<sup>180</sup> Among the most important achievements of the ICH was enabling pharmaceutical firms to file for approval in the world's three largest markets with one standardized Common Technical

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<sup>174</sup> Berman, "The Public-Private Nature of Harmonization Networks."

<sup>175</sup> Ibid.

<sup>176</sup> David Jordan, "International Regulatory Harmonization: A New Era in Prescription Drug Approval," *Vanderbilt Journal of Transnational Law* 25 (1992): 492.

<sup>177</sup> Ryoichi Nagata and Jean-David Rafizadeh-Kabe, "Japanese Pharmaceutical and Regulatory Environment," *Dialogues in Clinical Neuroscience* 4, no. 4 (2002).

<sup>178</sup> Ethan Watters, "Crazy Like Us: The Globalization of the American Psyche," in *The Globalization Reader*, ed. Frank Lechner and John Boli (Chichester: Wiley-Blackwell, 2015).

<sup>179</sup> John Abraham and Tim Reed, "Trading Risks for Markets: The International Harmonisation of Pharmaceuticals Regulation," *Health, Risk and Society* 3 (2001).

<sup>180</sup> Segev Shani and Zohar Yahalom, "The Role of the Pharmaceutical Industry in Disseminating Pharmacovigilance Practice in Developing Countries," *Food and Drug Law Journal* 63, no. 3 (2008).

Document. Until the 1990s, the US was the undisputed regulatory hegemon of the pharmaceutical sector, but European actors now play a greater role in standard setting.

## 4.2 Explaining the Pattern of Internationalization

Japan is often characterized as having a “dual economy” consisting of an internationally competitive set of industries (e.g., carmakers, electronics) that coexists with a separate tier of noncompetitive industries (e.g., agriculture). As shown in Table 4.2, the Japanese pharmaceutical sector straddles the divide between the two portions of this dual economy; it includes a handful of internationally competitive firms as well as a myriad of domestically oriented, small- to medium-size enterprises that have relied on protective government policy for their survival. The brand drug firms of the Japanese pharmaceutical industry fall into two groups. The first consists of four firms with a presence in the US and Europe: Takeda Pharmaceutical Company, Astellas Pharma Inc (created through a merger of Yamanouchi Pharmaceutical and Fujisawa Pharmaceutical), Daiichi Sankyo (created through a merger of Sankyo and Daiichi Pharmaceutical) and Eisai. These globally competitive firms had their beginnings in the early 20th century, when Japan stopped importing drugs from Germany due to World War I and adopted an import substitution policy that introduced subsidies for pharmaceutical production. These early firms were dedicated to the production of Western medicines and manufactured vitamins, hormonal preparations, anthelmintics, and sulfa drugs.

The second group consists of about 250 firms with no presence in the US or Europe, such as Shionogi and Tanabe Seiyaku.<sup>181</sup> A key reason for the relative weakness of the majority of Japan’s pharmaceutical firms was the lack of an industrial policy designed to develop a research-intensive, globally competitive industry. During the post-World War II period, the Ministry of Health and Welfare (MHW until 2001, now MHLW) regulated the industry, prioritizing public health agendas while producing drugs at a low cost for its large population. It also protected domestic firms from foreign competition and enabled firms to prosper without substantial investments in R&D, so Japanese firms began pursuing R&D much later than Western counterparts and ended up being less competitive.<sup>182</sup>

In the 1950s, foreign participation in the Japanese pharmaceutical industry was sharply restricted by the factors discussed in Chapter 2. Quotas regulated drug imports. Licensing of foreign products to local firms was heavily regulated and subject to caps on royalty rates. Foreign firms were prohibited from establishing wholly owned subsidiaries; foreign direct investment was allowed only through joint ventures with domestic firms, with foreign equity holding limited to 49 percent. In addition, under the Japanese process patent regime, domestic firms could launch existing drugs as new ones as long as they found another method to produce them, meaning that foreign products could be easily copied. At this time, the large manufacturers formed vertical groupings with pharmaceutical wholesalers to solve problems of excess supply; these vertical linkages created formidable barriers to new entrants.

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<sup>181</sup> There are also about 38 Japanese generic drug firms, but because generics comprise a relatively small part of the market and because these firms are generally small and uncompetitive outside of Japan, they are not included in this analysis. See Osamu Saigusa, "Japan's Healthcare System and Pharmaceutical Industry," *Journal of Generic Medicine* 4, no. 1 (2006).

<sup>182</sup> Maki Umemura, *The Japanese Pharmaceutical Industry: Its Evolution and Current Challenges* (London: Routledge, 2011).

As Japan started to take steps toward capital liberalization in the 1960s and 1970s, it created opportunities for foreign firms to enter the Japanese market. Early foreign entrants included SmithKline, Eli Lilly and Wellcome, but they remained relatively minor players in the sector. In the 1970s, the number of foreign entrants began to expand; in 1970, there were 74 foreign pharmaceutical firms operating in Japan, and this number had grown to 239 by 1980.<sup>183</sup> During this period, the government dismantled numerous regulations that favored Japanese industry. Although aimed explicitly at harmonizing pharmaceutical regulations with international standards, these changes also significantly eased earlier difficulties of doing business in Japan. In 1980, there was a general revision of the Pharmaceutical Affairs Law to realign Japanese regulations with commonly accepted global standards. Also, in 1985, new guidelines were issued on Good Manufacturing Practices, Good Licensing Practices, and preclinical data, and action was taken to facilitate the transfer of registration approvals to foreign firms.<sup>184</sup>

These changes were often spurred by American government pressure to deregulate and open up the Japanese market. In 1985, American and Japanese officials held the Market-Oriented Sector-Selective (MOSS) talks aiming to remove barriers to market access in pharmaceuticals and three other sectors. Business organizations such as the Pharmaceutical Research and Manufacturers Association (PhRMA) and the European Business Council also held regular talks with Japanese officials and requested reduced barriers via accepting foreign clinical data, clarifying the criteria for innovation, and improving transparency in the pricing process. Japan responded favorably to these requests, increasing competitive pressures in the industry.<sup>185</sup>

In addition, Japanese domestic pressure for regulatory change came from a series of scandals involving government ties to pharmaceutical firms and industry practices. For example, in the 1980s, 40 percent of Japan's 5,000 registered hemophiliac patients developed AIDS as a result of transfusions of tainted blood due to largely to the hesitancy on the part of MHW to introduce heat-treated blood products that had been developed abroad. This policy failure was popularly perceived to be a result of close ties between Japanese pharmaceutical firms, doctors, medical experts, and bureaucrats at MHW.<sup>186</sup> These scandals increased public awareness of health issues and decreased confidence in the bureaucracy.

As a result of these internal and external pressures, regulatory barriers were lowered and many of the leading foreign-based firms either entered the Japanese market or dramatically increased their presence in Japan. Included among these firms were Merck, GlaxoSmithKline, Ciba-Geigy, and Hoffman-La Roche.<sup>187</sup> Although foreign firms had been present in Japan for some time, the restrictions posed by the Japanese system as discussed in Chapter 2 limited foreign firms to upstream activities, providing new materials and licensing products to Japanese

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<sup>183</sup> Ibid.

<sup>184</sup> Robert Neimeth, "Japan's Pharmaceutical Industry Postwar Evolution," in *The Changing Economics of Medical Technology*, ed. Annetine Gelijns and Ethan Halm (Washington D.C.: National Academy Press, 1991).

<sup>185</sup> Christa Altenstetter, *Medical Technology in Japan: The Politics of Regulation* (New Brunswick: Transaction Publishers, 2014).

<sup>186</sup> Eric Feldman, "HIV and Blood in Japan: Transforming Private Conflict into Public Scandal," in *Blood Feuds: AIDS, Blood, and the Politics of Medical Disaster*, ed. Eric Feldman and Ronald Bayer (Oxford: Oxford University Press, 1999).

<sup>187</sup> Neimeth, "Japan's Pharmaceutical Industry Postwar Evolution."

manufacturers. Regulatory shifts changed the dynamics of competition and enabled foreign firms to expand into the downstream activities of sales, marketing, distribution and manufacturing.<sup>188</sup>

During the period from 1990 to 2000, both Japanese and foreign firms substantially increased their overseas operations. The harmonization of Japanese pharmaceutical regulations with those of the US and Europe described in the previous section made it easier for drugs approved in Japan to be approved elsewhere and vice versa; this led to increasing foreign competition in the Japanese market, which in turn prompted an unprecedented wave of corporate reorganizations and mergers.<sup>189</sup> These changes led to a rapid realignment in the industry. Simply by introducing drugs long established overseas, foreign firms have been able to gain significant market share and earn a tidy profit. Figure 4.1 illustrates the increasing presence of foreign firms in the Japanese market through a visualization of the top 20 firms ranked by domestic sales within Japan. The grey squares indicate the position of foreign or foreign-affiliated firms among the top 20 pharmaceutical firms in Japan ranked by domestic sales.

Figure 4.1 Top 20 Pharmaceutical Firms in Japan Ranked by Domestic Sales (1996-2013)<sup>190</sup>

Rank	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	
1																			
2									P										
3										P	P								
4												P							
5								P					P	P		P	P	P	
6																			
7											N				P				
8																	MSD	MSD	
9						P	P			N	GSK	N	N	N	N	MSD			
10									N					GSK		N	N	N	
11								N			B	GSK	GSK		GSK	GSK	S	S	
12				B	P				B						S	S	GSK	GSK	
13	B	B	B		B	B	B			GSK			B	S					
14			P	P			N	B	GSK	B	AZ	B		AZ	AZ	AZ	AZ	AZ	
15	CG	P			N	N						AZ	S						
16		N	HMR	N				GSK			CG		AZ					CG	BI
17	P						GSK			AZ		CG		CG	CG			BI	Ba
18			N					CG	S			BI	CG	Ba	Ba	CG			
19									CG	CG			BI	BI	MSD	BI			
20												S	Ba	MSD	BI	Ba	Ba	CG	

Abbreviations: A=AstraZeneca; B= Banyu (51% owned by Merck, USA); Ba = Bayer (Germany); BI = Boehringer Ingelheim (Germany); CG = Ciba-Geigy (Switzerland); GSK = GlaxoSmithKline (GSK); MSD = Merck & Co (USA); N = Novartis (Switzerland); HMR = Hoechst Marion Roussel (Germany); P = Pfizer (USA); S = Sanofi (France)

<sup>188</sup> Kenji Kushida, "Foreign Multinational Corporations and Japan's Evolving Syncretic Model of Capitalism," in *Syncretism: The Politics of Economic Restructuring and System Reform in Japan*, ed. Kenji Kushida, Kay Shimizu, and Jean Oi (Stanford: The Walter H. Shorenstein Asia-Pacific Research Center, 2013).

<sup>189</sup> Umemura, *The Japanese Pharmaceutical Industry: Its Evolution and Current Challenges*.

<sup>190</sup> Compiled from first quarter reports from Teikoku Databank, *TDB Gyoukai Doukou [TDB Industry Trends]* (1998-2016).

Although only three foreign firms ranked in the top 20 in 1997, almost half of the top selling pharmaceutical firms were foreign by the mid-2000s. Foreign firms had roughly 40 percent of the Japanese market in 2010.<sup>191</sup> This reflects a massive shift in the internationalization of the sector.

These new opportunities also led to increased interest in investing in Japan. Acquisitions of Japanese firms became a common mode for foreign firms to establish or expand their presence in Japan in the 1990s and early 200s (see Table 4.3).

Table 4.3 M&A Activity in the Japanese Pharmaceutical Sector<sup>192</sup>

Year	Foreign Firm	Japanese M&A Target
1983	Merck (USA)	Torii
	Merck (USA)	Banyu
1986	Merrill Dow (USA)	Funai
	Boehringer Ingelheim (Germany)	San-a & Yamaguchi
1989	Boehringer Mannheim (Germany)	Toho
1992	Solvay (Belgium)	Kowa Yakuhin
1994	MMD (USA)	Kodama
1996	BASF/Knoll (Germany)	Hokuriku Seiyaku
	Boehringer Ingelheim (Germany)	9% of SS Pharma
1998	Amersham (UK)	Roche stake in Nihon Mediphysics
1999	Akzo Nobel (Netherlands)	Kaneibo's pharmaceuticals division
2000	UCB (Belgium)	Fujirebio
	Boehringer Ingelheim (Germany)	SS Pharmaceutical
2001	Schering AG (Germany)	Mitsui Pharmaceutical
	Abbot Laboratories (USA)	BASF/Hokuriku Seiyaku
2002	Roche (Switzerland)	Chugai

Many Western firms have also bought out former joint ventures with domestic manufacturers to increase the recognition of their brands. These developments suggest decreasing dependency of foreign drugmakers on their local counterparts; in fact, foreign firms have been aggressively expanding their own sales forces in the country in order to sidestep the complex distribution system, eliminating the need to pay distribution fees to local rivals, providing greater efficiency and further enhancing brand recognition. However, barriers to foreign acquisition remain in pharmaceuticals and other sectors in Japan that continue to limit M&A activity.

### 4.3 The Political Landscape

Understanding the politics of pharmaceutical policy necessitates a brief discussion of the key actors involved in the policymaking process. While Japanese bureaucrats, politicians, doctors, and firms used to dominate this arena, an increasing number of actors are now involved in pharmaceutical policy, including Japanese patient groups and foreign pharmaceutical firms.

The key Japanese ministry involved in pharmaceutical policymaking is the Ministry of Health, Labor and Welfare (MHLW, formerly MHW until 2001). As mentioned previously, many scholars have pointed out that promotion of the pharmaceutical industry has never been a

<sup>191</sup> Interview with foreign pharmaceutical representative, 9 November 2010.

<sup>192</sup> Compiled from P. Reed Maurer, "Acquisition Failure? Don't Blame the Culture," *Pharma Japan*, November 1998; "Destruction of the Pharmaceutical Industry," *Pharma Japan*, 10 April 2000.



key objective of MHLW policymaking, unlike for METI and its constituent industries. The lack of an industrial policy designed to develop a research-intensive, globally competitive industry has been blamed for the relatively poor performance of the Japanese pharmaceutical sector.<sup>193</sup> Despite this lack of direct promotion, however, MHLW has historically interpreted its role as protector of the nation's health in a way that includes the idea that the domestic pharmaceutical industry merits protection. Over the post-WWII period, the ministry has been content with policies that have kept foreign drug firms out of Japan and ensured that costly pre-clinical and clinical trials must be conducted in Japan. These regulations have benefited domestic industry indirectly. Since 1961, low-cost medical treatment has been available to virtually all Japanese. Payment is divided into two categories of treatment and medicine, the cost of which is fixed by the MHLW; this price-setting authority often makes the ministry a focus of lobbying efforts by doctors and both foreign and Japanese firms, which will be discussed in detail in the subsequent issue case studies. MHLW oversees the Central Council (*Chuikyo*), which consists of representatives of health insurance payers, medical providers, and the public interest; the Central Council plays a major role in price setting. In 2004, the Pharmaceuticals and Medical Devices Agency (PMDA) was set up as an independent regulator; PMDA works with MHLW on key issues related to the drug approval process.

With respect to politicians, the Liberal Democratic Party has traditionally received substantial financial contributions from Japanese doctors, pharmacists, and pharmaceutical firms. The literature on Japanese politics has analyzed in some detail the role of *zoku*, or policy tribes, which can strongly influence policy within a government ministry; however, there is no pharmaceutical industry *zoku*, and the health and welfare *zoku* who oversee MHLW tend to be more broadly focused. Other political parties such as the Democratic Party of Japan (DPJ) and Komeito have also been engaged in health policymaking.

The Japan Medical Association (JMA) has historically been a powerful force within the Japanese policymaking system.<sup>194</sup> This was especially true during the period from 1957 to 1981 when it was led by Takemi Taro, a charismatic leader with strong links to the LDP. The JMA has a political arm wholly under its control which channels funds to political groups; some estimate that between 10 and 20 percent of the LDP's income came from doctors and dentists, which helped to maintain the strong political influence of these groups.<sup>195</sup> Since the early 1980s, the influence of JMA has been in decline due to decreasing influence in MHLW, decreasing numbers associated with small practices, and a series of scandals. The authority of the JMA within the profession is also declining because those who benefit most from membership are doctors who own or belong to small practices, but patients increasingly prefer to be treated in larger hospitals. Whereas over 95 percent of self-employed doctors are JMA members, only about one-third of hospital doctors join.<sup>196</sup> In addition, the image of the medical profession has been damaged by a series of scandals and concerns over tax evasion by physicians.

As mentioned in the previous section, the Japanese pharmaceutical industry falls into three groups: brand drug firms with an international presence, brand drug firms without an international presence, and generic drug firms. There are numerous industrial groups

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<sup>193</sup> Umemura, *The Japanese Pharmaceutical Industry: Its Evolution and Current Challenges*.

<sup>194</sup> See William Steslicke, *Doctors in Politics: The Political Life of the Japan Medical Association* (London: Praeger Publishers, 1973).

<sup>195</sup> Jeremy Howells and Ian Neary, *Intervention and Technological Innovation: Government and the Pharmaceutical Industry in the UK and Japan* (Houndmills: Macmillan Press, 1995).

<sup>196</sup> *Ibid.*

representing specific sections of the Japanese pharmaceutical industry and all firms belong to one or more of these. The most important industrial group is the Japanese Pharmaceutical Manufacturers Association (JPMA). It was formed in 1968 following an agreement among the leading Japanese pharmaceutical manufacturers that the industry needed to formulate a coordinated response to the internal challenge that was presented by the increase of MHW regulation and the external threat posed by the capital liberalization program, which was allowing foreign firms to establish a strong presence in Japan. As of 2016, JPMA includes 73 research-oriented pharmaceutical firms, including all the major Japanese firms, a number of medium-sized firms, and some wholly or partially foreign-owned firms. Some foreign firms are also able to exercise influence through Japanese partners who are members of the associations, as in the case of Merck, which acquired the Japanese company Banyu. Because there are only a small number of globally competitive Japanese firms, JPMA includes both the latter and less competitive Japanese firms; this can make it challenging for the organization to reach a consensus on issues.<sup>197</sup> The Japan Direct-Selling Pharmaceutical Manufacturers Association (JDSPMA), which currently has 37 member firms, represents only small, less competitive smaller drug manufacturers. JPMA and JDSPMA and their memberships do not necessarily share the same interests.<sup>198</sup>

Despite the general weakness of Japanese consumer groups, patient groups have risen in prominence over the last 20 years, as some of the taboos on speaking about illnesses such as cancer have been lifted.<sup>199</sup> Japan's medical culture began to change in the 1990s, with the growth of Internet use in particular enabling patients to gather information on diseases and new therapies. Japanese patients began to help expand demand for innovative drugs and to pressure authorities to accelerate drug approval. The Internet also facilitated the formation of patient networks to campaign for drugs that had yet to be approved in Japan. For example, patient groups such as Japan's Cancer Patients Support Organization were instrumental in obtaining approval for the drug oxaliplatin.<sup>200</sup> These groups sometimes worked together with pharmaceutical firms to promote potential approvals. The increasing importance of public opinion on policy matters has resulted in a paradigm shift for those working in advocacy. Whereas there used to be an insider attitude where firms saw their role as providing ministries and politicians with information, forging connections with citizens and civil society groups has now become a more prominent political strategy for both domestic and foreign firms.<sup>201</sup>

Foreign pharmaceutical firms have also begun to play a more prominent role in Japanese health care policy, in collaboration with foreign industry associations and chambers of commerce. The major foreign industry associations are the Pharmaceutical Research and Manufacturers Association (PhRMA) and the European Federation of Pharmaceutical Industries and Associations (EFPIA). Membership in these organizations is open to firms from any country, so there are some foreign firms with memberships in both; consequently, it is misleading to think that either organization represents American or European interests exclusively. PhRMA is one of the world's most politically influential and well-financed industry lobbies, with a strong presence

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<sup>197</sup> This is a common problem for Japanese industry associations, whose members often include both potential "winners" and "losers" from reform. See Vogel, *Japan Remodeled: How Government and Industry Are Reforming Japanese Capitalism*.

<sup>198</sup> Howells and Neary, *Intervention and Technological Innovation: Government and the Pharmaceutical Industry in the UK and Japan*.

<sup>199</sup> Interview with former foreign pharmaceutical firm representative, 7 August 2013.

<sup>200</sup> Umemura, *The Japanese Pharmaceutical Industry: Its Evolution and Current Challenges*, 90.

<sup>201</sup> Interview with government affairs specialist, 12 August 2013.

in Washington DC (297 full-time lobbyists on Capitol Hill, one for every two congressional representatives) and one international office in Tokyo, which is indicative of the importance of the Japanese market to American industry. EFPIA was founded in 1978 and works both within the EU and in Japan. Both PhRMA and EFPIA work in collaboration with the American Chamber of Commerce in Japan (ACCCJ) and the European Business Council (EBC), which often collaborate on joint initiatives. An interesting characteristic of the foreign pharmaceutical lobby is that although they are all competitors, there is widespread acknowledgement within the ranks of drug company executives that the best way for firms to create a better regulatory environment is for competing firms to join forces. PhRMA has been a critical player in framing this joint effort, seeing its mission as being to create “a market based upon competitive, customer choice, and a transparent pricing structure that supports innovation” and for drugs to be able to enter the Japanese market based on “global, objective, scientific standards.”<sup>202</sup>

The subsequent section describes the interplay between these key actors in the context of two specific policy debates over drug approval times and drug pricing.

#### 4.4 Pharmaceutical Approval Times and the “Drug Lag”

In 2001, a staggering 87 percent of significant pharmaceutical innovations were unavailable in Japan.<sup>203</sup> The average approval time for a drug was roughly 4 years. However, by 2015, Japan’s regulator, the Pharmaceuticals and Medical Devices Agency (PMDA) had edged out the US Food and Drug Administration (FDA) as the world’s fastest regulator, with a median approval time of 306 days for new active substances.<sup>204</sup> What changed over this 15-year period? In this section, I use the case of drug approval times to examine the specific political economic conditions of the pharmaceutical sector. I argue that the foreign pharmaceutical industry played an important role in influencing the Japanese government to take specific actions that led to the dramatic decrease in drug approval times during this period. In contrast to the case of agriculture that was examined in the previous chapter, the foreign pharmaceutical industry did not have to rely solely on its home government as a conduit for its demands. Instead, due to the pattern of internationalization in this sector, foreign business interests were able to utilize a much wider array of strategies within Japan, including lobbying Japanese politicians and bureaucrats and forming coalitions with Japanese firms and patient groups.

A “drug lag” is a mix of delay and exclusion for significant new drugs. Drug lags have been documented elsewhere in the world, most famously in the United States in the 1970s.<sup>205</sup> The drug lag phenomena in both the US and Japan were caused by a combination of scandal and a mismanaged regulatory reform process.<sup>206</sup> With respect to Japan, prior to 2004, the drug review process was handled by the Ministry of Health and Welfare in cooperation with the Central Pharmaceutical Affairs Council, an advisory organ composed of experts in the fields of medical science, pharmaceutical science, veterinary science and statistical science. Japan’s MHW

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<sup>202</sup> Watters, "Crazy Like Us: The Globalization of the American Psyche," 158.

<sup>203</sup> L.G. Thomas, *The Japanese Pharmaceutical Industry: The New Drug Lag and the Failure of Industrial Policy* (Cheltenham: Edward Elgar, 2001).

<sup>204</sup> Centre for Innovation in Regulatory Science, "New Drug Approvals in ICH Countries 2005-2014," (2015).

<sup>205</sup> William Wardell, "British Usage and American Awareness of Some New Therapeutic Drugs," *Clinical Pharmacology and Therapeutics* 14, no. 1022-1034 (1973); William Wardell and Louis Lasagna, *Regulation and Drug Development* (Washington, D.C.: American Enterprise Institute, 1975).

<sup>206</sup> Thomas, *The Japanese Pharmaceutical Industry: The New Drug Lag and the Failure of Industrial Policy*.

suffered a series of prominent scandals surrounding its drug approval process in the 1980s and early 1990s. This culminated in the Sorivudine scandal in 1994, when 16 patients died from side effects; it was subsequently discovered that Nihon Shoji, the Japanese firm marketing the drug, had suppressed information about patient deaths during clinical trials. Public outrage led MHW to significantly slow its approval process to ensure safety.<sup>207</sup>

Japan became slowly more exclusionary of foreign drugs after 1981, and then experienced a sudden and even more severe level of exclusion beginning in 1991.<sup>208</sup> Given the obvious consequences for the foreign pharmaceutical industry, the latter began to mobilize in the 1990s to counteract this trend. Early efforts focused on lobbying the key actors in the US government—including the Department of Commerce, the Office of the US Trade Representative, the State Department, and the US Embassy in Tokyo—for help in pressuring Japan. Recognizing the importance of the large Japanese pharmaceutical market to American industry, the US government agreed to include the pharmaceutical sector in the US-Japan Enhanced Initiative for Deregulation and Competition in 1997.

In addition, at the Birmingham Summit of G-8 countries in May 1998, the US received a landmark commitment from the Japanese government on four specific points to facilitate the deregulation of the pharmaceuticals sector.<sup>209</sup> First, the Japanese government agreed in principle not to impede the introduction of innovative products that bring more cost effective treatments to patients. Second, the Japanese government agreed to allow foreign pharmaceutical and medical device manufacturers meaningful opportunities to state their opinions in the relevant councils on an equal basis with Japanese manufacturers, and providing them on their request with opportunities to exchange views with MHW officials at all levels. Third, the Japanese government aimed to shorten the approval processing period for new drug applications, particularly for priority drugs; although Japan did not reach its target of a 12-month approval period by April 2000, this was an important commitment to the issue. Fourth, the Japanese government agreed to expand the acceptance of foreign clinical test data for pharmaceuticals through the incorporation of International Conference on Harmonization guidelines into Japanese regulations by August 1998, and to adopt a transparent and efficient acceptance process.

The foreign pharmaceutical industry viewed the Birmingham Agreement as a major breakthrough that transformed its relationship with MHW. It was a major step in helping foreign pharmaceutical firms to gain access to what had largely been a closed negotiating process between the Japanese government and Japanese actors. In 1999, MHW created a new study group to facilitate more effective consultation with PhRMA, the Japanese Federation of Pharmaceutical Manufacturers (FPMAJ), and EFPIA prior to meetings of the Ministry's chief advisory council, the *Chuikyo*. In a statement to the US House Ways and Means Committee, a PhRMA representative stated, "Such transparency would have been unthinkable a decade ago when we were often on the outside looking in, when key rule and policy changes were discussed behind closed doors with Japanese stakeholders."<sup>210</sup>

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<sup>207</sup> In addition, MHW faced procedural challenges when it initially attempted to harmonize its processes with those of the US and Europe in the early 1990s; although this was generally a step in the right direction, lack of MHW guidance resulted in a confusing transition that further slowed approval times.

<sup>208</sup> Thomas, *The Japanese Pharmaceutical Industry: The New Drug Lag and the Failure of Industrial Policy*.

<sup>209</sup> "Submission of the Pharmaceutical Research and Manufacturers of America (PhRMA) for the National Trade Estimate Report on Foreign Trade Barriers (NTE) 1999."

<sup>210</sup> Statement of Joseph Damond, PhRMA, at the Committee on Ways and Means, US House of Representatives, *United States-Japan Economic and Trade Relations*, One Hundred Ninth Congress, First Session, September 28 2005.

Other changes that were also in the works at around the same time had consequences for the availability of insider strategies to the foreign pharmaceutical industry. Patient advocacy became an important part of foreign firms' political strategies around 2000, when a DPJ Diet member publicly admitted that he had cancer and made the Cancer Control Act an issue. PhRMA began to do information exchanges with patients on drugs around this time, to increase awareness of drugs that were available elsewhere and to help drum up public support for reducing the drug lag.<sup>211</sup> PhRMA was not necessarily a well-known player in the pharmaceutical political scene in the 1990s, but its credibility began to increase in the early 2000s, when it also began working to build an extensive network of relationships with Diet members. In addition to holding regular information exchange events with Japanese politicians, PhRMA has its own "Diet door knock" networking event between Diet members and pharmaceutical company presidents twice per year, separately from the general event organized by the ACCJ for firms across all sectors.

PhRMA's self-reported mission became to "convince the government that not just Japanese patients but Japanese firms themselves are suffering under the present regime."<sup>212</sup> Importantly, this framing of the issue pitted the globally competitive firms, foreign and Japanese alike, against the smaller, less competitive Japanese firms. According to PhRMA, global pharmaceutical practices represented the objective market and innovation ideal to which excellent and competitive Japanese firms also aspire, and it was the less competitive firms that insisted on hampering progress toward these ideals. "To a certain extent, smaller local industry resists the ICH because it disadvantages them: they don't have the R&D power to produce innovative drugs; they haven't the ability to train and carry out clinical trials according to GCP standards. ICH standards come at a high cost to such firms because it is harder to prove efficacy of their drugs. The current situation favors the existence of scores of nonefficacious drugs that are only shown not to do harm."<sup>213</sup> The message was clear: global firms, both Japanese and foreign alike, benefit from rigorous, harmonized regulatory standards. The drug lag came to be seen as an issue of mutual concern, leading to the formation of a cross-national coalition between these globally competitive companies, despite their differing nationalities.

In order to reduce the drug lag, the pharmaceutical industry felt that the establishment of a new independent regulatory agency was essential. PhRMA began working closely with MHW as early as 1998 to advocate for this step. PhRMA deployed a number of different channels as part of its political strategy. Its representatives cultivated relationships with MHW, as well as the science divisions of MEXT and METI, which was important since those ministries often did not coordinate well with one another. On the US side, PhRMA coordinated with the Commerce section of the US embassy in Japan on a monthly basis and used influence channels through its headquarters in Washington DC to lobby the US government at home as well.<sup>214</sup> Most US government-level pressure was focused through the bilateral MOSS talks held by the US and Japan twice per year.<sup>215</sup> The large Japanese firms would also ask PhRMA to bring US pressure to

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<sup>211</sup> Interview with former PhRMA staff member, 6 August 2013.

<sup>212</sup> Kalman Appelbaum, "Educating for Global Mental Health: The Adoption of SSRIs in Japan," in *Global Pharmaceuticals: Ethics, Markets, Practices*, ed. Adriana Petryna, Andrew Lakoff, and Arthur Kleinman (Durham: Duke University Press), 93-94.

<sup>213</sup> Ibid.

<sup>214</sup> Interview with foreign pharmaceutical firm representative, 17 November 2010.

<sup>215</sup> While discussions regarding other sectors have long since concluded or moved to other fora, the MOSS talks have been a regularized government-level dialogue since the 1980s and currently focus solely on pharmaceuticals.

bear on issues, and in cases where Japanese firms' connections to government officials were better, foreign firms asked the latter to take the lead.<sup>216</sup>

At the urging of both foreign and domestic industry, a new better-staffed regulatory body called the Pharmaceutical and Medical Devices Agency (PMDA) was set up with the aim of reducing the drug approval time. PMDA was established by the Pharmaceuticals and Medical Devices Agency Law based upon the Reorganization and Rationalization Plan for Special Public Corporations approved by the Cabinet in December 2001. It was modeled on the US Food and Drug Agency and the European Medicines Evaluation Agency (EMA).<sup>217</sup> It consolidated the services previously provided by the Pharmaceuticals and Medical Devices Evaluation Center of the National Institute of Health Sciences (PMDEC), the Organization for Pharmaceutical Safety and Research (OPSR/KIKO), and part of the Japan Association for the Advancement of Medical Equipment (JAAME). As part of this process, foreign industry representatives worked closely with MHLW on a new system of user fees and benchmarks for speeding up the traditionally slow and cumbersome Japanese new drug evaluation process to the time frames achieved by the FDA and EMA.<sup>218</sup> Steps were also taken to make the use of foreign clinical trial data easier.

However, even after the establishment of PMDA in 2004, approval times were still well above the desired duration. In a hearing before the US House Ways and Means Committee, a PhRMA firm representative testified that,

“While we welcomed the creation of the PMDA, we are deeply concerned by the increasing delays in the new drug approval process and increasing indications that the agency is experiencing serious difficulties in assembling the trained personnel, expertise, and resources to carry out its mission...We are also concerned by the increasingly dire shortage of Japanese capacity for advanced clinical trials. Absent such capacity, it is vital that MHLW further expand the acceptance of foreign clinical data. In short, we urge an intensive effort by MHLW and PMDA to address the growing delays in the new drug approval process.”<sup>219</sup>

Thus, increasing the resources and staffing of PMDA became the subsequent goal of pharmaceutical industry lobbying efforts, which was pursued through the same political channels described previously. In 2005, MHLW began putting measures in place to cut the time lag. These included establishing a special committee that reviews drugs approved elsewhere and that can recommend fast-tracking a drug in Japan, hiring more review staff at PMDA, and softening drug application requirements to make it easier for pharmaceutical firms to apply to market a new drug in Japan.

The turning point for the drug approval issue came during the first Abe administration in 2006-2007. Then-Prime Minister Abe had a personal interest in healthcare issues, so a number of new health-related initiatives were announced, and health issues began to be more prominently featured in the public discourse. For example, the second quarter of 2006 was the first time that the term “drug lag” appeared in the general media, cited from a PMDA report.<sup>220</sup> On December 25, 2006, the Council for Science and Technology Policy, chaired by Prime Minister Abe, recommended that the number of PMDA reviewers be doubled in approximately three years starting from 2007 to realize more rapid and effective review of new drugs.

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<sup>216</sup> Interview with former PhRMA staff member, 6 August 2013.

<sup>217</sup> *United States-Japan Economic and Trade Relations*.

<sup>218</sup> *Ibid.*

<sup>219</sup> *Ibid.*

<sup>220</sup> Interview with foreign pharmaceutical industry representative, 4 July 2013.

PMDA's staff increased from 256 to 605 between 2004 and 2010, with the review center staff increasing from 154 to 381. PMDA's performance in terms of numbers of scientific consultations and approved new drugs improved in parallel with the increase in staff numbers. For example, in 2009, there were 1.82 times more scientific consultations and 2.18 times more approved drugs than in 2004; during the same time period, the number of staff increased 2.47 times.<sup>221</sup>

An increase in staff numbers alone would not have been sufficient to achieve the goal of resolving the drug lag problem, however. The improvement of training for new staff and reviewers to increase the quality of their performance was also important. In 2007, PMDA reorganized its training courses to make them more effective and established a target review time in normal procedure from 21 months in 2007 to 12 months in 2011. In 2008, PMDA agreed to consider data from global clinical trials in all drug applications as long as safety studies included Japanese patients. This was an important change for the industry; it meant that a company could conduct one trial around the world and potentially use it as the basis for a submission to the US FDA, the European Medicines Agency (EMA, formerly EMEA), and PMDA. Firms could apply for drug approval to all three agencies at the same time, substantially cutting the remaining drug lag.

The quest to shorten drug approval times was championed by Japanese politicians from all of the major political parties, including the LDP, the DPJ, and Komeito. For example, in November 2009, New Komeito's House of Representatives member Shigeuki Tomita drew national attention to the need for fast-track approval of high-priority drugs and lobbied then Prime Minister Yukio Hatoyama to take steps to redress the situation.<sup>222</sup> In August 2010, MHLW adopted a system to fast-track approval for drugs developed and used overseas, which can then be reimbursed under the national health insurance program. The system allows the Japanese government to recognize clinical data of a drug tested and approved by foreign regulatory bodies for use in Japan, thereby significantly reducing the domestic approval process and cost to the patient. These actions have begun to enable Japan to attract overseas pharmaceutical firms. For example, laws that took effect in November 2014 have allowed regenerative treatments to be approved and brought to market in as little as two to three years, compared with the roughly seven years required previously. This is the speediest approval process in the world for regenerative medicine; in Western markets, approval takes about seven years.<sup>223</sup>

Thus, although Japan historically had the longest regulatory approval times, this decreased following the creation of PMDA, and with its increase in resource and commitment, PMDA review timing is now equivalent to the FDA. The expedited review process played an important role in enabling PMDA to accelerate the approval of innovative medicines over the last decade. PMDA doubled its proportion of expedited NASs during this time.

It is important to note that shortening drug approval times is not necessarily always positive from a public health perspective, although the foreign and domestic pharmaceutical industry in Japan have been able to make that case for years due to the extent of the Japanese drug lag. It seemed plausible to the Japanese public that its welfare was being undermined when it had to wait years to access medical advances that were already saving lives in other countries,

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<sup>221</sup> Kazunori Ichimaru, Satoshi Toyoshima, and Yoshiaki Uyama, "PMDA's Challenge to Accelerate Clinical Development and Review of New Drugs in Japan," *Clinical Pharmacology & Therapeutics* 88, no. 4 (2010).

<sup>222</sup> "Foreign Drugs Now Fast-Track for Approval after Party Lobbying," *Komeito Party News*, 10 August 2010.

<sup>223</sup> "Japan's Swift Regenerative Medicine Approvals Already Attracting Pharmaceuticals," *Nikkei Asian Review*, 15 January 2015.

and politicians were sensitive to this sentiment. However, as the time for drug approvals has shortened, this has inherently increased the risk that PMDA will approve a drug that may have detrimental side effects.

There are already some signs that public opinion may be shifting on this issue. In 2013, for example, PMDA approved two human papillomavirus (HPV) vaccines called Gardasil and Cervarix, at the urging of the foreign pharmaceutical industry and patient groups. Merck and GlaxoSmithKline, the makers of Gardasil and Cervarix respectively, were active in lobbying Japanese politicians directly and in cooperation with ACCJ, EBC, EFPIA, and PhRMA.<sup>224</sup> The vaccine was included in the national immunization program in April 2013. However, in June 2013, MHLW suspended proactive recommendations for the HPV vaccine after unconfirmed reports of adverse side effects were reported in the media. In June 2014, the Vaccine Adverse Reactions Review Committee investigated and concluded that there was no evidence of a causal association with the vaccine, but they still did not reinstate proactive recommendations for its use. The priority for PMDA in the future will be to find and maintain the optimum balance between approving effective drugs quickly and being stringent enough to ensure that risky drugs do not make it through the approval process and prompt public backlash similar to what occurred in the early 1990s. Therefore, the foreign and domestic pharmaceutical industry may find it challenging to continue making the same kinds of arguments that it has in the past, since the worst of the problem has arguably been resolved.

#### **4.5 Drug Price Revisions**

As mentioned previously, the Japanese government controls drug prices. The state exercises a direct influence on the profitability of the industry as whole, and consequently, there is a clear tension between MHLW's role as a promoter of industry and as a custodian of public health services. MHLW fixes the prices of all the drugs that appear on the National Health Insurance (NHI) list and no doctor may be reimbursed by any of the health insurance systems for a medicine that does not appear on this list. Doctors both prescribe and dispense medicine; they are able to obtain the drugs for less than the NHI price, and they pocket the difference, which has led many to overprescribe high-margin drugs. Pharmaceutical firms have an interest in maximizing the NHI price, while the government wishes to minimize it in order to keep health care costs reasonable. In this section, I use the case of drug pricing to further examine the role of the foreign pharmaceutical industry in influencing Japanese government policy. As in the previous case of drug approval times, the foreign pharmaceutical industry utilized a wide variety of strategies. However, due to the nature of this issue, opportunities to appeal to the public interest are more limited; therefore, the industry has employed more standard lobbying techniques targeting bureaucrats both directly and in cooperation with globally competitive Japanese firms. The success that the foreign pharmaceutical industry has achieved has also been more limited in nature and requires sustained political attention in order to maintain what gains have been achieved. On the surface, it may not appear that industry has been able to change the downward trend in price revisions; however, the way that the price changes are decided and the mix of price revisions implemented provide evidence of business influence.

Since the 1960s, the Japanese health insurance system has covered virtually the entire population. By the mid-1970s, the Ministry of Finance had become alarmed by these huge

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<sup>224</sup> Interview with foreign pharmaceutical industry representative, 4 July 2013.



socialized costs, about 40 percent of which were comprised by pharmaceutical expenditures, and pressured MHW to rein in spending.<sup>225</sup> In response, MHW sharply reduced regulated pharmaceutical prices. In order to keep costs in check, the Japanese government instituted a system of price surveys in order to gauge what doctors are actually paying for drugs and a regularized downward revision of NHI reimbursement prices. Table 4.4 shows the average annual price revisions carried out by MHLW. Maximum prices for ethical drugs are set in a Reimbursement Fee Schedule (RFS) that is technically determined by the Central Council (*Chuikyo*), comprised of representatives of health insurance payers, medical providers, and the public interest. No pharmaceutical manufacturers or wholesalers are represented on this council. MHLW closely supervises this council, and the Ministry of Finance has important influence on price setting because it determines the overall health care budget. For those products selected for price reductions, the fall-off in demand has been clear due to the incentives for doctors to shift to prescribing more expensive drugs. Japanese firms have tried to adapt to price revisions by continuously introducing new products at higher prices to counteract the falling prices of their other drugs.

Table 4.4 Pharmaceutical Price Revisions (1967-2016)<sup>226</sup>

Year	Number of Drugs	Average Price Revision	Year	Number of Drugs	Average Price Revision
1967	6,831	-10.2%	1992	13,352	-9.2%
1969	6,874	-5.6%	1994	13,573	-8.1%
1970	7,176	-3.0%	1996	13,375	-6.6%
1972	7,236	-3.9%	1997	12,869	-6.8%
1974	7,119	-3.4%	1998	11,974	-4.4%
1975	6,891	-1.6%	2000	11,692	-9.7%
1978	13,654	-5.8%	2002	11,287	-7.0%
1981	12,881	-18.6%	2004	11,191	-6.3%
1983	16,100	-4.9%	2006	11,993	-4.2%
1984	13,471	-16.6%	2008	13,311	-6.7%
1985	14,946	-6.0%	2010	14,359	-5.2%
1986	15,166	-5.1%	2012	15,455	-5.8%
1988	13,636	-10.2%	2014	14,902	-6.0%
1990	13,713	+2.4%	2016	TBD	TBD

Foreign pharmaceutical firms did not emerge as an active force in the Japanese market until the 1970s, by which time this pricing system was firmly in place. Early efforts to combat the price revisions were channeled through the Market-Oriented Sector-Selective (MOSS) talks beginning in the 1980s.<sup>227</sup> Due to the MOSS talks, MHLW decided not to revise prices at all in 1987, and since that time, price reductions have occurred in April of every other year. Partial revisions were eliminated. MHLW also pledged to list new drugs in the tariff every three months; prior to the MOSS talks, the timing of new drug launches was unpredictable, and a year often went by without any new listings. These changes reduced much of the uncertainty in the

<sup>225</sup> Thomas, *The Japanese Pharmaceutical Industry: The New Drug Lag and the Failure of Industrial Policy*.

<sup>226</sup> Compiled from MHLW, "Chuou Shakai Hoken Iryou Kyougikai Yakka Senmon Bukai [Central Social Insurance Medical Council Special Committee on Drug Prices],"

[http://www.mhlw.go.jp/seisakunitsuite/bunya/kenkou\\_iryou/iryou/shinkou/dl/vision\\_2013b\\_01.pdf](http://www.mhlw.go.jp/seisakunitsuite/bunya/kenkou_iryou/iryou/shinkou/dl/vision_2013b_01.pdf).

<sup>227</sup> Howells and Neary, *Intervention and Technological Innovation: Government and the Pharmaceutical Industry in the UK and Japan*.

price revision and price listing policies due to the MOSS talks.<sup>228</sup> The increasing trade tensions between Japan and the US during this time also increased the general level of scrutiny over Japanese policymaking.

Japanese pharmaceutical firms were allowed to present their opinions to the Central Council, but without formal representation, they were often ignored, which led JPMA to try to win the support of the foreign business community. JPMA suggested the “R-zone” scheme, proposing that MHW should allow a reasonable margin of difference between the NHI list price and the price at which it is offered to the medical institute to allow for the profit of the wholesaler and the institute itself. As long as prices remained within this zone, the drug would not be eligible for price revision. The US PMA (now known as PhRMA) and the European Business Council eventually supported JPMA’s proposal. At first, the foreign business community suggested that negotiation over the size of the zone should be a matter for Japanese parties, but PMA began to take a more active role in 1989, arguing for higher margins. However, these proposals still encountered opposition from the members of the Central Council.

Foreign firms were able to overcome this opposition due to changes such as the Birmingham Agreement, which created opportunities for them to forge closer direct relationships with MHLW and the Central Council. It allowed American and other foreign pharmaceutical firms to participate directly in MHLW’s biennial price revision process and in the consideration by the ministry of potential changes to the National Health Insurance drug pricing rules. Foreign industry was able to form similar relationships with PMDA after its creation in 2004. In contrast to the early period, when foreign firm demands were largely channeled through US government initiatives such as the MOSS talks and the Structural Impediments Initiative, which had the effect of loosening ties between Japanese pharmaceutical firms and their distributors, foreign firms could now work directly with Japanese bureaucrats.<sup>229</sup> Industry representatives also report that the US government has less ability to intervene on issues like pricing these days; firms see themselves as having to take the initiative, with the government playing a supporting role, if any.<sup>230</sup>

Moreover, a shift occurred in the 1990s whereby the foreign firms were able to form a cross-national coalition with the big domestic Japanese firms on pricing issues:

Japanese government officials easily divided and conquered the industry. That is, they played Japanese industry associations off against foreign industry associations, effectively neutralizing the opposition. This changed when the entire industry worked out a unified position. Not a US, or Japanese or European policy, but an “industry” policy. Individual country or company proposals are not taken seriously.<sup>231</sup>

American, European, and Japanese firms convened a joint task force to work together on pricing issues. Since Japanese health care reform takes place in odd years (resulting in price revisions in even years), efforts often begin in odds years. Since the early 2000s, the American pharmaceutical industry has published a white paper on health care through ACCJ in odd years

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<sup>228</sup> P. Reed Maurer, "Drug Price Revisions in Japan," *Pharma Japan*, 25 May 1992.

<sup>229</sup> There is also some evidence that MHLW prefers the new firm-led arrangement to the older forms of *gaiatsu* from the US government. For example, one foreign pharmaceutical industry representative who worked with the US embassy on talking points for discussing price revisions with MHLW later reported receiving a call from the Minister of Health, requesting that industry just contact him directly the next time instead of going through the US government.

<sup>230</sup> Interview with foreign pharmaceutical firm representative, 17 November 2010.

<sup>231</sup> P. Reed Maurer, "Looking Back on the Past Six Years," *Pharma Japan*, 19 July 1993.

to respond to the most recent policy changes and lay out goals for reform in the year to come; in some years, this is a joint effort with the European Business Council.

Interestingly, instead of trying to divide industry, MHLW has also preferred to deal with the pharmaceutical “industry” as a group since the early 2000s; this arrangement shields it from pressure to defend the smaller, less competitive Japanese firms. By requiring the entire pharmaceutical industry to come to a position prior to ministry consideration, MHLW avoids having to adjudicate between competing business interests. Instead, it forces the industry to fight out these battles among themselves. This tends to advantage the globally competitive Japanese firms that act in coalition with foreign firms, and it disadvantages smaller firms who might have demanded protection.

Given the biannual nature of these price revisions, rather than go through their entire history, it is more instructive to look in-depth at one recent negotiation to see the type of dynamic that has developed between the American, European, and globally competitive Japanese firms. In 2009, MHLW asked for a proposal from the entire pharmaceutical industry regarding the scheduled 2010 price revision. The ministry’s stipulation was that it had to be “revenue neutral,” which meant that it had to balance three elements: 1) an increase in price for makers of innovative drugs (i.e., the globally competitive foreign and domestic firms); 2) a degree of benefit for those maintaining old drugs (i.e., the small domestic firms); and 3) slight growth in the generic market.

The US side, led by PhRMA, started the proposal; since there was no significant articulation of what industry thought policy should be, they hired a consulting firm to work on the initial draft. The Japanese industry association, JPMA, also independently started its own proposal. In the end, the one that ended up being accepted was close to the American version because the big global Japanese firms were in agreement with the US side. With JPMA’s mixed membership of over 60 small firms and roughly 10 larger, innovative firms, it was difficult for the organization to come to a consensus internally. But in this case, the big firms were able to use the foreign firms to overcome their intra-association disagreement by “pulling aside” the foreign firms and striking a deal.<sup>232</sup> It is clear that the real divide in pricing issues was not domestic versus foreign; it was global and competitive versus smaller and less competitive. In the end, the “industry” pricing proposal favored the makers of highly innovative drugs; it advocated that on-patent, innovative drugs would experience no reduction in price until the expiration of the patent.

After the submission of their “industry” proposal, JPMA handled discussions with the regulators and ministries; although the foreign firms have improved relationships with the latter, government entities still often prefer to deal with domestic firms. So, JPMA represented the entire industry’s interests to the Japanese government, while the foreign business associations dealt with the media and the Diet. There was opposition to the proposal, however. Insurance firms saw it as costing more money. Although JMA initially supported the proposal, it later changed its stance due to concerns about revenue and protecting its members’ incomes. MHLW’s Health Insurance bureau was concerned about budget. Also, some politicians saw the proposal as benefiting foreign firms disproportionately because the latter were the predominant producers of innovative drugs.

The plan crafted by the foreign and globally competitive Japanese firms was adopted largely because of MHLW support, political support, and some compromises as to who would reap the benefits. Although the pharmaceutical industry was initially worried about the plan being lost or not proposed due to the recent transition to the DPJ, it went through. Unlike in other

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<sup>232</sup> Interview with foreign pharmaceutical industry representative, 4 July 2013.

industries or areas, foreign firms had been meeting with the DPJ while they were in opposition, long before they took power, so there was not as much of a problem as there might have been. Also, PhRMA had been disseminating reports and education programs for Diet members on innovative drugs for a long time, which had laid the foundation for politicians to support exempting those drugs from price decreases. Interestingly, although the average price reduction for 2010 appears to be roughly commensurate with other years, the number obscures important information about the relative composition of the drug price revisions.

Although the case of drug pricing does not seem to be as dramatic a success as with drug approval times, there are several key ways in which the foreign pharmaceutical industry has achieved its policy goals. First, it has avoided the ever-present threat of annual price revisions. Although it has not been able to persuade the government to halt its price revision policy entirely or to revise prices less often, the industry has managed to maintain a steady schedule of biannual revisions. The predictability of this cycle lets them coordinate with coalition partners among competitive Japanese firms and to work closely with MHLW in advance of planned revisions. Second, the foreign pharmaceutical industry has established itself as a natural interlocutor in the policymaking process. The previous case study shows that both foreign and domestic pharmaceutical firms have a seat at the table with MHLW and that foreign firms are able to form coalitions with competitive Japanese firms, to the disadvantage of less competitive Japanese firms. Third, the foreign pharmaceutical industry has managed in some cases to shift the mix of price revisions to favor its own drugs and those of its coalition partners.

However, neither foreign nor domestic pharmaceutical firms have been able to as strongly appeal to the Japanese public for support as they were in the case of drug approval times. The pharmaceutical industry has tried to make the argument that decreasing prices hamper innovation, which hurts the health of the Japanese public, but drug price revisions are fundamentally a problem of profits. Downward price revisions are perceived to benefit the Japanese public by lowering drug prices and helping to balance the health care budget. Therefore, foreign firms have been more limited in their potential strategies and have chosen to focus more on coalitions with like-minded Japanese firms. Due to the distinct pattern of internationalization in the sector, this has allowed them to successfully influence Japanese policy, to the detriment of small, less competitive Japanese firms.

## **4.6 Conclusion**

The foreign pharmaceutical industry is arguably the most successful foreign lobby in Japan today. It has worked together across national lines, with European and American firms joining together at various times. With the assistance of government pressure in the early years, it was able to gain access to Japanese bureaucrats and regulators. Increased awareness and acceptance of health issues as a topic of public discussion also opened up opportunities for foreign pharmaceutical firms to work with Japanese patient groups and politicians directly in some cases.

The key argument of this chapter is that this success can be explained by the pattern of internationalization in the Japanese pharmaceutical sector, which has enabled foreign firms to form cross-national coalitions in a manner impossible in more closed sectors such as agriculture. In Chapter 3, we saw that due to low levels of internationalization in the agricultural sector, foreign agricultural interest groups tend to focus their political strategies on influencing their home governments. This has meant that agricultural groups' demands are sometimes deprioritized when their home government has to make tradeoffs between different

constituencies' interests in the context of bilateral or multilateral negotiations with Japan. While foreign pharmaceutical firms have sought support from their home governments, foreign firms in this sector are also able to access the Japanese political arena directly. Importantly, the pattern of internationalization in the pharmaceutical sector pits the globally competitive players, both foreign and Japanese, against the weaker, smaller players. This distinct pattern has created opportunities for foreign firms to form coalitions with large Japanese firms, to the disadvantage of other Japanese players.

Two other trends become apparent in this examination of the pharmaceutical sector. First, foreign pressure in the pharmaceutical sector has become more firm-led in recent years. While government pressure played an important role in the MOSS talks, the Structural Impediments Initiative, and the Birmingham Agreement, these early liberalization initiatives created space for the foreign industry to enter Japan and to begin to advocate on its own behalf. Industry-led strategies are now equally as important as government-led initiatives; the two sides work hand in hand to coordinate policy initiatives vis-à-vis the Japanese government. Second, the Japanese public is an increasingly important player in the politics of pharmaceuticals. In cases when foreign firms are able to appeal meaningfully to the Japanese public or to patient groups, this is a powerful source of influence. However, meaningful appeals are not always possible, and they may have their limits.

The issues of drug approval times and drug pricing have been at the top of the foreign industry's political agenda for decades, and foreign firms have seen some important successes in both cases. These issues have important consequences for the market environment of the Japanese pharmaceutical sector. The elimination of the drug lag has brought many new medical advances to the Japanese market, and there is evidence that Japan is now enticing new foreign pharmaceutical firms to conduct clinical trials within its borders. Decreased approval times also mean decreased costs for the Japanese government and for patients. Biannual decreases in prices that can deter firms from investing in innovative new drugs have been partially addressed through collaboration between the Japanese government and both foreign and domestic industry players. Some of the changes pushed by foreign firms have led to improvements in health care in Japan, notably the increased availability of medicines. However, the effects of lobbying are less clear-cut on issues of pricing, and as mentioned previously, there is an inherent tradeoff between approval times and risk, so the Japanese public may not be likely to support further decreases in approval times if there is evidence that unsafe drugs are being rushed to market.

The case of the pharmaceutical sector also provides an important model for foreign firms in other sectors. In the closely related field of medical devices, for example, foreign lobbyists have developed the idea of a "device lag" similar to the drug lag, and they have advocated for policy change based on the example of policy change used by the pharmaceutical industry.<sup>233</sup> Other sectors such as information and communication technology have also sought to forge meaningful relationships with Japanese civil society groups. However, the differing patterns of internationalization in these other two sectors present foreign business actors with slightly different menus of strategic options, resulting in a different pattern of coalitional formation than in the pharmaceutical sector. In the next chapter, we move to an examination of the financial sector, where a small number of foreign firms used early government pressure to enter the Japanese market and become very successful; however, instead of creating a collaborative

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<sup>233</sup> Interview with government relations consultant, 12 August 2013. See also Altenstetter, *Medical Technology in Japan: The Politics of Regulation*.

dynamic as in pharmaceuticals, these firms have chosen to work to keep other players, both Japanese and foreign alike, out of their markets.

## 5 Insurance: First Movers and the Advantages of Selective Deregulation

Japan has the second largest insurance market in the world after the United States and generates nearly 20 percent of global premiums. However, while a number of foreign firms are active in Japan, their strategies and influence look very different from the cases of pharmaceuticals and agriculture. While the previous chapter explored a situation in which foreign pharmaceutical firms formed cross-national coalitions with large Japanese firms to influence government policy, this is not the only potential scenario arising from the internationalization of a sector. In this chapter, I examine how market entry by foreign firms and limited deregulation resulted in a very different situation in the insurance sector, creating a dynamic in which first-mover foreign firms attempted to defend their market positions from all competitors, both Japanese and foreign alike.

Although some theories of political economy suggest that foreign or global firms should be in favor of extending deregulation or deepening free trade, the case of the insurance sector demonstrates that this may not always apply due to the advantages that can come with gaining an early privileged position in a foreign market.<sup>234</sup> In situations such as this, foreign firms can actually work to impede or slow the deregulation of a sector.<sup>235</sup> In the case of the insurance sector, the pattern of internationalization was characterized by a small number of early foreign market entrants that were able to carve out advantageous positions for themselves in a specific niche of the Japanese market known as the “third sector.” Two of these first movers, the American companies Aflac and AIG, were able to win the support of their home government to help them first attain and then maintain their market positions in Japan; they successfully lobbied the US government to ensure that their interests were represented in subsequent bouts of selective deregulation of the Japanese insurance market. Moreover, as early market entrants, they were able to cultivate ties to Japanese business and government actors that helped them to leverage this initial market advantage to effectively forestall other foreign and Japanese competitors.

The chapter begins with a brief discussion of the global dynamics of the insurance industry. This is followed by an explanation of the pattern of internationalization in the Japanese insurance sector and of the main actors involved in formulating insurance policy. The strategies of foreign insurance firms are then explored in greater depth through two case studies surrounding the deregulation of the third sector insurance market in the 1990s and 2000s. In the first case, dominant American firms successfully lobbied the US government, which in turn pressured the Japanese government to halt deregulation of the third sector until the rest of the insurance market had been liberalized. This was crystalized in a pair of US-Japan insurance agreements in 1994 and 1996. In the second case, these same firms worked with the US government to ensure that the newly privatized Japan Post Insurance (Kampo) would not be allowed to sell third sector products while simultaneously crafting market agreements to sell their own insurance products through Kampo’s formidable distribution network and through Japanese banks. Resolution of the Japan Post Insurance issue also became a condition of Japan

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<sup>235</sup> For an example of work exploring this dynamic in China, see Seung-Youn Oh, “Fragmented Liberalization in the Chinese Automotive Industry: The Political Logic Behind Beijing Hyundai’s Success in the Chinese Market,” *The China Quarterly* 216 (2013).

being permitted to join the negotiations for the Trans-Pacific Partnership (TPP), which served as an additional piece of leverage through which American government and private actors could influence Japanese insurance policy.

## 5.1 The Political Economy of the Global Insurance Industry

The finance industry—insurance, banking, and securities—became rapidly globalized in the 1990s. Financial services formed part of the World Trade Organization agenda to liberalize international trade in services. The sector also experienced rapid increases in productivity due to the widespread introduction of information technology. Increased integration of currency, banking, and securities markets around the world facilitated a dramatic rise in financial mobility. In addition, the financial sector became a larger percentage of economic activity in countries around the world, expanding its influence over other aspects of domestic political economy in a phenomenon known as financialization.<sup>236</sup> The increase of finance as a percentage of gross domestic product in advanced industrial countries such as the US, the UK, and Japan since the 1970s has led to a corresponding increase in the political influence of the political sector over this time period.<sup>237</sup>

In response to foreign market opportunities made available by deregulation and the globalization of their industrial customers, many insurance firms have increased their foreign direct investment. Factors such as demand for insurance services, the size of foreign insurance markets, bilateral trade, labor costs, economic growth, and the cost of capital have driven this trend.<sup>238</sup> However, some studies have shown that there may be limits to this approach; while multinational insurers do benefit from economies of scale up to a point, this may not necessarily be true for the insurers with the greatest international diversity.<sup>239</sup>

International insurance trade comes in two basic forms: cross-border or establishment trade. Cross-border trade occurs when the buyer purchases insurance from an insurer domiciled in another country. Establishment trade is an insurance transaction where the buyer and insurer are both located in the same country, but the insurer is foreign-owned. Such foreign-owned entities include branch operations, agencies, and subsidiaries. Due to varying cultures, languages, and regulations, it is often crucial for foreign insurers to be established locally in a host market in order to compete effectively. Establishment trade has been a relatively more important vehicle than cross-border trade in delivering services to foreign markets on a global basis.<sup>240</sup>

However, as in other sectors, it can be challenging for insurers to penetrate a foreign market due to the complexities of customizing their services. Some potential barriers come in the form of government policies, such as regulations that hinder international insurers' access to

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<sup>236</sup> For a review of the literature on globalization of finance and financialization, see Richard Deeg and Mary O'Sullivan, "The Political Economy of Global Finance Capital," *World Politics* 61, no. 4 (2009).

<sup>237</sup> See Greta Krippner, *Capitalizing on Crisis: The Political Origins of the Rise of Finance* (Cambridge: Harvard University Press, 2011); T.J. Pempel, "Two Crises, Two Outcomes," in *Two Crises, Different Outcomes: East Asia and Global Finance*, ed. T.J. Pempel and Keiichi Tsunekawa (Ithaca: Cornell University Press, 2014).

<sup>238</sup> Fariborz Moshirian, "Sources of Financial Growth in International Insurance Services," *Journal of Multinational Financial Management* 9, no. 2 (1999); J. Francois Outreville, "Foreign Affiliates of the Largest Insurance Groups: Location-Specific Advantages," *The Journal of Risk and Insurance* 75, no. 2 (2008).

<sup>239</sup> Frances Katrisha and Nicos Scordis, "Economies of Scale in Services: A Study of Multinational Insurers," *Journal of International Business Studies* 29, no. 2 (1998).

<sup>240</sup> Yu-Luen Ma and Nat Pope, "Determinants of International Insurers' Participation in Foreign Non-Life Markets," *The Journal of Risk and Insurance* 70, no. 2 (2003).



potential host markets.<sup>241</sup> Other factors that affect insurers' decisions to engage in international operations may be managerial concerns, such as a lack of knowledge of foreign markets.<sup>242</sup> Some studies have shown that the concentration of a country's insurance industry can hinder the involvement of international insurers' involvement in that market.<sup>243</sup>

While much attention has been paid to finance in general, the focus has been mostly on banking and brokerages, with relatively little work devoted to the political economy of the insurance industry specifically. A notable exception to this is Meier (1988) who demonstrates that, in contrast to predictions that industry will capture its regulator based on Stigler's theory of regulation, the insurance industry in the US is far too divided to impose its will on the regulatory system.<sup>244</sup> Instead, insurance regulation is the product of a complex interaction of industry interests, consumer groups, insurance regulations, and political entities.

## 5.2 Explaining the Pattern of Internationalization

In the post-World War II system, Japan's insurance industry shared many of the characteristics of the country's banking sector. Insurance companies were at the heart of the *keiretsu* system and the convoy (*goso sendan*) system, which were discussed in Chapter 2. Under the convoy system, even the weakest financial institutions in Japan (which included some insurance firms) were permitted to survive via the Ministry of Finance's regulatory policy of closely managing competition in the financial sector through uniformity and cooperative arrangements among competitors. This practice kept slow movers from failing but also impeded innovators. The stated policy of MOF was to protect the Japanese public by promoting the sound development of the insurance industry. In practice, this meant concerted regulation and guidance of the industry to minimize the potentially disruptive effects of "excessive competition" over product price and to ensure the profitability and survival of all Japanese firms in the industry. After World War II, 20 Japanese life insurance companies resumed operations, and their number did not change over the next 35 years. In the non-life sector, the number rose from 20 to only 22 firms over the same period. These 20 life and 22 non-life Japanese firms contrasted sharply to the more than 1,800 and 3,000 firms in the same fields in the US in the early 1980s.<sup>245</sup>

The Insurance Business Law strictly defined and separated the life and non-life (fire, casualty, and marine) insurance businesses, provided for tariff arrangements and other cartelized rate setting among insurance companies, and exempted the industry from the Anti-Monopoly Law. Foreign firms faced significant barriers in terms of government regulation of both product and price. Non-life insurance companies set rates on uniform products in a cartelized arrangement sanctioned by law and supervised by MOF. In the life insurance sector, insurance

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<sup>241</sup> Harold Skipper, "Protectionism in the Provision of International Insurance Services," *ibid.* 54, no. 1 (1987); Alan Zimmerman, "Effects of Trade Barrier Perception on International Services Trade: A Study of Insurance Executives," *Journal of Global Marketing* 12, no. 4 (1999).

<sup>242</sup> Frederick Schroath and Christopher Korth, "Managerial Barriers to the Internationalization of US Property and Liability Insurers: Theory and Perspectives," *The Journal of Risk and Insurance* 56, no. 4 (1989).

<sup>243</sup> Yu-Luen Ma and Nat Pope, "Determinants of International Insurers' Participation in Foreign Non-Life Markets," *ibid.* 70, no. 2 (2003).

<sup>244</sup> Kenneth Meier, *The Political Economy of Regulation: The Case of Insurance* (Albany: State University of New York Press, 1988).

<sup>245</sup> Arthur Alexander and Hong Tan, *Case Studies of US Service Trade in Japan* (Santa Monica: The Rand Corporation, 1984).

premium rates were established by a combination of ministerial guidance and competition. This strict uniformity of premium rates and product forms inhibited the ability of foreign firms to attract sales staff and to compete effectively for market share. The result was an industry with a limited range of products, stunted innovation, weak risk management, and peculiar forms of competition. For example, a major business area for insurance companies was the group insurance (*dantai hoken*) contracts that covered all employees of a particular firm; since insurers were unable to compete on price through product differentiation, they secured business through cross-shareholdings of other firms in their *keiretsu* networks and through a large and active sales force.<sup>246</sup>

Although foreign companies were allowed to operate in Japan in principle, applications had to be made via lengthy consultations with MOF officials, which often involved numerous modifications to the proposed plan and products to be offered. Since there was no statutory requirement that an application be acted upon within a particular period of time, the applicant had no ability to appeal to expedite the process, and waits of two to three years for license approval were common.<sup>247</sup> Though MOF restricted entry of new domestic insurance companies, it licensed 40 new foreign firms in the non-life sector from 1949 to 1984, at a rate of about one per year. In life insurance, licensing of foreign insurance firms did not begin until 1973 when the industry was liberalized to allow 100 percent foreign ownership of capital. Even then, licensing approval was restricted to cases where the foreign firm could introduce a novel product in terms of policy features or sales method; only a few foreign companies were able to meet this criterion because the barriers to proving that a product was truly new were usually very high. The novelty requirement was later relaxed due to political pressure and criticisms that it was incompatible with the equitable treatment clause in the Law Concerning Foreign Insurers.

In the early 1980s, foreign penetration of the Japanese insurance sector was relatively minor. In the non-life insurance sector, 20 Japanese companies accounted for 97 percent of total premiums, and 40 foreign insurance companies accounted the remaining three percent of premiums. 11 US insurance companies related to AIG and AFIA dominated 82 percent of that foreign market share. In the life insurance sector, six foreign firms (all American) held just 0.7 percent of the premium income of private companies. In 1979, US insurance companies in Japan produced just over \$350 million in premiums, or about one percent of the combined Japanese life and non-life insurance market.<sup>248</sup>

However, a few foreign firms were able to build very successful businesses in Japan. AIG was the first foreign non-life insurer to enter Japan after World War II, establishing a branch of American International Underwriters (AIU) in 1946 when General MacArthur wanted an American firm to insure American military occupation troops.<sup>249</sup> It became the largest foreign non-life insurer in Japan, offering more than 200 products and achieving notable market share in automobile insurance, overseas travel accident insurance, and comprehensive accident insurance for students and their schools. Alico Japan, a branch of American Life Insurance Company (part of the AIG group) was established in 1973, the first foreign life company to commence business after World War II. It was the largest foreign full-line life insurer and pioneered many “first in Japan” products such as nonpar level term and whole life insurance, full in-hospital coverage,

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<sup>246</sup> Paprzycki and Fukao, *Foreign Direct Investment in Japan: Multinationals' Role in Growth and Globalization*.

<sup>247</sup> See Alexander and Tan, *Case Studies of US Service Trade in Japan*.

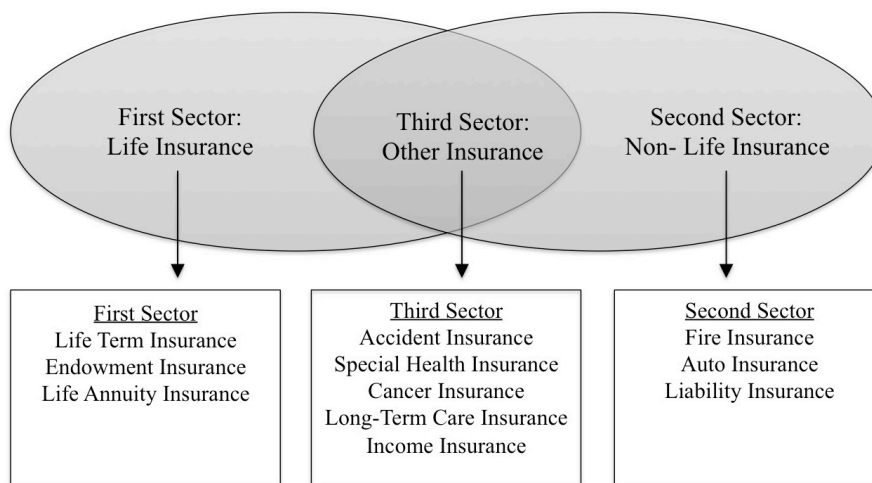
<sup>248</sup> Ibid.

<sup>249</sup> Ronald Shelp and Al Ehrbar, *Fallen Giant: The Amazing Story of Hank Greenberg and the History of AIG* (Hoboken: John Wiley & Sons, 2009).

living benefits insurance, long-term care insurance, and interest sensitive whole life. Although Alico did business in 60 countries, it did more business in Japan than in anywhere else in the world. AIU Insurance Co., Alico Japan, AIG Star Life Insurance Co. Ltd., and AIG Edison were all important components of the AIG insurance business activities in Japan.<sup>250</sup>

A consequence of the structure of the Insurance Law was the emergence of the “third sector” (*daisan bunya*), which became an important avenue through which foreign firms could enter the Japanese market. The definition and separation of life and non-life insurance left a gap that included items such as special health (cancer, stroke), disability, hospitalization, long-term care, and unemployment insurance. Figure 5.1 illustrates the divisions between the first, second, and third sectors in the insurance market. Beginning in the 1960s, MOF used its discretionary authority to develop the ambiguous third sector to license products that did not clearly fall within the definitions provided by the Insurance Law. Foreign insurers, notably AIG and American Family Life (Aflac), were able to obtain licenses and become successful in this niche market.

Figure 5.1 Segments of the Japanese Insurance Market



In 1974, Aflac received a license to sell cancer insurance in Japan.<sup>251</sup> Some observers claim that Aflac was given the license to placate US insurers, who were desperately trying to break into the Japanese market. Daniel Amos, Aflac CEO and nephew of founder John Amos, agreed with this conjecture, saying, “I think they definitely wanted to let a US insurer in and I think we were chosen because we would not be in direct competition with Japanese companies.”<sup>252</sup> No European firm would enter the Japanese insurance market until 1983, when Nationale Nederlanden concluded an agreement to sell policies through Shell’s sales network.<sup>253</sup>

At the time of Aflac’s entry, no Japanese company offered cancer insurance. Although it took four years for Aflac’s license application to be approved, MOF granted Aflac an eight-year

<sup>250</sup> A.V. Narsimha Rao, "AIG Crisis: Impact on Insurance Business with Special Reference to China, Japan and India," *The ICFAI Journal of Risk and Insurance* 8, no. 3 (2011).

<sup>251</sup> Aflac founder John Amos would later be hit with a \$77 million lawsuit by his former legal counsel, charging that he bribed his way into Japan, other countries, and some states. See Jim Montgomery, "Fighting Executive: Cancer Insurer Amos, Focus of Controversy, Likes to Play Hardball," *The Wall Street Journal*, 17 October 1980.

<sup>252</sup> Adrienne Hardman, "American Sumo: Aflac’s Heft May Come from Japan, but Its Agility Is Georgia-Bred," *Financial World*, 3 August 1993.

<sup>253</sup> "Nationale Nederlanden Will Sell Insurance through Shell Group," *The Japan Economic Journal*, 12 July 1983.

monopoly on selling cancer insurance until 1982. Amos claimed that MOF treated Aflac like an insider after its initial licensing, saying, “Once you receive a license, the Japanese authorities want to do everything they can to help you. The bureaucracy makes sure that everyone – companies and consumers – is protected.”<sup>254</sup> He argued “...the reason for [Aflac’s] success has been the government's willingness to bring us into the infrastructure - the thing companies gripe that they won't do, and they did do that for us.”<sup>255</sup> Once established in Japan, these first-mover foreign players became as much part of the system as their domestic counterparts. They were barred from offering insurance products in rival business areas, but they were also able to protect their existing turf from outside competition. Writing in 1992, one reporter aptly described the situation:

As made-in-Japan stories of corporate success go, this one is a classic. A company in a fledgling market was protected for years from competition by Japan’s powerful bureaucracy. It grew rapidly and piled up profits. Today, it is a powerhouse, rich and entrenched, so dominant that outsiders have little chance of cracking into its lucrative bailiwick...but there is a wrinkle. The company in question is American – Aflac Inc. of Columbus, Ga.<sup>256</sup>

Thus, the incumbents in Japan’s insurance market, foreign and Japanese alike, were largely sheltered from full competition as a result of the policies and practices of the Japanese government.

In addition, Aflac and AIG benefited from the *keiretsu* system that worked to disadvantage most foreign firms. For example, because Aflac was the only firm selling cancer insurance in the 1970s, many Japanese corporations were quick to become sales agents. They offered Aflac’s new insurance products to their employees, enabling Aflac to access *keiretsu* group companies that were normally so loyal to insiders. Once large Japanese corporations had signed up as sales agents, this acted as an entry barrier to other insurers, both foreign and Japanese alike.<sup>257</sup> AIG employed similar strategies, and both firms were able to plug into elite networks and to engage in the practice of *amakudari*, hiring former MOF and MHW bureaucrats who had been in charge of the insurance industry. They also hired division heads from major Japanese firms such as Tokyo Life, Tokyo Marine and Fire, Tokyo Bank, TV Tokyo, and accounting firms.<sup>258</sup> About 90 percent of Aflac’s assets and 80 percent of its profits come from Japan, leading some observers to claim that Aflac is more of a Japanese company than an American one. By the late 1990s, Aflac had an overwhelming 90 percent share of the cancer insurance market. AIG’s insurance business was more global in scale, but the Japanese market also represented an important part of its portfolio; for example, Alico Japan did more business in Japan than in any other country.

In the 1990s, the insurance industry entered a period of transformation due to deregulation, the Japanese financial crisis, and a global boom in M&A. Foreign pressure from the US government played a role in spurring deregulation forward, as will be discussed in the first issue case study to follow. Starting in 1996, the Japanese government introduced a series of

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<sup>254</sup> Steve Lohr, "Under the Wing of Japan Inc., a Fledgling Enterprise Soars," *The New York Times*, 15 January 1992.

<sup>255</sup> Cynthia Michell, "Aflac Chief Discusses Trade Issue," *Atlanta Journal and Constitution*, 6 July 1993.

<sup>256</sup> Lohr, "Under the Wing of Japan Inc., a Fledgling Enterprise Soars."

<sup>257</sup> Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Process."

<sup>258</sup> Nagami Kishi, *Kenshou Gaishikei Kigyou: Nihon Ni Okeru Seikoku Senryaku [Evaluating Foreign Firms: Successful Strategies in Japan]* (Tokyo: Nihon Noritsu Kyokai, 1989).

amendments to the Insurance Business Law for the first time in 56 years. These amendments allowed life and non-life insurers to enter each other's business, lifted the ban on insurance holding companies, changed product registration from an approval to a notification basis for many types of insurance, and streamlined the approval process, thus allowing greater product competition and innovation. It did, however, take some years before the full effects of these changes were felt by industry.<sup>259</sup> Insurance was one of the sectors with the largest influx of FDI into Japan in the 1990s. This was partly due to a global boom in M&A in services, but it was also related to the stagnation of the Japanese economy and the Japanese financial crisis, which caused nine Japanese life insurers and two Japanese non-life insurers to collapse between 1997 and 2001. Foreign competitors snapped up a number of failed and failing Japanese companies during this time (see Table 5.1).

Table 5.1 Bankruptcies and Acquisitions in the Japanese Insurance Industry<sup>260</sup>

Company	Year Collapsed	Buyer	Country of Buyer	Year Bought
Nissan Mutual	1997	Artemis	France	1999
Heiwa Life	---	Aetna (ING)	USA (Netherlands)	1999
Toho Mutual	1999	GE Capital	USA	2000
Nihon Dantai Life	---	AXA	France	2000
Nicos Life	---	Winterthur Group	Switzerland	2000
Daihyaku Mutual	2000	Manulife	Canada	2001
Daiichi Mutual Fire & Marine	2000	---	---	---
Orico Life	---	Prudential	UK	2001
Taisho Life	2000	Yamato Life	Japan	2001
Chiyoda Mutual	2000	AIG	USA	2001
Kyoei Life	2000	Prudential Financial	USA	2001
Tokyo Mutual	2000	T&D Financial	Japan	2001
Taisei Fire & Marine	2001	Sompo Japan	Japan	2002

A number of foreign insurers also established subsidiaries in Japan, meaning that most global players now have a presence in the country. Foreign firms' market share grew from less than 5 percent in 1997 to 25 percent in 2004.<sup>261</sup> Aflac and other foreign companies also benefited from a controversial deal struck between the Japanese and American governments in 1996 that delayed the entry of first- and second-sector Japanese firms into the third sector until 2001, which will be discussed in the first issue case study below. Since 2001, competition from domestic life insurers has increased dramatically and the third sector has turned into a competitive battleground. Figure 5.2 illustrates the rapid opening of the market and the increasing presence of foreign insurers in the Japanese life insurance market (including third sector products) since 1997.

<sup>259</sup> For a detailed discussion of the effects of deregulation, see Claire Preston, *Japanese Insurance: The Impact of Deregulation* (London: Financial Times Business Limited, 1998).

<sup>260</sup> Adapted from Paprzycki and Fukao, *Foreign Direct Investment in Japan: Multinationals' Role in Growth and Globalization*.

<sup>261</sup> Ibid.

Figure 5.2 Top 20 Life Insurance Firms in Japan Ranked by Domestic Sales (1996-2013)<sup>262</sup>

Rank	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
1																		
2																		
3																		
4																		
5								AL	AL	AL	AL							
6									H	H		AL	AL	AL	AL	AF	AF	AF
7									AF	AF	AF	AF	AF	AF	ME	ME	G	ME
8								AF								G	ME	G
9							AF			MA		I					PGF	
10					AF	AF			I	I	H	H	H					
11				AF														
12			AF		AXG	AL	AXG	H				MA		MA		AX		
13					GI		AL				MSM		MA		AX		AX	P
14		AF		AL		AXG		I			I	AX	MSM		G			
15	AF				AL	GI	I	AE	AE		AX	G	AX	AX		P	P	
16					GE	GE	GI	G	G	AX								
17	AL	AL	AL	P	P	AS	AE	AXG	P	G		MSM	I	P	P			MA
18				MA		P	P	P	AX	P	MA			G		MA		AX
19					I		AS	AX	AS	AE	P		P		MA	PGF	MA	
20		P	GE			MA	MA	AS	AXG	AS	G	PGF	PGF	MSM	AE			PGF

Grey squares indicate the position of foreign or foreign-affiliated firms among the top 20 companies in terms of domestic sales in Japan. Abbreviations: AE = AIG Edison (USA); AF = Aflac (USA); AL = Alico (USA); AS = AIG Star (USA); AX = AXA (France); AXG = AXA Group (France); GE = GE Edison (USA); GI = Gibraltar (USA); H = Hartford (USA); I = ING (Netherlands); MA = Manulife (Canada); ME = MetLife (USA); MSM = Mitsui Sumitomo MetLife (USA); P = Prudential (USA); PGF = Prudential Gibraltar Financial (USA)

Kushida characterizes this shift as one “from privileged segmentation and *gaiatsu*-entry to the gates wide open.”<sup>263</sup> However, the majority of the life insurance market is still dominated by Japan Post Insurance and the top four private Japanese insurers (Nippon Life, Meiji Yasuda Life, Dai-ichi Life, and Sumitomo Life). For example, in FY 2012, Japan Post Insurance had a 17 percent share in total life insurance industry premiums, and the top four private Japanese insurers had a 41.5 percent share.<sup>264</sup> While the success of foreign insurers in the Japanese market was largely due to their dominance in the third sector, they have expanded to other areas of the insurance business. Moreover, the third sector is no longer such a niche market; it has recently grown in popularity while other categories (e.g., death benefit products) have declined. For example, in 2004, about 30 percent of new policies were in the third sector.<sup>265</sup> Foreign insurers have been able to offer products at low premiums that are easier for customers to understand, while Japanese companies tend to sell more complex products with various additional benefits. As foreign insurers have become a more established part of the sector, they have expanded into direct marketing, including Internet sales, and they have forged alliances with major as well as

<sup>262</sup> Compiled from first quarter reports from Teikoku Databank, *TDB Gyoukai Doukou [TDB Industry Trends]*. Alico was purchased from AIG by MetLife in 2010.

<sup>263</sup> Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Process."

<sup>264</sup> Edward Lincoln, "Japan Post Insurance: Unjustified Favoritism," (New York: Columbia Business School, 2013).

<sup>265</sup> "6 Major Foreign Life Insurers' Premium Revenue Up 15% in FY04," *Nikkei Net*, 9 February 2004.

smaller second-tier and regional banks to sell individual pension insurance policies. They have also become integral to Japan's financial sector, which has increased their political influence.

### 5.3 The Political Landscape

Understanding the politics of insurance regulation necessitates a brief discussion of the key actors involved in the policymaking process. While the Ministry of Finance (MOF) used to be the most important domestic actor in this policy arena, the sector has become more open since Japan's financial reforms in the late 1990s. An independent regulator, the Financial Services Agency, was established in 2000. Japanese trade associations and inter-firm networks also exercise influence over policy. In addition, foreign pressure from governments, business associations, and individual firms has also played an important role in shaping insurance regulation.

Regulation of insurance in Japan was long the sole responsibility of the Ministry of Finance, particularly the Insurance Department of MOF's Banking Bureau. As mentioned previously, MOF exercised very strong regulatory authority over this sector during the post-World War II period, establishing a regulatory regime that emphasized close management by government and self-regulation by domestic industry. MOF was accorded the authority to demand reports from companies, conduct on-site inspections, remove officers, and apply sanctions for violations of the law or rules. The comprehensive legal authority accorded to MOF provided the backdrop for MOF to informally utilize "administrative guidance" that, though non-binding, was often followed due to companies' fears of retaliation by ministry officials. MOF's historical tendency to enforce uniformity of product design and pricing for most life and non-life products limited the ability of small Japanese companies and foreign companies to use product innovation as a way to gain market share.<sup>266</sup> Non-transparency was inherent in that licensing standards were not established by law and left to the discretion of the regulatory agency. MOF was able to sustain its regulatory regime through this nontransparent administration, the existence of a highly concentrated industry structure, and tolerance of exclusionary business practices fostered by restrictions on distribution.<sup>267</sup> In 2000, the Financial Services Agency (FSA) was established as an independent authority to regulate and supervise insurers as well as banks and companies. Although the FSA is still connected to MOF, the authority of the latter has been somewhat lessened as the independent regulator has come into its own.

Japanese trade associations also play a significant role in policymaking, with the largest being the Life Insurance Association of Japan (LIAJ). These associations were traditionally used by domestic companies to influence the administration of regulations in Japan. Before the establishment of the Financial Services Agency, MOF's relatively small staff traditionally relied on these associations and an advisory insurance council, both of which historically excluded foreign companies, to regulate their member companies.<sup>268</sup> This "self-regulation" enabled large domestic firms in leadership positions at trade associations to exercise a quasi-government

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<sup>266</sup> US-Japan Business Council, Japan's Financial Services Market: The Case for Expanded Access 5 (Washington, 3 June 1993)

<sup>267</sup> Charles Lake, "Liberalizing Japan's Insurance Market," in *Unlocking the Bureaucrat's Kingdom: Deregulation and the Japanese Economy*, ed. Frank Gibney (Washington, DC: The Brookings Institution, 1998).

<sup>268</sup> William Ferguson and Tamela Ferguson, "First Mover Advantage and Entry in Japanese Insurance Markets" (paper presented at the International Insurance Society, Inc. Annual Seminar Research Round Table, Singapore, July 14-17 2002).

authority. These large domestic firms consequently had the opportunity to bring “order” into the industry as MOF’s deputy, which provided them with an additional competitive edge over foreign firms. Since the 1990s, foreign firms have also been allowed to become members of LIAJ; however, the organization continues to be dominated by the “big four” Japanese insurance companies, Nippon Life, Daiichi, Meiji Yasuda, and Sumitomo.<sup>269</sup> Kushida makes the interesting point that LIAJ shifted from hindering foreign takeovers to facilitating them in the late 1990s, when the financial crisis swept through the sector and put all member insurers at risk by straining the insurance policyholder protection fund.<sup>270</sup> This bears some similarity to the pharmaceutical sector, where JPMA sometimes sided with foreign industry due to common goals. However, this collaboration was short-lived, as foreign and Japanese insurance firms had far fewer shared interests than in the case of the pharmaceutical sector, as will be discussed in the two issue case studies below.

Inter-firm networks (*keiretsu*) also influence the insurance sector. Group companies purchase insurance products only from the group insurer; moreover, group firms encourage their employees to purchase individual insurance products from the group insurer as well. For example, group firms might allow affiliated agents to visit their offices and prohibit agents affiliated with other insurers from doing so. According to a 1987 Federal Trade Commission report, 75.3 percent of Japanese companies said that group ties and fostering financial links were the primary factors determining their choice of insurance supplier.<sup>271</sup> This pattern has weakened somewhat today, but *keiretsu* ties remain influential. Moreover, lack of competition in types of insurance products meant that buyers often applied noncompetitive criteria to choose their insurers; in short, if all of the products were the same, it made sense to choose an insurer affiliated with one’s own corporate group. According to a 1993 ACCJ report, 11 *keiretsu* member companies accounted for more than 80 percent of the total non-life insurance market in Japan, and at least 92 percent of the insurance business of *keiretsu* groups was handled by financially related insurers.<sup>272</sup>

Foreign governmental pressure has also played a key role in influencing Japanese policy, and foreign private actors such as firms, industry associations, and chambers of commerce have increasingly taken the lead in shaping regulation. As discussed previously, foreign firms such as Aflac and AIG have been important players since the 1970s. The first case study below examines how these first mover firms leveraged home government pressure to preserve their market dominance, which resulted in the 1994 and 1996 US-Japan agreements on the third sector. Since the 1990s, many other foreign firms have entered the Japanese market and started to play a more active role. Since around that time, foreign insurers have been able to join the LIAJ; they can also rely on the American Chamber of Commerce and the European Business Council for support. Foreign governmental pressure, particularly from the United States, continues to be useful at key moments, particularly when focused around a broader pact such as the Trans-Pacific Partnership, which will be discussed in the second issue case study to follow.

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<sup>269</sup> Interview with LIAJ members, 3 July 2013.

<sup>270</sup> Kushida, "Inside the Castle Gates: How Foreign Companies Navigate Japan's Policymaking Process."

<sup>271</sup> Lake, "Liberalizing Japan's Insurance Market."

<sup>272</sup> ACCJ Financial Services Committee, *Study of Japanese Insurance Procurement Practices within Keiretsu Groups* (Tokyo: American Chamber of Commerce in Japan, 1993).



## 5.4 The US-Japan Agreements on the Third Sector

Access to the Japanese insurance market had been an issue for over 20 years when the sector was suddenly catapulted to the center of US-Japan trade relations as part of the Framework Talks in the early 1990s. As mentioned previously, Japanese insurance market regulations strictly defined and segregated life and non-life (fire, casualty, and marine) insurance in a way that led to the creation of the “third sector,” which included items such as special health (cancer, stroke), disability, hospitalization, long-term care, and unemployment insurance. American companies such as AIG’s subsidiaries Alico Japan and AIU and Aflac’s American Family became highly successful in selling third sector products and capturing large market shares. In 1992, the third sector market premiums were about 1.5 trillion yen (US \$12 billion), 38 percent of which was sold by foreign firms, which illustrates foreign firms’ dependence on the third market.<sup>273</sup> However, the dominance of these foreign firms became threatened in the early 1990s, when the Japanese government began proposing the deregulation of the third sector. These first-mover American firms then used their political influence and the power of the US government to halt the deregulation of the third sector, in an effort to keep Japanese firms out of their niche markets. They also used their market dominance to keep out other foreign firms that might have arisen as potential competitors. The cases of the 1994 and 1996 agreements between the US and Japan on the third sector provide examples of how early foreign market entrants can become barriers to further deregulation by using political strategies against both Japanese firms and foreign firms alike.

By the late 1980s, Aflac and AIG (through its subsidiaries) had become dominant players in the third sector. For example, by 1991, Aflac had achieved 90 percent market share in the area of cancer insurance; the Japanese market accounted for 75 percent of Aflac’s business, a larger share than for any other sizable American company. Meanwhile, large Japanese firms were largely unable to compete due to the strict regulations and the lack of appropriate products. In the late 1980s and early 1990s, the Japanese government began to consider deregulating entry restrictions in the third sector. It became apparent to Japanese industry and the Ministry of Finance that there was a significant market opportunity in this area. MOF began drawing up plans to change regulations to specifically open entry to large Japanese firms. The US firms involved, Aflac and AIG, brought this competitive threat to the attention of the American government, specifically USTR, which put the issue on the agenda of bilateral market access negotiations.<sup>274</sup> Deregulation of the third sector posed a danger to these companies, particularly if this deregulation were to be done without any reform to the elements of the Japanese insurance regulatory system that continued to impede their success in more traditional life and non-life insurance markets.

Aflac and AIG successfully used their influence on Congress and the strong connections between their leaders and the political establishment to transmit their demands to the Office of the USTR. The Aflac political action committee has been one of corporate America’s most active political influence purchasers for years, donating millions roughly equally between the two parties’ candidates and campaign committees. Similarly, AIG has been a top political donor, giving over \$72 million to American political parties between 1998 and 2008 alone; the company

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<sup>273</sup> Office of the US Trade Representative, *National Trade Estimate Report on Foreign Barriers* (1995).

<sup>274</sup> Stephen Harner, *Japan's Financial Revolution and How American Firms Are Profiting* (New York: M.E. Sharpe, 2000).

has been ranked as one of the top 30 lobbying powers in recent history.<sup>275</sup> Insurance became one of four priority areas in the US-Japan Framework Talks undertaken by the Clinton administration. The American goal was deregulation of the life and non-life insurance markets in Japan and ensuring that influential American firms in the third sector were not discriminated against in the name of deregulation. The American and Japanese governments came to an initial agreement on October 1, 1994. MOF agreed to a number of things related to transparency, liberalization, and competition; importantly for Aflac and AIG, it also agreed to not make any radical change in the third sector until foreign firms were allowed entry to the life and non-life sectors.<sup>276</sup>

The new Insurance Business Law was passed in May 1995. Despite major provisions enabling market entry and transparency, the law continued to delegate significant authority to MOF, which prompted American concerns that the latter would remain prone to pressure from the domestic insurance agency. The proposed regulations and directives announced by MOF in 1995 led to a new dispute over the interpretation of a provision relating to the third sector.<sup>277</sup> This in turn led to consultations and then renewed negotiations, culminating in the Supplementary Measures by the Government of the United States and the Government of Japan Regarding Insurance, signed on December 24, 1996. The Japanese government committed to deregulate its primary insurance markets by early 1998 and to enact deregulation legislation. It also strengthened its commitments to limit large Japanese insurance companies entering the third sector until primary sector deregulation took full hold; in return, the US government agreed to allow limited entry by Japanese firms. This meant that foreign companies would be able to enter mainstream sectors such as life, fire, and automobile insurance, from which they had been largely banned, while Japanese companies would have to wait until primary markets were opened before they could enter the smaller niche markets. This constituted a major victory for the major incumbent foreign firms in the Japanese insurance market.

Essentially, the 1994 and 1996 agreements constituted a freezing of the status quo. The agreement essentially provided foreign firms with unchallenged access to the market for third sector products until 2001, until they were permitted to participate equally in deregulated primary life and non-life product areas. The dominant American firms, Aflac and AIG, particularly benefited from this deal. A former trade negotiator who worked on the insurance agreements commented that, "The 1996 agreement on the third sector was about two things. The third sector was the area that MOF carved out for the foreigners to play with: cancer and personal injury, Aflac and AIG. And that's it."<sup>278</sup> Japanese observers also echoed this sentiment. A 1997 editorial in *The Nikkei Weekly* argued, "...the insurance talks are ultimately over protecting the interests of one US company, American International Group Inc., whose Japanese unit is Alico Japan. But the US treats the issue as an important matter concerning the US economy or bilateral relations as a whole."<sup>279</sup> The 1996 agreement granted Aflac an effective monopoly on the cancer market until 2001 and Alico Japan benefited similarly from protection for its third sector products, which contributed 30 to 40 percent of its total premium revenue.<sup>280</sup>

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<sup>275</sup> Carol Leonig, "AIG Founder Wielded Personal Influence in Washington," *The Washington Post*, 1 October 2008.

<sup>276</sup> Lake, "Liberalizing Japan's Insurance Market."

<sup>277</sup> Ibid.

<sup>278</sup> Interview with former USTR official, 4 July 2013.

<sup>279</sup> "Insurance Talks Need to Focus on What's Good for Consumers," *The Nikkei Weekly*, 23 September 1996.

<sup>280</sup> Eiji Furukawa, "US Insurer Reaps New Products from Global Net," *ibid.*, 23 November 1998.

USTR demanded a one-year implementation period with data collection before a decision was made on whether “substantial deregulation [had] occurred,” on which the US would get an effective veto. Only after that period would the three-year clock preceding third sector liberalization start. MOF claimed that this was unacceptable. It proposed that non-life subsidiaries of the large Japanese life insurance companies be allowed to enter the third sector to sell personal accident insurance (the “pot of gold”) in January 1997. Briefing materials from meetings between Rubin and MOF at the time clearly state the American position that, “Liberalization in the primary sectors is our objective—safeguards in the third sector are designed to keep our firms viable until that is completed...we can’t have a surge in Japanese subsidiaries in the third sector until after foreign firms have a foothold in the primary.”<sup>281</sup>

Thus, while pressure from the American government was instrumental in much of the deregulation in Japan in the 1980s and 1990s, the US actually opposed deregulation of the Japanese insurance market due to the vested interests of Aflac and AIG.<sup>282</sup> It should be noted that this agreement did not necessarily serve the interests of all foreign companies, or even all American companies. The extension of Aflac and AIG’s dominance gave them more time to cultivate market strategies and ties that would enhance their competitive position vis-à-vis competitors in preparation for the day when the market would eventually be fully liberalized. The powerful distribution networks and insider channels that they had cultivated through decades of doing business in Japan bolstered Aflac and AIG. For example, Aflac’s policies were sold through agencies run inside many of Japan’s biggest companies, which sold policies directly to employees; this enabled Aflac to make contact with a large proportion of Japanese workers in a way that most other foreign firms could not. The political or non-market strategies of Aflac and AIG, therefore, served to allow them to further support their market dominance. The agreement kept Japanese competitors out, while market monopoly meant that foreign competitors could not make headway in the niche markets dominated by Aflac and AIG.

The controversy continued after the signing of the agreement. Aflac and AIG continued to lobby the US government to defend their interests in the third sector. For example, in 1997, the Clinton administration attempted to lure the vote of Representative Mac Collins of Georgia by adding a section to the trade bill that would have directed the USTR to press for full enforcement of the 1996 insurance agreement.<sup>283</sup> MOF stated publicly that they had met all commitments to liberalize the primary sectors of the Japanese insurance industry and started its clock on July 1, 1998 for lifting restrictions on Japanese subsidiaries in the third sector by January 2001. The US publicly disagreed that the clock had started, maintaining that Japan had failed to implement two of the five criteria in the 1996 agreement for determining whether primary sector had been accomplished: 1) elimination of the power of rating organizations to set rates and 2) implementation of a standard 90-day approval period for new products. The Ministry of Finance was reluctant to reengage on the insurance issue.

Responding to Congress and requests from AIG and Aflac, the US administration agreed to send an interagency team to Tokyo in the fall of 1998 to discuss outstanding implementation

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<sup>281</sup> Jeffrey Schafer, *Your Meeting with Japanese Finance Minister Kubo and President Clinton's Meeting with Prime Minister Hashimoto*, Japan and the United States: Diplomatic, Security, and Economic Relations, Part III, 1961-2000 (Washington, DC: Digital National Security Archive, 1996).

<sup>282</sup> Takatoshi Ito and Michael Melvin, "Japan's Big Bang and the Transformation of Financial Markets," *NBER Working Paper No. 7247* (1999).

<sup>283</sup> Jim Drinkard, "Trade Bill Was Heavy with Deals," *Associated Press*, 10 November 1997.

issues under the bilateral insurance agreements.<sup>284</sup> MOF rebuffed efforts by the US embassy to set up these meetings. In a meeting between Rubin and Miyazawa in September 1998, Rubin highlighted Treasury's support for USTR's assessment that Japan had not yet met its commitments to deregulate the primary insurance sectors, which meant that the clock had not yet started for liberalizing the third sector. The position of Treasury was that MOF's efforts to deregulate the insurance sector had failed to achieve either of the basic objectives of eliminating anti-competitive, cartel-like arrangements and behavior or creating a regime that encourages innovation and price competition. Rubin demanded that MOF make significant progress in eliminating the power of rating organizations to set rates and reforming product approval procedures so that new insurance products or rates can be approved in the standard 90-day period. Eventually, these demands were met and deregulation of the third sector was set for 2001.

Throughout this time, Aflac and AIG continued to maintain political pressure on USTR to enforce the insurance agreement. There was also evidence of strife within the insurance industry. Allies of Aflac sought to block US rivals vying for the same specialty insurance market in Japan by proposing budget cuts to the Office of the US Trade Representative, for example.<sup>285</sup> Aflac CEO Daniel Amos met repeatedly with Japanese regulators throughout 2000 in hopes of easing the company's transition to a more competitive marketplace. To help secure its share of the cancer insurance market, Aflac established a marketing agreement with Dai-ichi Life in September 2000, wherein the companies would begin selling each other's products. Aflac also began to turn its focus toward small businesses in Japan, a market where it held only a 20 percent share by the end of 1999. By 1999, Japanese companies were finding ways to compete with foreign firms, and foreign firms were finding openings in the primary product areas. For example, Cigna Insurance controversially sold a majority of INA Himawari Life to Yasuda Fire & Marine, granting the latter Japanese company entry into the third sector. Deregulation of the third sector finally occurred in 2001, but by that time, the incumbent foreign firms had succeeded in strengthening their market positions to cope with increased competition.

## 5.5 Postal Privatization and the Trans-Pacific Partnership

Another major issue for the foreign insurance industry has been the privatization of the Japanese postal system, which included a formidable insurance enterprise component known as the Postal Life Insurance Service (Kampo). The entrance of this huge state-owned entity into the private sector posed a threat to foreign insurers, who again attempted to use home government pressure to stall and restrict Japanese government action while also utilizing market strategies to shore up their dominant positions. In particular, the dominant foreign insurers, Aflac and AIG, sought early deals with Japanese banks and with the soon to be privatized Postal Life Insurance Service to have their products sold through insider distribution systems.

In July 1916, the Postal Life Insurance Law and the Postal Life Insurance Special Account Law were enacted, and the Postal Life Insurance Service was launched as a state-run

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<sup>284</sup> US Department of the Treasury, *Supplemental Briefing Materials, Working Group Meeting, Secretary Rubin--Minister Miyazawa, Meeting in San Francisco, September 4, 1998*, Japan and the United States: Diplomatic, Security, and Economic Relations, Part III, 1961-2000. (Washington, DC: Digital National Security Archive, 1998).

<sup>285</sup> David Rogers, "House Votes to Withhold Census Funds in 227-201 Tally Nearly on Party Lines," *The Wall Street Journal*, 6 August 1998.

service in October 1916. Postal life insurance was originally created to provide the general public with affordable and modest insurance coverage. The maximum insurance coverage per person was limited to avoid direct competition with private insurers. Since then, post offices have offered mail services, postal saving services, and postal life insurance services. The Ministry of Posts and Telecommunications (MPT) operated the postal services before January 2001, when the MPT became the Ministry of Public Management, Home Affairs, Posts, and Telecommunications (MPHPT), which then in turn became the Ministry of Internal Affairs and Communications (MIC) in 2004. The Postal Services Agency was established to operate the postal services in 2001. These changes were largely the result of a larger process of Japanese administrative reform and were not targeted specifically at the insurance sector.

The privatization of the Japanese postal system was driven not by foreign pressure but by domestic economic and political developments in Japan. While foreign insurers and their home governments had long expressed concerns about the size of the Japanese postal savings and insurance systems, neither the US nor any other foreign country applied consistent pressure to request that Japan reform the postal system as a whole.<sup>286</sup> Instead, the issue was driven by domestic reformers. The key issue in postal privatization was the Fiscal Investment Loan Program (FILP), an enormous off-budget spending system that drew on postal savings, public pensions, and other funds to pay for the Japanese government's priorities and reduce demands on the budget. Park argues that this was a way for the Japanese government to engage in "spending without taxation."<sup>287</sup> FILP funds were often channeled to the constituencies of prominent LDP politicians, perpetuating long-standing patterns of pork barrel politics. In the wave of financial reforms that began in the 1990s, some reformist Japanese politicians began to stress that new rounds of financial liberalization would be all but meaningless if the bloated postal and FILP systems were not added to the agenda. The postal system experienced its first major institutional reorganization in 56 years in 1997, when the government moved to make it a public corporation, a change that was partly enabled by the declining power of postmasters to get out the vote for the LDP.<sup>288</sup>

More dramatic change would come during the administration of Prime Minister Junichiro Koizumi, who made structural reform, and specifically postal privatization, a major campaign issue. In response to opposition criticism of the LDP's policies and long-term legacy, Koizumi, a brilliant political tactician, adopted a strategy of "saving the party by attacking it."<sup>289</sup> While the LDP had long been successful at combining the promotion of economically competitive sectors with the provision of pork to its constituencies, this strategy had become increasingly unsustainable through the 1990s; Koizumi chose to attack the portion of his party that relied on the pork barrel politics enabled by the postal savings system.<sup>290</sup> He coopted the opposition's critiques by arguing that he could reform the LDP from the inside, and postal privatization became a major test of his claims. Koizumi introduced a package of bills proposing postal privatization to the Diet, and when they were rejected by the Upper House in August 2005, he dissolved the parliament. The subsequent elections were framed specifically around the postal

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<sup>286</sup> Patricia Maclachlan, *The People's Post Office: The History and Politics of the Japanese Postal System, 1871-2010* (Cambridge: Harvard University Asia Center, 2011).

<sup>287</sup> Gene Park, *Spending without Taxation: FILP and the Politics of Public Finance in Japan* (Stanford: Stanford University Press, 2011).

<sup>288</sup> Maclachlan, *The People's Post Office: The History and Politics of the Japanese Postal System, 1871-2010*.

<sup>289</sup> Kristi Govella and Steven Vogel, "Japan in 2007: A Divided Government," *Asian Survey* 48, no. 1 (2008).

<sup>290</sup> See T.J. Pempel, "Between Pork and Productivity: The Collapse of the Liberal Democratic Party," *Journal of Japanese Studies* 36, no. 2 (2010).

privatization issue, with Koizumi hand selecting pro-reform “assassins” to run against LDP members who had opposed the bills. The LDP won by a landslide, and Koizumi gained a new mandate that allowed for easy approval of postal privatization in both houses in October 2005.

While much of the attention was focused on the postal savings issue due to concerns about FILP, foreign and domestic firms alike have watched the privatization of postal insurance very carefully.<sup>291</sup> The entry of a huge player with well-established connections to the Japanese public presented a threat to private insurers; foreign firms have been particularly concerned about the entry of Japan Post Insurance into the third sector. Japan Post was given several privileges as a state-run business. It was exempt from paying corporate tax and enterprise tax. The government officially guaranteed the insurance policies sold by Japan Post, even though the latter did not pay anything to the government for this guarantee; this gave Japan Post a huge competitive advantage over private insurers, whose policyholders suffered from losses due to bankruptcies in the 1990s.<sup>292</sup> Postal life insurance was available all over the country because of the extensive nationwide network of post offices. For example, there were 24,791 post offices in 2003 (at least one in all 3,213 administrative regions), while life insurers only had 15,585 offices, mostly located in large cities.<sup>293</sup> Finally, unlike private insurers, Kampo was not supervised by the Financial Services Agency but by the Postal Services Policy and Planning Bureau of the Ministry of Internal Affairs and Communications (MIC).

The US raised concerns about Kampo, which offered insurance services that directly compete with private providers, both foreign and domestic. A Japanese government privatization framework released in July 2006 prompted objections from the American Chamber of Commerce in Japan and from the American Council of Insurers that the privatization plan would allow Kampo to compete with foreign insurance providers by offering new products before it has been completely privatized.<sup>294</sup> The dominant foreign insurers in the market, Aflac and AIG lobbied the American government to help ensure that Kampo would not be allowed to engage in the third sector or issue any new products that might take away from their market share.

At the same time as foreign insurers employed non-market strategies to convince the US government to pressure Japan on their behalf, they also utilized market strategies to shore up their dominance. AIG sought growth in the market by acquiring a third life insurance unit, GE Edison, creating the sixth largest life insurer in Japan at the time based on policy premium income.<sup>295</sup> AIG also entered into tie-ups with Japanese companies such as Mizuho Bank and Sumitomo Life to distribute its products through their networks.<sup>296</sup> Interestingly, both Aflac and AIG (via Alico) sought to have their products sold by Kampo itself, taking advantage of its

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<sup>291</sup> Foreign express delivery firms have also been keenly interested in the privatization of postal services due to concerns that Japan’s EMS has unfair market advantage.

<sup>292</sup> Hiroshi Aketa, "Issues in the Privatization of Postal Life Insurance: A Practical Proposal for Equal Footing," (NLI Research, 2004).

<sup>293</sup> Nobuyoshi Yamori and Taishi Okada, "The Japanese Insurance Market and Companies: Recent Trends," in *Handbook of International Insurance*, ed. J. David Cummins and Bertrand Venard (New York: Springer, 2007).

<sup>294</sup> Emma Chanlett-Avery et al., *Japan-US Relations: Issues for Congress* (Washington, DC: Congressional Research Service, 2009).

<sup>295</sup> "AIG’s GE Edison Acquisition Starts Fight for Survival," *The Nikkei Weekly*, 30 June 2003. AIG’s other two life insurance units at the time were Alico and AIG Star.

<sup>296</sup> "Mizuho to Sell Dollar-Based Annuity Insurance," *The Daily Yomiuri*, 30 June 2003; "Sumitomo Life to Tie up with US Insurance Firm," *The Daily Yomiuri*, 9 October 2004.

superior distribution works.<sup>297</sup> Thus, these foreign companies sought both to exclude Kampo from their market and to use its resources to their own advantage vis-à-vis other foreign and Japanese competitors. A government cable dated December 19, 2007 reported that:

In order to counter the potential negative effects of postal privatization, US insurers took steps to strike deals to market products through Japan's extensive postal network. Embassy Tokyo, working with Washington-based colleagues at State, USTR, Commerce, and Treasury, used the full range of tactics to press for U.S. insurers' market access. Insurance and postal privatization have been raised through the bilateral Regulatory Reform Initiative, yearly Insurance Consultations, behind-the-scenes work with key politicians, public comments on Japanese regulatory proposals, and direct engagement with all levels of the Japanese bureaucracy. At every stage, advocacy efforts have been closely coordinated with U.S. industry, both in Washington and Tokyo.<sup>298</sup>

Although the issue was framed in terms of "US insurers," this was an arrangement that benefited Aflac and Alico disproportionately; the advocacy described was not necessarily conducted impartially on behalf of all foreign industry or even all American industry.

On October 1, 2007, Japan Post was privatized and Japan Post Insurance was established. It was the largest insurance company in the world by assets and the fourth largest in terms of net premiums written. Japan Post Insurance lost some of the advantages that it had held as a state-run entity. For example, the Japanese government no longer guarantees its policies. All policies in force as of October 2007 were separated from the newly created Japan Post Insurance. The pre-2007 policies were transferred to a newly created public entity, the Management Organization for Postal Savings and Postal Life Insurance, and continue to enjoy a 100 percent government guarantee. However, new policies do not share this privilege. Japan Post Insurance is now regulated by the Financial Services Agency in cooperation with MIC; however, some argue that Japan Post Insurance receives special treatment within FSA because it is regulated by a special office that only oversees Japan Post Insurance and Japan Post Bank, and which is generally staffed by former MIC bureaucrats.<sup>299</sup>

Unlike in the case of pharmaceuticals, foreign insurance firms did not form coalitions with Japanese insurance firms. Although it could be argued that all private insurers were threatened by the impending privatization of Japan Post, the dominant foreign insurers, Aflac and Alico, were primarily interested in excluding Japan Post from the third sector in which they enjoyed dominant positions. This relatively narrow interest was not shared by the major Japanese insurers, since the latter did not have as much to lose from Japan Post Insurance's entry into the third sector. Therefore, they were not interested in forming coalitions with smaller foreign firms for whom the third sector posed enticing prospects. Data shows that the foreign insurers' third sector strategy was effective. While the traditional life insurers continue to generate an overwhelming portion of the total core profit of all life insurers, their share dropped by about 20 percent after the entry of Japan Post Insurance into the private insurance market in 2007. In contrast, third sector insurers' profits have remained relatively stable despite Japan Post Insurance's market entry. Figure 5.3 illustrates this trend.

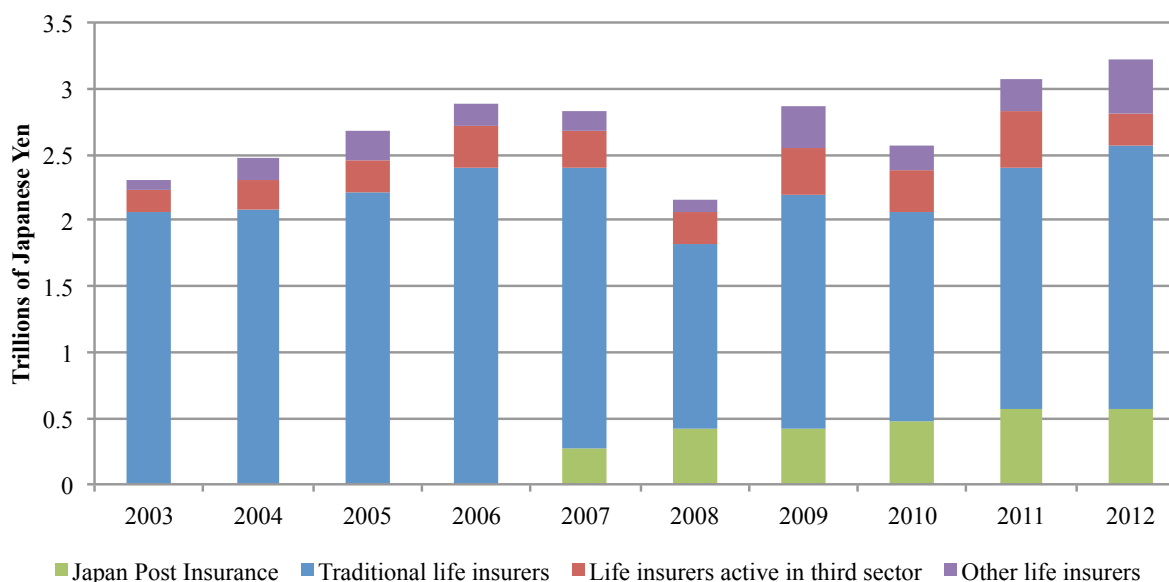
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<sup>297</sup> AIG was forced to sell substantial assets after it was taken over by the US government. MetLife bought Alico from the AIG group in 2010 for US \$15.5 billion. See Maurice Greenberg and Lawrence Cunningham, *The AIG Story* (Hoboken: John Wiley & Sons, 2013).

<sup>298</sup> "Japan: Insurance Advocacy Pays Off for US Companies." Available from <[https://wikileaks.org/plusd/cables/07TOKYO5610\\_a.html](https://wikileaks.org/plusd/cables/07TOKYO5610_a.html)>.

<sup>299</sup> Lincoln, "Japan Post Insurance: Unjustified Favoritism."

Figure 5.3 Core Profits of All Life Insurers in Japan<sup>300</sup>



The 2008 financial crisis triggered major changes for AIG, whose massive financial troubles necessitated a huge bailout from the US government. AIG had to significantly restructure its global business in order to repay the government bailout, and this restructuring hit its Japanese business units in 2010, when AIG began to withdraw from the Japanese insurance market by selling AIG Edison, AIG Star, and Alico. Gibraltar bought both AIG Edison and AIG Star. Alico, the biggest AIG Group insurance firm, was purchased by MetLife, which had until then been a relatively small player in the Japanese insurance market.<sup>301</sup> Although MetLife inherited the market position and political resources of Alico through the latter's acquisition, MetLife did not have nearly the political clout of AIG in the US, which left Aflac in an even stronger position in terms of its ability to successfully lobby the US government to gain representation for its demands.

Postal insurance continued to be an issue for foreign insurers for some time after the initial privatization of Japan Post Insurance. As the latter's full privatization was stalled by political factors in subsequent years, foreign insurers remain concerned about the latter's market dominance. The Trans-Pacific Partnership added another dimension to the politics of insurance regulation in Japan, providing an opportunity for the US to exert additional pressure at the governmental level on the issue of postal insurance. Insurance was one of three trade issues on which the US government wanted preliminary discussion before Japan's formal participation in TPP negotiations. Deputy USTR Demetrios Marantis suggested that these discussions were a means of getting support in the US Congress for Japan's participation in the TPP talks.<sup>302</sup> Insurance was the most contentious due to legislation recently passed by the Lower House that would continue to give the central government a major say over Japan Post Insurance Co. The

<sup>300</sup> Adapted from Hayanari Uchino and Koichi Sugaya, "Current State of Japanese Life Insurance Sector (3)," (Tokyo: Daiwa Institute of Research, 2014), 15.

<sup>301</sup> At the time of its sale to MetLife, Alico had a top-five market share in 23 of the 55 countries where it operated; however, about 70 percent of its total operating income came from Japan.

<sup>302</sup> "US Insists on Japanese Concessions on 3 Areas before TPP Participation," *Asahi Shimbun*, 21 April 2012.



legislation was expected to pass the Upper House and become law with support from the DPJ, LDP, and New Komeito. US officials were concerned that fair competition would not be possible against an entity that had the clear backing of the Japanese central government. The legislation would not obligate Japan Post Holdings Co., created through government funding, to sell off all shares in Japan Post Insurance. Moreover, the legislation had provisions that would allow Japan Post Insurance to freely move to new business sectors once the latter had sold off more than half its stake.

Such a development could have proven to be a major threat to insurance companies such as Aflac, especially if Japan Post Insurance decided to move into cancer insurance. Aflac then had a more than a 70 percent stake in the Japanese market in cancer insurance. Although it had slowly begun selling other kinds of insurance in the mid-1980s, cancer premiums still made up 85 percent of its total policies in the mid-2000s.<sup>303</sup> Aflac once again mobilized its political influence in Congress and its in-house advocates such as Charles Lake, president of Aflac Japan and former USTR Director of Japanese Affairs.<sup>304</sup> The “insurance” issue was widely seen as a euphemism for the “Aflac” issue. Japan Post Holdings President Jiro Saito commented in May 2012 that, “The insurance issue specifically refers to Japan Post Insurance’s potential foray into the cancer insurance market...I have no intention of standing in the way of the [Japanese] government’s TPP talks.”<sup>305</sup> Thus, the linkage between Aflac and Japan Post Insurance was clear to all the parties involved. Insurance was identified as an issue of American concern in the joint statement issued by Prime Minister Abe and Prime Minister Abe on February 12, 2013. This statement kicked off the US-Japan prior consultation process, which was settled on April 12, 2013. The issue of Japan Post Insurance was mentioned explicitly as being competitively unfair to American companies, and the Japanese government announced that it would freeze the handling of new products by Kampo as long as it continued to be supported by the government.<sup>306</sup>

While attempting to halt Japan Post Insurance’s entry into the third sector, Aflac and Alico (now MetLife) continued to press for market advantage by forming tie-ups with Japanese actors to sell their products through existing Japanese distribution and sales networks with strong access to Japanese consumers. Alico had sales arrangements with roughly 70 banks to market its cancer and other medical policies; although sales were suspended following the near collapse of the AIG group in 2008, they resumed in 2010.<sup>307</sup> A huge breakthrough for Aflac came in 2013 when it was announced that Japan Post would increase the number of post offices offering Aflac cancer policies. This agreement should be viewed in the context of the Japanese government needing to demonstrate to the US government that it would approach the TPP negotiations seriously. The Japanese government was under pressure to make concessions up front to show good faith upon becoming a participant in ongoing regional negotiations. Japan Post Insurance and Aflac agreed to gradually expand the number of post offices offering Aflac cancer insurance from 1,000 to eventually include all 20,000 post offices and around 80 direct JPI outlets handling insurance products. The Aflac-Japan Post development was seen as eliminating a major sticking

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<sup>303</sup> For a detailed timeline of Aflac’s introduction of new products and annual data on its new and cumulative cancer policies, see Aflac Japan, *30 Aflac Japan: Our History* (Tokyo: Amerikan Famirii Seimei Hoken Kaisha, 2004).

<sup>304</sup> “US Insists on Japanese Concessions on 3 Areas before TPP Participation.”

<sup>305</sup> “Japan Post to Stay Away from Cancer Insurance, Removing Thorn in Trade Talks with US,” *Asahi Shimbun*, 9 May 2012.

<sup>306</sup> Kaoru Ishiguro, “International Negotiations and Domestic Reforms in Trans-Pacific Partnership,” *Nanzan Review of American Studies* 36 (2014).

<sup>307</sup> “Banks Resuming Sales of AIG Units’ Policies,” *The Nikkei Weekly*, 8 February 2010.

point between the US and Japan. Japan Post Insurance had joined with Nippon Life in 2008 to explore prospects for developing proprietary cancer insurance, but it dropped these in-house plans after its partnership with Aflac.<sup>308</sup>

Critics expressed their displeasure at the deal between Aflac and Japan Post Insurance. Upon hearing word of the tie-up, the head of a major Japanese life insurance company said, "Protecting the interests of a particular company - Aflac - should not be used to settle the Japan-US negotiations."<sup>309</sup> An editorial run in *Sentaku* magazine argued that, "In bargaining with the US, however, Japan was forced to pay an excessively high price to become a party to the TPP talks by agreeing...to permit Aflac Inc., an American insurance firm, to market its products through the postal networks in Japan."<sup>310</sup> Representatives from other foreign insurers saw the TPP negotiations as clearly serving the interests of Aflac ahead of other foreign firms. They speculated that the new tie-up between Aflac and Japan Post Insurance would help to maintain Aflac's dominant market position. MetLife later announced plans to form a similar arrangement with Japan Post Insurance. Many smaller foreign insurers were skeptical that firms other than AIG and MetLife would be able to strike distribution deals with Japan Post Insurance; they also doubted that their governments would advocate for them as the US had done by holding the TPP negotiations hostage for Aflac. Thus, although the significant deregulation of the Japanese insurance sector has created opportunities for many foreign insurers to do business in Japan, the consequences of Aflac's early dominance in the market and its resultant political clout still remain salient.

Foreign insurers continued to press the American government to keep the pressure on Japan about Japan Post Insurance, even after employing these market strategies. In the first round of bilateral talks on TPP in August 2013, the US focused on insurance. This surprised Japan, whose negotiators had thought insurance would not be a contentious issue after the Kampo-Aflac deal to sell cancer policies. Wendy Cutler, acting deputy US trade representative and the head of the US delegation, demanded that the Japanese insurance market be further opened, saying a partnership in one product category with one U.S. company does not help other companies to enter the market. In response, the Japanese delegation reiterated that the government has barred Japan Post Insurance from creating new products for the time being.<sup>311</sup>

## 5.6 Conclusion

This chapter has demonstrated the consequences of a pattern of internationalization where a small number of foreign firms gain an early privileged position in a foreign market and resist further openings to their foreign brethren. The first mover advantages that accrue to these firms can enable them to become status quo players, insiders within the host country. In situations such as this, foreign firms can actually work to impede the deregulation of a sector in an effort to maintain their market dominance. In the case of the insurance sector, foreign early market entrants were able to carve out an advantageous position for themselves in the third sector. The American companies Aflac and AIG were able to win the support of their home government;

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<sup>308</sup> "Japan Post, Aflac in Cancer Policy Deal," *The Nikkei Weekly*, 29 July 2013.

<sup>309</sup> "Aflac, Japan Post Tie-up Reflects Aim for Mutual Gain by Insurance Giants," *The Nikkei Weekly*, 12 August 2013.

<sup>310</sup> "TPP No Longer About Free Trade," *The Japan Times*, 30 May 2014.

<sup>311</sup> "US Still Displeased with Japan's Insurance Barriers," *The Nikkei Weekly*, 12 August 2013.

they influenced the nature of US government demands such that their positions in Japan were maintained and enhanced by subsequent bouts of selective deregulation of the Japanese insurance market. Moreover, as early market entrants, they were able to cultivate ties to Japanese business and government actors that helped them to leverage their market advantage to keep out other foreign competitors.

An examination of the insurance sector in Japan shows that foreign firms cannot be assumed to be agents of generalized liberalization and deregulation. In some cases where a few foreign players have become insiders, they may actually act to oppose the deregulation of the host market. In this situation, a few first-mover foreign firms will use all market and non-market strategies available to exclude both foreign and Japanese companies from their turf. In the case of the Japanese insurance sector, this meant that Aflac and AIG used political tactics such as requesting home government pressure, lobbying the Japanese government directly, and acting through foreign business associations. They also used market strategies to leverage their advantages as first movers, developing strong ties to major Japanese companies that worked to exclude other foreign market entrants from important distribution channels.

Although the case of insurance may seem rather narrow, this dynamic can be seen in other areas as well. For example, Coca-Cola entered the Japanese market in the 1950s, formed close ties with Japanese *keiretsu*, and have subsequently worked to keep Pepsi out.<sup>312</sup> These patterns point to the importance of looking at the way that a sector has been liberalized or deregulated. It is not enough to say that there has been trade liberalization or deregulation and assume that this means that an opening has been created for further liberalization. In fact, if one or a few foreign firms have managed to gain a foothold in a host country, they could become more like insiders in the latter system, favoring the status quo over further liberalization initiatives.

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<sup>312</sup> Encarnation and Mason, "Neither MITI nor America: The Political Economy of Capital Liberalization in Japan."

## **6 Information and Communications Technology: Dueling Cross-National Coalitions**

This chapter explores the case of information and communications technology (ICT), an area where relationships between the private sector and the government are still in flux, both internationally and within individual countries. The landscape of technology, business, and regulation is quickly changing, which means that rules are often not fully formed and are thus open to contestation. This type of environment provides ample opportunity for firms both to employ political strategies to influence regulations and to exploit opportunities to gain a competitive edge by being the first to enter a specific market, as seen in the previous chapter about the Japanese insurance sector.

Governments are often especially open to input from ICT firms because they need private sector expertise in order to understand complex new technologies well enough to be able to regulate them. However, policymaking is complicated by not only the technical aspects of the sector but also by the fact that information technology crosses both national borders and the boundaries of multiple sectors of the economy. These interconnections mean that firms within and across sectors are often divided when it comes to policy issues, which can make it problematic for a home government to choose a side to support. This, in turn, makes the interaction between the domestic and international levels very intricate; firms must battle for the support of their home governments and simultaneously strive to form partnerships in their target country in order to maximize their chances of policy success. Moreover, the cross-border nature of information technology policy means that firms and governments in various countries may be competing with each other in order to put forward their own country's vision of the regulatory order as the standard for countries all around the world.

In the case of Japan, the information technology sector matured in relative isolation from some of the major global developments, the latter of which were pioneered primarily by American firms. Japanese technology companies tended to cater to their own domestic market, an approach that was successful for a time but was eventually disrupted by the market entry of major foreign firms. In this sense, Japanese firms have been somewhat peripheral and reactive to major political economic debates over global policies such as intellectual property and privacy, which are vital for information technology companies. However, given that the globally dominant foreign firms are divided and engaged in heated battles with one another in multiple national jurisdictions to define laws and regulations, Japanese firms have been drawn into the fray as allies with the potential to tip the political scales. Foreign and Japanese firms have partnered with one another against competing coalitions of other foreign and Japanese actors, each side advocating a different regulatory outcome than the other. This is in stark contrast to classic trade politics, where domestic actors often presented a united front against foreign influence, as seen in the analysis of agriculture in Chapter 3.

This chapter begins with an overview of some of the relevant developments in the global political economy of information technology over the last 30 years, with particular attention to issues of intellectual property rights and privacy, two of the most important issues facing ICT firms today. This is followed by a discussion of the pattern of internationalization in the Japanese ICT sector and a brief overview of the main actors involved in formulating relevant policy. The final portion of the chapter delves into two case studies of copyright term extension during the

Trans-Pacific Partnership (TPP) negotiations and of recent reforms in Japanese privacy law. These two cases illustrate the complex interaction between domestic and international factors in ICT policymaking and demonstrate Japan's role as a supporting player in global regulatory battles. Japanese actors rarely define the agenda but often serve as important allies for foreign multinational firms to achieve their global regulatory goals.

## 6.1 The Political Economy of the Global ICT Industry

The 1990s ushered in an information technology revolution that fundamentally shifted the structure of the global political economy and changed the way that information was transmitted around the globe. This revolution was composed of a highly complex reconfiguration of patterns of technological innovation and industrial reorganization involving the emergence of global production networks, the replacement of vertically integrated manufacturing by modular manufacturing, and a phenomenon termed "Wintelism," a new mode of innovation highlighted by the predominance of Windows and Intel. It emphasized the fact that market power could be located anywhere in the value chain, including product architectures, components, and software.<sup>313</sup> American companies drove these trends and ultimately benefited the most from them, resulting in a resurgence of US international competitiveness in the ICT sector, which would emerge as one of the most important global industries.<sup>314</sup> These shifts also had the effect of advantaging some US firms over others; for example, component providers such as Intel and Microsoft gained dominance over assemblers such as IBM and Dell by controlling architectural standards.<sup>315</sup>

The rise of these new technologies necessitated the creation of a host of new laws and regulations for governing the information age. The increased complexity of this policy domain has increased business influence in some respects, as it has made governments more reliant on firms for input on how to regulate these sophisticated new industries. But as Newman and Zysman point out, "Business interests may be driving the process of reformulating rules for a digital age, but there is no unified business position. There is certainly no 'digital sectoral' interest, let alone a class interest."<sup>316</sup> Firms in the ICT sector have different preferences and position on issues, each seeking to shape the new rules in ways that give them an advantage. Moreover, the complexity of technology, and the fact that the industry crosses the manufacturing-services divide, mean that companies occupying different positions in the market have distinct needs based on their specific roles. As these firms cross sectoral boundaries to deploy integrated product-service strategies, they alter the value-creation mechanisms of the

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<sup>313</sup> Michael Borrus and John Zysman, "Globalization with Borders: The Rise of Wintelism as the Future of Global Competition," *Industry and Innovation* 4, no. 2 (1997).

<sup>314</sup> Jeffrey Hart and Sangbae Kim, "Explaining the Resurgence of US Competitiveness: The Rise of Wintelism," *The Information Society* 18, no. 1 (2002).

<sup>315</sup> Some scholars suggest that Wintelism is reaching its limits and may be in decline. See for example, Boy Luthje, "The Rise and Fall of 'Wintelism': Manufacturing Strategies and Transnational Production Networks of US Information Electronics Firms in the Pacific Rim," in *Competitiveness of New Industries: Institutional Framework and Learning in Information Technology in Japan, the US and Germany*, ed. Cornelia Storz and Andreas Moerke (London: Routledge, 2007).

<sup>316</sup> John Zysman and Abraham Newman, "The State in the Digital Economy," in *The State after Statism: New State Activities in the Age of Liberalization*, ed. Jonah Levy (Cambridge: Harvard University Press, 2006), 296.

sectors that they enter, disrupting the traditional political configurations of those sectors in ways that result in new patterns of coalitional formation.<sup>317</sup>

This complexity and diversity of positions and interests has led to a burst of regulatory competition driven by both states and private actors. The content of these new laws and regulations "...is not compelled in any consistent way by the digital tools and networks themselves. Rather, the state finds itself struggling to manage digitally inspired conflicts fueled by business and public interest groups."<sup>318</sup> This struggle leads to different government approaches to the ICT sector, each of which is refracted through the lens of individual countries' unique political configuration. Correspondingly, international regulations are the product of conflicts being played out both domestically and in global forums. In the international arena, battles over standards are often fought by a handful of large multinational firms, but these skirmishes also interact with domestic politics. For example, Kennedy examines how a complex interplay between foreign firms, Chinese firms, and the Chinese government has shaped the adoption of different standards for wireless LAN and home networking; he finds that Chinese standards have a greater chance of succeeding against foreign-backed standards when supported by a broad coalition of both Chinese and foreign firms.<sup>319</sup>

One of the most important developments in global ICT regulation has been the proliferation of rules surrounding intellectual property (IP) rights. IP protections have arisen in the context of the commodification of information that has been heightened by the IT revolution. The purpose of these protections is to facilitate the compensation of content creators and to incentivize innovation. However, the rules governing intellectual property have to balance between the rights of their innovators and the rights of users consuming the information.

Finding this balance has been a contentious process. Companies have pushed hard to globalize their control over their intellectual property rights, trying to defend their power and position in the face of technological change and global interdependence. However, there are also many critics of IP protections. Although some protection is necessary to incentivize the creation of easily copied works, too much protection can actually raise the costs of creation for subsequent authors and inhibit innovation.<sup>320</sup> In addition, because IP protections have been defined and propagated by firms and governments from developed countries, there is concern that developing countries have not benefited from the new IP standards that they reluctantly accepted and that their national and firm growth prospects may actually be undermined by these protections.<sup>321</sup> Some have argued that the extension of IP protection can threaten the freedom, creativity, and dynamism of new information technologies.<sup>322</sup> Others claim that strong IPR

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<sup>317</sup> Mark Huberty, "The Dissolution of Sectors: Do Politics and Sectors Still Go Together?," in *The Third Globalization: Can Wealthy Nations Stay Rich in the Twenty-First Century?*, ed. Dan Breznitz and John Zysman (Oxford: Oxford University Press, 2013).

<sup>318</sup> Abraham Newman and John Zysman, "Transforming Politics in the Digital Era," in *How Revolutionary Was the Digital Revolution? National Responses, Market Transitions, and Global Technology*, ed. John Zysman and Abraham Newman (Stanford: Stanford University Press, 2006), 409.

<sup>319</sup> Scott Kennedy, "The Political Economy of Standards Coalitions: Explaining China's Involvement in High-Tech Standards Wars," *Asia Policy* 2 (2006).

<sup>320</sup> William Landes and Richard Posner, "An Economic Analysis of Copyright Law," *Journal of Legal Studies* 18 (1989).

<sup>321</sup> Keith Maskus and Jerome Reichman, "The Globalization of Private Knowledge Goods and the Privatization of Global Public Goods," *Journal of International Economic Law* 7, no. 2 (2004).

<sup>322</sup> See for example, Lawrence Lessig, *Free Culture: How Big Media Uses Technology and the Law to Lock Down Culture and Control Creativity* (New York: The Penguin Press, 2004).

protections actually serve to slow and inhibit the flow of information across borders, essentially amounting to new types of trade barriers.

A major step in the formation of an international regime for IP was the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which was negotiated at the end of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) in 1994. TRIPS was designed to solve problems of copyright piracy, unauthorized use of trademarks, and overly narrow patent regimes. Prior to TRIPS, the major threat to holders of IP was perceived to be industrial users, unauthorized users who intend to sell goods produced with misappropriated intellectual property in volume and for profit. This threat facilitated the formation of a coalition that included members from all IP industry sectors, both copyright and patent interest groups.<sup>323</sup> The patent side of this coalition was the dominant one, which led to the adoption of national-level solutions that best addressed industrial misappropriation.<sup>324</sup> However, these solutions were less effective for end-user misappropriation, since national patterns of patent protection differed widely. This presented a growing problem that was a larger concern for copyright interest groups.

As a result, TRIPS set a floor for intellectual property harmonization, but it was not sufficiently stringent for all parties concerned with IP protection. Copyright interest groups are now increasingly focused on end-user misappropriation. Since TRIPS permits countries to exceed TRIPS standards, copyright interest groups in the US and EU have worked with their governments to pressure other countries to do so. Consequently, the TRIPS approach is being supplemented by an expanding menu of alternatives, which includes bilateral and regional free trade and investment agreements such as the Trans-Pacific Partnership.<sup>325</sup> The proliferation of forums addressing intellectual property has increased opportunities for countries to engage in forum shifting; in particular, the US and the EU have been active in using this strategy to persuade individual developing countries or groups of such countries to introduce provisions that go beyond TRIPS requirements.<sup>326</sup>

Alongside these international developments, the interests of American content firms have resulted in a parallel strengthening of domestic IP protections within the US. Large commercial holders of intellectual property such as the Intellectual Property Committee, the International Intellectual Property Alliance, the Pharmaceutical Research and Manufacturers of America, the Recording Industry Association of America, and the Motion Picture Association have lobbied for stricter laws and enforcement.<sup>327</sup> These parties have won legislative victories such as the 1998

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<sup>323</sup> Robert Thomas and Cassandra Aceves, "Coalition Formation and Battles to Effect Intellectual Property Policy Change in the Age of ACTA, AIA, and the SHIELD Act," in *The Changing Face of US Patent Law and Its Impact on Business Strategy*, ed. Daniel Cahoy and Lynda Oswald (Cheltenham, UK: Edward Elgar, 2013).

<sup>324</sup> Susan Sell, *Private Power, Public Law: The Globalization of Intellectual Property Rights* (Cambridge: Cambridge University Press, 2003); "TRIPS Was Never Enough: Vertical Forum Shifting, FTAs, ACTA, and TPP," *Journal of Intellectual Property Law* 447 (2010-2011).

<sup>325</sup> Copyright interest holders have also been successful in enhancing copyright legal protection through the World Intellectual Property Organization (WIPO) Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT).

<sup>326</sup> Sell, "TRIPS Was Never Enough: Vertical Forum Shifting, FTAs, ACTA, and TPP."; Graham Dutfield, "'To Copy Is to Steal': TRIPS, (Un)Free Trade Agreements and the New Intellectual Property Fundamentalism" (paper presented at the International Studies Association, San Diego, California, 2006).

<sup>327</sup> Jonathan Aronson, "International Intellectual Property Rights in a Networked World," in *Power, Interdependence, and Nonstate Actors in World Politics*, ed. Helen Milner and Andrew Moravcsik (Princeton: Princeton University Press, 2009).

Digital Millennium Copyright Act (DMCA), which have further empowered them to extend their interests in the international arena.

A key conflict in the copyright debate involves the concept of “fair use,” a doctrine that permits limited reuse of copyrighted material without permission for purposes such as education, commentary, comedy, and art. Many consider fair use important for freedom of speech because it can facilitate debate and expression. Others argue that fair use is a major driver of Internet technology, culture, and commerce because it allows for innovators to build on existing technologies and to find creative ways of distributing and reusing media.<sup>328</sup> The most avid private sector proponents for fair use have been platform companies, most notably the American firm Google. However, content producers worry that the concept of fair use can be abused to steal intellectual property. Fair use, like other case law, is built on example, and some critics argue that moving from no fair use one day to active fair use the next might cause chaos and confusion.<sup>329</sup> For 150 years, this doctrine existed only in the US, until the Philippines, Israel, and South Korea adopted American-style fair use in the 1990s and 2000s. In countries like Japan, France and Germany, fair use protections are not as strong as in the US, and the legal process is much more rigid.<sup>330</sup> The case study at the end of this chapter will discuss the debate over fair use that occurred in Japan as part of the Trans-Pacific Partnership negotiations.

Privacy is another important issue for ICT firms. The IT revolution has led to an explosion in the creation of information and its collection by governments and private actors, which has prompted corresponding concerns about how the use of this information should be regulated. Some countries such as the US have chosen to place minimal restrictions on the use of personal data. These countries limit regulations to the public sector and a select number of sensitive industries, allowing firms to largely self-regulate. This has facilitated extensive data commodification and helped to enable the rise of many ICT firms, particularly in the US.

However, despite intense opposition from the US and other countries, Europe developed a comprehensive system of privacy regulation, privileging consumer protection and individual privacy against the economic interests of firms and governments. The adoption of these rules began in the 1970s and culminated notably in the 1995 EU Data Privacy Directive, which regulates the collection, transfer, and use of personal information and provides for enforcement by independent regulatory agencies. Since the mid-1990s, Europe has been the leading player in establishing privacy rules around the world, and the comprehensive privacy regulation system has become the de facto international model. Over 30 countries from five continents passed comprehensive privacy legislation between 1990 and 2006.<sup>331</sup>

However, battles over privacy continue, particularly with the emergence of the “big data” industry. The term big data refers to extremely large data sets that are analyzed computationally to reveal patterns, trends, and associations, often related to human behavior and interactions. This data can be used to better understand customers, reduce customer acquisition costs, and

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<sup>328</sup> Peter Decherney, "Fair Use Goes Global," *Critical Studies in Media Communication* 31, no. 2 (2014).

<sup>329</sup> Motion Picture Association of America Inc. Submission to the Australian Law Reform Commission. Available from <[http://www.alrc.gov.au/sites/default/files/subs/573.\\_org\\_motion\\_picture\\_association\\_of\\_america\\_inc\\_jul31.pdf](http://www.alrc.gov.au/sites/default/files/subs/573._org_motion_picture_association_of_america_inc_jul31.pdf)>

<sup>330</sup> For an overview of Japanese court cases involving fair use, see Teruo Doi, "Availability of the "Fair Use" Defense under the Copyright Act of Japan: Legislative and Case Law Developments for Better Adapting It to the Digital/Network Environment," *Journal, Copyright Society of the USA* 57 (2009-2010).

<sup>331</sup> For a discussion of the factors driving the development and diffusion of the limited and comprehensive privacy regimes, see Abraham Newman, *Protectors of Privacy: Regulating Personal Data in the Global Economy* (Ithaca: Cornell University Press, 2008).



drive product innovation and revenue. It can also be used to inform policy and social research. However, big data is controversial because it potentially infringes on the privacy of individuals who have not consented to the use of their data in this way. Major foreign firms such as IBM, HP, Dell, SAP, Oracle, Microsoft, Amazon, and Google have fought legal battles and lobbied to shape regulations around the world in ways that will allow them to collect and use individuals' data in their business models. While these firms' efforts have gained traction in the US, they have been resisted in particularly in Europe, where legal standards stress the rights of individuals.

Although Japan is a developed country whose firms would theoretically seem to have an interest in shaping global IP and privacy policy, Japanese firms have not been as active as American or European firms in international regulatory battles. This is due to the fact that Japanese ICT companies have often pursued domestic dominance at the expense of international competitiveness; they have also pursued Japan-specific standards that have not been adopted globally. The subsequent section explains how the government-led development of many key ICT product markets led to an environment where Japanese ICT companies came to play a somewhat peripheral role in international policy debates.

## 6.2 Explaining the Pattern of Internationalization

In this section, I demonstrate that the government-led patterns of development led to a pattern of internationalization that eventually enabled the formation of competing cross-national coalitions in ICT policy. First, Japanese government leadership and assistance enabled major Japanese firms to catch up in key high technology product areas and to dominate market share at home. Second, part of the Japanese government's strategy for fostering Japanese firms was to exclude foreign firms; foreign firms were eventually able to enter the Japanese market, but the pattern tended to be that only one or a few foreign firms became successful alongside the Japanese competitors dominating the market. Third, as technology began to evolve more quickly, the early dominance of Japanese firms was undermined; foreign firms emerged as leaders in establishing international standards and became more successful in the Japanese market. As a result, Japanese firms found themselves in the position of standard takers instead of standard makers, and in political battles, they were recruited by key foreign multinationals to bolster various sides of major debates over ICT policy.

In the 1960s, Japan emerged as a major innovator in industrial technology and established itself as a leading producer of consumer electronics. Japan had strong capabilities in consumer electronics, which allowed it to become a key exporter of products such as telecommunications equipment. Given the importance of high technology industries, the Japanese government made special efforts to nurture these sectors domestically; Japanese firms were subject to a great deal of state intervention, which meant that they were often encouraged to cooperate with other Japanese companies in order to facilitate national competitiveness in these key sectors. State guidance and support was effective in the catch-up phase of these industries; during this phase, the technological trajectory was clear, products could be imitated, and there was a strong consensus about how to use an industry to promote national development.<sup>332</sup> However, as technological change began to speed up in these sectors in the 1980s and 1990s, goals and

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<sup>332</sup> See Marie Anghel, *Reprogramming Japan: The High Tech Crisis under Communitarian Capitalism* (Ithaca: Cornell University Press, 2005).

appropriate methods became less clear. State guidance became less effective and had the effect of inhibiting the competitiveness of Japanese firms in some cases.

For example, in the area of computers, Japan was well behind the US in the 1960s. The US had the advantage of being able to build on the foundation of IBM's dominant position in the sector. In order to catch up, the Japanese government launched a national program designed to foster the Japanese computer industry, setting up tariffs, import quotas, and restrictions on foreign investment and offering subsidies, low interest loans, and loan guarantees to domestic companies.<sup>333</sup> IBM had been an early entrant to the Japanese market, and it sought permission from the Ministry of International Trade and Industry (MITI) to become Japan's first local producer of computers. However, in exchange for giving IBM limited market access, MITI negotiated the acquisition of IBM's patents on behalf of Japanese industry, ensuring that Japanese companies did not bid up the price by competing with one another to obtain them. MITI then gave the patents to Fujitsu, Hitachi, NEC, Mitsubishi, Toshiba, Oki, and Matsushita, which began producing computers commercially.<sup>334</sup> While MITI protected these Japanese firms, it also encouraged vigorous competition among them. It promoted the sector, ensuring a domestic market by encouraging Japanese companies and government departments to buy Japanese machines. Cooperative projects allowed firms to combine their resources, coordinate problem-solving efforts, and share risk. Government financing also overcame the difficulties associated with high R&D costs.

The US continually pressured Japan to open up its computer market during this time, and in 1971, the Japanese government agreed to liberalize the industry by the end of 1975.<sup>335</sup> IBM gained early concessions from the Japanese government, so it was able to retain its number one share of the Japanese market well into the 1970s. After liberalization of the sector, it continued to rank among the top two or three suppliers in the market for some time; few other foreign corporations were able to gain similar market positions.<sup>336</sup> By the mid-1970s, Japanese companies were making headway in catching up with IBM, partly due to alliances with foreign firms such as Amdahl and Honeywell. The Japanese computer market was largely dominated by Japanese firms, with the exception of IBM. Japanese firms were slow to move from super computers to personal computers; while large Japanese firms such as NEC and Fujitsu also dominated this new product market, IBM remained a player, and globally successful foreign firms such as Dell and Hewlett-Packard were also able to make some headway in the Japanese market. Table 6.1 shows the top five personal computer markers ranked by their share of the Japanese market over the period from 1985 to 2014.

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<sup>333</sup> *Computers, Inc: Japan's Challenge to IBM* (Cambridge: Harvard University Press, 1989); Ken Coates and Carin Holroyd, *Japan and the Internet Revolution* (Houndsmills: Palgrave Macmillan, 2003).

<sup>334</sup> Matsushita withdrew a few years later, leaving only five major firms.

<sup>335</sup> See Coates and Holroyd, *Japan and the Internet Revolution*. In preparation for this transition, MITI pressured the Japanese computer companies to merge into three groups: large computers (Fujitsu, Hitachi), medium-sized computers (NEC, Toshiba), and small, specialized use computers (Mitsubishi, Oki).

<sup>336</sup> Dennis Encarnation and Mark Mason, "Neither MITI nor America: The Political Economic of Capital Liberalization in Japan," *International Organization* 44 (1990).

Table 6.1 Top Five PC Manufacturers by Market Share in Japan (1985-2014)<sup>337</sup>

Rank	1985		1995		2005		2014	
1	NEC	51.3	NEC	43.3	NEC	20.6	NEC*	27.6
2	Fujitsu	15.2	Fujitsu	20.8	Fujitsu	17.9	Fujitsu	18.4
3	IBM	7.0	Apple	12.5	Dell	12.3	Toshiba	12.9
4	Toshiba	6.5	IBM	10.3	Toshiba	9.1	Dell	11.0
5	Seiko	6.2	Toshiba	5.5	HP	6.7	HP	10.8
	All Others	13.8	All Others	7.6	All Others	33.4	All Others	19.3

\*NEC and Lenovo formed a joint venture to produce PCs in 2011

However, when one compares Japanese domestic market share with world market share, it becomes apparent that the major Japanese firms were not globally competitive. For example, in 2013, the top five firms by market share in personal computers were Lenovo (headquartered in China, 17.1 percent), Hewlett-Packard (US, 16.6 percent), Dell (US, 12.0 percent), Acer (Taiwan, 7.8 percent), and Asus (Taiwan, 6.1 percent). The top ranking Japanese companies in terms of global market share were Toshiba (4.6 percent), Sony (2.0 percent), and Fujitsu (1.7 percent).<sup>338</sup>

Japan similarly failed to produce internationally dominant firms in the area of software, despite significant effort by the Japanese government to cultivate this industry. As it had in the case of hardware, the Japanese government again promoted large firms with close government and *keiretsu* ties such as NEC, Fujitsu, and Hitachi. However, these large government-backed firms did not produce the innovations necessary to establish their products as industry standards as an early date; instead, foreign firms such as Microsoft, IBM, Oracle, SAP, Ericsson, Symantec, HP, EMC, CA Technologies, Adobe, and others emerged as leaders in this industry. As users of these firms' software have increased, the products have become more dominant as standards, and their makers have accrued large network externalities. In contrast, Japanese software firms have been successful domestically, but their dominance is based on proprietary systems that have failed to gain a widespread user base internationally.<sup>339</sup> As in the case of computer hardware, the Japanese government sought to keep foreign software firms out of the Japanese market for as long as possible, with the result that not all of the major foreign software firms have found a major foothold in the Japanese market. In recent years, a few foreign firms have made some headway, as shown in Figure 6.1. However, the major Japanese firms initially promoted by the Japanese government remain dominant in their domestic market.

<sup>337</sup> Compiled from Nihon Keizai Shimbun, *Shijou Senyuuritsu [Handbook of Market Shares]* (Tokyo: Nihon Keizai Shimbun, 1987); *Shijou Senyuuritsu [Handbook of Market Shares]* (Tokyo: Nihon Keizai Shimbun, 1997); *Shijou Senyuuritsu [Handbook of Market Shares]* (Tokyo: Nihon Keizai Shimbun, 2007); *Nikkei Gyoukai Chizu [Nikkei Industry Map]* (Tokyo: Nikkei Keizai Shimbun, 2016).

<sup>338</sup> *Nikkei Gyoukai Chizu [Nikkei Industry Map]* (Tokyo: Nikkei Keizai Shimbun, 2015). NEC gained US\$230 million of shares in Chinese computer maker Lenovo in 2011 when it agreed to form a joint venture to sell PCs in Japan, but it did not hold a large share of global PC sales independent of Lenovo.

<sup>339</sup> Anchordoguy, *Reprogramming Japan: The High Tech Crisis under Communitarian Capitalism*.

Figure 6.1 Top 20 Software Firms in Japan Ranked by Domestic Sales (2007-2013)<sup>340</sup>

Rank	2007	2008	2009	2010	2011	2012	2013
1	NTT	NTT	NTT	NTT	NTT	NTT	NTT
2	Microsoft	Microsoft	Microsoft	Microsoft	Microsoft	Microsoft	Microsoft
3	NTT	NTT	NTT	NTT	Hitachi	Hitachi	Hitachi
4	Unisys	Unisys	Mizuho	Hitachi	NTT	SCSK	Hitachi
5	Mizuho	Toshiba	Unisys	Mizuho	SCSK	NTT	SCSK
6	Hitachi	Mizuho	Toshiba	Unisys	Unisys	Unisys	Mizuho
7	NSSOL	Hitachi	NSSOL	Toshiba	TIS	Fujitsu	Fujitsu
8	NEC	NSSOL	Hitachi	NSSOL	Mizuho	NSSOL	NEC
9	Hitachi	NEC	SCSK	SCSK	Toshiba	Mizuho	NTT
10	SCSK	SCSK	Oracle	Oracle	NSSOL	TIS	Unisys
11	NEC	NEC	NEC	NEC	Fujitsu	Oracle	NSSOL
12	Oracle	Hitachi	NEC	Uniadex	Oracle	Toshiba	Oracle
13	Intech	Oracle	Intech	TIS	NEC	Fujitsu	TIS
14	TIS	TIS	Uniadex	Kyocera	Intech	NEC	Toshiba
15	NEC	NEC	TIS	NEC	NEC	Uniadex	Fujitsu
16	Uniadex	Intech	NEC	Fujitsu	Uniadex	NEC	NEC
17	Fujitsu	Uniadex	Kyocera	Mitsubishi	NEC	Intech	Uniadex
18	CSK	Fujitsu	Fujitsu	Nissei	Kyocera	IBM	Intech
19	Mitsubishi	Mitsubishi	Nissei	SAP	Fujitsu	Hitachi	NEC
20	SAP	SAP	Hitachi	Toshiba	SAP	NEC	IBM

Considering the dominance of Japanese software firms at home, it is striking that almost no software for Japanese computers is sold abroad. According to a 2013 ranking of global software companies by revenue compiled by the International Data Corporation (IDC), only three Japanese software firms ranked in the top 100. Based predominantly on their dominance in the Japanese market, Fujitsu, Hitachi, and NEC ranked 12th, 20th, and 26th respectively.<sup>341</sup>

Another example of the government-led Japanese strategy in high tech can be seen in the telecommunications sector. Government influence was initially channeled through Nippon Telegraph and Telephone (NTT), a monopoly government-owned corporation established in 1952. In the catch-up phase of this sector, the country's goal was clearly to build a strong communications infrastructure in Japan. NTT was very effective at achieving this aim, but by the early 1980s, it was clear that NTT's dominance was having negative consequences for Japanese firms' ability to compete in an open market. Similar to the case of computers, changing technological, political, and economic conditions led to a decline in the effectiveness of the government-led approach in the telecommunications industry. A confluence of domestic and US pressure for change led to the partial privatization of NTT in 1985, opening up space for some competition. The reform meant that some of NTT's power was shifted to the Ministry of Posts and Telecommunications (MPT), which gained enhanced regulatory authority over pricing and new market entrants. Thus, deregulation looked something more akin to reregulation.<sup>342</sup> MPT generally used its discretion to protect established firms that would follow the ministry's lead and to prevent smaller companies from entering the sector, resulting in a slow, managed shift

<sup>340</sup> Compiled from first quarter reports from Teikoku Databank, *TDB Gyoukai Doukou [TDB Industry Trends]*.

<sup>341</sup> Pricewaterhouse Coopers, *PwC Global 100 Software Leaders (2013)*.

<sup>342</sup> Vogel, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries*.

toward greater competition.<sup>343</sup> Consequently, although Japanese firms benefited from NTT's privatization, not all benefited equally.

Some foreign firms such as Northern Telecom of Canada managed to sell equipment to NTT, but the gains by foreign firms were somewhat limited until Japan removed all foreign investment limitations on Type I carriers in 1998, which paved the way for a burst of foreign direct investment. Cable & Wireless took over International Data Communications in 1999 and British Telecom and AT&T acquired Japan Telecom (J-Phone). BT and AT&T later sold their share in J-Phone to Vodafone. Both Cable & Wireless and Vodafone withdrew from Japan, selling their operations to Softbank in 2004 and 2006 respectively.<sup>344</sup> These foreign firms were unable to compete with the sophisticated and highly specialized products that Japanese firms had developed specifically for the Japanese market. Since that time there have been no foreign phone companies with significant operations in the Japanese market. However, on the mobile handset front, Apple found success in the early 2010s with its iPhone, grabbing 40.7 percent of the mobile phone market share by 2014 and disrupting the control of Japanese manufacturers. Table 6.2 below shows the dominance of Japanese companies until 2010, and Apple's dramatic increase in market share in recent years.

Table 6.2 Top Five Mobile Phone Manufacturers by Market Share in Japan (2000-2014)<sup>345</sup>

Rank	2000		2005		2010		2014	
1	Matsushita	26.0	Panasonic	16.1	Sharp	22.8	Apple	40.7
2	NEC	23.4	NEC	15.6	Fujitsu	17.3	Sharp	13.4
3	Mitsubishi	14.7	Sharp	15.2	Panasonic	11.7	Sony	11.2
4	Sharp	8.9	Toshiba	10.8	NEC	10.7	Kyocera	11.1
5	Sony	7.3	Sanyo	9.8	Kyocera	10.4	Fujitsu	7.3
	All Others	19.7	All Others	32.5	All Others	27.0	All Others	16.3

Again, considering the dominance of Japanese mobile phone firms at home, their weakness in the global market is striking. The top five companies in the mobile phone market internationally in 2014 were Samsung, Microsoft (due to its acquisition of Nokia), Apple, Lenovo, and Huawei.<sup>346</sup>

As in the computer hardware and software industries, the government-led development strategy had lasting consequences for the telecommunications sector. Politics and regulatory structures in Japan shaped a specific set of competitive dynamics, which in turn shaped the choices of technology, standards, and corporate strategies that ended up isolating Japan's telecommunications market from global market.<sup>347</sup> Specifically, in the case of telecommunications, the vast resources of NTT enabled it to set a technological trajectory for Japanese manufacturers, while the political strength of MPT enabled the government to shape markets and influence Japanese firms' decisions. In concrete terms, these dynamics meant that NTT and the Japanese government took the lead in establishing standards. However, the

<sup>343</sup> Anchoroguy, *Reprogramming Japan: The High Tech Crisis under Communitarian Capitalism*.

<sup>344</sup> Paprzycki and Fukao, *Foreign Direct Investment in Japan: Multinationals' Role in Growth and Globalization*.

<sup>345</sup> Compiled from Nihon Keizai Shimbun, *Shijou Senyuuritsu [Handbook of Market Shares]* (Tokyo: Nihon Keizai Shimbun, 2002); *Shijou Senyuuritsu [Handbook of Market Shares]*; *Nikkei Shea Chousa [Nikkei Market Share Investigation]* (Tokyo: Nihon Keizai Shimbun, 2012); *Nikkei Gyoukai Chizu [Nikkei Industry Map]*.

<sup>346</sup> *Nikkei Gyoukai Chizu [Nikkei Industry Map]*.

<sup>347</sup> Kenji Kushida, "Leading without Followers: How Politics and Market Dynamics Trapped Innovations in Japan's Domestic "Galapagos" Telecommunications Sector," *Journal of Industry, Competition and Trade* 11 (2011).

standards that they chose did not end up becoming globally dominant; the institutional rigidity of these actors prevented them from responding quickly and more effectively to shifts in technology. At the same time, dominant Japanese firms such as NEC and Fujitsu were largely passive in the process of standard setting, content to follow NTT's technological lead.<sup>348</sup>

While Japanese firms were focusing on their domestic market, the global economy was beginning to change in ways that undermined the competitive advantage of Japanese business models, which traditionally relied on integral production and long-term relationships to foster incremental advances in production processes.<sup>349</sup> As mentioned earlier in this chapter, the decomposition of production associated with the "Wintel" era meant that integrated electronics firms such as AT&T or IBM no longer controlled technological standards; instead, control was shared with downstream suppliers. Integrated production became a liability for Japanese firms, making them slow to capture the benefits of modular production or the innovative potential of independent start-ups. The decomposition of production also propelled a shift toward more open architecture, which clashed with Japanese producers' preference for proprietary technology. Moreover, the integration of service functions into manufacturing fueled by ICT developments meant that Japan's weakness in services undermined its manufacturing prowess. In markets such as digital cellular handsets, ICT-related electronics, mobile Internet content, and high-speed broadband, Japanese firms lost their early global advantage and end up pursuing Japanese domestic market share to develop products of decreasing appeal to international audiences.<sup>350</sup> Although global demand for communications equipment expanded dramatically in the 1990s, Japan's share of telecommunications exports shrunk, and Japan was largely absent from the emergent Internet network equipment sector.<sup>351</sup> Japanese firms also failed to challenge global leaders in software and services.

In addition, while Japanese firms were leaders in network technologies and infrastructure in the 1980s and early 1990s, they were blindsided by the arrival of the Internet. Their habit of following the government's lead caused Japanese firms to be slow in the adoption of key standards such as TCP/IP and Ethernet, which later became the underlying basis for most international product markets. Through the late 1990s, high prices for Internet access and leased lines marked Japan as an outlier among OECD countries. However, although Japan managed again to catch up and develop some of the world's most advanced landline and mobile broadband networks, Japanese firms have still not emerged as leaders in IT-related innovations.<sup>352</sup>

Moreover, portions of Japanese telecommunications and tech sectors became decoupled from global markets, resulting in a situation where Japanese firms' decision to pursue domestic market share led to the development of technologies and products that were less and less relevant

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<sup>348</sup> Robert Cole, "Telecommunications Competition in World Markets: Understanding Japan's Decline," in *How Revolutionary Was the Digital Revolution? National Responses, Market Transitions, and Global Technology*, ed. John Zysman and Abraham Newman (Stanford: Stanford University Press, 2006).

<sup>349</sup> Steven Vogel, "Japan's Information Technology Challenge," in *The Third Globalization: Can Wealthy Nations Stay Rich in the Twenty-First Century?*, ed. Dan Breznitz and John Zysman (Oxford: Oxford University Press, 2013).

<sup>350</sup> Kushida, "Leading without Followers: How Politics and Market Dynamics Trapped Innovations in Japan's Domestic "Galapagos" Telecommunications Sector."

<sup>351</sup> Cole, "Telecommunications Competition in World Markets: Understanding Japan's Decline."

<sup>352</sup> Kenji Kushida, "Governing ICT Networks Versus Governing the Information Economy: How Japan Discovered the Dilemma of Winning in the ICT Infrastructure Race," in *Information Governance in Japan: Towards a New Comparative Paradigm*, ed. Kenji Kushida, Yuko Kasuya, and Eiji Kawabata (Stanford: Stanford Silicon Valley - New Japan Project, 2016).

to the global market. While Japanese product markets were often very advanced and sophisticated, they were simply unlike those anywhere else in the world.<sup>353</sup> As firms became more accomplished in the capabilities necessary to meet the demands of Japanese markets, they experienced declines in other capabilities that would have allowed them to pursue different directions.<sup>354</sup> For example, in the case of mobile phones, handsets that could access the Internet were in use more than a decade before similar technology became commonplace in the United States, yet Apple's iPhone was the handset that became globally dominant instead of an offering from a Japanese firm. This was in large part due to an important decision made in 1993 by NTT to adopt a closed digital standard known as personal digital cellular (PDC); PDC was adopted only by Japan, while the European-driven GSM was adopted by 120 countries by the end of 1998.<sup>355</sup> While NTT dominated the standard-setting process in Japan, the GSM standard-setting process involved broad participation by a number of nations. The narrow focus of Japanese actors on dominating the domestic sector meant that they missed an opportunity to cultivate a more widely accepted standard that might have facilitated easier entry of Japanese projects into the international market.

To sum up, efforts by the Japanese government to foster leading firms in areas such as computers and telecommunications equipment were successful to some extent; however, Japanese ICT firms often wound up dominant at home but peripheral to international markets. This sidelining of Japanese firms was due to a number of different reasons. First, in some cases, government-driven development let Japanese firms to be more reactive than proactive to technological changes, with the consequence that many did not rise to occupy leading positions as innovators in their markets. Second, some Japanese firms were highly innovative, as in the case of the mobile phone industry, but due to the interaction of political and economic environments, these firms ended up producing sophisticated products that were not marketable outside of Japan due to incompatibility with international standards or tastes. Third, both the Japanese government and Japanese firms reacted slowly to the development of the Internet, which set Japan behind in key areas of the ICT sector.

Japanese firms succeeded in developing highly sophisticated technologies, but their inability to market these technologies abroad meant that these firms were unable to become major global players in their own industries. The loss of first mover advantage in many technological product markets sidelined Japanese firms both economically and politically. This meant that foreign (often American) firms were the ones to become dominant in ICT product markets; this economic influence in turn meant that foreign firms were also the ones with the incentive and clout to become dominant players in influencing international policymaking around ICT issues. Due to their narrow focus on the particularistic Japanese domestic market, Japanese firms were peripheral to many of the battles over standards, regulations, and laws being waged around the globe. When Japanese firms did become involved in such battles, it was often a reaction to developments brought to their doorstep. This is in stark contrast to the very proactive role that foreign firms such as Microsoft, Google, and Apple came to play internationally.

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<sup>353</sup> Benjamin Hentschel, "Mobile Consumers and Consumption in Japan," in *Japanese Consumer Dynamics*, ed. Parissa Haghirian (London: Palgrave Macmillan UK, 2011).

<sup>354</sup> Giovanni Dosi, "Technological Paradigms and Technological Trajectories," *Research Policy* 11 (1982).

<sup>355</sup> Jeffrey Funk, *Global Competition between and within Standards: The Case of Mobile Phones* (Houndsmills: Palgrave, 2002).

Despite early disadvantages, the major foreign ICT firms have begun to gain significant market share in many ICT products in Japan. For example, by 2014, Apple had gained 40.7 percent of the mobile phone market in Japan, 43.9 percent of the tablet market, 5.8 percent of the personal computer market.<sup>356</sup> Apple also had 40.8 percent of the mobile music player market in 2012. Google had 11.4 percent of the search engine market in 2012, and 57.5 percent of the video website market through YouTube.<sup>357</sup> Microsoft had the second highest sales in the Japanese software market in 2014, while Unisys, Oracle, and IBM ranked 10th, 12th, and 20th respectively.<sup>358</sup> Still, the Japanese market often remained dominated by Japanese firms that were not competitive globally, as illustrated by the data presented in this section.

### 6.3 The Political Landscape

In this chapter, I highlight the ways that cross-national coalitions between foreign and Japanese firms are actively connecting Japanese domestic political battles with larger global policy debates. In order to highlight this dynamic, the two cases studies in this chapter focus on privacy and intellectual property rights, two broad debates that have important consequences for the ICT sector. In this section, I provide a brief overview here of the actors involved specifically in debates over intellectual property (specifically copyright terms) and privacy. These two debates are the focus of the subsequent two case studies. The key actors involved are government agencies, firms, and civil society actors from Japan, the United States, and Europe.

The organizational structure of the Japanese government was designed for pre-Internet telecommunications structures, so regulatory and policy authority is disbursed across a number of ministries and agencies, particularly when a complex issue like copyright is involved. The IP Strategy Headquarters and the IT Strategy Headquarters in the Cabinet Secretariat are responsible for national IP and ICT policy, but most policy and regulatory functions for telecommunications and broadcasting are under the Ministry of Internal Affairs and Communications (MIC). The Ministry of Economy, Trade and Industry (METI) is responsible for ICT hardware and software, and as discussed previously, has traditionally played a role in promoting Japanese high tech industries. Copyright policy is generally under the jurisdiction of the Cultural Affairs Agency, which is part of the Ministry of Education, Culture, Sports, Science and Technology (MEXT). In contrast to METI, MEXT was not historically focused on Japan's international industrial competitiveness and was consequently less inclined to listen to the wishes of business and industry associations.<sup>359</sup> The Japan Fair Trade Commission plays a role in regulating the ICT marketplace in the areas of platform and content services. The delegation of regulation authority between ministries over privacy, security, and data portability has been very ambiguous. Due to the accelerated pace of technological change and the fact that Japanese industries are no longer in a catch-up phase, Japanese government actors have become less adept at dealing with shifts in both technology and technology-related policy. In many areas, the influence of government ministries has decreased as Japanese firms have become more

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<sup>356</sup> *Nikkei Gyoukai Chizu [Nikkei Industry Map]* (Tokyo: Nihon Keizai Shimbun, 2016)

<sup>357</sup> *Nikkei Shea Chousa [Nikkei Market Share Investigation]* (Tokyo: Nihon Keizai Shimbun, 2012).

<sup>358</sup> *TDB Sangyou Doukou [TDB Industry Trends]* (Tokyo: Teikoku Databank, 2015).

<sup>359</sup> Kenji Kushida and John Zysman, "The Services Transformation and Network Policy: The New Logic of Value Creation," *Review of Policy Research* 26, no. 1-2 (2009).



independent and as international pressure for liberalization has led to the opening of Japanese markets.

In terms of business lobbying over copyright extension, the battle lines have been drawn between firms that produce content and firms that see themselves primarily as distribution platforms. The coalition on the side of extending copyright terms consists of firms engaged in content creation and their associated industry associations in both the US and Japan. These firms wish to eliminate the unauthorized use of their intellectual property in order to maximize the value of each product. In the US, the most powerful proponent of strong copyright protection has been the film industry, which is dominated by six Hollywood studios based in Los Angeles (Disney, Fox, Paramount, Sony Pictures, Universal, and Warner Bros). Today, these six studios account for over 90 percent of revenues in the US film industry, which continues to consolidate. The six studios are divisions of a broader media oligopoly made up of five firms (Bertelsmann, News Corporation, Time Warner, Viacom, and Walt Disney), which are supplemented by other firms through co-financing deals, strategic alliances, and interlocking directorates.<sup>360</sup> Together these firms control the most lucrative domains of media and entertainment in the US and increasingly in Europe, as well as emerging markets across Asia and Latin America. In addition to the film industry, American and European software firms such as Microsoft, IBM, Oracle, and SAP dominate the global market for software, making them leading proponents of increased IP protection.<sup>361</sup> The music industry (Universal/Polygram, SonyBMG, Warner Music Group, EMI) and the book publishing industry also have an interest in strong copyright protection; while the former is successful in marketing its products in Japan, most foreign publishers have a limited presence in Japan due to the limited appeal of foreign language books.

These industries have parallels in Japan. For example, the Recording Industry Association of Japan (RIAJ) has pushed for stronger copyright protections in Japan, particularly with reference to imposing penalties for illegal music downloads, while the Motion Picture Producers Association of Japan (MPPAJ) has similar concerns for films. Japanese Society for Rights of Authors, Composers, and Publishers (JASRAC) successfully lobbied MEXT to ban the illegal uploading of copyrighted content in 2010. The Japan Writers' Association also favors stronger copyright protections.

On the opposing side of industry, Internet companies such as Google, open source companies such as Red Hat, and many tech startups favor less restrictive copyright and patent rules. The most avid private sector proponents for fair use have been platform companies. Intermediary companies that provide storage, navigation, and delivery of the digital content of others are working to establish a long-term position in a fluctuating economic, legal, and cultural environment. These companies have attempted to brand themselves as "platforms" in order to emphasize their role as purveyors and not creators of content.<sup>362</sup> Firms like Google, Facebook, Pinterest, Twitter, and YouTube process millions of requests from content creators to take down copyrighted content per month.<sup>363</sup> Google in particular has been an active proponent codifying fair use as a concept; fair use underlines much of its business model and functionality from its

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<sup>360</sup> Andrew Currah, "Hollywood Versus the Internet: The Media and Entertainment Industries in a Digital and Networked Economy," *Journal of Economic Geography* 6 (2006); Ben Bagdikian, *The New Media Monopoly* (Boston: Beacon Press, 2004).

<sup>361</sup> Kenneth Shadlen, Andrew Schrank, and Marcus Kurtz, "The Political Economy of Intellectual Property Protection: The Case of Software," *International Studies Quarterly* 49 (2005).

<sup>362</sup> Tarleton Gillespie, "The Politics of 'Platforms'," *New Media & Society* 12, no. 3 (2010).

<sup>363</sup> Mike Masnick, "MPAA: Millions of DMCA Takedowns Proves That Google Needs to Stop Piracy," *Techdirt*, 17 December 2012.

search engine to its video service, YouTube. Google has faced many challenges in copyright law outside of the United States, which has prompted it to greatly expand its lobbying offices both inside and outside the US to advocate for fair use internationally.<sup>364</sup> Other firms such as Yahoo (and Yahoo Japan, a joint venture with Softbank), and Amazon have similar positions on fair use. Divisions between American firms on issues of fair use have made it difficult for organizations such as the American Chamber of Commerce in Japan (ACCJ) to advocate for a unified American business position. The Japanese firm Rakuten also supports fair use to some extent.

Turning to civil society actors involved in the copyright debate, there is a diffuse coalition of American and transnational civil society actors that favor fair use, including organizations such as the Electronic Frontier Foundation, Creative Commons, and the Wikimedia Foundation. These organizations have been successful in framing the issue in terms of copyright protections encroaching on and undermining the creativity of individuals and collaborative efforts. They have been able to target the growing number of “user-producers” active on the Internet and in other forms of media.<sup>365</sup>

Japanese civil society groups such as Creative Commons Japan, MIAU, and thinkC have also been active in this debate; there is a vibrant community of amateur creators in Japan who want to be able to use copyrighted material for things like fan art, fan videos, fan fiction, and doujinshi. Doujinshi are comics where authors take characters and background elements from manga, anime, or video games and develop them with a different storyline, eventually selling these comics for a profit. Although these activities might seem trivial, works by “mini-creators” who get their inspiration from copyrighted material constitute an increasingly large grey zone for copyright law.<sup>366</sup> Approximately 35,000 creators sell their wares at Comiket, an annual doujinshi fair held in Tokyo, and 590,000 people attended in 2013. The online digital archive Aozora Bunko, which digitizes Japanese books that are out of copyright in a fashion similar to Google Books, is also in favor of strong fair use provisions. Foreign firms such as Google have been able to form alliances with these Japanese civil society actors to advocate fair use.

In the case of privacy, firms with significant information assets view data as a private good, supporting policies that constrain information access and distribution. Major Japanese ICT companies with oligopolistic positions in their markets initially took this position. Firms with few private information assets operate in a network effects economy and therefore benefit from policies that promote a liberal data environment.<sup>367</sup> This group of firms includes major foreign multinationals such as IBM, HP, Dell, SAP, Teradata, Oracle, SAS Institute, Palantir, Accenture, PricewaterhouseCoopers, Cisco, Microsoft, Amazon, and Google.<sup>368</sup> Japanese firms such as Fujitsu, NEC, and Hitachi have also increasingly come to see data as the future of their businesses and have come around to this stance.

Other advocates of comprehensive and strong privacy protections include academics and government actors from EU countries. Privacy policy has important implications for individual freedom and the power of the state. Personal information can be used and abused for the

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<sup>364</sup> Decherney, "Fair Use Goes Global."

<sup>365</sup> Leonhard Dobusch and Sigrid Quack, "Framing Standards, Mobilizing Users: Copyright Versus Fair Use in Transnational Regulation," *Review of International Political Economy* 20, no. 1 (2013).

<sup>366</sup> Nobuko Kawashima, "The Rise of 'User Creativity': Web 2.0 and a New Challenge for Copyright Law and Cultural Policy," *International Journal of Cultural Policy* 16, no. 3 (2010).

<sup>367</sup> Abraham Newman, "What You Want Depends on What You Know: Firm Preferences in an Information Age," *Comparative Political Studies* 43, no. 10 (2010).

<sup>368</sup> Jeff Kelly, "Big Data Vendor Revenue and Market Forecast 2013-2017," *Wikibon*, 12 February 2014.

purposes of surveillance by the state, and the customization enabled by big data can also be utilized negatively for discriminatory purposes. These and other concerns have prompted members of the academic community in countries around the world to express strong reservations about laws that would ease the collection and transmission of personal data. As mentioned previously, the countries of the European Union have adopted particularly strong comprehensive privacy legislation, and government actors from these countries have been involved in pushing other countries to adopt similar legislation.<sup>369</sup>

#### 6.4 Copyright Term Extension in the Trans-Pacific Partnership

As described earlier in this chapter, copyright issues became the focus of international attention in the 1990s and 2000s; however, they did not come to a head in Japan until it decided to join the negotiations for the Trans-Pacific Partnership in 2013. Trade agreements like TPP are not just tools for easing the movement of goods across borders; their inclusion of sophisticated elements such as intellectual property rights mean that they are increasingly considered to be instruments of supranational economic regulation. In the case of copyright issues, foreign firms in Japan were divided over the issue of strict copyright protection versus a doctrine of fair use. While content creators such as the foreign film, software, music, and book publishing industries favored the former, foreign platform companies tended to favor the latter. In this section, I demonstrate that the evolving nature of this debate led to the formation of competing cross-national coalitions. Foreign proponents of strict copyright protection found allies in Japanese content creators, while foreign advocates of fair use formed coalitions with the Japanese academic and creative communities. TPP provided a focal point for lobbying efforts by the foreign and Japanese content industries that culminated in a turning point for Japanese copyright law. The power of the US government in the TPP negotiating context gave the content industry firms the leverage they needed to change the status quo, resulting in a significant extension in copyright protection from 50 to 70 years after an author's death.

Unlike some of the other issue areas described in this dissertation, Japan's policies toward copyright have largely been in line with international standards. Japan has had copyright statutes in place since 1899, when it enacted the Copyright Act incorporating the basic principles of the Berne Convention for the Protection of Literary and Artistic Works of 1886; the current Copyright Act superseded the original piece of legislation in 1971. Japan also ratified the Berne Convention Paris Act in 1975 and acceded to the Rome Convention in 1989. In 1995, Japan became party to the TRIPS Agreement. After making extensive amendments to the Copyright Act, it acceded to the WIPO Internet Treaties (i.e., the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty), which took effect in 2002. Like other signatories to the Berne Convention, Japanese law dictated copyright term to be life of the author plus 50 years.

With regard to copyright terms, the US is an outlier, embracing a significantly longer copyright term of life of the author plus 70 years; the US has tried to push other countries to adopt this standard in order to gradually establish it as the global norm. Japan repeatedly considered and rejected proposals to extend its copyright term by 20 years to match the standard in the US. The Japanese Society for the Rights of Authors, Composers and Publishers (JASRAC) had long lobbied for the extension.<sup>370</sup> However, these proposals were rejected on the grounds

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<sup>369</sup> Newman, *Protectors of Privacy: Regulating Personal Data in the Global Economy*.

<sup>370</sup> Eric Johnston, "Farmers Stealing TPP Spotlight from Other Key Issues," *The Japan Times*, 22 July 2013.

that such a change would not benefit Japanese producers.<sup>371</sup> Until the late 2000s, unauthorized copying was not even a legal issue in Japan. Unauthorized uploading of copyrighted content did not become illegal until 2009. In 2010, MEXT passed an amendment making unauthorized downloads illegal as well, due to heavy lobbying by JASRAC.<sup>372</sup> In June 2012, the Japanese government passed a new copyright bill that enacted criminal penalties for downloading, uploading, and simply viewing copyrighted materials.

When the Japanese government decided to join the negotiations for the Trans-Pacific Partnership, it knew that extended copyright terms would be on the American list of demands. The US had advocated for the inclusion of IP protections from the earliest days of its involvement with TPP's predecessor, the Pacific 4 (P4). The US sought to craft a high-quality regional trade agreement in Asia that would include substantially all trade and also deal with complex issues such as intellectual property; the US perceived that other potential Asian FTAs such as the China-led Regional Comprehensive Economic Partnership (RCEP) were likely to exclude sensitive sectors such as agriculture and would almost certainly avoid tackling IP. American government officials felt that they had to act to establish the regional rules for IP before other actors such as China with an interest in weak IP protections did so. Throughout his advocacy for TPP, US President Barack Obama made statements to the effect that the US "can't let countries like China write the rules of the global economy."<sup>373</sup> By the time that Japan joined the negotiations, it had become clear that TPP would incorporate a broader scope of protections than TRIPS.

When Japan joined the TPP negotiations, the domestic politics of Japanese copyright policy became intertwined with the politics of the US, producing competing cross-national coalitions that fought to influence regulations. Copyright issues were a major source of contention in Japan. Copyright-related groups based in Japan supported TPP, seeing it as an opportunity to extend and standardize the copyright protection period in Japan and welcoming the introduction of a statutory damages system.<sup>374</sup> These groups included the Japanese Society for Rights of Authors, Composers, and Publishers, the Recording Industry Association of Japan, the Motion Picture Producers Association of Japan, and the Japan Writers' Association.

For the most part, the provisions sought by USTR in TPP negotiations mirrored American law, but there were some important exceptions. When it came to provisions of US law that were favorable to rights holders, American negotiators sought to require other countries to adhere to US law in great detail; however, with regard to limiting copyright or patent holders' rights, the language favored by the US was more abstract and open-ended. For example, the broad concept of fair use enshrined in US copyright law was not included in initial TPP proposals; the language merely stated that nations "shall endeavor to achieve an appropriate balance" in their copyright systems by adopting "limitations or exceptions" such as a right to

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<sup>371</sup> Martin Frid, "Japan and the US Align on TPP Provisions That Harm Japanese Creators," *Electronic Frontier Foundation*, 12 August 2015.

<sup>372</sup> "Japanese Panel Pushes Ban on Illegal Downloads Forward," *Anime News Network*, 20 December 2007.

<sup>373</sup> "Statement by the President on the Trans-Pacific Partnership," <https://www.whitehouse.gov/the-press-office/2015/10/05/statement-president-trans-pacific-partnership>.

<<https://www.whitehouse.gov/the-press-office/2015/10/05/statement-president-trans-pacific-partnership>>

<sup>374</sup> Aurelia George Mulgan, "To TPP or Not TPP: Interest Groups and Trade Policy," in *The Political Economy of Japanese Trade Policy*, ed. Aurelia George Mulgan and Masayoshi Honma (London: Palgrave Macmillan UK, 2015).

comment and criticism. In some cases, US negotiators proposed TPP language that favored IP protections to an extent that ran contrary to the rulings of American courts.<sup>375</sup>

The divisions among actors in the American technology sector played an important role in shaping the course of US demands in the TPP negotiations. Internet companies such as Google, open source firms such as Red Hat, and many tech startups favor less restrictive copyright and patent rules. The Computer and Communications Industry Association represents these and other firms whose businesses are harmed by broad patent protection and aggressive anti-piracy efforts. However, while a leading US firm such as Google would typically be able to influence the US government, its clout was challenged by opposition from other major American companies. Older, more established companies, especially those that sell packaged software, tend to favor stronger legal protections. The Business Software Alliance (BSA), a software industry group that includes Microsoft, Adobe, and Oracle, has hired former USTR officials, and former USTR officials have also taken jobs at IBM, Microsoft, and Apple. USTR is not as well connected to the portions of the technology sector that favor less extensive copyright and patent protections. Support for strong legal protection from the media and entertainment industries also pushed USTR to adopt a firmer stance on copyright protection.

Copyright posed a sticky issue for the negotiations from the beginning, so it was not until late 2014 that negotiators began to focus their full attention on intellectual property, which appeared to be the last major hurdle to forging an agreement. In February 2014, the entertainment industry pushed the Obama administration not to incorporate “fair use” protections, according to an internal email obtained through the hack of Sony Pictures Entertainment and posted online by WikiLeaks.<sup>376</sup> Counterparts from JASRAC, RIAJ, MPPAJ, and the Japan Writers’ Association simultaneously lobbied the Japanese government to support the copyright term extension.

The majority of the TPP negotiations were conducted secretly, prompting criticisms about lack of transparency; however, leaked information about the agreement led to protests from civil society actors in Japan. In February 2015, a blog post by Japanese copyright lawyer Kensaku Fukui about the TPP’s threats to Japanese Internet users and culture went viral. In March 2015, a group of artists, archivists, academics, and activists joined forces to demand that Japanese negotiators oppose the addition of copyright extension requirements to TPP. Representatives of the Japanese digital rights organizations MIAU, Creative Commons Japan, and thinkC presented a joint statement endorsed by 63 organizations and businesses describing the threats that the TPP’s copyright provisions would pose to Japan’s culture. Creators such as playwright Oriza Hirata, cartoonist Ken Akamatsu, journalist Daisuke Tsuda, and Yu Okubo of the online digital archive Aozora Bunko also spoke out.<sup>377</sup>

The members of this anti-TPP opposition were particularly concerned by a provision that stated that “competent authorities may act upon their own initiative to initiate a legal action without the need for a formal complaint” by the copyright holder. This verbiage led to fears of a major crackdown on derivative works. Without the exceptions provided by an American-style fair use system, in which there are flexibilities for uses based upon the nature, purpose, amount,

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<sup>375</sup> Timothy Lee, "Here's Why Obama Trade Negotiators Push the Interests of Hollywood and Drug Companies," *The Washington Post*, 26 November 2013.

<sup>376</sup> Dana Liebelson, "Leaked Email Reveals How Hollywood Opposed 'Fair Use' Protections in Secretive Trade Agreement," *Huffington Post*, 17 April 2015.

<sup>377</sup> Maira Sutton, "Massive Coalition of Japanese Organizations Campaigns against TPP Copyright Provisions," *Electronic Frontier Foundation*, 17 March 2015.

and effect of the use on the market for the original copyrighted work, Japanese fans could be criminally liable for their work. Critics worried that this would have a huge chilling effect on fan communities in Japan.<sup>378</sup>

Civil society actors in the US expressed similar concerns. Opponents of the copyright term extension argued that pushing the American standard not only angered trading partners but also locked the US itself into a copyright lifespan that it might want to lower someday. Some feared that TPP would go too far in supporting technologies that helped copyright holders prevent piracy and control copying or altering of works, thus chilling free speech and so-called fair use of protected content for research, reporting, and other purposes.

However, these criticisms seemed to have little effect on the TPP negotiations. In April 2015, the American entertainment industry fought to convince Democratic lawmakers to back renewal of fast track for President Obama, seeking to ensure that the copyright provisions they were lobbying to obtain would actually be passed by Congress.<sup>379</sup> In July 2015, developments during the Maui meeting of TPP ministers and negotiators and a recently leaked draft of the IP chapter showed Japanese negotiators moving closer to the US on copyright issues and against explicit protection of the public domain.

These developments motivated Japanese activists to step up their campaigns against the agreement.<sup>380</sup> A coalition of Japanese copyright activists calling themselves the Japan Forum for the Intellectual Property Aspects and Transparency of TPP (thinkTPPIP) presented a petition to the Diet in which 110 groups and 3,637 individuals spoke out against copyright term extension and the new enforcement measures.<sup>381</sup> In August 2015, the Japan Playwrights Association, the Japan Theatrical Producers Association, and the Japan Theatre Arts Association jointly issued an appeal opposing the Japanese government's participation in TPP talks. The groups expressed strong concern that controversial issues on intellectual property rights were being negotiated without any public discussion in Japan and asked the government to hold open debate sessions.<sup>382</sup>

Although complaints by users and creators did not seem to sway the position of US negotiators, in July 2015, some tech companies and policymakers had some success in lobbying to increase the flexibility of the TPP's language on exceptions and limitations to copyright. According to reports, lobbyists representing Google and other members of the Internet Association and lawmakers like Senator Ron Wyden worked behind the scenes to pressure USTR to reopen the text for amendment. Tech companies' renewed pressure prompted USTR to offer to go back and revise these provisions ahead of the last negotiation round. According to a spokesperson for the US Chamber of Commerce, in exchange for support for the controversial Fast Track legislation, the USTR promised to make the TPP's exceptions and limitations language more permissive and be a requirement, rather than being purely a suggestion, for all TPP products.<sup>383</sup> The US entertainment industry was outraged and immediately worked to counter

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<sup>378</sup> Ibid.

<sup>379</sup> Don Lee, "Hollywood Joins Push for Obama's Trans-Pacific Partnership Trade Deal," *Los Angeles Times*, 6 April 2015.

<sup>380</sup> Frid, "Japan and the US Align on TPP Provisions That Harm Japanese Creators."

<sup>381</sup> See <http://thinktppip.jp/?p=792&lang=en>

<sup>382</sup> "Actors and Playwrights Express Opposition to TPP Talks, Urging the Government to Disclose Information on Negotiations Concerning Intellectual Property Rights," *The Japan Agricultural News*, 22 August 2013.

<sup>383</sup> Maira Sutton, "Will Hollywood's Whining Thwart Better TPP Copyright Rules?," *Electronic Frontier Foundation*, 18 August 2015.

the move. They urged members of Congress, including every House member from California, to pressure the USTR not to touch these closed provisions.

The negotiations were completed in October 2015; the final text of the agreement reflected the influence of the US entertainment industry, although there was some language clearly designed to assuage some of the doubts of Google and other proponents of fair use. Copyright terms were extended from 50 years after the life of the author established in TRIPS to 70 years for individuals, and either 95 or 120 years after creation for corporate owned works. Signatory nations were required to pass statutes banning the circumvention of Digital Rights Management software, commonly used to prevent unauthorized access or use of digital goods, and had the option to treat the circumvention of such as a separate offense in addition to any copyright violation. The treaty reiterated a three-step test for fair use of copyrighted material that was included in the TRIPS agreement. The agreement also required all members to enforce the equivalent of the Digital Millennium Copyright Act in regards to its safe harbor provision for Internet service providers, removing the need for judicial notice before takedown requests for copyrighted materials are honored.

While the entertainment industry in the US and Japan praised the agreement, many proponents of fair use were disappointed and angry with the nonbinding exception for education, criticism, news reporting, and accessibility, which countries can choose not to enact in their national laws. The Wikimedia Foundation, whose website Wikipedia thrives on the principle of shared knowledge and includes millions of articles illustrated with public domain images released a press statement saying, “TPP tips the balance in favor of rigid copyright, at the detriment of the public domain we all share.”<sup>384</sup> The Electronic Frontier Foundation saw the extension of the copyright term to life plus 70 years as the biggest overall defeat for users. They judged that it “simply amounts to a transfer of wealth from users to large, rights-holding corporations. The extension will make life more difficult for libraries and archives, for journalists, and for ordinary users seeking to make use of works from long-dead authors that rightfully belong in the public domain.”<sup>385</sup> However, the organization acknowledged that it could have been worse, as earlier drafts had hinted at a 120-year copyright term for corporate works.

The reaction from Japanese civil society, particularly amateur creators, was mixed. A summary of the pact released by the Japanese government in October 2015 confirmed that copyright violations would be prosecutable even if the owner does not press charges. For example, even if a manga’s creator does not press charges against any doujinshi made and sold of his or her work, authorities can still charge those creating them. After the conclusion of the negotiations, the Japanese government quickly announced that cases that do not affect the profitability of rights holders would be considered valid exceptions. However, there is no language to this effect in the TPP agreement itself. Instead, the agreement notes only that parties “shall confine limitations or exceptions to exclusive rights to certain special cases that do not conflict with a normal exploitation of the [work...] and do not unreasonably prejudice the legitimate interests of the rights holder.”<sup>386</sup>

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<sup>384</sup> Yana Welinder, Stephen LaPorte, and Jan Gerlach, "What's TPP? The Problematic Partnership," *Wikimedia Foundation Blog*, 3 February 2016.

<sup>385</sup> Jeremy Malcolm, "The Final Leaked TPP Text Is All That We Feared," *Electronic Frontier Foundation*, 9 October 2015.

<sup>386</sup> Rebecca Gan, "Anime, Manga, and the Trans-Pacific Partnership: Will Fan Works Be Spirited Away by TPP Copyright Restrictions?," *Asia IP Law*, 30 November 2015.

This still leaves ambiguity as to what is permissible and what is not; while small-scale sale of doujinshi may be fine, massively profitable doujinshi may not, for example.<sup>387</sup> The Japanese Society for Rights of Authors, Composers and Publishers suggested clarifying certain terms that are being used, such as what would constitute a “commercial scale offense” or what the parameters of a “major impact” would be. JASRAC has also suggested that copyright holders be contacted and asked whether or not they want to prosecute violators.<sup>388</sup> The ambiguity also attracted criticism from academics and major newspapers, who argued that the Copyright Act should be made clear on this point to relieve creators’ concerns.<sup>389</sup>

Overall, an examination of the politics of copyright term extension in TPP reveals a pattern of competing cross-national coalitions. Foreign firms were at the forefront of the battle between fair use and increased copyright protections, with each side attempting to recruit Japanese actors to bolster their strategic position in the trade negotiations. While the US entertainment industry sought allies such as JASRAC, RIAJ, MPPAJ, and the Japan Writers’ Association, Google sought coalitions with Japanese civil society actors, particularly amateur creators. Although Google fell short of achieving the codification of fair use in TPP, it supported the agreement as a whole, praising it for requiring countries to balance the interests of copyright holders with the public’s interest in the wider distribution and use of creative works and saying that, “The endorsement of balanced copyright is unprecedented for a trade agreement.”<sup>390</sup> It does appear that the effects of Google and its civil society allies in both the US and Japan had some effect because the general provision on exceptions and limitations that was included in TPP had not previously appeared in any free trade agreements negotiations. In this sense, although TPP provides very strong copyright protections, some argue that it also provides evidence of the evolution of the US government’s negotiating position to be more accommodating to principles of fair use.<sup>391</sup>

The influence of the US entertainment industry—now united with Google, which has shifted to supporting the trade agreement now that its text has been finalized—and its Japanese partners will now be put to the test as TPP faces ratification in both countries. TPP faces difficult prospects for approval in the US, with the 2016 presidential election creating an environment in which free trade is a hard sell. Labor unions lead the opposition to TPP in the US, and a host of opposition groups including agriculture make up the opposition in Japan.<sup>392</sup>

## 6.5 Privacy Regulation in Japan

In addition to intellectual property rights, privacy presents another major issue for ICT firms. The growing pervasiveness and profitability of information technology was met with different responses from Europe and the US, as discussed previously. While the US adopted a limited set

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<sup>387</sup> Mariko Tai, "Cosplayers Breathe Sigh of Relief over Copyright Rules," *Nikkei Asian Review*, 8 October 2015.

<sup>388</sup> "Japan Considers Revising Copyright Law Due to Trans-Pacific Partnership," *Anime News Network*, 15 November 2015.

<sup>389</sup> "Editorial: Copyright Revisions under TPP Must Take Cultural Development into Consideration," *Mainichi Shimbun*, 20 February 2016.

<sup>390</sup> Kent Walker, "The Trans-Pacific Partnership: A Step Forward for the Internet," *Google Public Policy Blog*, 10 June 2016.

<sup>391</sup> Justin Hughes, "Fair Use and Its Politics - at Home and Abroad," in *Copyright Law in an Age of Limitations and Exceptions*, ed. Ruth Okediji (Cambridge: Cambridge University Press, 2016).

<sup>392</sup> Mulgan, "To TPP or Not TPP: Interest Groups and Trade Policy."



of regulations and gave firms the leeway to commoditize individuals' data under self-regulation, the EU adopted a comprehensive approach to privacy legislation that was much less friendly to the emerging needs of ICT firms. In the early 2000s, Japanese firms were influenced by pressure from the European Union and from Japanese civil society to adopt comprehensive privacy legislation. However, as big data became an increasingly lucrative industry, Japanese firms found themselves targeted by American firms eager to recruit them as allies in a global battle to establish dominant privacy regulations. Japanese firms became more sympathetic to the interests of American firms looking to facilitate easier commoditization of data as they themselves began to see the potential profit in the emerging big data industry. Although Japanese firms were not leaders in the services and technologies most affected by the American firms, these Japanese firms wanted to support the creation of a regulatory framework that allows extensive commodification in hopes that they might one day reap the same advantages that would accrue to the American firms in the short term.

In the 1990s, Japan had the weakest privacy principles of any Asia-Pacific country with a data privacy law. The 1988 Act on Protection of Personal Information Held by Administrative Organs and Processed on Electronic Computers regulated the government's processing of information, but there were no laws restricting the use of personal data by private companies or non-governmental actors. Its privacy system was much more similar to that of the United States than to Europe, which had passed its comprehensive set of privacy legislation in the form of the 1995 EU Data Protection Directive.

Japanese privacy regulation changed suddenly in the early 2000s due to two concurrent factors. First, countries around the globe were moving toward comprehensive privacy regulation. Over 30 countries from five continents passed comprehensive legislation between 1990 and 2006, including Australia, Canada, New Zealand, and Switzerland. These moves were driven by the adoption by the EU in 1995 of the Data Protection Directive and the promotion of comprehensive privacy legislation by EU regulators.<sup>393</sup> Large Japanese firms were influenced by their trade relationships with the EU to advocate for the legislation. They reasoned that their international trading operations with EU companies were already subject to significant data protection regulation, and since the US had agreed to the Safe Harbor agreement with the EU in 2000, Japanese firms believed that moving toward the EU system would not affect US-Japan trade. To the contrary, a shift in privacy legislation had the potential to put Japanese firms at a competitive advantage with the EU.<sup>394</sup> In December 2000, a Japanese Cabinet official had a meeting with Keidanren representatives that put forward new laws on data protection modeled on the EU Directive.<sup>395</sup>

Second, around the same time, Japanese citizens became concerned by proposals by the Japanese government to link Juki Net, the nationwide computer network sharing data between government agencies, with a national identity numbering system. These proposals received a great deal of negative attention in the Japanese media, which pointed out the possibility of fraud and called for stricter controls on misuse of information by the Japanese government. The regulations were meant to reassure the public that privacy would be fully safeguarded and to calm fears about private-sector use of personal information.

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<sup>393</sup> Newman, *Protectors of Privacy: Regulating Personal Data in the Global Economy*.

<sup>394</sup> Andrew Adams, Kiyoshi Murata, and Yohko Orito, "The Development of Japanese Data Protection," *Policy & Internet* 2, no. 2 (2010).

<sup>395</sup> Keidanren, "「Kojin Jouhou Hogo Kihon Housei Ni Kansuru Taikou」 Ni Tsuite [Outline of Personal Protection of Information Law]," <http://www.keidanren.or.jp/japanese/policy/2000/065.html>.

As a result of this combined pressure from the European Union and the Japanese media, the Japanese Diet passed the country's first comprehensive privacy law, the Protection of Personal Information Act (PIPA), in 2003. It went into effect on April 1, 2005. PIPA was similar to the EU Data Protection Directive in the sense that it established a required framework for Japan's ministries to implement through detailed regulations in all sectors of Japanese life. Different ministries developed specific regulations that conformed to the law. For example, the Ministry of Justice issued regulations regarding personal data involved in universities, while MIC issued regulations over telecommunications. The law defined personal information very broadly, and parties that handled individuals' personal information were not allowed to provide their data to third parties without obtaining consent from those individuals.

Although PIPA could have been perceived as disadvantaging Japanese ICT firms in key ways, they did not make privacy a focus of lobbying efforts because they operated in fairly oligopolistic markets and had larger internal consumer bases due to the pattern of government-led development described earlier in the chapter. Unlike in the US, where firms relied on information exchange across very fragmented sectors, Japanese firms had less incentive to advocate for rules that would allow for the easy commodification and utilization of consumer data. Therefore, as long as the privacy regulations were helping to facilitate trade with the EU and the US, Japanese firms were largely uninterested in proposing alternatives.

This stood in stark contrast to American ICT firms, who had already become interested in utilizing data for commercial purposes and were fighting to shape global regulations. Because the European Union adopted much stricter privacy protections than the United States, major ICT firms such as Google and Microsoft increasingly found themselves drawn into legal battles in Europe. In the world of regulatory competition, the first mover advantages to establishing the rules of the constantly shifting ICT world are potentially huge. Foreign firms realized this and sought to influence policies in major markets. However, because of the historical development of EU data privacy regulations and the strong pro-privacy position of many European regulators, and possibly also due to the fact that many leading ICT companies are American, the influence of these ICT firms in the European political context has been notably more limited.

As a result, these foreign firms came to see Japan as a potential counterweight to European regulatory influence.<sup>396</sup> If these firms could influence Japanese policy, they might be able to tip the development of global privacy regulation in their favor by first influencing Japanese policy. In 2009, the American Chamber of Commerce in Japan released a white paper calling for a new set of discussions with Japan around capturing the innovation and growth potential of the emerging global Internet economy. Accompanying the call were a set of over 70 specific recommendations for discussion in areas such as privacy, security, intellectual property, spectrum management, cyber security, and competition. The paper resonated with the DPJ government and the Obama administration, which was looking for a new direction to take US-Japan relations in an atmosphere of relative tension. As a consequence, the US-Japan Internet Economy Dialogue was launched in 2010, partially as a way for the US and Japan to work together to counter the regulatory influence of the EU. This dialogue has since constituted an annual opportunity for the American and Japanese governments to discuss policy, with firms such as Microsoft, Google, Intel, Hitachi, Fujitsu, and NEC also occupying a seat at the table.

Because Japanese firms were not heavily engaged in big data activities that required permissive privacy laws, they were not initially active on the privacy front. According to a 2014

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<sup>396</sup> Interviews with government relations representatives from major American ICT firms in Japan, 15 March 2013, 5 August 2013, and 8 August 2013.

survey by the Japan Users Association of Information Systems, only about eight percent of Japanese companies utilize big data in their systems.<sup>397</sup> As time has passed, however, the appeal of “big data” to Japanese firms increased as the potential profit from this new industry became more obvious. Firms such as Fujitsu, NEC, and Hitachi believe that big data is going to be the next wave of profitability for them, and they want to have the room to enter that line of business. Nomura also has an interest in big data and has influenced Keidanren to support permissive privacy legislation. Consequently, these Japanese business actors have willingly entered into cross-national coalitions with foreign firms.

These foreign and Japanese firms found a willing ally in the Japanese government. METI has supported legal revisions that would enable big data because it wants to help facilitate the competitiveness of Japanese firms in this new industry. The Abe administration has also sought to facilitate businesses’ greater use of big data for development, sale and advertising of new products and services as part of its bundle of “Abenomics” initiatives. In 2014, The IT Strategic Headquarters began formulating the necessary new legislation in 2014, calling for an “open data” strategy allowing government information to be used by the private sector as well as a “big data” strategy related to the use of the vast quantities of information arising from the use of smartphones and other devices.

In 2014, the Japanese government’s Personal Information Review Working Group published a report with the goal of changing the legislation on data protection and privacy in 2015. The initial proposal by Japan’s IT Strategic Headquarters called for the creation of a system to determine how government bodies and companies can use personal information through a revision of the PIPA that would regulate the gray zone of personal information other than names and addresses. In the proposal, this information fell into two categories: “low personal specificity data,” which could be used without receiving permission as long as anonymity was maintained, and “semipersonal information,” which would include information such as terminal ID and facial recognition data.

In response to this report, the Internet Economy Task Force (IETF) of the American Chamber of Commerce put out a viewpoint advocating changing laws and regulations to make it easier for companies to use data.<sup>398</sup> In particular, it pushed for permitting the transfer of deidentified data to third parties and for the elimination of the overlapping authorities within the GOJ for data protection. Japanese firms also voiced their support for regulations that would enable the utilization of personal data for commercial purposes. For example, the Japan Association of New Economy, headed by Hiroshi Mikitani, President and CEO of Rakuten, also argued that privacy regulations should not hinder innovation or run counter to global business trends.<sup>399</sup>

In response to this criticism, the IT Strategic Headquarters revised its initial proposal, allowing industry to first voluntarily establish its own rules, after which a third-party body would gauge their suitability. Privacy advocates such as academics and security vendors pointed to the need to take effective steps to make sure that individuals’ privacy is not compromised in promoting the use of private information as a business tool. However, the confluence of interest between foreign and Japanese firms, as well as the push from the Abe administration resulted in the passage of an amendment to Japan’s data protection and privacy laws in September 2015.

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<sup>397</sup> Hideki Kishimoto, "Nation to Promote Big Data Experts," *The Japan Times*, 21 January 2015.

<sup>398</sup> ACCJ Internet Economy Task Force, *GOJ Policy Review on the Protection and Utilization of Personal Data* (Tokyo: The American Chamber of Commerce in Japan, 2015).

<sup>399</sup> Waiichi Sekiguchi, "'Big Data' Raises Big Legal Questions in Japan," *Nippon.com*, 28 November 2014.

The revision supported many of the recommendations from ACCJ Internet Economy Task Force. The law allowed companies to use personal information for purposes other than those originally stated without obtaining the consent of the people involved. Another important change was the establishment of a Personal Information Protection Committee, a single body to oversee personal data law and to coordinate governance to replace the overlapping ministerial jurisdictions that existed previously.

The tension between the US and EU approaches to privacy is likely to persist, particularly with the uncertainty surrounding the end of the Safe Harbor agreement; this will leave Japan in the position of being the target of lobbying by both sides. As a leading developed country with large high tech firms, Japan's policies have the potential to tip the regulatory scales in favor of either approach. Therefore, though as in the case of intellectual property policy, Japanese firms are not the ones crafting global regulations, they still have an important role to play as members of cross-national coalitions battling for policy outcomes within Japan. Given the network effects of these kinds of policies, the domestic-international regulatory nexus in Japan is likely to continue to be important battleground for some time to come.

## **6.6 Conclusion**

Information and communications technology is a sector where products, services, and regulations are in a constant state of evolution. In this chapter, I have demonstrated that this rapid pace of change, combined with the cross-sector and cross-border nature of information technology, has resulted in a complex political environment of shifting cross-national coalitions. Firms must battle for the support of their home governments and also strive to form partnerships in their target country simultaneously in order to maximize their chances of policy success. Moreover, due to the network effects of technology standards and regulations, firms and governments in various countries may be competing with each other in order to put forward their own country's vision of the regulatory order as the correct one for countries all around the world. Japan has emerged as an important supporting actor in this regulatory development. Japanese government actors and firms have rarely set the global regulatory agenda, but they have been key coalition partners for the major foreign governments and firms seeking to write the global rules.

I have argued that the pattern of internationalization in the Japanese ICT sector led to this pattern of corporate political activity. Japanese technology companies initially tended to cater to their own domestic market and follow the lead of government ministries in deciding what technologies and standards to adopt. This inward and reactive approach led Japanese firms to become somewhat peripheral to major political economic debates over policies such as intellectual property and privacy that are vital for the leading global ICT firms. However, given that the dominant foreign firms are divided and engaged in heated battles with one another in multiple national jurisdictions to define laws and regulations, Japanese firms have been drawn into the fray as allies with the potential to tip the political scales. Foreign and Japanese firms have allied with one another against competing coalitions of other foreign and Japanese firms, each side advocating a different regulatory outcome than the other. This is in stark contrast to classic trade politics, where domestic actors often presented a united front against foreign influence.

The case of the Japanese ICT sector provides insight into the evolving dynamics of policymaking in an age where complex regulatory issues are at stake. Similar dynamics to the ones described in the previous case study have occurred in countries around the world around

copyright issues, with major multinational firms attempting to influence the IP policy of other countries, often with the help of their home governments. For example, there is evidence that the US government lobbied the government of New Zealand during its copyright reform in 2008 to increase copyright protections to the detriment of fair use provisions. The US government was also willing to fund a recording industry enforcement initiative backed by the Recording Industry Association of New Zealand (RIANZ) and the Australasian Mechanical Copyright Owners Society (AMCOS).<sup>400</sup> Similar actions were taken by the US toward New Zealand during the TPP negotiations, and IP holders encountered similar opposition from civil society organizations such as the Fair Deal Coalition. Foreign ICT firms are engaged in legal battles over privacy on an ongoing basis, with new court rulings and legislation continually adding to the complex web of privacy regulation. They seek like-minded allies in all of the countries in which they do business. These examples point to a similar process of cross-national coalition formation in these countries.

This examination of the ICT sector also demonstrates the importance of Japan in international battles over regulations and standards. Although Japan is sometimes criticized for its lack of leadership in the international system, it is an important supporting actor in these debates. The ICT sector illustrates the ways that “middle powers” such as Japan can play an influential role in the international political economy. The Japanese government can be an important collaborator in global regulatory debates and foreign private actors can often find willing coalition partners among Japanese firms and civil society organizations. Even the most powerful countries and private actors need allies if they hope to shape the complex web of regulations that increasingly defines the ICT sector.

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<sup>400</sup> Michael Geist, “Wikileaks on New Zealand Copyright: US Funds IP Enforcement, Offers to Draft Legislation,” 30 April 2011. Available from < <http://www.michaelgeist.ca/2011/04/nz-wikileaks-copyright/>>

## 7 Government-Business Relations in a Globalizing World

Politics shapes markets, and markets shape politics; there are many actors involved in these mutually constitutive processes, including governments, firms, civil society groups, and individuals. This dissertation has focused predominantly on multinational firms in order to gain a window into these expansive processes of globalization and liberalization. As economic actors positioned at the intersection of the domestic and international arenas, multinational firms have to make sense of these complex forces and find ways to do business in a shifting political and economic environment. This examination of foreign firms in Japan across time and across sectors reveals a number of broad trends in government-business relations in a globalizing world.

First, the early stages of trade liberalization have important consequences for the political economy of a country. Globalization is not a uniform force leading to worldwide convergence. It permeates individual countries in distinct ways, breaking down national trade barriers with governments and private actors as the soldiers on the front lines. These early battles are messy and rarely result in clear victories for the forces of either protectionism or liberalization. Instead, compromises are forged through which initial patterns of internationalization are created, and these patterns of internationalization in turn shape the landscape of future battles by defining the potential strategies and alliances that the actors can access.

This path dependence is important not only for the domestic arena of a particular nation but also for the establishment of international trade governance. Because the latter is shaped by the interaction of the international and the domestic arenas, the ways that these coalitions form in individual countries is important to determining the shape of emerging international rules and standards. Again, the early decisions made in crafting these rules and selecting these standards have lasting consequences for the international political economy. Early adopters of influential standards will benefit from the diffusion of the latter and often actively seek to promote that diffusion. Late adopters and their home governments will often be competitively disadvantaged. Consequently, early regulatory decisions have ramifications for both domestic politics and for international relations.

Second, after foreign firms gain a foothold in the market of a target country, their goals change and their menu of potential political strategies expand; the latter shift means that while the early stages of market liberalization are often facilitated by government-to-government negotiations, subsequent stages are likely to find firms operating on more equal ground with state actors in policy battles. As foreign firms are able to develop relationships with domestic actors in a target country, they become less reliant on their home governments for pressure. Chapter 2 demonstrated that foreign governmental pressure, often from the United States, served as a major driving force of trade liberalization in Japan in the early post-World War II period. Japan had a long history of being suspicious of foreign investment, but a confluence of foreign government pressure and internal drivers of change broke down many of its formal trade barriers. Since that time, foreign firms have gained new ways to influence the Japanese government on their own, as illustrated in the detailed treatment of the pharmaceutical, insurance, and ICT sectors in Chapters 4 through 6. These firms may still continue to draw on support from their home governments, but these firms are less reliant on the latter.

This is consistent with the work of scholars who have pointed out that trade politics are in a transition from a phase where the goal was simply the elimination of trade barriers toward a phase where the manner of liberalization is key. Private actors have a larger role to play in this

process, in providing governments with the information necessary to make appropriate policy. This alteration in the nature of government-business relations has put public and private actors in much closer cooperation with one another, creating opportunities for them to influence each other's interests and preferences in unexpected ways. As shown in the case studies, politics shaped the market opportunities for foreign firms in Japan, but now these firms are in turn shaping Japanese politics. Similar processes are occurring in other countries that have undergone trade liberalization and admitted foreign firms across their borders.

Third, the concepts of a "national" interest and "foreign" or "domestic" actors are becoming steadily more difficult to define. Now that the issue is not whether to liberalize but how to liberalize, issues more often divide firms in a given country. This means that it is harder for home governments to pick a side to support; the relationship between these firms' interests and some kind of national good is murky. It is no longer true a firm's potential allies are located close by in one's home country; instead these potential allies may reside in other countries. If firms are able to form connections with these would-be partners abroad, they may be able to shift the political balance of their own domestic political battles. Consequently, we need to understand the interaction of the international and the national, the public and the private. This is complex and often confusing, but understanding the ways that globalization and liberalization are shaping our world requires both a more nuanced understanding and a more integrated analysis that crosses borders, sectors, and disciplinary boundaries.

Analytically, this means that the multiple models of international relations discussed in Chapter 1 are often operating simultaneously in the trade politics of a country; the challenge is to recognize which model is the most appropriate where and when. Making this determination requires looking at the details of sectoral political and economic dynamics. In sectors where internationalization is minimal, a two-level games framework may be the most appropriate. In many other sectors where some liberalization has occurred and foreign firms have been able to gain a foothold in a target market, models of cross-national coalitions help to understand the burgeoning interaction between foreign and domestic actors. As globalization proceeds and interdependence deepens, we may come closer to an environment where interactions are truly transnational, making those models increasingly appropriate for analysis. Simply recognizing that international politics is changing is not enough; we have to dig deeper to identify the forces driving this change and be able to respond with the appropriate analytical tools.

In this concluding chapter, I synthesize the findings from the preceding chapters and discuss the implications for this research for Japan, for other countries, and for the field of political science. I begin by briefly summarizing the differing patterns of coalitional formation found in the case studies in Chapters 4 through 6 before offering some extensions of this theoretical framework to other sectors in Japan. I then discuss some of the larger implications of this work for the study of Japanese politics and other countries. I conclude with some observations on the increasing importance of the domestic-international nexus in political science.

## 7.1 Coalitional Configurations and Political Change

The framework presented in this dissertation is not a deterministic structural theory. It demonstrates that early patterns of trade liberalization create opportunities that may then be acted upon (or not) by foreign firms in ways that lead to the development of political patterns. Coalitions can last for just a single policy debate, but in many cases, the early pattern of internationalization will structure political opportunities in a way that favors a specific configuration of collaboration. If this collaboration is a successful experience for the coalition partners, it may lead to further collaboration in the future; it can also be a negative experience that discourages future coalitions.

In Table 1.1, I attempted to connect the varying patterns of coalitional figuration with types of political dynamics in a sector. In the case of agriculture, the low level of internationalization in the sector constrained the ability of foreign agricultural interests to form cross-national coalitions with Japanese actors in order to pursue their policy goals. Instead, the resultant coalitional configuration was one of foreign firms versus Japanese firms. This configuration is typical of classic trade politics where formal trade barriers abound and firms are reliant on their home governments to open markets abroad on their behalf. The preceding chapters have shown that this coalitional configuration is less common than it was in the past; however, it remains the case in situations of limited trade liberalization, such as agriculture.

A very different coalitional configuration emerged in the Japanese pharmaceutical sector; while initially dependent on their home governments to pressure Japan to reduce trade barriers, after market entry, foreign pharmaceutical firms were successful in forming partnerships with like-minded Japanese firms. The coalitional configuration in this sector was one of a cross-national coalition involving foreign firms and globally competitive Japanese firms versus smaller, less competitive Japanese firms. This configuration has led to a gradual globalization of the Japanese pharmaceutical sector, with global Japanese and foreign firms pushing for greater harmonization of Japanese regulations and laws with those of the international arena. This pattern of politics is the one most often called to mind when thinking about multinational firms in a target country; there is often an assumption that the entry of these foreign firms will result in greater liberalization of the target market and further expansion of opportunities for foreign firms.

However, the case of the Japanese insurance sector demonstrated that this is not always the case; once foreign firms have entered a target market, they may fight to close the door behind them and restrict market access for other foreign firms. Due to the early entry of first-mover foreign firms, the coalitional configuration in the Japanese insurance sector was one of these first-mover foreign firms versus both Japanese firms and foreign new market entrants. However, in this case, the latter were unsuccessful in forming a competing cross-national coalition. As a result, early first-mover foreign dominance in selected segments of the Japanese insurance market resulted in a pattern of slowed and fragmented liberalization.

The final case, information and communications technology, presented an example of the opposite of the coalitional configuration first introduced in Chapter 3. While agricultural politics pitted foreign actors versus domestic actors along clear lines, the political economy of the ICT industry has resulted in complete blurring of those lines. Instead of nationally based alliances, the coalitional configuration is one of competing cross-national coalitions of mixed nationalities. Foreign and Japanese firms have partnered with one another against competing coalitions of other foreign and Japanese actors, each side advocating a different regulatory outcome than the



other. This situation is the most different from classic trade politics scenario where domestic actors often presented a united front against foreign influence. This political pattern can be characterized as one of regulatory competition played out on multiple domestic, regional, and international levels.

These four types of coalitional configurations describe the major patterns of political alignments that can result between foreign firms and their counterparts in a target country. Each has consequences for the politics of that specific sector, leading sometimes to greater harmonization between domestic and international policies and sometimes to further exclusion of foreign firms. The next section offers some potential extensions of this framework to other sectors of the Japanese economy.

## 7.2 Applications to Other Sectors in Japan

The theoretical framework of coalitional formation outlined in this dissertation may be extended to other sectors in order to more fully understand the strategies and influence of foreign firms in Japan. In the following section, I present some examples from other sectors to give a sense of related developments in very different areas of the economy. These examples are suggestive of dynamics that may be found not only in Japan but also in other countries around the world, a topic that will be taken up later in this chapter.

### 7.2.1 Retail

Some of the most heated battles over trade liberalization between the US and Japan were fought over the retail sector. A famous example of Japanese trade protectionism was the Large Store Law, which prohibited the construction of big chain stores without the approval of rural residents, who were often strongly tied to small business interests. American companies such as Toys ‘R Us and Walmart enlisted the aid of the US government in breaking down this and other regulatory barriers, which became a major goal of the Structural Impediments Initiative, as described in Chapter 2. In the same manner as the agriculture sector, which was discussed in Chapter 3, foreign retail firms were largely limited to political strategies rooted in their home countries; these strategies were embedded in a larger two-level game being played by the national governments of the US and Japan. Although foreign retail firms were limited in their ability to directly form cross-national coalitions with Japanese firms, the attention drawn to the Large Store Law due to SII caused some reverberation within the Japanese private sector; large Japanese retailers also shared foreign firms’ interests in abolishing the law, though there was no direct coordination between the two parties. This domestic support amplified the impact of foreign pressure from the US government, and as a result, the Large Store Law was abolished in 1990, creating opportunities for large stores—both foreign and Japanese—to move into rural areas.<sup>401</sup>

In stark contrast to two decades ago, there is relatively little demand for home government intervention on the part of foreign retail firms operating in Japan today.<sup>402</sup> After these retail companies were able to enter the Japanese market, their focus shifted away from

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<sup>401</sup> Schoppa, *Bargaining with Japan: What American Pressure Can and Cannot Do*.

<sup>402</sup> Interviews with current and former USTR officials, 10 September 2010 and 3 June 2011.

political strategies and toward market strategies, actions taken in the market environment to create value by improving the economic performance of the firm. The liberalization of the sector was applied uniformly, reducing the chances for first-mover foreign firms to establish dominance and advocate for selective deregulation. Instead, foreign firms focus on excluding potential competitors through market strategies. In terms of political strategies, interviews suggest that much of these retail firms' interaction with the Japanese government is purely public relations or part of their corporate social responsibility efforts to preserve the environment, improve public health or promote educational exchanges between Japan and their home country.<sup>403</sup> This is predictable given that the market environment determines the significance of political issues to the firm. Given that the market environment necessarily fluctuates, developments may sometimes prompt firms in these sectors to employ political strategies in a reactive fashion.

However, the relatively infrequent use of political strategies in this sector does not necessarily imply that foreign retail firms are now wildly successful in Japan; it simply means that they are relatively free to do business in Japan without the encumbrance of formal trade barriers. The unique market institutions of Japan still pose challenges, and in order to succeed, foreign firms must skillfully employ market strategies in order to maximize their profit and market share. Finding the correct marketing strategy, tailoring products for local Japanese consumers, and forming market relationships with the most suitable Japanese joint venture partners are some of the potential market strategies that can help foreign firms to become successful. Some foreign firms have found great success in Japan, but many others have not been successful in their market strategies. While many foreign retailers entered Japan after deregulation, a large number left over the following two decades, giving up on the Japanese market.

### **7.2.2 Soft Drinks**

The pattern of internationalization in the soft drinks sector was similar to that in the insurance sector discussed in Chapter 5; it began with limited deregulation of the sector and the entry of a few foreign first-mover firms, notably Coca-Cola and Pepsi. The Japanese government initially allowed Coca-Cola and Pepsi to import, bottle, and distribute their products in Japan, but they and their local bottlers were severely restricted in terms of advertising, pricing, and sales. Coca-Cola eventually granted a Japanese company control over local bottling in exchange for limited access to the civilian Japanese market. While small, this initial foothold in the Japanese market gave Coca-Cola the opportunity to form a cross-national coalition with Japanese partners; it targeted one of its largest opponents, Kirin Beer Company, and Mitsubishi Heavy Industries, an important machinery supplier, as its allies in hopes of leveraging their influence vis-à-vis the Japanese government. These Japanese partners helped Coca-Cola to convince the Japanese government to stop controlling the allocation of foreign exchange necessary for Coca-Cola to import syrup ingredients that were unavailable in Japan. Coca-Cola was able to commence production of its concentrate in Japan through its yen-based company in 1960.<sup>404</sup>

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<sup>403</sup> Interviews with foreign firm representatives and government relations consultants, 11 March 2013, 30 July 2013, 2 August 2013, and 12 August 2013.

<sup>404</sup> See Encarnation and Mason, "Neither MITI nor America: The Political Economic of Capital Liberalization in Japan."

The skillful selection of these coalition partners allowed Coca-Cola to leverage both their market and political resources and to ascend to a dominant position in the Japanese soft drinks market. In this sense, Coca-Cola became a first-mover foreign firm in its sector similar to Aflac and AIG in the insurance sector. Coca-Cola was able to utilize both market and political strategies establish its dominance and to keep its primary global competitor, Pepsi, in a clearly subordinate position in the Japanese market. In the mid-1990s, Pepsi attempted to form a partnership with Suntory in hopes of improving its sales; Pepsi only accounted for three percent of the soft drink market at the time, while Coca-Cola had 31 percent.<sup>405</sup> However, Coca-Cola has maintained its dominance in the Japanese market.

Since the Japanese soft drinks market is no longer highly regulated, Coca-Cola has shifted to focusing primarily on market strategies to maintain its dominance. As in the case of retail, there are generally few developments in the soft drinks market that require political action, so much of Coca-Cola's energy is focused on corporate social responsibility activities. The company does, however, monitor the Japanese media in order to be conscious of developing trends and potential problems. For example, concerns about obesity that have posed a challenge to Coca-Cola in other countries have not yet become salient in Japan, but the firm constantly monitors the situation and tries to proactively promote an image of itself as conscious of public health issues.<sup>406</sup>

Unforeseen events can prompt the use of political strategies in the soft drinks sector in unexpected ways. For example, after the disastrous earthquake, tsunami, and nuclear disaster of March 11, 2011, concerns about energy shortages led to Coca-Cola becoming the target of criticism for the energy consumed by the one million vending machines that it owns and operates across Japan. In response, Coca-Cola formed a project team to lobby ministries and the governor of Tokyo and was able to prevent this from taking place, partially by using ongoing research to create vending machines that only used electricity at night. However, situations like this are the exception to the rule, with most of firms' attention being focused on more market-oriented strategies.

### 7.2.3 Luxury Goods

Japan accounts for 11 percent of total global luxury sales and is considered the world's most concentrated source of revenue for luxury brands, making it a very important market for many foreign firms. In contrast to other sectors where foreign firms in Japan are predominantly American, many luxury goods firms operating in Japan are European. For example, Japan is the single largest market for Baccarat, Burberry, Louis Vuitton, and Salvatore Ferragamo. Intellectual property protection has become the most important political issue for these foreign firms in recent years.<sup>407</sup> The Japanese luxury goods market is broadly deregulated, which means that foreign luxury goods firms have been able to enter the market and establish large presence in Japan; this has enabled them to successfully form cross-national coalitions with Japanese online retailers and websites to try to combat counterfeiting and to advance joint sales. In this way, the luxury goods sector bears some resemblance to the ICT sector, which was described in Chapter

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<sup>405</sup> "Pepsico and Suntory in Alliance in Japan," *The New York Times*, 4 October 1997.

<sup>406</sup> Interview with Coca-Cola representative, 6 August 2013.

<sup>407</sup> Interview with government relations consultant, 1 July 2014; interview with European Business Council representative, 9 July 2015.

6. The intellectual property issues that they face are inherently global in nature, and foreign luxury goods firms are attempting to recruit Japanese technology firms as allies in this global battle; these cross-national coalition partners have also worked together vis-à-vis China to try to combat counterfeiting.

Online marketing and sales of their luxury goods products has created issues for foreign luxury goods firms; allegedly authentic parallel imports are mingled with counterfeit goods, and individual firms are unable to keep up with the pace of faked goods going into circulation. This presents a problem for both the makers of authentic goods and online websites striving to maintain their credibility to their customers, so foreign luxury goods firms have formed coalitions with the operators of the major Japanese online auctions and shopping websites Yahoo Japan, Rakuten, and DeNA to combat piracy. These Japanese firms have introduced increased monitoring and enforcement measures to reduce counterfeiting. Rakuten, for example, test-purchases suspected counterfeit goods and works with foreign firms to confirm authenticity. Yahoo Japan has hired a staff of 200 people to monitor its auction service and regularly exchanges information on counterfeiters with major brands via rights holders' associations.<sup>408</sup> These cross-national coalitions have also jointly pressured the Japanese government to increase its IP protections in Japan and to adopt IP-related provisions in the Trans-Pacific Partnership.

As also demonstrated in the case of the ICT sector, battles over intellectual property are simultaneously occurring in multiple domestic contexts around the world, as well as in the realm of international relations; this has led the cross-national coalition of foreign luxury goods firms and Japanese retailers to jointly apply pressure to third parties that are involved in the problem. For example, in 2015, the European Business Council estimated that China accounted for 92.9 percent of all fake goods entering Japan.<sup>409</sup> Consequently, Japanese and foreign firms have worked together to try to influence the Chinese government to step up its regulation and enforcement of intellectual property rights; they have also pushed Chinese online retailers such as Alibaba to improve their internal policing processes. This illustrates how cross-national coalitions formed in one domestic context can be aimed at third-party countries, introducing further complexities in studying these dynamics.

#### **7.2.4 Automobiles**

As with other sectors examined in this dissertation, the foreign automobile industry initially relied heavily on its home governments to pressure Japan to open up its markets. Automobiles became a source of constant tension between Japan, the US, and Europe, as the Japanese auto industry became highly successful worldwide and significantly ate into the share of the major Western firms. Given the importance of the automobile industry in the US and in Europe, this industry exercised much influence over their respective home governments; many of the trade disputes of the 1980s and 1990s centered around low sales of foreign automobiles and auto parts in Japan, which were at odds with the tremendous success of Japanese products in Western markets. As a result of the pressure from these foreign governments, Japan no longer has any tariffs on cars and trucks from the US, but a host of nontariff barriers continue to significantly

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<sup>408</sup> European Business Council, "Taking Action: The EBC Report on the Japanese Business Environment," (Tokyo: The European Business Council in Japan, 2014), 16.

<sup>409</sup> "Golden Opportunity: The EBC Report on the Japanese Business Environment," (Tokyo: The European Business Council in Japan, 2015), 16.

impede the sales of foreign cars in Japan. For example, complaints by the US auto industry in 2015 included issues relating to standards and certification and barriers hindering the development of distribution and service networks.<sup>410</sup> The persistence of these barriers has led the foreign auto industry to continue rely on its home governments to pressure the Japanese government, similar to the case of agriculture in Chapter 3.

Unlike agriculture, however, the dismantling of formal trade barriers in the auto sector created opportunities for the foreign auto industry to enter Japan and to form partnerships with Japanese actors. Foreign automobile firms formed joint ventures with Japanese automakers in order to try to strengthen their influence in Japan, with major tie-ups between foreign and Japanese firms such as Renault and Nissan, Ford and Mazda, and DaimlerChrysler and Mitsubishi Motors. Foreign automakers were able to increase their sales to Japan somewhat through these relationships, but overall sales remained low. They were not able to leverage the political resources of Japanese automakers in order to deal with the non-tariff barriers in the Japanese system. Moreover, the market strategies of foreign automakers often did not align well with Japanese consumers who often prefer the features of vehicles produced by Japanese automakers.

Thus, lobbying their home governments has continued to be the most successful political strategy for foreign automakers; in addition to continuing to seek the elimination of non-tariff barriers in the Japanese automobile market, foreign auto makers and their associated unions have used their political influence at home to continue to disadvantage Japanese cars being sold in their own home markets. Some recent evidence for this is provided by the negotiations over the Trans-Pacific Partnership. Pressure from the US government led Japan to agree to make it easier for American automakers to export vehicles to Japan, to increase transparency in its decision-making processes, and to form a joint committee with the US to address issues in the sector. However, perhaps a more significant victory in the short term was the lengthy delay that American automakers won in securing a phaseout of the tariffs that protect domestic truck production in the US. These tariffs preserve the status quo on the most profitable part of the American auto market; by taxing foreign trucks, the US has forced Japanese automakers to build truck and SUV plants in the US. American tariffs on auto parts were also granted a complicated and extended phaseout schedule. In exchange for this victory, the US agreed to allow Japan an extended phaseout period for its tariffs on agriculture, much to the disappointment of the American agricultural industry, as discussed in Chapter 3.

### **7.2.5 Civil Aviation**

The Japanese commercial aircraft market has been dominated by US manufacturers since the 1950s; because the civil aviation, aerospace, and defense industries are closely related, Japan has often preferred to keep its economic relationships in this sector closely aligned with its major security ally. The civil aviation industry can be seen as similar to the insurance industry, where first-mover American firms entered into Japan due to favorable political conditions; in this case, the result was even more pronounced because the market entry of American firms was underwritten by the US-Japan security alliance. Once Boeing entered the market, it was able to build close relationships that helped it to increase both its economic and political influence in

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<sup>410</sup> See USTR, *National Trade Estimate Report on Foreign Trade Barriers* (Washington, DC: Office of the United States Trade Representative, 2015), 223-24.

Japan. Over the last six decades, Japanese firms have come to play an important role as Boeing's suppliers; this close cooperation benefited major Japanese firms such as Mitsubishi Heavy Industries, Kawasaki Heavy Industries, and Fuji Heavy Industries; Boeing claims that the business it gives Japan adds up to 22,000 jobs, 40 percent of the nation's aerospace workforce.<sup>411</sup> 35 percent of the parts of the Boeing 787 are made in Japan. In return, these relationships enable Boeing to dominate the Japanese civil aviation market with a share of more than 80 percent.

Due to Boeing's strong relationships with these Japanese firms, it is able to draw on their political resources when trying to influence policy in Japan.<sup>412</sup> The economic fate of these Japanese firms is strongly tied to the sales of Boeing airplanes, incentivizing them to pressure other Japanese actors to buy Boeing. In addition to forming coalitions with these actors, Boeing can also use its strong relationships with the US government to pressure Japan. Historically, this has been a recipe for success: Japan Airlines (JAL) purchased planes exclusively from Boeing until 2013, and All Nippon Airways (ANA) has also historically purchased the majority of its planes from Boeing. Airbus has had a difficult time increasing its sales in Japan, despite attempting to use political strategies such as requesting pressure from the EU and trying to entice Japanese firms Mitsubishi, Kawasaki, and Fuji with offers of subcontracting and joint development.<sup>413</sup>

However, Airbus has recently found some success in forming a cross-national coalition with JAL, which was frustrated due to the delays and expenses caused by the troubled Boeing 787 launch. In 2013, JAL signed a deal to buy 31 Airbus A350s, its first ever purchase of European jets, giving Airbus a major boost in the Japanese market. However, the case of the Japanese insurance sector suggests that the early dominance of Boeing will be difficult for Airbus to overcome, as Boeing will utilize both home government pressure from the US and cross-national coalitions with its domestic Japanese suppliers in order to maintain its market position. Concerns have already been raised that Boeing might shift its production outside of Japan due to JAL's decision to purchase planes from Airbus.<sup>414</sup> Japanese airline carrier ANA has also ordered Airbus planes in recent years, but its purchases still tend to be heavily skewed toward Boeing planes. The battle will be even more difficult for Airbus to win due to the ties between the Japanese civil aviation and defense industries, which make the market a particularly important one for the US government to monitor. This security dimension gives Boeing an extra edge in claiming that its private interests are closely tied to those of US defense policy.

### 7.3 Implications for Japanese Politics

Taking a step back from the details of the sectoral case studies, what are the implications of these findings about the political strategies of foreign firms in Japan for Japanese politics more broadly? Viewed through one lens, the presence and influence of foreign firms would seem to be very limited and perhaps even inconsequential. While the number of foreign firms operating in Japan has increased dramatically over the last two decades, these foreign firms still represent a small part of the total Japanese economy in absolute terms. Although some of the traditional

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<sup>411</sup> Jennifer Thompson, "ANA \$16.6bn Aircraft Deal Loosens Boeing's Grip on Japan Market," *The Financial Times*, 27 March 2014.

<sup>412</sup> Interview with Boeing representative, 8 July 2015.

<sup>413</sup> See William Love and Wayne Sandholtz, "David and Goliath: Airbus Vs. Boeing in Asia," in *Winning in Asia, European Style: Market and Nonmarket Strategies for Success*, ed. Vinod Aggarwal (New York: Palgrave, 2001).

<sup>414</sup> Tim Kelly, "Japan Worries About Boeing Retreat in Wake of JAL Defection," *Reuters*, 9 October 2013.

features of the Japanese economic system have broken down, practices such as cross-shareholding and institutions such as distribution networks still pose challenges to foreign firms. Formal barriers are less common, but doing business in Japan is still no easy feat; foreign firms may enter Japan, but they are certainly not guaranteed to succeed. While some had high hopes that an influx of foreign investment would spur competitiveness among Japanese firms, diffuse Western business practices, and revitalize the Japanese economy, these predictions have fallen short of expectations. Moreover, the interest of foreign firms in Japan has declined. Many now bypass Japan in favor of more attractive investment destinations with less onerous regulations and cheaper labor costs. Japan now finds itself in the position of trying to attract foreign firms, as seen in the recent inclusion of FDI as part of the third arrow of Abenomics, but the country's relationship with foreign investment remains cautious at best, and these latest initiatives are not expected to yield substantial change.

If all of this is true, why is this story about foreign firms important for Japanese politics? First of all, it tells us something meaningful about the ways that Japan as a country is changing. The material discussed in this dissertation supports the claim that the Japanese political economy is open to a greater diversity of actors than it has ever been in the past. The preceding chapters have demonstrated that foreign firms are able to employ political strategies within Japan in a way that was previously impossible. Furthermore, this increased opening of the Japanese political and economic spheres is not limited only to foreign actors; domestic Japanese actors such as new market entrants and civil society actors that have traditionally been disadvantaged by the institutions that strongly linked politicians, bureaucrats and business also have greater room to influence Japanese policymaking. These newly empowered Japanese actors are potential allies for foreign firms and may help to give the latter further inroads to the Japanese policymaking process, or they may serve to block the interests of these foreign firms.

Clearly, important limitations to these changes exist. The political and economic shifts in Japan are relatively large, but they remain subtle in absolute terms. Japan politics are changing—but not quickly and not in the most obvious ways. However, given that the future of Japan, like that of all countries, is strongly conditioned by its past and by its existing institutions, looking for such dramatic change may be the incorrect approach—and it may lead analysts to miss the important changes that *are* taking place. Foreign firms are engaged in Japanese politics, despite the odds being stacked against them for most of the post-World War II period. Foreign firms are playing the game by Japanese rules, and they are winning, at least some of the time. This constitutes a meaningful change from an earlier period, and it helps scholars of Japan to understand the ways that the country has been transformed over the past few decades. Foreign firms are part of the domestic process of Japanese policymaking; they exert an influence on Japan's internal reform processes in a way that was previously unfathomable.

Second, although these changes in the Japanese political economy are relatively small, they are likely to become more prevalent and more important over time. In many sectors, Japan faces intensifying challenges from abroad. It is under increasing pressure to change its ways, and unlike in the early post-World War II period, this pressure is coming not only from foreign governments but also from actors operating within its own borders. Japanese actors frustrated with the country's stagnation and rigidity are demanding change and finding willing coalition partners in foreign firms. These cross-national partnerships will grow more common as globalization continues to reshape existing Japanese institutions. Moreover, Japan as a country is increasingly being drawn into global and regional policy battles over issues such as intellectual property rights and privacy, which will be discussed further in the final section of this chapter.

Third, and most importantly, the changes described in this dissertation illustrate an important change in Japanese politics: it is becoming more difficult to define “foreign” pressure. Decades of previous research characterized Japan as a reactive state that only took action when confronted with foreign pressure; while this may still be true to some extent, trade liberalization and globalization have meant that this “foreign” pressure has been internalized within Japan. Instead of a policy debates in which domestic and foreign actors neatly line up against one another, contemporary developments make it increasingly difficult to define who is foreign and what exactly is in Japan’s national interest. Some foreign firms such as Aflac might be defined as Japanese if one were to take where they make the bulk of their profits into consideration; foreign firms such as these are so deeply embedded in the Japanese political economy that their status as truly foreign is questionable. Interests cut across national borders and industrial sectors, and business preferences within the same country are increasingly divided as regulatory issues become more complex, as seen in the case of the ICT sector. This means that foreign actors often share common interests with Japanese actors and act in willing coalition with the latter. Older theoretical models of foreign pressure and reactivity must be updated to account for these new dynamics.

#### **7.4 Implications for Other Countries**

Beyond Japan, the findings of this study have implications for the study of both developing and developed countries. First, while much of the existing literature in comparative political economy has focused on characterizing national models of economic relations, this study lends support to a growing body of research that suggests that multiple different models may be at work within a single country. Countries have liberalized sectors at different rates and in different ways. Both domestic and foreign firms respond to sector-specific challenges, and the activities of these firms in turn define the regulations and institutions of these sectors. The scholarly debate over whether globalization leads to convergence seems to have arrived a consensus that globalization pushes countries closer toward each other in some important ways yet important differences remain. This dissertation illuminates the ways that the forces of globalization are filtered through national and sectoral institutions. It also gives agency to these forces by focusing on the behavior of foreign firms. This approach illustrates that change may not always be in the expected direction; while foreign firms may push for greater liberalization and harmonization of policies in many areas, they may also become forces for protectionism if it suits their interests.

Second, and relatedly, the organization of this study around a cross-sectoral comparison in Japan yields insights into parallel developments occurring in other sectors around the world, in developed and developing countries alike. Sectoral analyses of government-business relations gain explanatory power from the fact that sectors embody distinct constellations of more basic economic characteristics that exist in countries around the world. The politics of agriculture, pharmaceuticals, insurance, and information technology are based in national arenas but they also have characteristics that transcend these borders. The economic characteristics of the firms themselves and that of their sector shapes the incentives for how they interact with one another and the state, by inducing firms to act collectively in the market and in their dealings with the government; to not cooperate and act independently; or to avoid any involvement at all with the state. As a result, the lessons of this study have the potential to travel readily to any other countries doing business in these sectors.



Third, for developing countries, the Japanese case offers insight into the consequences of early decisions about trade liberalization for a country's political and economic environment. Much scholarly attention has usefully focused on the activities of multinational firms in developing countries. In situations where national institutions are relatively weak and underdeveloped, the entry of foreign firms can have very dramatic consequences for domestic firms and for the development of the country's national economy as a whole. The mechanisms of influence and change that have been identified in this dissertation, particularly the ones surrounding differing patterns of coalitional formation, may be useful to scholars of developing countries in thinking about the ways that politics are affected by the entry of foreign firms into a national arena.

Finally, the study of developed countries can also benefit from the examination of Japan as an extreme case of protectionism among OECD countries. It is generally accepted that advanced industrial states have greater ability to control their national economies than developing countries; among these developed countries, the Japanese government was particularly adamant in its attempt to limit foreign influence within its borders. The relatively closed nature of the Japanese economy made it easier in this project to identify the strategies of foreign firms seeking to influence Japanese policy; these strategies can be thought of as causal mechanisms whereby global, or foreign, forces affect a national economy. If these mechanisms are at work in even an extreme case such as Japan, they can be located and tested in other developed countries around the world. The fact that foreign firms were able to influence politics even in Japan implies the dynamics observed in the preceding case studies are even more pronounced and prevalent in developed economies that are more open to trade.

## **7.5 The Domestic-International Nexus in Trade Politics**

In many ways, this dissertation is about Japan, but it is also very much about political and economic processes occurring at the sectoral, regional, and global levels. The preceding chapters have dealt with sector-specific arrangements such as the US-Japan insurance agreements, regional developments such as the Trans-Pacific Partnership, and global pacts such as the GATT and the WTO. This interweaving of the sub-national, national, regional, and international levels has been essential to understanding the political economy of the four sectors examined in this project. Without any one of these components, it would have been impossible to understand the political dynamics that are increasingly coming to define political economy. In this way, a project that is ostensibly about a single country can be used to shed light on developments around the world.

The findings of this dissertation emphasize the need for greater examination of the places where comparative politics and international relations intersect and mutually shape one another. Although subfields in political science have traditionally been grouped in such a manner, collaboration and cross-fertilization across areas is increasingly important. The intersection between comparative political economy and international political economy, for example, holds many fruitful areas of inquiry that require a deft interweaving of the national, regional, and global levels. The growing international role of domestic institutions means that domestic initiatives can have significant and often unanticipated consequences for global governance, and global governance in turn affects the evolution of these domestic institutions. In trade as well as in security, a greater diversity of actors are involved in policymaking. Global environmental issues have also drawn in a wide assortment of actors operating at multiple levels. It is difficult

to define a clear line between the domestic and international aspects of the politics surrounding these and so many other topics.

Many analysts have attempted to model and study domestic-international intersections in the past. A key contribution of this project has been the incorporation of some of the most prominent of these frameworks into a single analysis. We are not in a world of closed countries, nor are we in a world of complete global integration. We are somewhere in between, and this ambiguity requires greater analytical precision on the part of scholars if we are to understand precisely how these dynamics are playing out. Frameworks such as two-level games and transnational interactions give us important tools with which to analyze the dynamics of political economy, and I have offered the concept of cross-national coalitions as an additional analytical device with which to characterize the areas where cross-border networks collide and intersect with the domestic policymaking process.

In addition, this dissertation has also fundamentally dealt with the interaction between public and private actors. It suggests that public-private partnerships are an increasingly important part of politics, and that studies that exclude these perspectives offer an incomplete picture of the dynamics at work. Moreover, corporate political strategies go beyond simple lobbying or campaign finance; in many cases, firms are actively forming political alliances with other actors in order to accomplish their goals in a way that is not easily quantified or predicted. These firms are also actively writing the rules of the international political economy. Private forms of governance add an additional layer of complexity to the emerging web of global rules and regulations. These important developments are too often neglected by political science, judged as either too peripheral or too technical to have real relevance for politics. And while literature in business and economics has delved more earnestly into understanding the evolving role of firms, these examinations have often been narrowly focused without important political context.

All of these observations point to the need for more flexible theoretical frameworks that integrate multiple fields of study, including political science, economics, sociology, business, and area studies. The incorporation of these disciplinary perspectives with multiple levels of analysis will allow analysts to move our understanding of political economy to the next level. In many ways, we are struggling still with the problem of moving beyond the simple observation that multiple variables are related to the next step of specifying exactly how these elements are related. Making this leap will require a challenging combination of both greater precision and broader scope of analysis. Meeting this challenge will be essential to ensuring that scholarship evolves quickly enough to keep up with our rapidly changing world.

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