

## **OECD REVIEWS OF REGULATORY REFORM**

### **JAPAN**

#### **PROGRESS IN IMPLEMENTING REGULATORY REFORM**

##### **EXECUTIVE SUMMARY**

In the years since 1999, when the OECD regulatory reform review of Japan was published, the Japanese government has introduced a number of measures to enhance regulatory quality and promote regulatory reform, competition policy and market openness. This monitoring exercise was initiated to assess the progress made, to identify some of the lessons that can be learned about the process of implementation and to indicate what more can be done in the light of current challenges. The monitoring exercise covers the core issues of capacity for regulatory quality, competition and market openness, each presented in a chapter of its own.

Efforts to improve regulatory quality have the objective of enhancing the environment for competition, innovation and growth, while ensuring that regulations efficiently serve important social obligations. Although regulatory reform is clearly part of the domestic agenda, it has international ramifications, not least because regulatory systems can help promote market openness, and regulatory co-operation can help promote harmonisation and recognition of foreign conformity. Regulatory systems contribute to the overall profile for competitiveness and the quality of public governance.

Regulatory reform has helped Japan cope with its low rate of economic growth in recent years, which has been symptomatic of its need to address structural problems. There is further scope to improve regulatory quality in the service sector, particularly to encourage inward investment. This would strengthen competition, with positive effects on growth. Better use of regional assets, which the special zones programme encourages, should strengthen innovation and resiliency in the Japanese economy. Further reform now may make it easier to cope with problems in the future related to the size of the public debt and the demographic transition related to the ageing of the population.

In the recent past, the emphasis in Japan has been on deregulation. The goal in 1998, when Japan was reviewed, was to complete the move from a model of state-led growth to a model of market-led growth characterised by a more efficient and flexible economy. In Japan as in other countries, this transition shifts attention away from the quantity of regulation to its quality. As policy objectives become more diverse and respond to social and economic change, to new problems and to technological innovation, regulation itself is becoming more complex. This calls for further efforts to improve regulatory tools and institutions, to reassess existing regulations in the light of current economic and social developments, and to assess the impact of new regulations when they are drafted. Sustained, comprehensive action is needed to ensure the thorough implementation of measures already taken, to broaden the constituencies in and out of government supporting the regulatory reform agenda, reinforcing procedures and institutional capacities to ensure that good regulatory practices become integral to the culture of the public administration. A whole-of-government approach is one of the main challenges for Japan's next three-year Program for Regulatory Reform.

Much has been accomplished since the end of the 1990s as a foundation for the future. A pragmatic and incremental approach toward implementation, and strong political leadership at the highest level have been important factors. The competition authority has been strengthened, the Council on Regulatory Reform (CRR) has helped to consolidate support for the government's agenda, and the special zones programme, which is also part of the Prime Minister's office, has promoted significant local initiatives and accelerated the process of revising existing regulations. In its recent reports, the CRR has taken up reform in areas of social regulation such as medical care, social services and education. On 19 March 2004, the Cabinet decided on the next Three-Year Programme for Promoting Regulatory Reform, and a three-year mandate for the CRR (renamed the Council for the Promotion of Regulatory Reform). The highlights include establishment of a ministerial committee to serve as a headquarters for regulatory reform, continuation of the CRR based in the cabinet office as a private-sector advisory body, introduction of Regulatory Impact Analysis, promotion of reform through the programme for special zones for structural reforms, and a focus on reform in 17 priority areas. These measures could further strengthen the horizontal co-ordination of regulatory reform. Although regulatory reform depends on the political support of the prime minister, the priorities of any prime minister will change over time, with the result that the agenda for regulatory reform may not be given the attention it deserves, consistently and for a long enough period, to sustain a change of administrative culture.

The review of existing regulations and administrative simplification measures is underway but the process is incomplete. Japan's e-government policy aims to make all existing administrative procedures and transactions possible through the Internet. By April 2004, 97% of all procedures handled by the national government (around 13 000) were available on-line. Most OECD countries have considerable stocks of regulation and administrative formalities that have accumulated without adequate review and revision. Yet regulations may soon be outdated due to technological innovation or social or economic change. The elimination of regulations to balance supply and demand, and the conversion of ex-ante permits and licenses to *ex post* notifications, have been key objectives of regulatory review programmes since 1999. Despite success in eliminating most supply-and-demand regulations in many sectors, surveys show that the number of ex-ante permits and licenses has not been significantly reduced. Numbers do not reveal qualitative improvements, of course; and new authorisations may be needed to meet new health, safety, environmental and business laws. But the steady flow of new ex-ante permits indicates the progress still to be made to reduce administrative burdens, and promote alternatives to regulation.

Japan has made substantial progress in the most important competition policy areas highlighted in the 1999 Report. Key issues identified at that time included the scope of exemptions from competition law and non-competitive tendencies in regulation, including the penchant for "supply-demand" balancing controlling entry, and administrative guidance countenancing co-ordination. Progress in the reform of economic regulation is demonstrated by the removal from most sectors of supply-demand balancing as a consideration for controlling entry. Removing the exemption for "inherent monopoly" has permitted the FTC to take more enforcement actions in regulated network industries. The FTC has a new economic unit and substantially more resources. A new law which gives the FTC new powers to deal with official involvement in bid-rigging takes some steps against administrative tolerance of collusion. Private suits are now authorised to seek orders as well as damages, and many have been attempted. Increasing the financial charges against violators will bring Japan's competition enforcement more into line with levels of deterrence in many other OECD countries.

As traditional barriers to trade and investment have declined over recent years, the impact of domestic regulatory frameworks on market openness has become increasingly apparent. In general terms, progress in improving the economic efficiency and competitiveness of national economies is determined less by new measures liberalising border treatment for trade and investment, and more by *behind the border* regulatory reform in areas such as standards, sanitary and phyto-sanitary measures, markets for services, investment, etc. The role of market openness within the regulatory reform process is to support the attainment of

regulatory objectives, including safety, health and environmental quality, in a manner that minimises negative impacts on domestic competition and efficiency. The integration of market openness considerations within regulatory systems becomes important. A big step forward was taken in 2001 when two government bodies dealing specifically with issues raised by both domestic and foreign businesses regarding regulations that impede access to the Japanese market were moved to the Cabinet Office: the Office of Trade and Investment Ombudsman (OTO) and the Office for Government Procurement Challenge System (CHANS). Progress made in recent years highlights the positive linkages and mutually reinforcing patterns between domestic regulatory reform and targeted efforts to facilitate market openness.

An analysis of concrete results in terms of better integrating market openness within the Japanese regulatory system has yielded inconsistent results to date, but the overall trend appears to be positive. A clear framework has been put into place which could support further progress. Improvements in customs administration have been significant in recent years. In the medium term, judicial reforms will help domestic and foreign producers by enhancing the transparency and predictability of an economic system traditionally less reliant on the open application of rules than on discretion and custom as a means of resolving disputes. Although some progress has been made in various fields, it is clear that better integration of the need to avoid trade restrictiveness into the regulatory system would enhance the business environment and help avoid disputes with trading partners.

One recommendation of the 1999 report encouraged the Japanese Government to promote public understanding of the benefits of regulatory reform. Active efforts have been made in this regard, in particular with respect to inward FDI. In a context of generally improving conditions for FDI since 1999, particular impetus was given by Prime Minister Koizumi's decisive efforts to overcome suspicion of foreign ownership as part of his goal to double the amount of inward FDI into Japan over 5 years. Negative misperceptions of foreign investment must be challenged in a conscious effort to improve the image of FDI. Inward FDI is normally long term, brings technology and can be a key element for revitalising the Japanese economy.

Transparency-related measures are common to concerns about competition policy, measures to improve market openness, and regulatory quality. The Administrative Procedure Law adopted in 1993 has played an important role in improving administrative transparency and predictability by requiring government agencies to specify and make public the standards used to evaluate applications, and to specify standard processing periods for issuing licenses, permissions and approvals. The provisions of the law could be strengthened to monitor compliance. The government is committed to review the Administrative Procedure Law of 1993 as part of its new Three-Year Plan for Regulatory Reform.

The Public Comment Procedure of 1999 sets out regulations for the implementation of a system for public comments within the rulemaking process. The "No Action Letter" (NAL) system enables firms to seek prior clarifications on how regulations will be applied in certain situations. Both measures are positive steps, but their effectiveness could be improved. For example, the Public Comment Procedure is not applied to government procurement.

In accordance with the new Three-year Plan and Programme for Regulatory Reform of March 2004, RIAs are to be conducted by Ministries and Administrative Agencies on planned and existing regulations, beginning in 2004, as appropriate. The text of the Plan however does not indicate the criteria to be employed. The plan implies rather than formal, binding obligations regarding RIA will emerge from an experimental, introductory phase. Training programmes will be needed, and some consideration could be given to establishing a centre-of-government unit which could monitor the progress being made in ministries to introduce and diffuse RIAs. This is especially important insofar as RIAs should consider the effects of foreign trade and investment or of competition, when such criteria may not be the primary concern of a ministry or agency.

The programme for deregulation by establishing so-called special zones is a unique example of a place-based approach to regulatory reform. Thanks to the Special Zones programme based in legislation approved in 2002, certain regulations can be eased or lifted in geographically limited areas as a testing ground and first step for reforms to be implemented at the national level. Given the large degree of independence of national ministries, nation-wide reform can be difficult to co-ordinate. In Japan, therefore, an area-based approach which combines regulatory reform with elements of decentralisation can lead to initiatives which might otherwise take longer, due to resistance by special interest groups. The system of prior screening of applications for the programme however raises questions about criteria for accepting or rejecting a project. Although it is too soon to assess this initiative definitively – the first zones were not approved until April 2003 – it has succeeded in generating hundreds of proposals, many of which have been implemented locally, and eventually nationally. However, the procedures which require an evaluation committee which meets only once a year to assess whether regulatory exemptions allowed for a particular special zone should be implemented nationally, discontinued, or maintained only in a special zone, limits the impact of this programme on the stock of regulations.

Three issues need attention if Japan's ambitious agenda for regulatory reform is to be realised:

- Commitment in the bureaucracy. Reform takes time and energy, and may not be rewarded. Sectoral ministries may be close to businesses in their sector.
- Public-private co-operation. An important driver for reform, but difficult to promote insofar as the constituency outside the government is diffuse, and may adopt a sectoral approach favouring reform on some issues but not on others.
- Multi-level co-ordination. The Special Zones programme highlights the importance of innovation at the local level, to design rules that are better adapted to local needs and opportunities. But decentralisation can pose new challenges related to co-ordination between central, regional and local governments.

The policy environment for reform is better now than it was a few years ago, but this is not the time to relax the effort. In many OECD countries, a crisis created the opportunity to pursue regulatory reform aggressively. The weak performance of the Japanese economy since the bubble burst in 1992 constitutes a crisis of sorts, insofar as it precipitated a debate about the need for structural reforms, and coincided with other changes in the economic environment, such as the emerging economy of China, the ageing of the population and the rise of the Internet, which call for a more adaptive economy. The association of regulatory reform with deregulation reflects the objectives of the recent past. Implicitly, regulatory reform embodies a vision of the future. However important the technical and legal dimensions of regulatory reform may be, they will only be implemented thoroughly insofar as people see them as progressive, forward-looking measures in keeping with changes already underway in Japan. A high quality regulatory regime requires a proactive role for government in the creation and enforcement of regulations.