



The Internet in Japan: Catalyst for Change?

DEWEY BALLANTINE LLP
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
202/862-1000

CYBERWORKS JAPAN
1745 Pennsylvania Avenue, N.W.
Suite 118
Washington, D.C. 20006
202/223-0370

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Dewey Ballantine LLP's International Trade Group (www.dbtrade.com), based in Washington, D.C., includes a "think tank" function which produces analytical studies and offers economic consulting services with respect to foreign markets and government policies. The Group has analyzed the international trade and competitive environment in individual industries, as well as the trade, industrial, and regulatory policies of China, Japan, Russia, Korea, Taiwan, the European Union, Brazil and many other countries. Tom Howell, a partner, oversees a group of economists and trade specialists with foreign language and area expertise. Eight of the Trade Group's professionals are fluent in East Asian languages, including Japanese, Mandarin and Korean. Mr. Howell and Maki Hishikawa, the firm's Director of Japanese Research, are currently working on a book on the liberalization of trade and investment policy in Japan from the Occupation to the present, based on Japanese language sources. Jennifer Danner Riccardi, a senior associate in the Trade Group, most recently worked on a study entitled "The Horse Racing Industry in the Age of the Internet."

Cyberworks Japan (www.cyberworksjapan.com) maps the available Internet space for foreign companies going online in Japan. CWJ assumes that the Internet is a unique marketing route - a potentially open, efficient, and culturally neutral distribution channel - but that foreign firms will need more than technology for lasting success in Japan's online marketplace. Rachel Howe has specialized in research and analysis of Japan market access issues while Managing Partner of DSA Analytics, Trade Specialist in the International Trade Group of Dewey Ballantine, and Information Officer in the East Asia Group at the CIA. Ms. Howe holds a B.A. from Smith College, an M.A. from Yale University, and is an American Translators Association credited translator.

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The Internet in Japan: Catalyst for Change? provides a more complete understanding of the regulatory and business issues shaping the growth of ecommerce in Japan. Please note that the study is not intended for use as an authoritative treatise on Japanese law; rather, it is intended as a general guide outlining emerging issues in ecommerce in Japan. In addition, it should be noted that no attorney licensed to practice law in Japan reviewed the included summaries of Japanese law.

THE INTERNET IN JAPAN: Catalyst For Change?

EXTENDED SUMMARY¹

Japan's insularity and resistance to change have exasperated Japanese internationalists and reformers for nearly two centuries. However, notwithstanding the country's abiding conservatism, at a few key junctures in Japan's history, revolutionary reforms have been implemented with dramatic speed. Both the Meiji Restoration of 1868 and the postwar U.S. Occupation saw the rapid, wholesale dismantling of failed institutions and outmoded structures, clearing the way for sustained periods of dramatic economic growth and technological improvement. Today many Japanese observers believe their country is on the verge of another such revolution – this one driven by the advent of the Internet and ecommerce – which will lift Japan out of its protracted recession, sweep away remaining obsolete regulatory and economic arrangements, and catapult the country into a position of world leadership in information technology. Many Japanese leaders, including Prime Minister Mori, are actively seeking to realize this vision.

But it remains an open question whether the diffusion of Internet access and ecommerce throughout Japan can bring about epochal changes in Japan's economy, or whether this initiative will become only the latest in a series of failed reform efforts. Powerful domestic constituencies oppose deregulation and regard the Internet with suspicion. Rival ministries have advanced competing and in some respects inconsistent visions of the measures needed to adapt Japan's economy to the new technologies. A vast array of laws and regulations enacted before the Internet existed act as a drag on the spread of ecommerce. Japan's effort to promote the Internet as a catalyst for economic reform may be seen as a very powerful force for change which is only beginning to engage very firmly entrenched structures and interests. Skeptics note that the Japanese government, whose regulatory policies are blamed by many for the country's economic stagnation, should not be attempting to lead the IT (information technology) revolution -- "what needs to be done first is to have the government take its hands off IT."² Thus, while the prospects for the present Japanese economic reform effort are probably better than for any which have preceded it in the past half century, the outcome is nevertheless still viewed as uncertain.

The "lost decade." The recession which has gripped Japan since 1990 has fostered a widespread sense that radical change in government and the business world will be required to restore the country to acceptable levels of economic growth. While Japan's economic malaise has generated no shortage of diagnoses by Japanese and foreign analysts, perhaps the most common

¹ This paper summarizes a 250 page study prepared in cooperation with Sponsors, General Electric Japan, Ltd., IBM World Trade Asia Corporation, Microsoft Asia Limited, and Kodak Japan Ltd. The paper represents the work product and perspective of Dewey Ballantine LLP and Cyberworks Japan and does not necessarily reflect the views of the Sponsors, who did not exercise an editorial role. The Sponsors' role has been to provide information, perspective based on their experience, and commentary.

² Kenichi Omae, management consultant and author, in "There Will Be No Information Technology Revolution In Japan," *Kyoto Voice* (September 2000).

observation is that the policies, structures and practices which once produced the “economic miracle” of the 1950s and 1960s are now acting as a drag on Japan’s economic performance, in general, and on its adoption of the new information technologies, in particular.³ Japan’s economic “lost decade” stands in particularly painful contrast to the sustained economic expansion which has taken place in the United States, now attributed, in substantial part, to the pervasive, positive effects of promoting new information technologies throughout the U.S economy.⁴ Japanese leaders note with dismay that their country not only lags behind the United States in diffusion of information technology, but by some indicia, behind some of its Asian neighbors as well. As of early 2000, there were an estimated 2.6 million host computers in Japan, as compared to some 53 million in the United States, and Internet penetration in Japan lagged behind that of countries such as South Korea, Taiwan, Hong Kong, and Singapore. A Korean information technology expert recently commented that:

We respect Japan in terms of technology, but Korea has little to learn from Japan as far as IT policy matters are concerned.⁵

The “IT Strategy.” A recurrent sense of falling behind the rest of the world has driven many of Japan’s most successful economic and technological achievements – including the Meiji Restoration itself – and Japan’s perceived lag in embracing the Internet has given rise to a major government reform effort. In July 2000, Prime Minister Yoshiro Mori, calling for a “rebirth of the Japanese economy,” pledged to place IT policy at the center of his economic policy:⁶

I will personally demonstrate leadership in order to bring about a ‘Japanese IT society’ in which everyone, from children to the elderly, can enjoy the benefits of IT.⁷

Mori created a new cabinet post, “IT Minister,” responsible for coordinating the IT policies of various ministries and spearheading the Prime Minister’s IT promotion campaign.⁸ Mori also established a blue-ribbon “IT Strategy Council,” headed by Sony Chairman Nobuyuki Idei, to recommend a strategic direction for the country. To support the Council, Mori created an “IT Promotion Office” within the cabinet Secretariat, consisting of about 50 staff members drawn

³ “IT Strategy Council Head Idei Interviewed on Obstacles to IT Revolution,” *Chuo Koron* (November 2000); “Mr. Prime Minister Obuchi, Your Economic Policy is Faulty,” *Gendai* (July 1999); “Without Reform, Japan Risks Underdevelopment,” *Kyodo News*, July 15, 1999; Richard Katz, *JAPAN, THE SYSTEM THAT SOURED; THE RISE AND FALL OF THE JAPANESE ECONOMIC MIRACLE* (Armonk, NY: M.E. Sharpe, Inc., 1998); “Japan Seeks its ‘Third Way’ to Adapt to Globalization,” *Le Monde*, December 17, 1999.

⁴ “Japan’s Lost Decade a Blessing in Disguise,” *Asahi*, December 31, 2000.

⁵ Dr. Sonn Sang Young, Korea Information Society Development Institute, “South Korea Questions Japan’s IT Commitment, Strategy,” *Kyodo News*, November 27, 2000.

⁶ Prime Minister Yoshiro Mori, Speech at the *Rebirth of Japan Public Policy Conference* (December 13, 2000).

⁷ *Kyodo News*, July 28, 2000.

⁸ *Kyodo News*, July 27, 2000.

from government ministries and the private sector.⁹ A number of government ministries established internal IT-specific councils and committees to study measures to promote IT.¹⁰

The IT Strategy Council quickly proclaimed a national goal of overtaking the United States as the world's "high-speed Internet superpower" within five years, and established the IT Basic Law, the foundation for IT promotion legislation that was quickly enacted by the Diet in November 2000. In order to promote ecommerce, the government is now undertaking a wholesale revision of laws and regulations affecting virtually every part of the Japanese economy, and is implementing what is arguably the biggest restructuring of its own bureaucracy since the U.S. Occupation. Among other things, the Ministry of Posts and Telecommunications (MPT),¹¹ which regulates Japan's telecommunications system, has been merged into a new super "Ministry of Public Management, Home Affairs, Posts and Telecommunications" incorporating the old Management and Coordination Agency and the Ministry of Home Affairs. The new entity has made it clear that it will seek massive public works funding to construct optical fiber communications networks linking most of Japan's households with high speed, high volume Internet access. In July 2000, the Mori Cabinet approved 34.2 billion yen (or approximately US\$ 300 million) for IT projects to be funded from Japan's public works reserve in fiscal 2000. For fiscal 2001, IT-related budget requests from various ministries total nearly 800 billion yen (or approximately US\$ 7 billion).¹²

If successful, Japan's belated embrace of the Internet may well produce what some Japanese analysts are already proclaiming to be a "paradigm shift" – a dramatic departure from practices and patterns of doing business that have characterized the Japanese economy since the War. Eisaku Sakakibara, a highly respected former Vice Minister of Finance, comments effusively that "this is a revolution. . . . In Japan, as in the United States, the existing [economic] order will collapse."¹³ *Mainichi Shimbun*, Japan's third largest daily newspaper, observed on April 3, 2000:

A great current of creative destruction is sweeping over the economy of Japan, forcing change on the financial industry, overall industry, and the lives of the people. This great current is taking down the paradigms (the basic framework and value structure of major technology and systems) that have supported and led the

⁹ *Jiji Press*, July 28, 2000.

¹⁰ Industrial Structure Council, Information and Economy Subcommittee, The Ministry of International Trade and Industry, *Improvement of Competitive Environments Concerning Network Infrastructure and Systems, Reforms to Facilities, the IT Environment (First Proposal- draft)* (August 2000); *Nihon Keizai Shimbun*, July 16, 2000; *Nihon Keizai Shimbun*, July 27, 2000.

¹¹ MPT became part of a new Ministry of Public Management, Home Affairs, Posts and Telecommunications on January 6, 2001. Although a number of ministries' names were changed on January 6, 2001 pursuant to a restructuring of the government, the previous names are used in this paper so as to be easily identifiable.

¹² *Nikkan Kogyo Shimbun*, September 1, 2000; <Ministry of Finance website>; *Nihon Keizai Shimbun*, July 26, 2000.

¹³ "Responding to the World's 'Americanization,'" *Ronso Toyo Keizai* (March 2000).

nation in the 20th century, and is producing the new paradigms that will be used in the 21st century.¹⁴

A changing Japan. The Japanese government's efforts to revitalize the economy through promotion of information technologies are accompanied by startling changes in the Japanese business world and in the broader society, which have become increasingly manifest during the course of the "lost decade." These developments reinforce the view that the country really is in the process of shedding the tangled array of outmoded practices, arrangements, and attitudes blamed by many for its current economic stagnation:

- The Japanese **financial system**, protected by the government since the financial panic of the 1920s, is now being subjected more fully to market forces. Non-performing financial institutions are being allowed to fail, making them less willing to provide financial support to *keiretsu* member companies – thus placing greater competitive pressures, in turn, on those firms.
- Financial and industrial **keiretsu relationships**, which have long constituted an impediment to mergers, acquisitions, and other forms of restructuring, are eroding. Financial institutions and trading companies are divesting themselves of cross-held equity stocks of *keiretsu* firms which serve no readily apparent strategic or investment purpose.¹⁵ Japanese manufacturers' *keiretsu* systems, consisting of vast networks of suppliers of parts and subassemblies, are weakening as both manufacturers and their affiliated parts suppliers move to develop relationships outside their groups.¹⁶
- **Foreign direct investment**, viewed by generations of bureaucrats and business leaders as a threat to be contained, is now being warmly encouraged both by the government and the private sector. Foreign acquisitions of, and mergers with, Japanese firms – traditionally regarded as taboo – are proliferating. Foreign investment levels more than doubled in 1999 over 1998 levels, as did M&A activity involving combinations of Japanese and U.S. firms. U.S. venture capitalists, noting changes in Japanese attitudes and legal and tax laws which are more conducive to venture businesses, are opening offices in Japan; one such investor comments that "I saw the culture opening up. I saw risk-taking starting to be somewhat obvious, and I saw a chance to form a [Japanese] venture firm that could really perform the way Americans do."¹⁷
- The tradition of **lifetime employment**, "the most fundamental custom of postwar Japan," is being abandoned by some companies with what appears to be widespread approval within Japanese society. Job-hopping by ambitious individuals drawn by merit compensation systems is increasing.

¹⁴ *Mainichi Shimbun*, April 3, 2000.

¹⁵ "Reborn Japan Starts With Individual," *Nihon Keizai Shimbun*, January 3, 2000; "Japanese Manufacturers Promoting Real Reform," *Nikkei Telecom*, October 30, 2000.

¹⁶ "Requirements for Excellent Companies in the 21st Century: Japanese Companies Will be Transformed by IT-based 'Direct Democracy,'" *Ekonomisuto*, October 17, 2000.

¹⁷ "American VCs Land in Japan," *Venture Capital Journal* (May 2000).

- The ***Liberal Democratic Party***, whose total monopoly on political power for nearly four decades impeded the development of a more competitive economy, has seen its monopoly steadily erode since it lost its majority in the Upper House of the Diet in 1989. The LDP fell from power in 1993, and, although it regained power a year later, has been forced into coalitions with shifting combinations of opposition parties in order to retain it. The struggle over economic reform will produce further divisions in the LDP and a more sharply competitive political environment – a dynamic which is likely to prove conducive to economic reform.
- Japanese leaders are placing emphasis on more vigorous ***enforcement of the Antimonopoly Law***, long seen by many as an unwelcome and unnecessary vestige of the U.S. Occupation. The Ministry of International Trade and Industry (MITI),¹⁸ which has traditionally protected cartelized industrial sectors from the Japan Fair Trade Commission's (JFTC) enforcement efforts, is today actually working in alliance with the JFTC to foster greater competition in the telecommunications market.
- Japanese companies and the government, which have been reticent to employ ***foreign advisers*** in any strategic capacity since the early days of the Meiji reforms, are now making more use of foreign advisers for a broad array of public and private strategic planning purposes. The Japanese government is commissioning studies by foreign consultants and inviting foreign companies to participate in the industry-government advisory groups that have traditionally formulated recommendations that provide the basis for Japanese regulatory and industrial policy. Japanese companies are using foreign information technology consultants, investment advisers, and strategic planners. The IT Strategy Council has recommended that Japan seek to attract 30,000 foreign IT experts by 2005.¹⁹
- ***Japanese women***, who have long found their opportunities in the business world sharply constrained, are using the Internet to establish and expand a proliferation of new ebusinesses, effectively bypassing traditional barriers.

Japan's recent changes have been sufficiently pronounced that on a recent visit Malaysia's Premier Mohamad Mahathir, a frequent critic of Western economic systems, chided Japan for "trying to introduce Western methods in its political and economic systems at a stroke," and for "abandoning its traditional virtues."²⁰

Impediments to radical economic reform. Notwithstanding numerous signs that Japan is undergoing fundamental change, it is not at all clear that the paradigm-shattering, Internet-driven upheaval sought by the current generation of reformers will actually occur. It should be recalled that in 1971-72 the popular Prime Minister Eisaku Sato, with substantial support within the government and from the business community, undertook a similarly ambitious effort to internationalize Japan's economy and sweep away investment and trade barriers on a wholesale basis – only to see the effort bog down in the face of resistance in the bureaucracy and opposition

¹⁸ MITI's name was changed to the Ministry of Economy, Trade and Industry on January 6, 2001.

¹⁹ *Nikkei Telecom*, January 14, 2001.

²⁰ "Mahathir Blasts Japan's 'Westernization,'" *Mainichi Daily News*, January 19, 2001; "Malaysian PM Mahathir Urges Japan 'to Think Twice' Before Westernizing," *Jiji Press*, January 18, 2001.

from important threatened constituencies, notably the farm sector.²¹ The advent of the Internet, like the liberalization Sato sought to achieve, is potentially destabilizing to a number of domestic vested interests, and, if the past is a guide, they will not passively accept their own obsolescence. The reformers' deregulation drive, which has increasingly come to emphasize the Internet, has encountered stout resistance, with critics charging that deregulation is a "craze" and a "call to follow the American way," discarding national assets such as administrative guidance and Japanese-style management, which at one time produced high rates of economic growth.²² Government ministries, the Diet, the business community and the LDP itself are increasingly divided between advocates of reform and defenders of the status quo. Threatened constituencies will resist rapid change or seek to gain control of the new technologies in a manner that prevents them from disrupting established relationships and arrangements.

In the telecommunications sector, which must provide the infrastructure for the diffusion of the new technologies, the abiding dominance of Nippon Telegraph and Telephone (NTT) raises significant questions as to whether the highly competitive, Internet-driven economy envisioned by the reformers can actually be achieved. NTT's high interconnection rates, more than any other single factor, have limited the growth of Internet usage in Japan. Sony Chairman Nobuyuki Idei, Chairman of Japan's IT Strategy Council, summed up the problem in November 2000 when asked to identify the biggest obstacle to Japan's IT revolution:

It is the fact that in this country, the communications volume is extremely small, while the communication fees are so high. A new industry can never be born and grow under this condition.²³

A. Shaping the Japanese Internet

Japan has not lagged in all aspects of information technology, as popular accounts sometimes suggest. Japanese IT hardware manufacturers – makers of computers, telecommunications equipment, and semiconductors – are world leaders in many key product areas. Japanese-made, lightweight, Internet-mode color handsets, for example, "are arguably the most sophisticated in the world."²⁴ Japan's cellular phone network is superior to that of the United States, a fact which underlies an emerging Japanese leadership in the mobile Internet, and Japan leads the United States in geographic coverage of its fiber optic network. However, Japan's regulatory regime, which has contributed to the country's success in some areas, has retarded the growth of ecommerce in general, and is channeling the country's Internet growth in directions which, from a U.S. perspective, are idiosyncratic, and, from a Japanese perspective, may forestall the

²¹ "To Speed up Liberalization to Avoid Post-Textiles Tension," *Yomiuri*, June 26, 1970; "MITI Varies About Rising Protectionist Movement; To Control It Through Liberalization," *Mainichi*, August 12, 1970; "Government to Liberalize Imports of Grapefruit, Race-Horses, Etc. from June 30," *Tokyo Shimbun*, June 29, 1971.

²² "The Answer Cannot be Written with Theories of Deregulation and Structural Change," *Sekai* (March 1998); "The Next Century Should Be a Time to Keep the U.S. at a Distance," *Kyoto Voice* (January 1998); "IT War: U.S. Strategy to Contain the NTT Optical Empire," *Shokun* (August 2000).

²³ Interview with Nobuyuki Idei, *Chuo Koron* (November 2000).

²⁴ "Cell Mates," *Red Herring* (January 30, 2001).

emergence of the competitive economy envisioned by the reformers. Because the current dominant position of the United States with respect to the Internet is the benchmark against which Japanese planners will measure the success of their own vision, it is, perhaps useful to note those aspects of the Japanese Internet which differentiate it from its U.S. counterpart today:

- ***Slow growth of Japan's PC-based Internet.*** The explosive growth of PC-based Internet usage which has characterized the United States (40 percent of households by the end of 1999) has simply not occurred in Japan (12 percent of households in the same period).
- ***Exponential growth of mobile access.*** Japan's adoption of mobile Internet usage has grown exponentially, from zero to 20 million subscribers in an 18-month period in 1999-2000, reflecting NTT Docomo's global leadership in this technology.
- ***Japan's lagging business-to-consumer (B2C) sector.*** According to MITI's most recent estimates, Japan's B2C ecommerce penetration rate, the percentage of online revenues to all household spending, was only .25 percent in 2000, compared with 1.37 percent in the United States.
- ***The singular role of convenience stores.*** Japanese convenience stores are emerging as key centers of B2C Internet sales. Consumers order products over the Internet at home or at terminals located in the stores, pay for the goods at the store (avoiding online use of a credit card) and take delivery at the store the next day. No analogous phenomenon exists in the United States.
- ***The fiber optic network.*** Japan leads the United States in coverage of its fiber optic network, and is pressing ahead with an ambitious plan to link its entire population with broadband connections by 2005.

The existing domestic Internet foundation upon which Japan's planners must build to realize their goal of overtaking the United States thus presents them with a mix of advantages, handicaps, and peculiarities. The advantages include Japan's leadership in the mobile Internet, the strength of its hardware manufacturers, and its telecommunications infrastructure; its principal handicaps arise out of its regulatory regime, both in telecommunications and in the economy generally; and the peculiarities (which may ultimately prove to be advantageous, problematic, or a mix of both) represent patterns of commercial and personal behavior that have arisen out of generations of heavy government regulation of economic activity.

The telecommunications regime. Historically, MPT, which regulates Japan's telecommunications industry, has to date allowed the dominant NTT to exercise market power to limit (although not wholly foreclose) the market entry and development of new competitors. Proponents of the IT strategy argue that the relative lack of competition in telecommunications has been and remains the primary impediment to the widespread adoption of the Internet in Japan.²⁵ Thus, the deregulation of the MPT/NTT-dominated telecommunications regime represents the central issue facing Japanese policymakers who seek to promote Internet usage in Japan:

²⁵ See, e.g., interview with Keio University Professor Heizo Takenaka, *Mainichi Shimbun*, January 4, 2001.

- **High interconnection rates.** NTT charges Japanese and foreign competitors high rates for access to its network, which most of them must connect with in order to provide service in Japan. NTT also charges for each local phone call, which means that the clock is ticking for Japanese Internet users who tend to limit their time online as a result. Such high interconnection and phone rates have arguably stunted the growth of the PC-based Internet in Japan, making it far more costly for consumers to spend time online than is the case in the United States and other countries.
- **Impediments to new entry.** Japanese critics of NTT charge that it is using its dominant position to forestall competitive challenges by other service providers, a charge which NTT denies. In October 2000 the JFTC initiated an investigation into complaints that one of NTT's regional units had deliberately hindered competitors from starting digital subscriber line (DSL) services by intentionally delaying connections and the installation of the necessary equipment in NTT's branch offices.

Rationale for NTT policies. NTT's defenders point out that it has used its relatively high interconnection fees to finance R&D in advanced communications technologies, to establish state-of-the-art communications networks, and to compete in international telecommunications markets.²⁶ NTT has indicated a willingness to reduce its interconnection fees over time, but not in such a dramatic manner that its R&D efforts and investments in the telecommunications infrastructure are jeopardized. NTT operates some of the foremost electronic research laboratories in the world, and between 1995 and 1999, invested an annual average of US\$ 3 billion in R&D – making it “one of Japan's principal investors in information and communication-related R&D.”²⁷ NTT's wireless affiliate, NTT Docomo, developed wireless Internet-capable “i-mode” service which has proven instantly and phenomenally popular with Japanese consumers, prompting NTT Docomo President Keiji Tachikawa to say:

If there were any company that could dare to say ‘We don't need Docomo's technologies,’ I would like to see it.²⁸

In addition to R&D, NTT is attempting to provide most of Japan's 43 million households with broadband connections within five years – a massive undertaking. NTT President Junichiro Miyazu commented in June 2000 that:

The point [with respect to interconnection fee reductions] is how to make a compromise between order in competition and [NTT's] universal service policy. It is necessary to set fees according to new services, and this is one of the important factors of competition.²⁹

²⁶ “IT War: U.S. Strategy to Contain the NTT Optical Empire,” *Shokun* (August 2000).

²⁷ National Science Foundation Tokyo Regional Office, *Research and Development at the Nippon Telegraph and Telephone Corporation*, Report Memorandum #99-09 (September 21, 1999).

²⁸ *Nihon Keizai Shimbun*, July 26, 2000.

²⁹ Interview in *Mainichi Shimbun*, June 18, 2000.

The progress of deregulation. MPT and NTT are well aware of the ongoing criticism of their policies and have taken a variety of steps to introduce more competition into the telecommunications market on their own initiative. Since 1998 MPT has permitted foreign companies to acquire majority interests in “Type 1” telecommunications carriers (entities that provide service through their own facilities), which has led to market entry by firms such as MCI Worldcom, Cable & Wireless, and Media One. In 1999 NTT was divided into two regional carriers (NTT East and NTT West), a long distance carrier (NTT Communications), and a holding company (NTT Corporation). Effective in 1998, Type 1 carriers need not obtain prior approval from MPT to change their tariffs to end users. NTT is currently advocating the elimination of the legal limit of 20 percent on foreign investment in NTT and the requirement that the government hold at least one third of its shares. In January 2001, MPT announced plans for measures to facilitate use of NTT’s lines by competitors at lower cost, including the new “Mylene” service, which will permit phone users to select and register with a phone carrier of their choice, making it unnecessary to dial access codes.³⁰

The incremental reforms implemented to date by MPT/NTT have not satisfied Japanese critics of the current regime, who remain critical of the relative lack of competition in the telecommunications system. In a typical comment, Lower House Diet Member Ichizo Ohara observed in March 2000:

The information technology industry is indisputably an industry without a national boundary. The industry should be completely open to foreign capital and at the same time, it should be free to enter foreign countries. The responsibility for removing the closed nature of NTT lies not only on NTT itself, but also on the Fair Trade Commission. In fact, I have heard voices of criticism against NTT’s monopoly from senior officials of new common carriers and Docomo as well as from NTT officials themselves.³¹

The Telecommunications Council, a government advisory body, is recommending that NTT be required to open its fiber optic and other networks to its direct competitors, which NTT opposes. The Council also proposes that NTT reduce its equity holdings in its mobile and long distance subsidiaries to less than 50 percent. One measure under consideration would require NTT to disclose a set of transparent terms for connecting to its networks, and would prohibit NTT companies from sharing information within the NTT group about clients and competitors. In 2001, the government plans to submit a bill to the ordinary session of the Diet revising the NTT Law to increase competition in telecommunications and stimulate the diffusion of information technology.

While a number of proposed reforms would increase competition in Japan’s telecommunications market, they will not produce an environment as competitive as that prevailing in the United States without a more fundamental change in the regulatory regime. The U.S. regulatory system promotes competition through a “dominant carrier” approach. Carriers whose control over facilities and services gives them the potential to limit competition are subject to regulatory

³⁰ *Nikkei Telecom*, January 8, 2001.

³¹ “Coexistence With Asia is Japan’s Path,” *Ronso Toyo Keizai* (March 2000).

constraints, while carriers without such power can operate under fewer restrictions, a scheme which has facilitated the introduction of innovative services and technologies. The Japanese system, by contrast, focuses on whether carriers own or lease lines and regulates relationships between lessors and lessees – there has been no overriding mandate to promote competition. In the trenchant words of Sony’s Idei, “The government has talked loudly about the proliferation and uses of the Internet, but has done nothing about the Law on Nippon Telegraph and Telephone.”³²

Japan’s Mobile Internet. While Japan lags behind the United States and some East Asian countries in a number of indicia of Internet usage, it leads the world in one area – the mobile Internet, a sector that may provide the principal springboard for Japan’s challenge to U.S. Internet leadership. By contrast, the United States lags far behind in mobile Internet access, reflecting the fact that the U.S. market is divided among five incompatible wireless standards which make it difficult to establish a uniform subscriber base. By contrast, NTT Docomo (67 percent owned by NTT), Japan’s principal cellular phone provider, launched mobile Internet access service in February 1999, and in the 18 months that followed, mobile Internet access among all providers virtually exploded, from zero to over 20 million subscribers. Mobile access appears poised to leapfrog Japan’s PC-based access as the principal medium through which the Japanese access the Internet.

The mobile-accessed Internet emerging in Japan differs substantially from the PC-accessed Internet that predominates in the United States. While the PC-based Internet is open and is not dominated by a single entity, the mobile Internet is a “walled garden,” separated from the PC-based Internet by an array of technological and commercial elements reflecting the dominance of NTT Docomo and Japan’s two other mobile Internet service providers.

- Technological constraints of the small mobile screen size require that mobile Internet sites be written in a different markup language than HTML, the hyper-text markup language used by the open Internet, with the result that a mobile Internet user cannot access millions of open Internet sites written in HTML.
- Payments by subscribers for services over the mobile Internet go directly to, or through, NTT Docomo, which charges a 300-yen flat monthly fee for Internet service, a volume-based data transmission fee for activity such as e-mail and visiting official websites, and a 9 percent commission when a surfer browses a site and downloads pay-for-service information.

The Government’s promotional strategy. The Japanese government’s strategy for promoting Internet usage in Japan represents a departure, in one very substantial respect, from most of the industrial promotion programs it has implemented since the end of the Occupation. Japanese industrial policy has traditionally been characterized by government guidance of industry with respect to investment, research targets, “industrial structure” (e.g., the size of enterprises and their interrelationships) and the relative intensity of domestic competition. Japan’s new information technology strategy, by contrast, emphasizes market-based competition as the driving force behind Internet diffusion in Japan. The government’s stated role is merely to ensure that free and fair competition can occur and that the adoption of the new technologies is

³² Chuo Koron (November 2000).

not impeded unnecessarily by existing laws and regulations – which will require wholesale revisions of Japanese laws. Government promotional measures are thus far focused mainly on support for research and development and the funding of basic infrastructure, such as fiber optics networks. These policies, if implemented according to the framework established in 2000, will be not unlike the market-driven information technology policies that have been pursued by the United States with spectacular success in the last decade.

Prime Minister Mori created in July 2000 an “IT Strategy Council,” consisting of senior public and private sector officials charged with developing a plan for the promotion of “The IT Revolution” and turning the results into government measures quickly. Sony Chairman Nobuyuki Idei headed the Council, which proposed sweeping legislation that was enacted by the Diet in November 2000, effective January 6, 2001 – a mere six months after the formation of the Strategy Council. The IT Basic Law establishes a framework for promoting, on an urgent basis, a “highly advanced information telecommunication society in Japan.” The IT Basic Law calls for the establishment of a strategic headquarters in the Cabinet, led by the Prime Minister and consisting of Cabinet Ministers and private sector experts and scholars, to promote “quickly and as a high priority” measures for IT development.

The formulation of centrally directed industrial promotion policies pursuant to special legislation on the basis of recommendations of industry-government advisory bodies has characterized Japanese industrial policy since the 1950s, and some elements of the new strategy resemble prior initiatives. Most importantly, the government will subsidize research and development projects and infrastructure improvement which are frankly intended to enhance the international competitiveness of Japanese industry – and specifically, to overtake the United States as an “Internet superpower” in five years. However, the IT Basic Strategy and Law represent a departure from traditional industrial policy in several key respects:

- ***The private sector is charged with the leading role*** in promoting Internet usage, without, as frequently in the past, a requirement that private sector initiatives be approved by “the competent Minister.” The role of national and local governments is, in effect, to “stay out of the way” by eliminating regulatory impediments to IT growth.
- ***Enforcement of the Antimonopoly Law is to be reinforced*** to promote more vigorous internal competition in Japan, rather than relaxed, as it has been under previous promotion schemes including as recently as the 1995 Business Reform Law.
- ***Transparency of administrative rules*** affecting the Internet is to be promoted and safeguarded by the government, which has a tradition of pursuing its policies through nontransparent guidance. The IT Strategy calls for adoption of the U.S.-style “no action letter” system that requires government agencies to make written replies regarding administrative policies to private sector inquiries.

Japan’s investment in broadband. “Broadband” refers to a communications medium, such as a wire, capable of transmitting two or more channels simultaneously at high speed (1.54 million bits/second). “Broadband content” refers to complex communications which require high transmission speed (high definition television, Internet radio, MP3 files, motion pictures, video-on-demand, 3-D video games, etc.) and “broadband distribution” refers to the various technologies which transmit such content, including cable television (CATV), digital subscriber

lines (DSL) and integrated services digital networks (ISDN). Japan currently lags behind the United States in the number of subscribers for every mode of broadband distribution. However, the Japanese government is seeking to leapfrog the United States in broadband technology in the next five years, with a goal of 30 million Japanese households with “always on” broadband access by 2005.

In 1991, pursuant to the Telecommunications Infrastructure Completion Special Measures Law, the government began funding the installation of a fiber optic network capable of carrying multiple broadband (high speed, high content) digital communications. As of the end of 1999 roughly US\$ 54 billion had been spent to cover about 36 percent of Japan’s regions with such cables (compared with 25 percent coverage of the United States with all forms of potentially high-speed communications). This task has been facilitated by the high geographic concentration of the Japanese population, which has made it possible to connect a larger proportion of the country’s businesses and households to such networks than is the case in the United States, where distances are larger and the population more dispersed. In late 2000, the government earmarked 600 billion yen from its supplemental budget for the construction of “IT infrastructure,” particularly fiber optic networks.³³

The emerging Japanese broadband environment may be distinguishable from that of the United States in four key respects:

- Japanese broadband access may be far more heavily weighted toward non-PC “information appliances,” in which Japanese manufacturers excel, and may create a “tectonic shift” away from PC-based access, the “linchpin of America’s digital dominance.”
- Building on its leadership in the mobile Internet, Japan is adopting mobile broadband access more quickly and smoothly than the United States.
- Japanese broadband distribution will be more heavily weighted toward the B-ISDN mode than that of the United States.
- NTT is likely to continue to dominate the broadband environment, whereas in the United States broadband distribution is much more highly fragmented among a broader range of service providers.

Japan’s aggressive investments in its fiber optic network suggest that it ultimately may lead the United States in bringing broadband Internet service to a larger percentage of its population. While the implications of such a development are far from clear, at a minimum Japan may ultimately enjoy a more efficient Internet access structure than the United States, much as it now enjoys a superior rail network. One Japanese observer goes so far as to assert that U.S. government pressure on NTT to lower its interconnection fees is aimed at depriving it of revenue needed to complete its fiber optic network – “the day that NTT announces the completion of turning all Japan into an ‘optical empire’ will be the ‘x-day’ that the United States fears most.”³⁴ In fact, it is unlikely that U.S. interests could be jeopardized by Japan’s completion of a highly efficient broadband network, which will actually work to the advantage of U.S. firms whose

³³ “IT Projects Receive ¥700 Billion of Supplemental Budget,” *Nikkei Telecom*, October 18, 2000.

³⁴ “IT War: U.S. Strategy to Contain the NTT Optical Empire,” *Shokun* (August 2000).

commercial strategies are based on, in whole or in part, ecommerce. However, the widespread availability of broadband access in Japan may prove advantageous to certain Japanese manufacturers of “information appliances” (such as interactive television) which will be served by those networks. Sony’s Nobuyuki Idei comments that:

The idea is to install fiber optic networks primarily to put in an Internet system, not a phoning system. All individual households can get into the networks and use the Internet at all times. They can connect their phones, Walkman machines, and televisions to the networks. So many things can be sent to and received from the far corners of the world. That will lead to the birth of new technologies and new business chances.³⁵

Japanese electronics hardware manufacturers are developing products that may shift Internet usage away from personal computers to televisions and other digital devices. The manufacturers reportedly see the introduction of next-generation, IPv6, web addresses, which “will enable all sorts of information equipment to be connected to the net,” as “an opportunity to blast a hole in the U.S. dominance of the Internet.”³⁶

The role of outside pressure. An important force for change in postwar Japan has been outside pressure, which has frequently been exploited by domestic leaders as a means of liberalizing Japan’s economy and in trade relations. Pressure from the International Monetary Fund, the United States, and the European Community, for example, was instrumental in enabling the Japanese government to form a domestic political consensus for the elimination of legal controls on foreign exchange and quantitative restraints on most import items in the 1960s.³⁷ Similarly, since the early 1980s bilateral pressure from the United States has been utilized by MITI and other domestic constituencies to promote the deregulation of the Japanese telecommunications industry. The importance of outside pressure has been sufficiently pronounced that a Japanese academic complained in 1998 that “the political leadership for changing Japan does not originate from our own country, but comes from outside, that is, the United States.”³⁸

While Japanese observers sometimes complain that the United States dictates to Japan all aspects of its economic life, most U.S. economic pressure on Japan has been limited to particular Japanese policies or practices that are perceived by the United States to be “unfair” or which distort markets in a way that adversely affects U.S. commercial interests or the regional and world economy. Prime Minister Mori’s current initiatives in ecommerce, which are designed to promote competition and a more open market, do not fit this description – indeed, the American Chamber of Commerce in Japan (ACCI), which has seldom hesitated to criticize restrictive Japanese policies in the past, has concluded that Japanese ecommerce promotion efforts will

³⁵ Interview with Nobuyuki Idei, *Chuo Koron* (November 2000).

³⁶ “With the Start of Digital TV Broadcasts, Japanese Home Appliance Makers Now Engaged in Fierce Struggle for Dominance,” *Chuo Koron* (December 2000).

³⁷ “Liberalization and Future Economic Policies,” *Yomiuri Shimbun*, July 26, 1961; “90 Percent Liberalization Should be Carried Out,” *Tokyo Shimbun*, September 13, 1962.

³⁸ Keio University Professor Yoshiaki Kobayashi, “With no Leadership, Reliance on Gaiatsu,” *Shukan Toyo Keizai*, July 4, 1998.

foster changes which “should and will be positive, creating exciting new opportunities for all businesses in Japan.”³⁹ Pressure from outside is unlikely to play a significant role in the effort to promote ecommerce except to the extent that the reform program is seen to be falling short of its stated objectives. This is most likely to occur in the telecommunications sector.

Despite deregulatory measures taken since the mid-1980s and the partial privatization of NTT, both the U.S. government and the ACCJ remain highly critical of Japanese regulatory policy in telecommunications, particularly NTT’s high interconnection rates and barriers to entry by new competitors. In July 2000, following extended negotiations, the United States and Japan reached an agreement pursuant to which NTT would reduce its regional interconnection rates by 50 percent over a two-year period and local access by 20 percent, with the cuts being front-loaded and made retroactive to April 1, 2000. The agreement also committed Japan to reduce or eliminate restrictions on access to the NTT network by new entrants and to study whether the interconnection with NTT Docomo should be more strictly regulated. The U.S. government characterized the agreement as a “win-win for the United States and Japan” which “will create opportunities for U.S. firms and benefits for Japanese consumers and the economy as a whole.”⁴⁰ In fact, this agreement significantly advances one of the principal objectives of Japan’s economic reformers:⁴¹ “By bowing once more to U.S. pressure, Japan might find itself better off.”⁴² As former Vice Minister of Finance Eisaku Sakakibara, a proponent of steep cuts in NTT’s interconnection fees, commented in 2000:

The NTT connection fees issue is quite different in nature from previous U.S.-Japan trade issues. The reason is that, unlike the automobile or insurance talks, a very glaring and conspicuous United States interest does not exist here. The greatest beneficiaries of lowered connection fees will be Japanese communications businesses. . . . At the same time, Japanese consumers will probably receive the benefit of lowered communication fees.⁴³

However, although the agreement represented progress, as President Clinton recently commented, this accord was merely a “good start,” an assessment with which many Japanese leaders probably concur.⁴⁴ Outside pressure, linked to domestic reform efforts, is likely to remain a factor supporting change in the telecommunications sector.

While the United States has proven to be the most important direct source of outside pressure during the preceding decades, multilateral institutions have also played a role in inducing Japan

³⁹ American Chamber of Commerce in Japan, *Promoting a Vibrant E-Commerce Environment: General Principles and Specific Issues* (July 2000).

⁴⁰ Office of the U.S. Trade Representative, Press Release, *United States and Japan Agree on Interconnection Rates* (July 18, 2000).

⁴¹ See “[Assistant] USTR Cutler Welcomes Comments on NTT by Japanese Politicians,” *Kyodo News*, June 15, 2000.

⁴² “U.S. Pressure May Give Japan IT Industry Boost,” *Yomiuri Shimbun*, July 1, 2000.

⁴³ “Sakakibara on NTT Connection Fee Cuts,” *Mainichi Shimbun*, May 4, 2000.

⁴⁴ “MPT’s ‘Hopeless’ Negotiation Power,” *Sentaku* (August 2000).

to liberalize restrictive policies. Japan's commitments to the IMF, the OECD, and the General Agreement on Tariffs and Trade (GATT) were important factors underlying Japan's reduction of legal investment and trade restrictions in the 1960s and 1970s.⁴⁵ More recently, proscriptions on anticompetitive practices in the WTO General Agreement on Trade in Services (GATS) were invoked by the U.S. government in the NTT negotiations, and this "WTO weight put pressure on NTT."⁴⁶ However, despite the existence of various multilateral rules affecting ecommerce issues, at present no comprehensive international framework of regulation exists with respect to the Internet and ecommerce, although a number of WTO working groups are examining various issues that affect ecommerce. Accordingly, Japanese reformers will not consistently find themselves in a position to invoke Japan's international commitments as a means of advancing their ecommerce agenda.

B. The Impact of the Internet on Distribution

Perhaps the principal test of whether the Internet can revolutionize the Japanese economy will be its impact on the distribution sector. The U.S. government has long identified the Japanese distribution sector as "a significant trade and investment barrier" to foreign companies, a diagnosis shared by many Japanese analysts. Japanese distribution, particularly of physical consumer goods, has been widely viewed by Japanese and foreign observers as inefficient, unnecessarily complex, and a drag on competition. In many industries distributors are controlled (*keiretsunized*) by manufacturers in a manner which can limit market entry by competitors and restrict competitive pricing. The Japanese government, recognizing that the existing distribution structure contributes to the country's economic problems, has implemented a series of measures to encourage Japanese companies to adopt ecommerce as a way to streamline distribution. A number of observers have cited the advent of the Internet as heralding the end of Japan's traditional distribution practices:

- "If the Internet is about anything, it is about disintermediation – or cutting out the middleman. And if Japan is about anything, it is a nation of middlemen. For scores of Japanese middlemen, then, the rise of the Internet industry threatens the end of an era. The Internet, and particularly business to business (B2B) e-commerce, looks set to rid the country of swathes of inefficient distributors, disrupting long-established supply chains and lowering distribution costs."⁴⁷
- "If the Internet spreads, it will make intermediaries such as trading companies and wholesalers, the so-called middlemen, redundant and will cut costs."⁴⁸

⁴⁵ See, e.g., "Cabinet Meeting for Promoting Trade and Exchange Liberalization," *Tsuho Sangyo Seisaku-shi*, 17 SHIRYOU (REFERENCE MATERIALS) 376-78.

⁴⁶ "U.S.-Japan Dispute NTT Interconnect Fees," *Shukan Toyo Keizai*, May 27, 2000.

⁴⁷ Alexander Nusbaum, "Web Cuts Out an Infinite Order of Middlemen: Business-to-Business e-Commerce in Japan is Threatening the Livelihood of Thousands of Intermediaries," *Financial Times*, January 5, 2000.

⁴⁸ "Middlemen Fighting Disintermediation," *Nikkei Net Business* (December 2000).

- “[T]he Internet allows merchants to circumvent the many layers of middlemen who clog this country’s distribution system, adding cost every time merchandise changes hands.”⁴⁹
- “If there’s one thing the Internet does in Japan – and it may be the only thing it does – it will finally destroy the Byzantine Japanese distribution system.”⁵⁰

To date, however, notwithstanding such comments, the advent of the Internet has produced only mixed results in the distribution field, clearly enhancing competition in some sectors but having relatively little effect in others.

A regulatory legacy – the power of convenience stores in ecommerce. The Internet appears to be strengthening, rather than rendering obsolete, one of the most important groups of distribution intermediaries in Japan – the nation’s 36,000 convenience stores. The extraordinary influence of these stores in Japan’s daily economic life is itself attributable to the country’s regulatory regime.

Over 30 years ago MITI identified Japan’s distribution sector as inefficient and characterized by numerous “irrational business practices.” It recognized that foreign investment in the sector could introduce efficiency through competition, but feared that this would directly disadvantage Japanese manufacturers in the domestic market relative to their foreign competitors. Accordingly, the government adopted a policy of “systemization” of distribution, which encouraged vertical integration of distributors under the control of Japanese manufacturers. The government agreed to allow foreign capital into the distribution sector in 1972, but mitigated the effects of this liberalization by enacting the Large Stores Law (*Daitenho*) in 1973, which operated to restrict the site of retail stores. A dramatic, unintended consequence of the *Daitenho* has been the phenomenal growth and influence of convenience stores, whose small floor space leaves them outside the scope of regulation by the *Daitenho* and its successor law, the Large Store Location Law (effective June 1, 2000).

Japan’s convenience stores are utilizing advantages inherent in their 24-hour, 365-day operations and their vast array of outlets to seize a central position in Japan’s ecommerce market. At the stores, customers who are reluctant to use credit cards online and/or have no Internet access in their households can order products online at home or at an Internet terminal in the store, pay for them at the store register, and pick up the goods at the store, usually the next day. This business model is seen as so potentially attractive that Japanese observers are proclaiming that “he who can dominate convenience stores can dominate ecommerce in Japan.”⁵¹

No single chain dominates Japan’s convenience stores, but the stores’ rapid evolution as a main focal point for Japanese B2C transactions adds a centralizing dimension which is not present in the highly fragmented U.S. B2C market. Moreover, large Japanese trading companies have

⁴⁹ Hiroshi Mikitani, “Log On and Get Your Kimonos Here, Mrs. Eggs,” *New York Times*, June 7, 2000.

⁵⁰ “Japan: Store Wars in Cyberspace – Internet Shopping is Set to Put an End to Japan’s Byzantine Distribution Sector,” *Financial Times*, February 8, 2000 (quoting a Tokyo-based investment banker).

⁵¹ “He Who Can Dominate Convenience Stores Can Dominate Ecommerce in Japan,” *Nikkei Electronics*, February 28, 2000.

identified convenience stores as “a strategic base to develop new business in the ecommerce and finance sectors,” and are rushing to “encircle convenience stores.”⁵² Observing proliferating ties between major trading companies and the convenience store chains in the ecommerce field, one Japanese scholar predicts that a “new zaibatsu” [combine] might emerge in the ecommerce distribution sector.⁵³

The book industry. The revolution in book marketing that has taken place in the United States as a result of online sales by ecommerce firms like Amazon.com and Barnes & Noble.com has not occurred in Japan. The Japanese book industry is dominated by large wholesalers, while both the publishing and retailing segments are fragmented. In addition, Japanese law authorizes resale price maintenance contracts in this industry, and the industry has utilized this exemption from the Antimonopoly Law to avoid discounting at the retail level. The U.S. online retailer Amazon.com, which began selling English-language books online in Japan years ago, but was not able to begin selling Japanese-language books until November 2000, has done so in an alliance with an established Japanese book wholesaler, and reportedly does not plan to challenge the resale price maintenance system. In the interim, a number of Japanese online bookselling operations came into existence, including one, e-Shopping! Books Corp., in which Japan’s largest book wholesaler, Tohan, is a participant and which involves online sales to consumers through Japan’s Seven-Eleven stores.

Automobile sales. Online car sales have grown dramatically in Japan, but not in a manner that radically transforms the *keiretsu*-based system of territorial division among manufacturer-controlled dealerships. In the United States, dealers can use online brokers to reach beyond the local geographic area to find new customers and to compete on price. This is difficult in Japan, where strict territory agreements limit dealers’ customer bases and *keiretsu* relationships discourage dealers from discounting. The arrival of Western online firms has reportedly had little effect on these practices. While some Japanese car manufacturers have embraced the foreign entrants, others have embarked on solo projects, such as Toyota’s “Gazoo” system. Gazoo is a full-fledged portal site, offering cars, loans, insurance, downloadable music, travel tickets, CDs, etc., through computer terminals known as “G-towers” at dealers’ showrooms and convenience stores. Japanese Toyota dealers have so far been faithful to the manufacturer, with only nine dealers signing up with one of the foreign firms by May 2000.

The travel industry. The Internet is posing a major competitive challenge to Japan’s travel agents, who may well be bypassed as airlines and other travel enterprises increase their direct online sales to consumers. In 2000, Japan’s largest air carrier, Japan Airlines (JAL) began selling discounted tickets directly to consumers over the Internet. Travel agents reacted with fury at this move, which they argued “clearly represents an attempt to bypass travel agencies.”⁵⁴ Later in 2000, all three of Japan’s major air carriers announced plans to form a joint company to sell tickets directly to purchasers over the Internet, prompting the Japan Association of Travel

⁵² “Trading Companies Accelerate Efforts to Enclose Convenience Stores,” *Nihon Keizai Shimbun*, January 15, 2000.

⁵³ “21st Century-Style Reorganization of Finance and Industries Started,” *Ekonomisuto*, March 8, 2000.

⁵⁴ “JAL and JAIA Fight over Discount Offer for Airline Tickets Over the Internet,” *Nikkei Ryutsu Shimbun*, February 22, 2000.

Agents to complain that it felt “totally ignored” by the move.⁵⁵ Travel agents have responded by aggressively developing their own online sales initiatives, including the sale of package tours and hotel reservations and the formation by one agency, JTB, of a joint venture with Yahoo Japan and a Softbank subsidiary, Softbank Ecommerce, to provide online travel services. The travel agents have been constrained, however, by regulatory restrictions on their operations under the 1952 Travel Business Law, which has been construed to prevent marketing innovations such as the online auction of unsold tickets. This law was revised in 2000, however, to permit online confirmation (rather than written confirmation) of travel arrangements pursuant to the E-Notification Law.

C. Regulatory and Legislative Reform

One of the clearest indicators of the government’s intention to use the Internet to promote fundamental change in Japan is its undertaking of a massive legal revision with the goal of clearing away regulatory impediments to ecommerce. According to a recent survey by the Japanese government, at least 124 laws and 733 regulations circumscribe Japanese business activity on the Internet. The E-Notification Law, passed in 2000, amends roughly 50 laws to facilitate e-business transactions. These efforts perhaps lend the most credence to arguments that Japan’s evolving ecommerce environment is a liberalizing force for change. Further legislative changes will be implemented in 2001.

Some of the deregulatory measures and the newly enacted legislation, however, appear not to go far enough. The E-Notification Law *did not* amend all of the laws and regulations identified by the IT Strategy Council as requiring paper documentation procedures.⁵⁶ One such law is the Money Lending Business Law, which governs the consumer lending industry, and which, as explained below, poses significant obstacles to conducting online transactions if not modified by the E-Notification Law. In yet other instances, the deregulatory measures are being coupled with promotion measures - government-sponsored programs targeting specific industries or technologies - that suggest that not all initiatives in this area are intended to create a market-driven environment. Finally, in some cases the new legislation, such as the Basic Privacy Law, appears at this stage to be overly broad; or in other cases, as with the new Digital Signatures Law, the legislation is more technologically focused and restrictive than its U.S. federal counterpart.

The privacy regime. The real or perceived lack of protection of consumer privacy online is a major impediment to the growth of ecommerce, and the Japanese government is taking steps to strengthen online privacy protection. The only law in effect at present governing privacy applies only to government and public entities. The protection of privacy in ecommerce is enforced

⁵⁵ *Nikkei Sangyo Shimbun*, August 10, 2000.

⁵⁶ The four basic areas left unchanged are documentation procedures requiring a notary public’s certificate, such as under the Corporate Collateral Law [*Kigyō Tanpōho*] or the Leased Estate Law [*Shakuchi Shakkaho*]; procedures involving a physical presence or that are completely unrelated to ecommerce, such as the Pawnbrokers Business Law [*Shitsuya Eigyo*]; procedures subject to international treaties, such as the International Carriage of Goods by Sea Law [*Kokusai Kaijō Buppin Unsoho*]; or areas where “trouble” is expected to arise in a contract, such as the Money Lending Business Law [*Kashikinyō Kiseiho*] or the Commodity Exchange Law [*Shohin Torihikiho*].

through quasi-legislative administrative guidelines established by MITI, the Management and Coordination Agency,⁵⁷ and the Japan Information Processing Development Center (JIPDEC), an industry-government entity. The government is contemplating a series of measures which would establish a more comprehensive regime which is likely to be three tiered:

- A new *Basic Privacy Law*, drafted by the Cabinet in 2000 and likely to be enacted in 2001 would establish certain basic principles with respect to consumer privacy, to which users of personal information must conform, including (1) a stated specific purpose for use of personal information; (2) appropriate means of collection of such information; (3) accuracy and currency of personal information; (4) assurance of “appropriate security” for personal information; and (5) transparency with respect to the use of, and access to, personal information.
- Two new *Auxiliary Laws* governing telecommunications and personal credit information would codify the existing welter of guidelines, notifications, and administrative guidance issued by various ministries into legislation. The substantive changes the proposed new laws would effect in the existing regulatory regime has not yet been disclosed.
- Additional *Administrative Guidelines*, consistent with the principles laid down in the Basic Privacy Law, will address industry-specific issues and fill gaps where legislation does not provide a clear framework, but where clear roles are required. If past practice is indicative, these rules will be implemented, in part, by authorizing individual industry associations to create sector-specific guidelines. A current example is the Japan Direct Marketing Association (JADMA) “Online Trustmark System,” pursuant to which JADMA bestows its seal of approval on online businesses that conform to its consumer privacy protection guidelines.

Online consumer protection. In 2001, three legislative initiatives are pending that will have an identifiable impact on ecommerce transactions:

- The proposed *Ecommerce Contracts Law* would clarify that contracts concluded over the Internet become effective when the associated contracts are received, rather than when they are sent out. In other words, a buyer could back out of an online purchase prior to receiving email confirmation of the sale, rather than, as now, being contractually bound at the instant the seller sends out the confirmation email.
- Amendments to the *Door-to-Door Sales Law* will take effect in 2001 extending its prohibition of exaggerated advertisements to websites and requiring ecommerce companies to provide easily understandable explanations of transaction rules on their websites (responding to a recent spate of incidents in which consumers have mistakenly entered into contracts through typing errors). MITI also supported the E-Notification Law, under which the Door-to-Door Sales Law (and 49 other laws) is now interpreted as allowing electronic notification (e.g., email) to satisfy the legal requirements for hard-copy confirmations of payment.

⁵⁷ The Management and Coordination Agency became part of a new Ministry of Public Management, Home Affairs, Posts and Telecommunications on January 6, 2001.

- An amendment to the *Law Pertaining to Installment Sales* will take effect on June 1, 2001 which removes a prohibition on “cardless purchases” over the Internet. Such purchases enable consumers to buy products online by inputting short ID numbers agreed to with credit card companies beforehand as an alternative to inputting full credit card numbers.

While these changes in consumer protection laws will serve to increase consumer confidence in ecommerce transactions, a number of other consumer protection laws may operate to impede some forms of ecommerce if they are not amended:

- The *Money Lending Business Law* requires “money lenders” to register with government authorities and establishes an array of restrictions and oversight requirements governing the provision of loans and credit. In April 2000, it was reported that the government had invoked this law to delay an affiliate of Softbank Corporation, E-Loan Japan, from starting a service introducing individuals to lenders over the Internet – the government took the position that E-Loan Japan had to register under this law (although it was not proposing to loan money) and to comply with all of the pertinent laws and regulations. More fundamentally, moreover, the Money Lending Business Law requires that consumer lending companies provide *written* confirmations and disclosures not only for each loan origination, but also for each subsequent borrowing and repayment under a revolving account. Consequently, if not changed, the Money Lending Business Law is likely to be a significant damper on efforts to utilize *i-mode* and related electronic technologies by the consumer finance sector, which ironically has been among the most progressive in pursuing electronic channels.⁵⁸ However, along with the Commodity Exchange Law, the Money Lending Business Law was left untouched by the E-Notification Law. They were categorized by the Japanese government as areas where “trouble” is expected to arise.
- The *Law Pertaining to Operating in Used Goods*, originally enacted to prevent traffic in stolen goods, requires any individual or entity dealing in used goods to register with, and be approved by, the government, a process which is reported to be cumbersome and which requires the seller to furnish a registered address in Japan.

Digital signatures and certification. In 2000, MITI, MPT, the Ministry of Justice and the National Police Agency⁵⁹ collaborated to establish a new framework for digital signatures and certification services which will be phased-in in 2001. Foreign companies were extensively consulted by the government during this process, and a number of leading U.S. companies in the field of electronic signatures were members of the “Electronic Authentication System Promotion Council,” which, among other things, provided guidance to the government as it developed the new legislation:

⁵⁸ In addition, the requirement to send written disclosures, even where the consumer has indicated that he prefers not to receive such material at home, creates a conflict between complying with these technical requirement of the Money Lending Business Law and respecting the privacy concerns of many of the consumers in this industry. Electronic notification, by comparison, would seem to be a well-tailored solution to this dilemma, by providing a fast, secure and private means of making these disclosures to consumers, at least where the consumer has agreed to such electronic disclosures.

⁵⁹ The National Police Agency’s name was changed to the National Public Safety Commission on January 6, 2001. Although the names of a number of ministries and agencies were changed on January 6, 2001 pursuant to a restructuring of the government, the previous names were used here to be easily identifiable.

- *The Law Pertaining to Digital Signatures and Certification Services* becomes fully effective on April 1, 2001. The law provides a procedure under which an entity can voluntarily seek government accreditation to certify electronic documents which are presumed to represent the intent of the signer and have the same legal effect as an ink signature or personal seal. Accreditation may be granted by a competent ministry or by an “investigating organization” designated by a competent ministry. While the government took into account a number of foreign concerns in preparing this legislation, a significant number of unknowns remain, including the question of whether existing laws that may affect digital signatures and certification are deemed to be automatically amended by the new law. In addition, over two dozen issues remain to be resolved by subsequent ministerial ordinances, including matters such as the criteria for choosing “investigating organizations,” the accreditation application procedure, time limits for review, etc.
- An Amendment to the *Commercial Registration Law* took effect in October 2000 authorizing digitalization of corporate trade names, corporate seals, names of company managers, corporate digital signatures, and the like.
- An amendment to the *Notary Public Law* in April 2000 authorizes notaries to authenticate an electronic record with an electronic signature, and to conduct electronically other functions which notaries have traditionally carried out on paper.

In addition to these legal changes facilitating the use of digital signatures and certification, MPT is launching its own person-to-person electronic certification system pursuant to which a sender will transmit a document electronically via the Internet, and the Postal Service will certify the authenticity of that document and deliver it. MITI is funding a program intended to develop a common authentication system for use throughout Asia.

Registration of domain names. A registrant for an Internet address ending in “.co.jp” – the Japanese equivalent of “.com” in the United States – must have a physical presence in Japan in order to register a domain name. In addition, in the past, the registering entity was able to register only a single domain name and could not transfer the domain to another entity, rules designed to preclude cyber-squatting. The combined effect of these rules has been to slow down and increase the cost of the website start-up process. The cost of setting up a domain in Japan with a “.co.jp” address for a foreign entity lacking a pre-existing presence can run as high as US\$ 10,000, a market entry cost that has posed a significant barrier to small foreign start-ups seeking to enter the Japanese market. While Japanese consumers can access a website with a URL ending in “.com” as readily as one ending in “.co.jp,” the lack of a Japanese commercial identity can be a deterrent to online sales in Japan – consumers prefer, for example, to deal with firms with relative geographic proximity, avoiding perceived settlement and delivery problems associated with a seller on the other side of the world.

The Japan Network Information Center (JPNIC), a MITI-supervised agency which administers domain name policy and registration, is currently in the process of revising the domain name registration system, and has established a new, private, profit-making enterprise, Japan Registry Service, to administer most of the domain name registration process in Japan beginning in 2001. Under the revised system, registration of more than one domain per entity will be possible as will domains associated with trademarks. In addition, JPNIC has established formal dispute

resolution procedures (which did not previously exist) partially based on international domain name dispute resolution policies.

Emoney. “Electronic money” is defined by Japan’s Ministry of Finance (MOF) as “a mechanism for settlement by transferring or renewing an electromagnetic record that is issued according to funds paid by a user, or the electromagnetic record itself.”⁶⁰ MPT has been aggressively testing a variety of emoney schemes, including debit cards, multipurpose IC (integrated circuit) cards and other media that can be used at participating stores. NTT has implemented a “SuperCash” system, which is incompatible with international emoney standards. In addition, a number of private sector emoney initiatives have been launched, including projects involving Visa and MasterCard in alliance with groups of Japanese banks, and a venture involving Sony, NTT Docomo and Toyota which will enable consumers to pay for purchases of up to 50,000 yen online or at bricks-and-mortar stores. The Japanese government has been contemplating legislation to establish standards and rules governing emoney transactions, but the legislation has been delayed by inter-ministerial turf struggles and by the fact that a national emoney standard has not emerged from the plethora of public and private emoney pilot initiatives.

The MOF established an emoney study group which issued a report in 1998 with a series of recommendations which provided the basis for draft legislation to be introduced in 1999 (although the introduction date has been postponed until probably 2001). Key considerations with respect to any legislation which emerges include:

- Whether the universe of agencies authorized to issue emoney will be circumscribed;
- Whether the government will establish a Japan-specific technological standard, particularly with respect to IC forms of emoney, which would require foreign firms to modify their existing emoney technology; and
- Whether the technologies currently being funded, primarily by MPT, will provide the basis for the emoney system which eventually emerges.

Criminal laws. Japan has experienced a number of recent episodes involving attacks on government websites by hackers and fraudulent schemes and transactions involving the Internet. The government is now funding R&D to develop Internet security-related technologies, and has adopted new legislation in response to some of the reported problems.

- The ***Unauthorized Computer Access Law*** was enacted in 1999, prohibiting acts of unauthorized computer access, and providing for fines and prison terms for violations. The law also obligates access administrators to take necessary measures to protect computers.
- A ***Child Pornography Law*** was enacted in 1999 and has been applied to distribution of child pornography over the Internet.

⁶⁰ MOF, *Report by Discussion Group Toward Improving Environment for Electronic Money/Electronic Settlement* at 2/4 (June 17, 1998).

Significant civil laws. A number of existing Japanese civil laws may operate in a way which impedes the growth of ecommerce in Japan. At present there are no known initiatives under way to revise these laws.

- Under Japan's *Customs Tariff Law*, duties and a 5 percent import consumption tax are levied on imports which are mailed from overseas above a *de minimis* value of 10,000 yen (about US\$ 86 at an exchange rate of 116:1). This rule could well result in tariffs and taxes on foreign products ordered by Japanese consumers over the Internet that exceed the actual value of the product itself, undercutting one key advantage of ecommerce, low cost.
- Japan's *Customs Law* does not allow for issuance of import clearance before a shipment actually arrives in Japan, and does not allow release from Customs until duties are paid. (In the United States, shipments may be cleared prior to arrival and duties paid after release.) This rule may undercut another advantage of ecommerce, timely delivery.
- The *Law Concerning Foreign Securities Dealers* requires foreign securities dealers to obtain licenses in order to sell securities to Japanese investors. This law may work to restrict the growth of online finance because e-finance companies are reportedly experiencing difficulty complying with the law's requirement that they ensure customers have read explanatory documents.

D. Intellectual Property

Japan has trailed behind the United States in extending intellectual property rights protection into cyberspace, and an animated debate is under way in Japan over the appropriate intellectual property policies for facilitating, rather than impeding, the growth of the Internet in Japan. One significant issue is the fact that Japan's Copyright Law, as it exists at present, does not unambiguously grant right holders the ability to control the making of temporary copies of their works. Another controversial subject is the extension of patent protection to business methods, an issue of substantial controversy in the United States as well that has caused a re-examination of the U.S. patent office's position. Many Japanese policymakers and observers believe that business method patents are a mechanism through which U.S. firms will solidify a permanent hegemony over the Internet.

Temporary copyright protection. Under the laws of the United States, the European Union and other jurisdictions, right holders in software programs have the ability to control the making of temporary copies of their works, such as those made when a software program is used remotely over a local area network (LAN). In a LAN environment, if one permanent copy of a software program is installed on a server, any user of a personal computer connected to the LAN may use that program by creating a temporary copy of the program in random access memory of that personal computer. If unauthorized, this use is a form of piracy that deprives the software developer of the potential sales that would otherwise exist with respect to the LAN users utilizing the copies. United States, EU and other jurisdictions' rules granting right holders the ability to control temporary copies are consistent with obligations under international treaties, including the Berne Convention, the TRIPS Agreement and the WIPO Copyright Treaty.

Japanese copyright law currently does not unambiguously extend this protection to right holders in software programs and other works. The Japanese government studied this issue in a 1995 Green Paper, but reached no definitive policy conclusions. However, failure to bring Japanese law clearly into conformity with international norms on this issue may retard the growth of the Internet in Japan. A number of observers attribute the slow growth of Japan's packaged software industry to the lack of protection against temporary copies and other forms of misappropriation of software.

Business Method Patents. In 1997, the U.S. Court of Appeals for the Federal Circuit ruled that the transformation of data through a series of mathematical calculations into a "useful, concrete and tangible result" is itself a patentable process, a decision which induced U.S. firms to apply for patents on computer software programs implementing methods of doing business on the Internet. In December 1999, Amazon.com obtained a preliminary injunction against Barnes & Noble barring it from using Amazon's patented "one-click" shopping method. This action caused widespread concern in Japan that U.S. business model patents could be used to stifle Japan's adoption of the Internet. Indeed, Japanese media outlets branded U.S. business model patents as the "new black ships sent by the U.S. for U.S. companies to dominate the Internet era."⁶¹ The response to this perceived challenge, to date, has been fourfold:

- ***Patent Japanese business models.*** Japanese companies are accelerating efforts to patent their own business methods in Japan. Toyota, for example, has filed over 200 patent applications for its computerized "just-in-time" production methods. Japanese consulting services on business model patents are flourishing, and some companies are offering prizes to employees who propose patentable business method ideas.
- ***Clarify Japanese patent policy.*** The Japan Patent Office (JPO) is establishing guidelines for granting business method patents which are narrower in scope than those applied in the United States. Under draft standards promulgated by the JPO, business methods which "can be easily conceived by combining public knowledge of the business field related to the patent and technological knowledge of the technology" will not be patentable.
- ***Challenge perceived U.S. dominance diplomatically.*** The Japanese government is seeking to "coordinate" patent examination standards between the United States, the European Union and Japan in order to avert the adoption of current U.S. standards internationally.
- ***Study individual U.S. business model patents.*** With assistance from MITI and funding from the Japan Development Bank, 30 Japanese companies have formed GreenNet, a consortium which has thus far translated 300 U.S. business method patents, evaluated them, and disseminated them to its members. According to GreenNet's president, one of its objectives is to "challenge the United States as it sought to establish a unilateral global standard for patent approval."⁶²

⁶¹ *Nikkei Business*, March 20, 2000.

⁶² *Nikkei Business*, May 1, 2000.

E. Conclusion

With the advent of the Internet and a powerful movement for reform, the prospects for meaningful change in the Japanese economy have probably never been better than at any time in the postwar era. As the respected diplomatic correspondent and columnist Yoichi Funabashi wrote in December 2000, reflecting views that are widely echoed:

Information technology-driven globalization has turned India and Singapore into Asia's leading IT powers, which in turn has highlighted Japan's backwardness It is time now for Japan to revive its voracious readiness of the past to learn from other nations' examples. It must forget about its pride and successes. Japan should discard what is not fit for the new age and the obstacles for opening a new path to the future.⁶³

Japan's IT initiative is opening up major commercial opportunities for U.S. as well as Japanese companies. The most critical question is whether the new technologies and the momentum behind the current reform movement will prove sufficient to bring about the structural changes in Japan's economy that have frustrated past reform efforts. As the leaders of Japan's IT Strategy would be the first to concede, sweeping overhaul of the nation's regulatory structure remains to be implemented. A question for the longer term – and one which is unanswerable as of this writing – is how Japan's apparent emerging leadership in several key areas of IT, such as the mobile wireless Internet and broadband penetration, will ultimately affect the shape of the global Internet.

⁶³ "Japan's Lost Decade a Blessing in Disguise," *Asahi News*, December 31, 2000.