

JAPANESE CO-OPERATIVE LEGISLATION: ITS CHARACTERISTICS AND THE IMPACT OF RECENT LEGAL REFORMS

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Introduction

Japan's co-operative economy has a sheer size: agricultural co-ops are the world-class organizations ranked as the largest ones in the World Cooperative Monitor while consumer co-ops have 27% of turnover and 71% of membership of their European counterparts affiliated with the EUROCOOP. But co-operatives are operating under fragmented co-operative legislation regulated by different competent ministries. There are more than 10 industry-specific co-operative laws regulated by different ministries. The competent government department's approval is required when co-operatives are incorporated, merged or liquidated. There are no legal instruments for workers' co-ops despite strong campaigning for decades. There is no common public policy and there are no official statistics on co-operatives and co-operatives have no super-structure among them. The evolution of co-operatives adapting to different socio-economic contexts and legal environments over 70 years has resulted in contrasting organizational cultures and political affiliations. The agricultural co-ops grew as the agency for implementing protectionist policy, heavily supported by the government while the consumer co-ops endured small retailers' anti-co-operative campaigns without any support from the government. The former co-operatives are top-down organizations and support the ruling conservative party while the latter societies are bottom-up organizations and often support the opposition camp. As a result, these co-operatives have little identity among them, nor recognition as a distinguished sector. The Consumer Co-operative Act was amended in a positive direction for the first time in 2007 while the Agricultural Co-operative Act was revised to dismantle their privileges in 2015. Do these legal reforms have an impact on co-operative activities and co-operative identity? This paper starts with a brief history of co-operative legislation. It will explain the institutional framework of agricultural co-operatives (Jas) and the reform of the Agricultural Co-operative Act in 2015. Then, it will do the same for consumer co-ops. Finally, it discusses the characteristics of Japanese co-operative laws in the light of the Principles of European Co-operative Law (PECOL).

1. Brief history of co-operative legislation

The Industrial Co-operative Act was enacted in 1900 by the strong initiatives of the state under the influence from German Law based on the Raiffeisen and Schulze model, although the indigenous mutual associations had already existed as the co-operative precursors in the Edo era and the first consumer co-ops were formed in Tokyo and Osaka in 1879 following the Rochdale model. Because Japan had built its legal system following the Prussian legislation based on the imperial sovereignty and the German legal advisors to the government such as Mr. Paul Mayet and Mr. Udo Eggert suggested creating Raiffeisen-style co-ops. In 1891 Mr. Yajiro Shinagawa, then Interior Minister, and Mr. Tosuke Hirata, then

Legislation Bureau chief, who both visited Germany to study the law, submitted a draft Credit Society Act but that was in vain due to the dissolution of parliament. Their continued efforts and the government's promotion resulted in the enactment of the Industrial Co-operative Act in 1900.

Therefore, the Act had paternalistic elements reflecting the top-down approach initiated by bureaucrats. The co-ops were placed under strong government control; the governor could give permission to the establishment of co-ops, order reporting at any time, make inspection, reverse the resolutions of general assemblies, order the re-election of office bearers, and suspend or dissolve societies. Accordingly, the Act had many common aspects with the Indian Co-operative Credit Societies Act of 1904 although there was major difference in that the former had not provided for the direct injection of share capital and management by the state.

The Act was the all-embracing law governing credit, marketing, supply and production (later replaced by service) co-ops. It mainly aimed to serve agricultural co-ops in rural areas but also covered credit and consumer co-ops in urban areas. During the World War II the agricultural sector was reorganized to the state body to strengthen the control of farmers aiming at increasing the food production due to deteriorating food supply. The rural industrial co-ops, farmers associations and other agricultural organizations (livestock, sericulture, and tea growers' co-ops) were integrated by the Agricultural Associations Law of 1943. With this, they became the wartime mobilization mechanism for controlling farmers with compulsory membership, losing the remnant co-operative character. On the other hand, the consumer sector was deprived of opportunities for trading basic food items such as rice by the Staple Food Control Act of 1942. The air raids on major cities had destroyed co-op facilities and driven them to the brink of collapse.

The end of the World War II had opened a new way to the co-operative legislation; separate legislation was made under the American Occupation. This period spanned from the Japanese surrender in 1945 to the recovery of independence in 1951. In this period, the US military administration called the General Head Quarters of the Occupation Army (GHQ) ruled Japan aiming at demilitarizing Japan and transforming it to a democratic state in accordance with the Potsdam Declaration of 1945. In the political arena, it helped Japan to enact a new Constitution based on the principles of people's sovereignty, pacifism and basic human rights. The imperial system was maintained transforming from the almighty sovereign to the symbol of national unity. The Japanese army was dissolved while the bureaucracy remained untouched to ensure smooth ruling. In the economic arena, it introduced the key democratizing measures; dismantling of *Zaibatsu*¹ by the Anti-Monopoly Act of 1947, legitimating of the trade unions by the Trade Union Act of 1945 and the agrarian reform by the Land Reform Act of 1946. In the social arena, the revised Civil Code of 1947 gave the equal rights to women while family register and family-based systems in taxation and social policy were retained.

The process of co-operative legislation was a part of such overall transformation and heavily influenced by so-called New Dealers who were seeking to introduce economic democracy. The Anti-Monopoly Act (Article 24) exempted certain co-operatives from its application except for the restrictive

¹ *Zaibatsu* ("financial clique") is a Japanese term referring to industrial and financial business conglomerates in the Empire of Japan, whose influence and size allowed control over significant parts of the Japanese economy from the Meiji period until the end of World War II.

trade practices, following the example of the Capper-Volstead Act of 1922. Such co-ops should be established based on the legal provisions and meet four requirements; a) aiming at mutual benefits among small producers or consumers, b) voluntary and open membership, c) equal voting rights for each member, d) limited compensation when distributing surplus. Thus, the Anti-Monopoly Act defined the criteria for Ideal-types of co-operatives to be applied to all kinds of co-ops. The Corporation Income Tax Act of 1948 allowed all kinds of co-operatives to pay a lower tax rate although the difference of rate compared with conventional companies have been reduced from 12.3% to 4.4%.

The Agricultural Co-operative Act (ACA) was enacted in 1947 after the agrarian reform was introduced. As early as in December 1945 General MacArthur of the GHQ issued a Directive for Farmers Liberation to democratize the rural economy by liberating farmers from exploitation by landlords which had led the poverty-stricken villages to support Japan's militarism and expansionism. This objective was achieved by the drastic land reform and GHQ intended to dissolve the Agricultural Associations and establish agricultural co-ops anew based on democratic principles. The law was redrafted several times since there were the differing opinions between the GHQ and the Ministry of Agriculture and Forestry (MAF); the former insisted on separating the credit business from other businesses as in other industrialized countries while the latter persisted in maintaining the multi-purpose model. Finally, the GHQ made concession and the ACA was enacted. In the process of transformation in 1947-1948 the MAF took measures called comprehensive succession; the properties, the offices, the boards and employees of the Agricultural Associations were taken over by multi-purpose agricultural co-ops. Thus, the agricultural co-ops had inherited the basic character of the industrial co-ops as state agencies. This process resulted in farmers lacking the consciousness that they spontaneously set up their co-ops; for many of them the signboard was changed to the co-ops overnight. What is more, the MAFF continued to authorize only one multi-purpose co-op in one area on the ground the competition among many co-ops could weaken their financial basis. This measure has led to a territorial monopoly, depriving farmers of the choice. In 1948 the national federations for guidance, marketing and supply were formed and in 1954 the Central Union of Agricultural Co-ops (CUAC or *Zenchu*) was set up as the apex organization.

The Consumer Co-op Act (CCA) was enacted in 1948 when the improved food supply resulted in the collapse of so-called "food acquisition co-ops" which had been organized in the neighborhoods or workplaces to cope with the serious shortage of food just after the war. They had mushroomed culminating in more than 6,500 co-ops in 1947, out of which only one sixth could survive until 1950. The Co-operative League of Japan (CLJ) campaigned strenuously campaign for the enactment of a new law to facilitate business opportunities of rationing and wholesaling which had been severely limited to authorized enterprises under the controlled economy, consulting with the GHQ and all political parties. Dr. Grashdanchev of GHQ had given positive advice when the CLJ was drafting the law while 3 ruling parties proposed their own drafts. Finally, the Law drafted by the Ministry of Health and Welfare (MHW) was adopted at the Diet on July 5th, 1948 when a clause prohibiting the transaction with non-members was introduced by a conservative party backed by the small chemists. The CLJ was disappointed by the CCA, which had some impediments to co-operative development, and immediately started campaigning to revise the Act. The CCA abolished the Industrial Co-operative Act and prompted the reorganization of consumer co-ops. The Japanese Consumers' Co-operative Union (JCCU) was set up to succeed CLJ in 1951.

In this period, the other co-operative laws were separately enacted to serve the specific needs of the co-ops; the Fishery Co-op Act of 1948 for fishermen and the marine product industry, the Small & Medium Enterprises Co-op Act of 1949 for industrial rehabilitation of SMEs, the Credit Bank Act of 1951 for urban businesses and the Labor Bank Act of 1953 for workers welfare etc. Such separate legislation had a great impact on the co-operative organizations. It fostered co-ops to take the quite different paths, which made it difficult to conduct joint actions and formulate common strategy. The separation of regulatory bodies has contributed to such tendencies, often spurred by the sectionalism of the ministries.² The other problem is the legal blankness for the newly created co-ops including worker co-ops, hybrid co-ops etc.

2. Institutional framework of agricultural co-operatives

The Agricultural Co-op Act of 1947 is an organization law for regulating agricultural co-operatives (JAs).³ It has some characteristic provisions as follows.

- Two-tiered membership

The qualification for membership of an agricultural co-op is as follows, which is to be defined in its bylaws (Art.12, Sec.1).

(i) Farmers, except corporations who usually employ 300 or more employees and with capital exceeding JPY 300 million.

(ii) The individual who has an address in the area of the agricultural cooperative or one who has continued to receive supply of the goods and services concerning its enterprise from the cooperative, and can appropriately use the cooperative facilities.

(iii) The agricultural cooperative, whose area is the same or a part of the areas of the existing agricultural cooperative.

(iv) Agricultural organization, such as the *Noji Kumiai Hojin*.

As such, membership consists of Regular member (i) who has full-fledged rights and Associate member (ii,iii,iv) who has neither voting right nor claim for distribution of surplus.

- Limitation of non-member's trade

ACA allows agricultural co-operatives to trade with non-members up to the amount of 20 percent of trade with members for the relevant business year in accordance with provisions of their bylaws. Some

² MAF was replaced by the Ministry of Agriculture, Forestry and Fisheries (MAFF) for the first industry co-ops while MHW was replaced by the Ministry of Health, Labor and Welfare (MHLW) for consumer co-ops. The Ministry of Finance (MOF) regulated credit and labor banks while the Ministry of International Trade and Industry (MITI, later replaced by the Ministry of Economy, Trade and Industry:METI) regulated the SME co-ops.

³ JA stands for Japanese Agricultural co-operative. It is used as an acronym such as JA Zenchu (CUAC).

exceptions are provided; allowance of 25 percent for loans and savings, that of 100% for health care, no limits to loans for municipalities or nonprofits (Art.10, Sec.17 ff). Those who belong to the same households are treated as members. However, since JAs had largely increased non-member trade for banking and insurance activities mainly in urban areas, MAFF took the critical stance requesting them to submit annual reports including the state of non-member trade to the administrative authorities which shall grasp the state of non-member trade in the annual hearing of co-operatives.⁴

- Multiple business activities

Co-operatives can carry out only economic activity stipulated by the relevant cooperative laws. Art. 10, Sec. 1 of ACA enlist the following activities; instruction for members on agricultural management and technology improvement, provision of loans for member's enterprise and life, acceptance of member's savings and term deposits, supply of goods required for member's enterprise and life, installation of common use facilities, installation of facilities for improved efficiency of agrarian labor, reclamation of agricultural land, its sale, rent and exchange, distribution, processing, storage and marketing of goods which member produces, installation of rural industry, institution of *kyosai*⁵, institution of health care, institution of elderly welfare, institution of improvement of rural life and culture, making agreement for improvement of member's economic status, and activities which accompanies the above. As such, ACA provides for a wide range of activities to be undertaken by agricultural co-operatives.⁶ The multi-purpose co-operatives can carry out all these activities while the single-purpose co-operatives are specialized in one of these activities (i.e. dairy co-operatives, citrus fruit co-operatives etc). The former is a dominant form and carries out banking and insurance businesses while federations for financial activities are not allowed to be engaged in other activities (Art 10, Section 23 and 24). Such combination of financial and other activities brought a bulky and complicated structure to ACA as a result of incorporating regulations pertaining to these businesses. In fact a large number of provisions in Banking Act, Financial Instruments and Exchange Act, Insurance Business Act shall apply *mutatis mutandis* to the ACA. In this regard, the organizational law incorporates business laws. In addition, such special arrangement that allows cooperatives to carry both economic (supply, marketing and others) and financial activities has been often criticized by financial industries that are given licenses and strictly regulated by the Financial Services Agency (FSA).⁷ Now agricultural cooperative's banking activity is subject of special audits by the FSA.

⁴ It is based on "General Guidelines for Supervision aiming at Agricultural Cooperatives etc" published by the MAFF in August 2012 and backed by order for collecting information (Art.93, Sec.1, ACA).

⁵ *Kyosai* literally means mutual aid but can be used in a variety of ways. There is a consensus in that *Kyosai* in cooperative laws means co-operative insurance that is used in the English translation of those cooperatives undertaking *Kyosai* activity.

⁶ There are other activities stipulated by other special laws for agricultural warehouses, land leasing and commissioned businesses.

⁷ Art.4 of Banking Act reads "No Banking Business may be conducted without having obtained a license from the Prime Minister." Insurance Business Act allows Stock Company and Mutual Company to carry on insurance business under the license of the Prime Minister prescribed in Art. 3, para. 1.

- Incorporation by competent administration's approval

Co-operatives are incorporated upon the approval of the administrative authorities⁸ that must approve the establishment of organizations within two months after filing the application except for some cases. The exception includes the legal violation in the procedure of establishment and the contents of bylaws or the business plan, the lack of necessary managerial basis, and the overlapping area with that of other cooperative, in which the administrative authorities have to consult with concerned municipalities and prefectural cooperative unions before approving (Art 60, ACA). Such a limitation in establishing a new cooperative in the overlapping area is often criticized as infringing the freedom of association.

Co-operatives are subject to public supervision by the administrative authorities. The ACA provides for a wide range of supervising measures including collection of reports, inspection, order of dissolution, measures against violation of laws and ordinances, revocation of decisions at the general assembly but does not provide for public auditing. Since JAs are engaged in a wide range of financial activities, they are subject to much more inspections compared with consumer co-ops. In 2011, a guideline pertaining to the implementation of inspection on financial activities was jointly published by the MAFF and the FSA. The tripartite joint inspection by Prefectures, the MAFF and the FSA is being conducted on banking and insurance activities of JAs in accordance with these guidelines since 2011.

- Central union's strong functions

The provisions on JA Zenchu (national central union) and JA Kenchu (prefectural central unions) were introduced by the amended ACA in 1954. They have been exclusively designated by central and prefectural governments and have compulsory membership of JAs and federations.⁹ JAZenchu can publish model bylaws that bind outsiders as well. It can make proposition on co-op-related matters to the government. Zenchu(National Audit Organization) can conduct compulsory auditing of JAs. Kenchu could make territorial coordination within a prefecture when new co-ops are established.¹⁰

In addition to the ACA, other laws have given impacts on JA's evolution by facilitating its reorganization and business operations.

- Special laws to rescue ailing co-ops and promote mergers among agricultural co-ops

After the enactment of the ACA, agricultural co-ops faced serious financial problems because of small size, shortage of share capital, inherited debts and lack of management skill. The situation was worsened when the austerity policy was introduced to stop hyperinflation by the GHQ (Dodge lines) in 1949 and the Japanese economy fell into depression. In 1950, 43% of co-ops were in the red while 1,054 co-ops stopped/limited the reimbursement of member's deposits. Based on the request from central organizations

⁸ The administrative authorities shall mean the Minister of Agriculture, Forestry and Fisheries (and the Prime Minister delegating to the FSA Commissioner for inspection of banking activity) with respect to central unions of agricultural cooperatives, agricultural cooperatives, their federations and so on having for their area of activity exceeding the sphere of a prefecture, and federations having a prefecture for their sphere of activity, and the prefectural governor with respect to other co-operatives (Art. 98, ACA).

⁹ JA Zenchu was privatized and transformed to a special civil corporation in 2002.

¹⁰ It was intended to avoid competition among primaries. This function was removed in 2013.

of agricultural co-ops, the Agricultural, Forestry and Fishery Co-ops' Reconstruction and Readjustment Act was introduced to rescue ailing co-ops in 1951. This law requested co-ops to set up 5-year plans to comply with financial standards through raising share capital and liquidating inventories while they could get public loans. 2,480 co-ops and 142 federations were designated by the Act when their accumulated loss was JPY12.3 billion while their equity capital was JPY3.4 billion. The primary co-ops made progress in the reconstruction while federations were still in bad shape. Therefore, the Agricultural, Forestry and Fishery Co-op Federations' Reconstruction and Readjustment Act was introduced to cover most of the federations in 1953. The federations not only got the reduction of interest payable to the Norinchukin Bank but also received public subsidies and tax concessions. They quickly recovered thanks to these special measures, but that resulted in strengthened public intervention in the agricultural co-ops and had long lasting effects to the co-ops' autonomy and independence.

The Agricultural Basic Act passed in 1961 provided for the principles and measures of agricultural policy aiming to enhance labor productivity and farmers' income, and change the structure of agriculture. As a part of this policy, the Act for Promoting Mergers among Agricultural Co-ops was introduced to accelerate the mergers. JAs were given subsidies for building facilities and tax concessions. This Act was extended several times and JAs adopted the policy of promoting mergers. Accordingly, the number of JAs was halved from 12,221 to 6,185 in the 1960s. It has reduced to 654 as of 2017 compared to 1,718 municipalities.

- Foodstuff Control Act of 1942

The Foodstuff Control Act was passed in 1942 to control the production and distribution of staples such as rice and wheat under the wartime economy, in which they were wholly collected and rationed to cope with the severe shortage of food during and immediately after the war. This system had provided for the institutional framework of controlling price and quantity of staple food as well as the distribution channel. The government bought all the crops in the initial stage, decided prices and margins for buying, wholesaling and retailing and controlled the entire international trade. The distribution channel was fixed to a singular line from farmers to consumers, leaving no room for choice. Agricultural co-ops were assigned as sole collecting agents; from primary co-ops to provincial federations and national federation (Zen-noh). Only licensed wholesalers or retailers could deal with staples. When the urgent food crisis was overcome, and oversupply became the major problem after 1960's, the dual pricing system (higher producer price and lower consumer price) accumulated negative margins to be compensated by tax, the system was modified to introduce a larger role for the market mechanism, but the basic idea was not changed.

This system has brought some significant effects to agricultural co-operatives. First, farmers pressed the government to raise rice price beyond equilibrium while the higher price stimulated the overproduction. From the 1960's onwards, co-operatives strongly mobilized farmers in a rice price campaign in parallel with trade unions' drive for higher wages since but they soon had to co-operate with the government's program of cutting back the acreage under cultivation. Secondly, the raised price helped marginal farmers who might otherwise have exited, to stay in unprofitable farming. They were employed in factories and other businesses to earn a living and constitute a bulk of co-operative membership. They were concerned with multiple services provided by co-ops, rather than competitive marketing capacity. Thirdly, JAs were designated as sole agents for collecting staple food and almost became a monopoly in

collecting government controlled rice with nearly 30% of wholesalers. They could automatically earn handling charges and deepened dependence on rice distribution as a mainstay of marketing business. Zen-noh exerted decisive power in maintaining a higher price in the quasi market for rice price. As such co-operatives contributed to the continued existence of food control system for more than 50 years. This law has been modified step by step since the 1980s and was finally replaced by the Staple Food Act in 1995. That introduced deregulation measures for distribution channels.

- Agricultural Land Act of 1946

The Agrarian reform created numerous small-holders to be protected by JA's. The Agricultural Land Law was enacted in 1952 to protect owner farmers by placing various restrictions on the transfer of land; restricting a lot's space for ownership, prohibiting absentee landlords, controlling rents for tenants and requiring permission to cancel leasing contracts. It also confined farmland ownership to farmers and did not allow corporations to enter. These restrictions contributed to maintaining small scale land ownership while hampering the expansion of a farm's scale through concentration of land use and/or ownership to entrepreneurial farmers. In addition, rapid economic growth triggered skyrocketing land prices with the effect of preventing farmers from buying at an earnings discounted price. Farmers in suburban areas could become upstart millionaires by selling land after getting permission for conversion from cultivation to the other development purposes. Since the cost of ownership for farmland was very low in terms of property and inheritance tax, farmers chose to retain land expecting a huge gain in the future. These factors have contributed to delaying any concentration of land in the hands of viable farmers and to the retention of part-time farmers. The law was amended several times but could not reverse that trend. Agricultural co-ops pursued an egalitarian approach and tended to maintain the current structure based on owner farmers, reflecting the interests of part-time farmers as against entrepreneurial farmers, and preventing new entries from non-agricultural sectors, especially joint stock companies. Thus, it can be said they have contributed the maintenance of the status quo in land ownership.

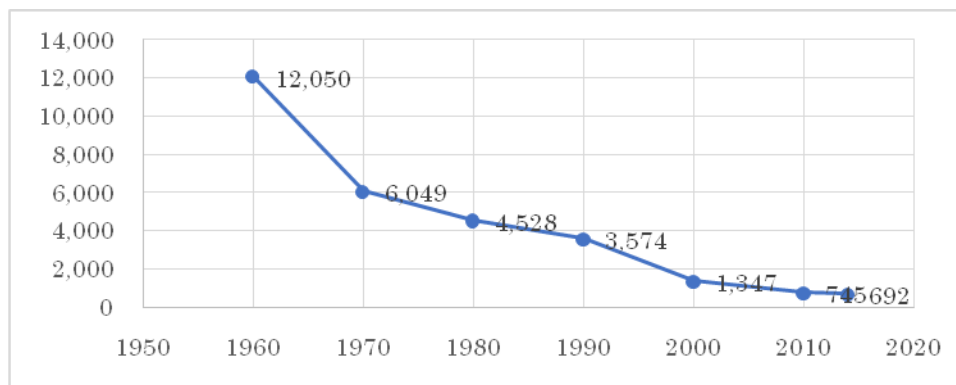
As a result, the land ownership remained small (on average 1.5 hectare per farm), which largely inhibited rationalization and mechanization. While farmer's overall standard of living has been enhanced thanks to out-of-agriculture incomes and their income surpassed worker's income in 1970, the productivity of agriculture was not improved as expected by the Agriculture Basic Law of 1961. The diversified diet of consumers accompanied with a westernized lifestyle resulted in the sharp increase of importation of food and fodder. As a result, the food self-sufficiency rate on a calorie base has dropped substantially from 79% in 1960 to 40% in 2000.

Under such an institutional framework, JAs have made a dramatic growth based on homogenous membership with small land ownership (0.5 hectare on average). The number of JAs has reduced from 4,528 to 703 in 1980-2013 through mergers (Figure 1). The associate members rapidly grew and outnumbered full members in 2009 and the gap is widening (Figure 2). In each area of business, the national and provincial federations were set up and they were affiliated with the national and provincial unions. Thus, JA group developed the three-tier hierarchical agricultural co-operative system called *keitou* in line with the administrative system (state, prefectures and municipalities).

However, JAs have faced intensified competition since the 1980s. The globalized economy forced them to lower the price of produce while the deregulation of agricultural policies obliged them to compete

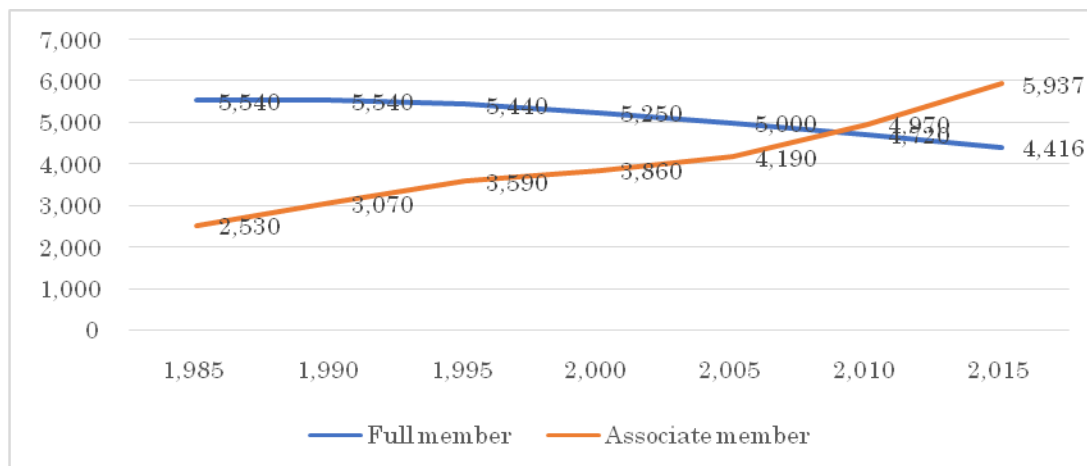
with for-profit firms. The member's business became heterogenous in terms of size/scope while large farmers requested the lower price of inputs and the higher margin of produce. To cope with such a situation, the vertical integration from three tiers to two tiers has been carried out since the 1990's with mixed speeds. Zenkyoren (National Mutual Insurance Federation of Agricultural Co-ops) integrated all prefectural federations in 2000. Zen-noh (National Federation of Agricultural Co-ops) integrated 35 prefectural federations out of 47 while Norinchukin Bank (Central Bank for Agriculture and Forestry) integrated 10 prefectural federations. The supply, marketing and insurance businesses have been declining while banking business is still maintaining deposits and loans. The losses generated in supply and marketing businesses have been offset by profits earned by banking and insurance businesses (Figure 3).

Figure 1 Mergers reducing number of JAs



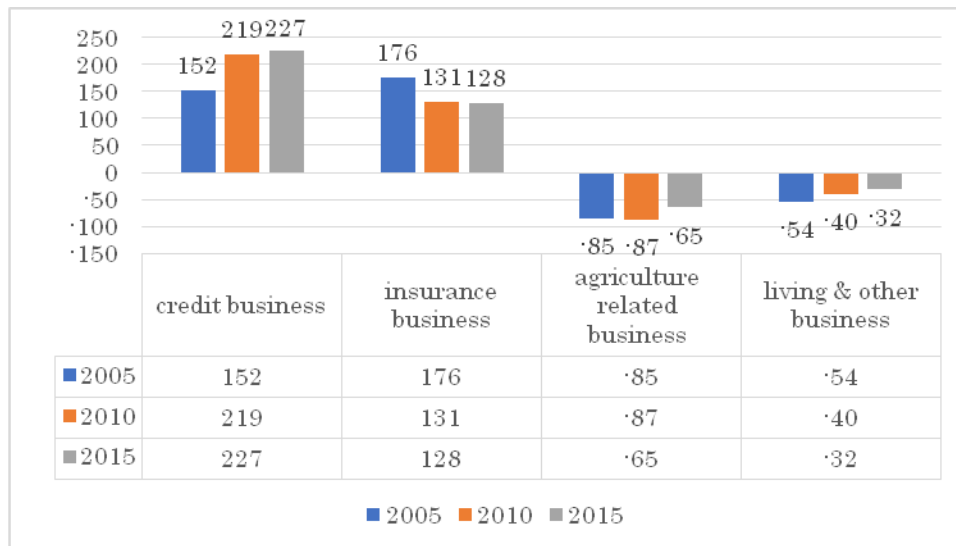
Source: MAFF's statistics on agricultural co-ops

Figure 2 Associate members outnumber full members (in thousands)



Source: MAFF's statistics on agricultural co-ops

Figure 3. JA's profit and loss (JPY billion)



Source: MAFF's statistics on agricultural co-ops

3. Reform of Agricultural Co-operative Act in 2015

The JA group has evolved into a complex group of organizations with multiple dimensions. It has a dominant economic force offering a variety of goods and services. It has been a major employer in rural areas and provides the basic infrastructure for rural population ranging from supply/marketing for farms, banking and insurance to health/elderly care, funeral services, land development and housing, travel, culture, media and so on. It has functioned as a MAFF's agent for implementing agricultural policies on pricing of produce, crop collection and distribution, production ramp-up and ramp-down in accordance with priorities of the time. To influence government policies on agriculture, it has grown to a strong lobby and pressure group with rural voters supporting the ruling Liberal Democratic Party (LDP).¹¹

However, JA's identity has been questioned; is it a professional co-op for farmer's interests or a territorial co-op serving to wider rural population? JAs in large cities function as a financial institution rather than agribusiness since associate members largely outnumber full members while JAs in rural areas function as infrastructure serving all kinds of population's needs. They increasingly became the subject of criticisms by academic circles and media. The corporatist structure through 'agricultural policy triangle' made of JAZenchu, MAFF and Member of Parliaments (LDP) was criticized as a protectionist coalition hampering the Free Trade Agreement negotiations and the innovation for competitive agriculture. Zenchu's function of compulsory auditing and consulting was incompatible and gave detrimental effects

¹¹ Leading agronomists described JA's characteristics as the combination of triple natures of state's agent, pressure group and co-op per se (Prof. Fujitani), the institutionalized co-ops with all farmer's affiliation, *keitou* system and multi-purpose business (Prof. Otawara) or the co-ops typical in developing counties (Prof. Ishida).

to primary co-op's entrepreneurial drive. JA's expansion of non-member trade and associate members was also criticized. JA's characteristics as multi-purpose co-ops conducting both economic and financial businesses have been questioned since other financial institutions are not allowed to conduct non-financial business. Such criticisms have been intensified whenever JAs opposed trade liberalization of farm products and culminated when they led the campaign against the Trans-Pacific Partnership (TPP) in recent years. Now the traditional coalition is shaken under the Abe administration.

The Cabinet Office's Council for Regulatory Reform's proposed the radical reform of JAs in May 2014 for dismantling of JA Zenchu, demutualizing of JA Zen-noh, separation of financial business from other businesses and limiting associate member's use. The government proposal for the ACA reform was announced in June 2014. JA group made a strong reaction against imposed reform and organized nationwide campaigns. The other co-operatives expressed opposition to such a move while the ICA published a press release expressing major concern in October. Finally, JA Zenchu agreed to the ACA reforms in February 2015 and the amended ACA passed the Diet in September 2015.

The ACA included the following amendments;

- Transformation of JA Zenchu to a general incorporated association from 2019
Zenchu shall be transformed to a purely private organization such as the Japan Federation of Economic Organizations or other trade associations based on specific industries or professions. Kenchu shall be transformed into prefectural co-op federations.
- Separation of auditing function from JAZenchu
JA group's auditing firm will be established succeeding to the functions of Zenchu's National Audit Organization. JAs with deposits exceeding JPY 20 billion will have to be audited by either the newly created auditing firm or other auditing firms after 2019.
- Facilitating changes of corporate status
JAs can separate organizations and transform into Public Limited Companies (PLCs), consumer co-ops or social medical corporations. Zen-noh and economic federations can be transformed to PLCs.
- Purpose of organizations
In addition to "making the utmost services for members", "paying maximum attention to the increased farming income" was added. The not-for-profit provision was removed.
- Composition of board to strengthen its capacity
A majority of JA's board needs to be entrepreneurial recognized farmers and/or those who have practical capacity in agricultural marketing, corporate management and so on.
- Limiting use of associate members
It was not included in this amendment but needs to be reexamined in 2019.

4. Institutional framework of consumer co-operatives

The Consumer Co-op Act of 1948 is an organization law for regulating consumer co-operatives. It has the following characteristic provisions:

- Membership

The qualification for membership in a consumer cooperative shall be determined by the bylaw applicable to the following persons (Art.14, Sec.1).

(i) Persons who have residence in the fixed area in the case of community-based co-ops.

(ii) Persons who are engaged in the occupation in the case of work place co-ops.

Sec. 2 In case of the co-operative by area, persons whose place of employment falls within the area of the co-operative and who have reasonable needs to utilize its facilities.

Sec.3. In case of the co-operative by occupation, persons who, living in the neighborhood of the place of occupation, have reasonable needs to utilize its facilities and who had worked in the place of occupation.

Sec.4. Students in case of the co-operative in universities and schools.

As such only user-members are allowed while there exist no corporate members in the primary co-operative. Employees working in the area of co-ops and students can become members of consumer co-ops, thus enabling multi-stakeholder membership.

- Prohibition of non-member trade

CCA completely prohibits consumer co-operatives to trade with non-members, which have had long-standing effects on the evolution of cooperatives (Art. 12). Co-operatives had been attacked by the retailer association's persistent anti-cooperative campaigns, which led to the enactment of Special Retail Measures Law in 1959 that brought further restrictions to non-member trade and introduction of the clause of coordination with the Ministry of International Trade and Industry (MITI) regarding to the interests of small retailers. The Ministry of Health and Welfare (MHW) conducted administrative inspections from time to time to gauge the extent of non-member trade.¹² Thereafter cooperatives had to fight back right up until the last anti-cooperative campaign was staged in 1986, when the stance of the government's commercial policy shifted to pro-competition.

- Limitation of operating area within prefectures

The other peculiarity is the limitation of area of activity within a prefecture. The co-operative shall not be established covering a wider area than that of a prefecture, except in case of the co-operative by occupation under inevitable circumstances and of the co-operative federations. (Art. 5) The restriction on co-operative operating area has often prevented co-operatives from serving consumers who live in their catchments areas, but have home addresses registered in another prefecture. This restriction has proved to be anachronistic as the economy has expanded to a global scale and to cyberspace. Under such circumstances, co-operatives had to adopt a strategy of establishing regional federations (consortia) in the

¹² The final administrative inspection was conducted by the Management and Coordination Agency in 1991.

1990s aiming at enhanced economies of scale. This solution bypassed the restriction, and prevailed throughout the country¹³.

- Limited area of business

Art.10, Sec.1 of CCA confines activities that consumer co-op can undertake; to purchase and to supply materials needed by the members for their daily life, activity to establish useful common facilities for its members, activity to improve the mode of living and elevate the standards of culture for its members, activity to operate *kyosai*(insurance) on the lives of its members, activity to improve knowledge of its members and employees concerning a co-operative, activity concerning health care for its members, activity concerning to welfare for elderly, handicapped etc., activities incidental to the accomplishment of each of the preceding items. Consumer co-operatives have not been allowed to undertake banking activity despite their strong requests since the inception of CCA¹⁴ They are allowed to provide only small loans for livelihood expenses provided they have bylaws and rules approved by the competent authorities and observe the regulations set by Moneylending Control Act. A large number of provisions in Insurance Business Act apply *mutatis mutandis* to the CCA.

- Incorporation by competent administration's approval

Co-operatives are incorporated upon the approval of the administrative authorities¹⁵ that must approve the establishment of organizations within two months after filing the application except for some cases. The exception includes the non-fulfilment of requirements prescribed in each item of Art. 2, Sec. 1, the legal violation in the procedure of establishment and the contents of bylaws or the business plan, the lack of necessary managerial basis, but there is no provision on limitation in the overlapping area (Art.58). Therefore, the area of consumer co-operatives is often overlapping especially in the large cities where some co-ops with different orientations are competing with each other. Co-ops are also prohibited from making use of co-ops for specific political parties (Art. 2, Sec.2).

Other laws have been impacting consumer co-ops' activities.

- Foodstuff Control Act of 1942

Consumer co-ops could not have retail license for rice under the Foodstuff Control Act. During and after the Second World War, co-ops had petitioned to get retail license for rationing rice and other basic commodities but in vain. So, they had to pay a high rent to licensed retailers to sell rice as tenants. This law was modified step by step since 1980s and finally replaced by the Staple Food Act in 1995 introducing deregulation measures for distribution channels. Consumer co-ops could take part to rice retailing after registering to the competent administration. They were also excluded from retail licenses of liquors since bottle shops have prevented new entries by pressing tax authorities not to grant new licenses.

¹³ More than 90 percent of cooperatives' turnover is concentrated in consortia and mega cooperatives.

¹⁴ Agricultural, fisheries and credit cooperatives can provide loans and accept savings while business cooperatives can only lend loans.

¹⁵ The administrative authorities shall mean the Minister of Health, Labor and Welfare with respect to consumer cooperatives having for their sphere of activity, by area or by occupation, which exceeds the sphere of a prefecture, and the prefectural governor with respect to other cooperatives.(Art. 97, CCA)

Since liquor retailers' associations have been so strong that they succeeded in blocking deregulation until recently. It was only in the late 1990s that liquor retailing was liberalized.

- Large-scale Retail Store Act of 1973

The retail industry has been a safety valve for unemployment and there had been always a pressure of small retailers to curve competition by forming cartels or lobbying to protect their interests against modernized large-scale retailers. They had exercised the strong political voice to the ruling party as they had votes and money to push their protectionist stance in formulating commercial policies. Thus, the Department Store Act was enacted to require the government's permission for store opening, operating dates/hours and so on in 1937. It was once abolished in 1947 but revived under strong pressure from retailers in 1956. This new law was replaced by Large-scale Retail Store Act in 1973 to include fast growing supermarkets within the regulatory framework, which required developers to undergo the prior examination by Commissions for Adjusting Retail Activities before filing notice to open new stores with selling floor exceeding 1,500 m² (3,000m² for megalopolis). It also required large stores to conform to various restrictions on operating hours per day and a minimum number of closing days per month. This law was further amended in 1978 to strengthen restrictions. Consumer co-ops were also subject to the similar regulations published by the ministry. These regulations have delayed modernization in retailing but could not reverse the decline of independent small retailers despite subsidies and low-interest loans.

The public commercial policy shifted its basic stance from protectionist to pro-competition in late eighties. It is partly due to foreign pressure for market liberalization on the pretext of enhancing consumer's choice but also due to the increasing concerns for environment. The regulations set by the Large-scale Retail Store Act has been gradually eased since 1987 and finally replaced by the Large-scale Retail Store Site Act in 1998. This new law abandoned the idea of adjusting supply and demand of selling floor in favor of small retailers but introduced a new regulatory framework concerning to environmental impacts of large stores in terms of noise, traffic and garbage disposal. It is applied to all enterprises regardless of organizational forms. Co-operatives are also subject to the same regulations and facing the stiffer competition although they are not placed in the level playing field.

- Discriminating tax rate

The large-scale co-ops are taxed at higher rate compared with other co-ops since 1988. This measure was introduced by the Act on Special Measures concerning Taxation. The co-operatives with more than 500,000 members and revenue of more than JPY 100 billion are subject to higher rate of Corporation Income Tax. Only the large-scale consumer co-ops were targeted since no other entities had such a size.

Adapting to the institutional framework, consumer co-ops developed the specific organizational culture of strong self-reliance and adherence to membership. For example, co-op had to display in-store signboards stating, "This co-op store caters to members only. Please make use of the store after joining the co-op" to comply with legal requirements prohibiting non-member's use. Complying with the law entailed adopting a strategy of enrolling all customers as co-op members and conducting member recruiting drives every year, which contributed to the rapid expansion of their membership, thus turning a handicap to their advantage. Co-ops learned to rely on members' patronage and members' capital investment. They promoted various ways to involve members in the administration through *Han* groups, district committees

and consumer panels in addition to the legally required AGM. Thus, they have developed a Japanese model of member participation based on the identity principle. Co-op's adherence to membership has resulted in an independent and self-sustained organizational culture.

At the same time, the containment of mutual interests among its members might have curtailed co-op's potential in the society at large, thus leading to a closed or complacent organizational culture. Co-ops could only grow by mobilizing internal resources derived from members while they were not very active in marketing to consumers at large nor in promoting their values to opinion leaders. In addition, some co-ops were closely associated with the left-wing opposition parties while only a limited number of co-ops maintained contacts with the conservative ruling party. Although co-ops have now grown to be the single largest consumer organization, involving 40% of all households in Japan, their influence in Japanese society at large had been limited.

5. Reform of Consumer Co-operative Act in 2007

The CCA was amended in 2007. It was an epoch-making event in that no substantial amendments have been made since this Act was originally enacted in 1948. The historical changes in the socio-economic environment and the unprecedented growth of consumer co-ops in these 60 years revealed a great discrepancy between the premises of the Act and the reality of consumer co-ops to an intolerable extent. The Japanese Consumer Co-operative Union (JCCU), therefore, took the initiative requesting the overhaul of the CCA.

Several factors were attributable to the major amendment. The most explicit factor was the overall deregulation and competition prompted by globalization. The changing stance of the government's commercial policy and the increasing pressure from the US resulted in easing the regulation of the Large-scale Retail Store Act in the 1990s, and finally replacing it with the Large-scale Retail Store Site Act in 1998. This new law focused on the environmental impact of retail development such as noise, traffic jams and waste management. In 2006 the legislation for retail planning was amended to curtail the excessive development of out-of-town shopping centers and activate inner cities that were hollowing-out. This move was generally welcomed by retailer's associations and municipalities, although it was criticized by major retail chain stores as a serious setback.

There has been a change in retailer's attitude to the CCA. After the Second World War, the overall number of retailers continued to increase until the early 1980s while it declined from 2.2 million to 1.6 million in 1982-2004. This period was characterized by the growing market share of big chain stores, but independent retailer's reactions to large stores were more diverging; some retailers were against the opening of mega stores, while others opposed to the withdrawal of the latter. While the Japan Chamber of Commerce and Industry (Nissho) had been a staunch anti-co-operative campaigner in past decades, it took more neutral stance on the amendment of the CCA.

Another factor that directly affected was the growing pressure from insurance companies, that complained of their market share being taken by co-operative insurance (*Kyosai*) and insisted that *Kyosai* should be subject to the same kind of regulation by the financial authorities. The pressure increased as

foreign insurance companies joined this claim that *Kyosai* should be placed on a level playing field. Accordingly, the ACA and the SME Co-operative Act were amended in 2004-2006, while the Insurance Business Act was amended to outlaw non-institutional *Kyosai* in 2005. The Life Insurance Association, the General Insurance Association and the American Chamber of Commerce in Japan (ACCIJ) requested to amend the CCA in the same way.

At the same time, a number of governance problems in consumer co-ops surfaced in the late 1990s. The manipulation of accounts by the CEO of Co-op Sapporo, the second largest co-op, brought this co-op to the brink of bankruptcy, while the unethical behavior of top management was revealed by whistleblowers in Osaka Isumi Co-op, then ninth largest co-op. Co-op Saga was criticized as disguising the regular beef as a top brand. Some co-ops also experienced financial crises or went bankrupt due to mismanagement. These events led to the urgent need to make thorough overhaul of co-operative governance.

The amendment covered three areas. In the first area regarding the business operations of consumer co-ops, the strict rules were relaxed to some extent. For example, the legal business operating area, which had been restricted to within a single prefecture, was extended to adjoining prefectures when necessary for implementing retail business. This would enable co-ops to make inter-prefectural mergers to enhance the economy of scale and solve the governance problems associated with dual board structure in co-op consortiums. The framework prohibiting non-member trade was maintained; the business of consumer co-ops remained unavailable for non-members. However, regulations were eased to some extent and exceptional cases were enlisted. Those cases that do not require government permission are shown in the table below, while the extent of non-member trade was stipulated.

Non-member trade allowed in consumer co-ops

Government permission	Cases in which non-member trade are allowed	Extent to be allowed
Not required	Statutory car insurance for compensation	Unlimited
	Goods supplies in case of emergency	Unlimited
	Sales of monopolies	Unlimited
	Use of gymnastic and cultural facilities	Unlimited
	Business commissioned by governments	Unlimited

	Health and social care business	100% of MP
	Sales to institutions where co-op operates	20% of MP
Required	Goods supplied to remote areas	20% of MP
	Meals supplied to day care and nursing homes	20% of MP
	Goods supplied between co-ops	20% of MP

MP: Member's patronage

The health and social care businesses were clearly stated in the Act as part of consumer co-op's businesses. Co-ops are requested to maintain and provide separate accounts from other businesses and observe non-distribution constraint of surpluses generated in these businesses on the ground they are financed by tax and social insurance fees. The financial loan businesses were incorporated into the scope of businesses, which consumer co-ops can conduct under the condition of complying with regulations of the Moneylending Control Act. This was introduced to enable co-ops to offer micro-loans to support social entrepreneurs and help solve problems of heavy indebtedness.

The second area addresses the rules concerning governance of consumer co-ops. The original CCA of 1948 presupposed to deal with small organizations involving hundreds of members in line with the Civil Code, but some provisions became apparently unfit to govern the contemporary large-scale organizations with considerably large memberships. Therefore, provisions were introduced to improve co-op's governance corresponding to those of the Commercial Code. The newly introduced provisions on co-operative governance relate to the intensified competence of the board of directors; stipulation of the board of directors and the board chairs as statutory bodies, decision on maximum loan amount, standing orders for the board proceeding, methods of election, remuneration and compensation, the term of office, qualification, responsibilities of board members. Provisions for intensified functions of auditors; obligatory full-time auditors in larger co-ops with debts exceeding JPY 20 billion, investigation of proposed agenda to the AGM, a claim for suspending board member's misconducts, independence of auditors. Provisions for individual member's rights; a claim for inspecting books, a legal claim for invalidating AGM's resolutions or requesting suspension of a board's action, right of a member's derivative action. Provisions for disclosure and the third-party commitment; enlarged external directors from one fifth to one third, obligatory external auditors in larger co-ops, procedures disclosing books and minutes. Provisions for supervision by competent government bodies; orders for the removal of directors or enlarging the scope for mandatory liquidation of co-operative societies.

The third area includes provisions regarding insurance businesses referred to the Insurance Business Act. They aim to increase the soundness and transparency of management while maintaining the Ministry's regulatory framework. The newly introduced provisions on co-op's insurance business prohibited running other businesses in the co-op federations and primary co-ops whose insured amount exceeds JPY 1 million or whose premium income exceeds JPY 1 billion. Provisions to ensure financial stability; minimum share capital, obligatory buildup of reserves, appointment of actuaries, level of solvency margins, early correcting measures, obligatory external auditing. Provisions for protection of policyholders and increased transparency; obligatory disclosure of management information, prohibition of improper conducts on recruiting, change of contract terms and transfer of engagement in case of bankruptcy, regulations on agents.

6. New legislation's impact to the co-operative identity

In relation to the amendment of the ACA for reforming agricultural co-ops, changes are taking place. JA Zenchuis is coordinating to implement the reform agenda towards the deadline of September 2019, including its own transformation and creation of auditing firm. Zen-noh is requested to lower the agricultural input's price to help farmers while Norinchukin Bank is absorbing some JAs' credit business but many things are still in the pipeline. Mr. Okuno was elected as new president of JA Zenchu in 2015 and took a reformist stance. He had close dialogue with Mr. Okuhara of MAFF and Mr. Koizumi of LDP but looks like deepening dependence upon the latter rather than intensifying autonomy and independence. In the election of Zenchu's president in July 2017, the candidate whom Okuno supported was defeated by Mr. Nakaie who had the traditional stance but admitted the necessity of the reforms. Therefore, it is too early to make a judgement on the JA group's future.

In relation to the amendment of the CCA for modernizing regulations, some changes took place. Co-ops conducting insurance and other businesses were obliged to maintain separate organizations. Accordingly, the Japanese Co-op Insurance Federation (JCIF) was set up by the JCCU, Zenrosai, 3 regional consortiums and 157 primary co-ops in October 2008. It started operation in March 2009 taking over the insurance businesses transferred from affiliated co-ops. Co-operative groups such as Pal System and Seikatsu Club also created their own insurance co-op federations. The Japanese Health and Welfare Co-operative Federation (HeW CO-OP JAPAN) was established separating from the JCCU in 2010. Based on the provisions on the establishment of regional co-ops covering adjacent prefectures, some mega consumer co-ops were set up. In 2011, Co-op Kobe absorbed its sister society Osaka Kita Co-op and had a membership of 1.68 million. In 2013, Co-op Tokyo, Saitama Co-op and Chiba Co-op merged to Co-op Mirai with 3 million members while Co-op Kanagawa, Co-op Shizuoka and Yamanashi Co-op joined to set up U Co-op with 1.76 million members.

As far as the co-operation among co-operatives is concerned, the International Year of Co-operatives (IYC) could not generate a tangible impact in Japan. In 2010, all the co-op organizations joined to organize the Japan National Planning Committee for IYC that submitted "a Co-operative Charter" seeking for the recognition of co-operatives to the government which gave no response. However, the liaison committees were set up or revived in many prefectures and national federations' leaders started the discussion on the possibility of creating an umbrella organization representing the Japanese co-ops.

7. Japanese co-operative laws in the light of PECOL

As described above, the Japanese co-operative legislation had modeled after the German law but evolved to quite country-specific laws. Co-operatives are required to seek government approval for incorporation, merger and liquidation and are placed under the strong supervision of competent ministries. In this regard, the Japanese legislation retain some elements of that of developing countries.

However, PECOL provides useful points of reference to the Japanese co-op laws. The Section 1.1 (Definition and objectives of co-operatives) makes distinction between “mutual co-ops” mainly pursuing the interest of their members and “general interest co-ops” mainly pursuing the general interest of the community. In the Japanese laws, JA *Koseiren* (agricultural co-operative federation for health care) falls in the latter since it is designated as a public medical institution under the Medical Services Act. It is not allowed to distribute dividends nor residual assets. In case of health co-ops regulated by the CCA, they are not allowed pay dividends.

The Section 1.5 (Non-member co-operative transactions) provides that mutual co-operatives may engage in non-member co-operative transactions unless their statutes provide otherwise and they shall keep a separate account of such transactions. In that case, profits from non-member transactions shall be allocated to indivisible reserves. In this regard, the Japanese law’s prohibition of non-member transactions needs to be reconsidered.

The Section 3.8 (Liquidation) provides that in case of liquidation of a co-operative, members shall be entitled only to recover the nominal value of their shares and their portion of divisible reserves as provided in the co-operative statutes, while residual net assets shall be distributed in accordance with the principle of disinterested distribution. In the Japanese laws, it is not banned to distribute residual assets (divisible reserves) but in most cases restrained by the provisions of bylaws.

The Section 4.3 (Auditing entity and auditors) provides that the auditing entity is the entity in charge of the co-operative audit, which conducts it through independent auditors specifically qualified for co-operative audit according to minimum standards established by the law and may be the state, another public authority, unions or federations of co-operatives or other private entities recognized by the state according to minimum requirements established by the law. In the ACA, audit function is being separated from the JA Zenchu (Central Union of Agricultural Co-ops). The large co-ops must undergo the external audit by CPA while small co-ops are audited by internal auditors.

Conclusion

The institutions matter in the evolution of organizations. Co-operatives are still divided by the different institutional frameworks and suffer from the lack of identity. It is attributable mainly to the fragmented co-operative legislation and different public policies. The favorable environment brought by the agriculture protection policy with supportive laws and subsidies resulted in the JA system that is politically influential as an agency for implementing the government policy and a strong pressure group.

On the contrary, adversarial environment placed by the commerce protection policy combined with retailers' anti-co-operative campaigns characterized as "containment policy" resulted in the consumer co-ops that are highly independent but least influential in the political arena. The former's top-down organizational culture and close affiliation with the conservative party contrasts with the latter's bottom-up organizational culture and close connection with the opposition parties. Strong path dependency can be observed in the co-operative's evolution in these 70 years.

However, the wave of globalization and deregulation since the 1980s has had a strong impact on that institutional setting. Both the ACA and the CCA were amended to cope with such changes. This paper analyzed the outline of these laws and recent legal reforms. The following questions need to be answered; how JAs design and implement their own reform to become autonomous co-operative organizations independent from MAFF and LDP, how consumer co-ops break "containment policy" and how co-ops can regain an identity and recognition.

In addition, co-operatives are increasingly influenced by the changes in the Commercial Code (CC) and business laws. The provisions on the governance and financing in the CC are being taken in co-operative laws while the business laws for the banking and insurance industries are being applied irrespective of corporate forms. The competition laws and tax laws are also making an impact on co-operatives. The relevance of these laws to co-operative development need to be further analyzed.

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