

# The Dark Side of Private Ordering: An Institutional and Empirical Analysis of Organized Crime

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*This Article provides theoretical and empirical support for the claim that organized crime competes with the state to provide property rights enforcement and protection services. Drawing on extensive data from Japan, this Article shows that, like firms in regulated environments everywhere, the structure and activities of organized criminal firms are significantly shaped by state-supplied institutions. Careful observation reveals that in Japan, the activities of organized criminal firms closely track inefficiencies in formal legal structures, including both inefficient substantive laws and a state-induced shortage of legal professionals and other rights-enforcement agents. Thus, organized crime in Japan—and, by extension, in other countries where significant gaps exist between formal property rights structures and state enforcement capacities—is the dark side of private ordering.*

*Regression analyses show negative correlations between membership in Japanese organized criminal firms and (a) civil cases, (b) bankruptcies, (c) reported crimes, and (d) loans outstanding. Professors Milhaupt and West interpret these data to support considerable anecdotal evidence that members of organized criminal firms in Japan play an active entrepreneurial role in substituting for state-supplied enforcement mechanisms and other public services in such areas as dispute mediation, bankruptcy and debt collection, (unorganized) crime control, and finance. They offer additional empirical evidence indicating that arrests of gang members do not curb the growth of organized criminal firms. Their findings may have a significant normative implication for transition economies: efforts to eradicate organized crime should focus on the alteration of institutional incentive structures and the stimulation of competing rights-enforcement agents rather than on traditional crime-control activities.*

Organized crime is flourishing. It thrives in transition economies; it persists in developed nations; it prospers under globalization. Criminal groups may control 40 percent of the Russian economy, for example.<sup>1</sup> In Japan, the influence of organized crime extends from prostitution to golf course development, from banking and securities

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<sup>1</sup> Louise Shelley, *Paying the Price*, *The Russian* 14 (Apr 1997).

to disaster relief.<sup>2</sup> In the United States, mob developments continue to make front-page headlines.<sup>3</sup> In recognition of the severity of the problem, both the United Nations and the G8 have begun to devote resources to combating international organized crime.<sup>4</sup>

Why does organized crime emerge, and what function does it play in an economy? Despite a growing recognition of the vulnerability of developing societies and emerging democracies to this problem, and continued study of the phenomenon in mature economies, no consensus exists even on the definition of organized crime,<sup>5</sup> much less on the

<sup>2</sup> See, for example, Henry Sender, *Mafia Capitalism: Just the Tip of the Iceberg?*, Japan J 25 (1991).

<sup>3</sup> See, for example, Raymond Bonner with Timothy L. O'Brien, *Activity at Bank Raises Suspicions of Russian Mob Tie*, NY Times A1 (Aug 19, 1999); Joseph Berger, *Gotti Pleads Guilty to Rackets Charges on Eve of His Trial*, NY Times A1 (Apr 6, 1999).

<sup>4</sup> See M. Cherif Bassiouni and Eduardo Vetere, eds, *Organized Crime: A Compilation of U.N. Documents 1975–1998* (Transnational 1998); Diane Coyle, *The Dark Side of Globalisation Where the Black Economy Thrives: Diane Coyle on Why the G8 is Worried About Crime*, The Independent 24 (May 14, 1998).

<sup>5</sup> Academic definitions abound. One leading organized crime text defines organized crime merely as “a nonideological enterprise that involves a number of persons in close social interaction, organized on a hierarchical basis for the purpose of securing profit and power by engaging in illegal and legal activities.” Howard Abadinsky, *Organized Crime* 7 (Nelson-Hall 2d ed 1985); another posits that “[o]rganized criminal groups are simply business organizations operating under many different management structures and dealing in illegal products.” Denny F. Pace and Jimmie C. Styles, *Organized Crime: Concepts and Control* 21 (Prentice-Hall 2d ed 1983). Richard Posner defines organized crime as “criminals organized into illegal firms . . . operating in such criminal fields as loansharking, prostitution, gambling, and narcotics but also in legitimate fields as well, and employing violence and the corruption of police as key business methods.” Richard A. Posner, *Economic Analysis of Law* 242 (Little, Brown 4th ed 1992). Diego Gambetta describes the Italian mafia as “that set of firms which (1) are active in the protection industry under a common trademark with recognizable features; (2) acknowledge one another as the legitimate suppliers of authentic mafioso protection; and (3) succeed in preventing the unauthorized use of their trademark by pirate firms.” Diego Gambetta, *The Sicilian Mafia: The Business of Private Protection* 155 (Harvard 1993).

Policy-makers likewise disagree. Since 1992, the United Nations Economic and Social Council Commission on Crime Prevention and Criminal Justice has struggled without success toward a definition. See M. Cherif Bassiouni and Eduardo Vetere, *Towards Understanding Organized Crime and its Transnational Manifestations*, in Bassiouni and Vetere, eds, *Organized Crime: A Compilation of U.N. Documents 1975–1998* xxvii (cited in note 4) (distinguishing organized crime from other criminal groups and legitimate enterprises occasionally employing criminal means). In the U.S., the Racketeer-Influenced and Corrupt Organization Act (RICO), Organized Crime Control Act of 1970, Pub L No 91-452, 84 Stat 941, codified at 18 USC §§ 1961–68 (1994), the primary legal weapon against organized crime in the United States, contains no clear definition of its target. Although it initially included an amendment that would have criminalized membership in the “Mafia” or “La Cosa Nostra,” see Organized Crime Control Act of 1970, S 30, 91st Cong, 2d Sess (Oct 7, 1970), in 116 Cong Rec H 35343 (Oct 7, 1970) (amendment proposed by Representative Biaggi), the amendment was eventually rejected, both on the grounds that it violated the Equal Protection Clause, and because it was an underinclusive definition of organized crime. Id at H 35344–46. See also Gerard E. Lynch, *RICO: The Crime of Being a Criminal, Parts I & II*, 87 Colum L Rev 661, 685–86 (1987) (discussing the constitutional and political drawbacks of criminalizing “mafia” membership only); Gerard E. Lynch, *RICO: The Crime of Being a Criminal, Parts III & IV*, 87 Colum L Rev 920, 937–45 (1987) (discussing “the enterprise

more theoretically fundamental and practically significant questions. Without a richer understanding of the phenomenon, organized crime will continue to thrive because the roots of the problem will remain unexposed.

This Article draws on new institutional economics literature and extensive empirical analysis to show that the structure and activities of organized criminal groups are significantly shaped by the state. Organized crime, we argue, is the dark side of private ordering—an entrepreneurial response to inefficiencies in the property rights and enforcement framework supplied by the state.

A substantial literature has exposed the bright side of private ordering.<sup>6</sup> Many scholars have shown that over a wide range of human activity, informal norms provide efficient and effective mechanisms to govern conduct. Occasionally a commentator will note that not all private ordering arrangements result in efficient norms, or that private ordering is subject to the same collective action problems that plague formal lawmaking processes.<sup>7</sup> These cautionary asides in the literature, however, are rare and have never been developed into a robust theory of the organized, private exploitation of defects in state structures. We seek to provide analytical and empirical support for such a theory by focusing on a simple fact: in order to be effective, private ordering often requires the participation of intermediaries who possess information, time, and skill—intermediaries we refer to as rights-enforcement agents and information agents. In the United States, these roles are typically filled by lawyers or other organized professionals, who, to borrow Ronald Gilson's famous phrase, function as "transaction cost engineers."<sup>8</sup> When property rights and enforcement institutions are

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offense").

<sup>6</sup> See, for example, Robert C. Ellickson, *Order Without Law: How Neighbors Settle Disputes* 280–83 (Harvard 1991) (concluding that value maximizing norms, not law, are central to social order); Mark D. West, *Legal Rules and Social Norms in Japan's Secret World of Sumo*, 26 J Legal Stud 165, 187 (1997) (demonstrating that private rules and norms can effectively be used to maximize wealth); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J Legal Stud 115, 157 (1992) (arguing that private dispute resolution in the diamond industry is superior to recourse to the legal system); Robert Cooter and Janet T. Landa, *Personal Versus Impersonal Trade: The Size of Trading Groups and Contract Law*, 4 Intl Rev L & Econ 15, 21–22 (1984) (arguing that trading groups are a response to inefficient legal structures).

<sup>7</sup> See Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 144 U Pa L Rev 1643, 1678–94 (1996) (describing "community failures"). See also Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U Pa L Rev 1697, 1698, 1705–10 (1996) (providing examples of inefficient norms).

<sup>8</sup> See Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 Yale L J 239, 255 (1984) (arguing that "[l]awyers function as *transaction cost engineers*, devising efficient mechanisms which bridge the gap between capital asset pricing theory's hypothetical world of perfect markets and the less-than-perfect reality").

misaligned, however, these agents may emerge from sources operating outside the bounds of established legal and social norms. Illicit entrepreneurs, then, substitute for state-supplied or state-sanctioned public services, especially as alternative enforcers of property rights. This “dark-side private ordering,” heretofore overlooked by theorists, provides a convincing explanation for the emergence and role of organized crime in both developed and developing economies.

To explore the linkage between state-sponsored institutions and illicit organizations, we provide an in-depth theoretical and empirical analysis of organized crime in Japan. Although caution is warranted when drawing general conclusions from the experience of a single country, Japan provides unusually fertile ground for such a study. Private ordering is often seen as a key component of Japanese policy success in such diverse areas as crime prevention, civil dispute resolution, and labor relations.<sup>9</sup> Counterintuitively, however, Japan shares important parallels with transition economies: it has an institutional environment rife with incentives for the creation of alternative (illicit) enforcement mechanisms and a very active network of organized criminal groups.<sup>10</sup> Yet unlike virtually any other country, Japan also provides a wealth of relevant but unexplored data on organized crime.<sup>11</sup> As explored below, the Japanese experience offers insights into organized crime in environments as diverse as Russia and Sicily.

Multiple regression analysis of the data from Japan supports substantial anecdotal evidence that members of organized crime in that country play an active entrepreneurial role in substituting for state-supplied property rights and enforcement mechanisms in such areas as dispute mediation, real estate foreclosure, corporate monitoring, lending, and (unorganized) crime control. We offer additional empirical evidence suggesting that the success of organized crime prevention may rest more heavily on the design of state-supplied institutions than on traditional anti-crime strategies. Our empirical analysis thus supports a significant normative claim: To combat organized crime most

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<sup>9</sup> See, for example, John Owen Haley, *The Spirit of Japanese Law* 38, 79, 134–39, 199 (Georgia 1998).

<sup>10</sup> See *Twelve Percent of Japanese Consider Mobsters a “Necessary Evil”*, Agence France Presse (Apr 19, 1993) (“According to the Japanese police, the criminal underworld numbers about 90,000 members in 3,300 gangs.”).

<sup>11</sup> U.S. data on organized crime is surprisingly sparse. See, for example, David J. Fried, *Rationalizing Criminal Forfeiture*, 79 J Crim L & Criminol 328, 360–61 n 146 (1988) (noting “extreme scantiness and unreliability of the data available” and “extreme uncertainty of the data” about income attributable to crime). Data on U.S. street gangs vary widely as well. See, for example, G. David Curry, Richard A. Ball, and Robert J. Fox, *Gang Crime and Law Enforcement Record Keeping*, National Institute of Justice Research in Brief 1 (June 1994) (detailing problems in definitions, recording, and reporting of gang-related information).

effectively, a state should alter its institutional incentive structure and introduce additional rights-enforcement agents.

Although we rely on the Japanese experience for data, our discussion has more universal import. The state acts as an institutional designer<sup>12</sup> in any economy, determining, among other things, which business activities will be criminalized and which will be actively encouraged. How the state performs in this capacity affects not only the development of legitimate organizations, but of illicit ones as well. In the spectrum of property rights structures and regulated business activities, Japan lies between the United States and more heavily state-controlled systems such as the former Soviet Union.<sup>13</sup> Each of these systems features its own brand of organized crime, reflecting the institutional environment in which it evolved.<sup>14</sup> The universal point emerging from our study is that where the state fails to get the institutions “right,” it invites dark-side private ordering to fill in the gaps.<sup>15</sup>

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<sup>12</sup> Masahiko Aoki, *The Japanese Firm as a System of Attributes: A Survey and a Research Agenda*, in Masahiko Aoki and Ronald Dore, eds, *The Japanese Firm: The Sources of Competitive Strength* 11, 30 (Oxford 1994).

<sup>13</sup> Curtis J. Milhaupt, *Property Rights in Firms*, 84 Va L Rev 1145, 1166, 1177–78 (1998) (arguing that Japan occupies a middle ground with respect to property rights and regulatory policy between the U.S. and South Korea).

<sup>14</sup> In the U.S., organized criminal firms—the mafia among others—have traditionally operated in black market and gray market activities, selling commodities and services that consumers want but that the state declares illegal (creating black markets for drugs or alcohol during Prohibition) or prices out of the market by inefficient regulation (creating gray markets in the garment or transportation industries). Organized crime firms flourished in Nevada until prostitution was legalized, and all over the U.S. under the Volstead Act during Prohibition. See, for example, Humbert S. Nelli, *The Business of Crime: Italians and Syndicate Crime in the United States* 143–78 (Oxford 1976) (describing the crime syndicates that flourished in the wake of the Eighteenth Amendment).

In the former Soviet Union, the state regulated virtually all economic activity through direct participation in the planning and production processes. Because so much economic activity was so heavily regulated, the activities of criminal firms in the Soviet Union were indistinguishable from the activities of firms that we would consider to be legitimate businesses in well functioning capitalist economies. See, for example, Stephen Handelman, *Comrade Criminal: Russia's New Mafiya* (Yale 1995) (noting that organized crime in the former Soviet Union controlled trade in “spare parts, automobiles, timber, caviar, and gems”). In post-Soviet Russia, organized crime filled the vacuum created by the disintegration of state control. See Louise I. Shelley, *Post-Soviet Organized Crime: A New Form of Authoritarianism*, 2 *Transnational Organized Crime* 122 (1996). As will be shown below, Japanese organized crime plays a role somewhere between that of its counterparts in the United States and Russia: neither operating exclusively in illegal territory nor substituting for a dysfunctional state apparatus.

<sup>15</sup> Organized crime is more limited in the U.S. because the U.S. never went through the type of “overnight” property rights transformations that occurred in Japan and Russia. These rapid property rights developments created greater opportunities to exploit inefficiencies in state structures. Some systems compound the problem of weak property rights enforcement with weak government, which leads to public corruption rather than to privately organized crime. See Andrei Shleifer and Robert W. Vishny, *Corruption*, 108 Q J Econ 599, 615 (1993) (concluding that a weak central government facilitates corrupt agencies and bureaucracies).

To gain a better understanding of the role of organized crime in an economy, we adopt two heuristics. First, we use the term “organized criminal firms” to emphasize the fundamentally entrepreneurial role of organized crime. Second, as more fully developed below, we characterize the private enforcement activities of organized criminal firms as “illicit entrepreneurialism” because it takes place outside the bounds of state ordering, in the shadow of violence.

The Article proceeds as follows. In Part I, we survey the theory of organized crime, which is characterized by lack of agreement on fundamental principles and a shortage of empirical grounding. In Part II, we illustrate the close linkage between rights enforcement and organized crime in Japan in such areas as bankruptcy, property, debtor-creditor relations, and corporate law. Part III presents a formal model to test empirically the relationship between state institutions and illicit entrepreneurialism in Japan. Our regression analysis results are consistent with the theory that organized criminal firms in Japan substitute for state institutions in such key areas as dispute resolution, crime control, and finance. Part IV examines the implications of the Japanese experience and applies those lessons to economies in transition.

## I. ORGANIZED CRIME THEORY

The literature on organized crime displays a marked lack of consensus on fundamental issues. As noted above, there is little agreement even on a definition of organized crime, less still on the question of why the phenomenon exists. The result, as one commentator notes, “is a patchwork of ideas, only loosely related to each other and having little consequence for empirical research.”<sup>16</sup>

Economic theory has traditionally emphasized the monopoly that organized crime enjoys over illegal products and services. Thus, criminals organize themselves into firms for the same reasons that “legitimate” firms organize: to reap economies of scale or monopoly rents.<sup>17</sup> Organized criminal firm monopolies tend to arise in the same ways as traditional monopolies—economies of scale may dictate that only one firm can effectively serve the market, small producers may merge, and barriers to entry may be created by government regulation and re-

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<sup>16</sup> Peter Reuter, *Research on American Organized Crime*, in Robert J. Kelly, Ko-Lin Chin, and Rufus Schatzberg, eds, *Handbook of Organized Crime in the United States* 91, 110 (Greenwood 1994).

<sup>17</sup> Thomas C. Schelling, *Choice and Consequence* 162 (Harvard 1984).

strictions.<sup>18</sup> The primary means for achieving success, economists hold, is extortion.<sup>19</sup>

Sociological literature, by contrast, traditionally has focused on the cultural or ethnic linkages that dictate the structure and cohesiveness of organized crime groups, largely bypassing the more fundamental question of why such groups emerge. More recently, sociologists have argued that the primary market for organized crime services is in “unstable transactions in which trust is scarce and fragile,”<sup>20</sup> and, more generally, that organized criminal firms arise in societies characterized by a lack of trust.<sup>21</sup> Thus, for example, the rise in organized crime in Eastern Europe and Russia is explained as an outgrowth of Communism, which is said to have systematically destroyed trust in government.<sup>22</sup>

Neither approach, however, is wholly satisfying. First consider the sociologists’ recent fascination with trust. Many of the services that organized criminal firms offer around the world involve not risky black or gray market transactions, but intervention in transactions that ought to be “stable,” in that they are formally supported by the legal system—debt collection or labor dispute resolution, for example. Even more damaging to the proposed correlation between low trust and organized crime is the case of Japan, which no sociologist has managed to explain. Japan has extensive organized crime, yet Japan’s social system is widely viewed as founded on trust. Francis Fukuyama, for instance, defines Japan as a “high-trust society” in which social capital is in abundant supply.<sup>23</sup> Cross-country empirical analyses of trust confirm

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<sup>18</sup> See John E. Kwoka, Jr. and Lawrence J. White, eds, *The Antitrust Revolution: Economics, Competition, and Policy* 9–10 (Oxford 3d ed 1999).

<sup>19</sup> See Schelling, *Choice and Consequence* at 160–61 (cited in note 17) (stating that extortion and criminal monopoly are the two types of businesses comprising racketeering).

<sup>20</sup> Gambetta, *The Sicilian Mafia* at 17 (cited in note 5). See also Donald Black, *Crime as Social Control*, 48 *Am Soc Rev* 34 (1983).

<sup>21</sup> Gambetta, *The Sicilian Mafia* at 77 (cited in note 5). See also Diego Gambetta, *Mafia: The Price of Distrust*, in Diego Gambetta, ed, *Trust: Making and Breaking Cooperative Relations* 158, 158 (Basil Blackwell 1988).

<sup>22</sup> See, for example, Federico Varese, *Is Sicily the Future of Russia? Private Protection and the Rise of the Russian Mafia*, 35 *Archives Européennes de Sociologie* 224, 225–26, 257–58 (1994).

<sup>23</sup> Francis Fukuyama, *Trust: The Social Virtues and the Creation of Prosperity* 26–28 (Free Press 1995). On the relationship of trust and social capital to institutions, see James S. Coleman, *Foundations of Social Theory* 300–06 (Belknap 1990) (arguing that social capital determines performance of societal institutions); Robert D. Putnam, *Making Democracy Work: Civic Tradition in Modern Italy* 174–76, 184–85 (Princeton 1993) (same, focusing on differences between Northern and Southern Italy); Rafael La Porta, et al, *Trust in Large Organizations*, 87 *Am Econ Rev* 333, 337 (1997) (using World Values Survey data to show that “theories of trust hold up remarkably well when tested on a cross section of countries”).

that characterization and generally cast doubt on the utility of mistrust as a key explanatory variable in the origins of organized crime.<sup>24</sup>

Turn now to the traditional economic approach. Theorists have cast doubt both on the idea that organized crime relies primarily on extortion, and that monopoly is the best concept to understand the activities of organized criminals. In the past several years, observers have begun to change their perspective on the services provided by organized criminals and the relationship between organized crime and the state. Focusing on Sicily, for example, Diego Gambetta argues that organized criminals deal not in extortion, but in protection, including the protection of contracts in the form of dispute settlement.<sup>25</sup> Even more interestingly, he argues that rather than being a monopoly, organized crime competes with the state to provide this service.<sup>26</sup>

This recent turn in the literature is intriguing on several levels. First, it is consistent with an extensive body of literature emphasizing the entrepreneurial nature of organized crime and thus the general applicability of economic principles to firms engaged in illicit as well as legitimate activities.<sup>27</sup> Second, it implicitly suggests that the state's

<sup>24</sup> See, for example, World Values Study Group, World Values Survey, 1981–1984 and 1990–1993 (ICPSR 6160) (1994), available online at <<http://www.icpsr.umich.edu/cgi-bin/archive/prl?path=ICPSR&num=6160>> (visited Nov 6, 1999) (covering 45 countries, 379 variables, and nearly 90,000 survey respondents). The survey reports responses to the question, “Generally speaking, would you say that most people can be trusted or that you can’t be too careful in dealing with people?” According to our calculations, 52.5 percent of Japanese respondents answered that “you can’t be too careful,” compared with 47.4 percent in the U.S., a mere 30.6 percent in Sweden, and relatively high 58.0 percent, 60.2 percent, and 61.9 percent figures in Russia, Mexico, and Italy, respectively. Although some general conclusions might be drawn from the high distrust in Italy and other countries that are often said to be plagued by organized crime, Japan’s lower figure is more comparable to that of the U.S.

A recent study of World Values Survey data for twenty-three market economies finds greater evidence of trust in Japan. Stephen Knack and Philip Keefer examined what they term “trustworthiness,” as measured by responses to questions on civic cooperation. Across societies, they found (unsurprisingly) positive correlations between trust and trustworthiness. Although Japan has relatively low “trust” scores, they found trustworthiness in Japan to be the third highest in the survey, well ahead of the Scandinavian countries and the U.S. Italy placed above the U.S. as well. Stephen Knack and Philip Keefer, *Does Social Capital Have an Economic Payoff? A Cross-Country Investigation*, 112 Q J Econ 1251, 1258–59, 1285 (1997). Compare Toshio Yamagishi, et al, *Uncertainty, Trust and Commitment Formation in the United States and Japan*, 104 Am J Soc 165 (1998) (finding statistically significant evidence that the level of general trust is higher in the U.S. than in Japan); Toshio Yamagishi, *Shinrai no Kōzō* [*The Anatomy of Trust*] 64–66 (Tokyo 1998) (noting differences between natural trust (“lovers’ commitment”) and strategic trust to reduce transaction costs (“yakuza commitment”)).

<sup>25</sup> Gambetta, *The Sicilian Mafia* at 16–19 (cited in note 5). See Barbara Alexander, *The Rational Racketeer: Pasta Protection in Depression Era Chicago*, 40 J L & Econ 175, 184–85, 198 (1997) (arguing that the actual Depression era pasta racket in Chicago stands “in sharp contrast to Hollywood portrayals that depict gangsters as crude extortionists”).

<sup>26</sup> See Gambetta, *The Sicilian Mafia* at 80 (cited in note 5).

<sup>27</sup> In two influential articles, Thomas Schelling proposed that market structures and economic principles generally applicable to all forms of organization apply to illegal markets con-



institutional structure supplies incentives for illicit firms just as it does for legitimate enterprises; thus, firm adaptation is the central problem of economic organization in illegal as well as legal markets.<sup>28</sup> Finally, the stylized histories of regions as diverse as post-feudal Sicily and post-Soviet Russia, which Gambetta and others rely upon in developing their arguments, contain interesting parallels with Japanese history, suggesting that societies currently experiencing significant organized crime problems began from a common starting point.<sup>29</sup> Even the U.S. experience with organized crime suggests a linkage between ineffective or ill-advised state structures and organized criminal activities.<sup>30</sup>

Institutional analysis—properly informed by empirical research—is a way to unite the insights provided by existing approaches to organized crime. As Gambetta posits with his theory of substitutes for state enforcement, and implicit in the economic ideas of firm organization, organized criminal firms often arise shortly after the historical establishment of formal property rights regimes.<sup>31</sup> Post-feudal Japan, for instance, like post-feudal Italy and post-Soviet Russia, is characterized by dramatic increases in formal property rights. Similar to these other countries, post-feudal Japan also is characterized by a weakness of complementary enforcement mechanisms.<sup>32</sup> The Japanese transition out of feudalism left a void for private transaction-makers and rights-enforcers that was filled by a hodgepodge of groups, which

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trolled by organized criminal firms. Thomas C. Schelling, *What is the Business of Organized Crime?*, 20 J Pub L 71 (1971), reprinted in Schelling, *Choice and Consequence* 179, 182–83 (cited in note 17); Thomas C. Schelling, *Economics and Criminal Enterprise*, 7 Public Interest 61 (1967), reprinted in Schelling, *Choice and Consequence* 158, 162–64. More recently, scholars added to Schelling's governance-structure analysis by applying transaction cost analysis to organized criminal firms. See Annelise Anderson, *Organized Crime, Mafia and Governments*, in Gianluca Fiorentini and Sam Peltzman, eds, *The Economics of Organized Crime* 33, 42–47 (Cambridge 1995); Andrew R. Dick, *When Does Organized Crime Pay? A Transaction Cost Analysis*, 15 Intl Rev L & Econ 25 (1995).

<sup>28</sup> For a discussion of firm adaptation in licit markets, see F.A. Hayek, *The Use of Knowledge in Society*, 35 Am Econ Rev 519, 527 (1945).

<sup>29</sup> See, for example, Handelman, *Comrade Criminal* (cited in note 14) (containing a history of organized crime in Russia); Oriana Bandiera, *Competing for Protection: Land Fragmentation and the Rise of the Sicilian Mafia* (unpublished manuscript dated July 1, 1999) (noting rise of mafia in nineteenth-century transition from feudalism to capitalism).

<sup>30</sup> See, for example, Dennis Hevesi, *New Home Costs Found Highest in New York*, NY Times B1 (July 28, 1999) (reporting on study finding "arcane and byzantine" zoning and building codes and organized crime infiltration of labor unions and construction companies to be significant contributing factors to New York City's high home building costs).

<sup>31</sup> See Gambetta, *The Sicilian Mafia* at 77–81, 252 (cited in note 5) (describing the social circumstances that gave rise to the mafia and arguing that property rights come with a desire to protect those rights with force when necessary).

<sup>32</sup> See Philip C. Brown, *'Feudal Remnants' and Tenant Power: The Case of Niigata, Japan, in the Nineteenth and Early Twentieth Centuries*, 15 Peasant Stud 5, 7–10 (1987) (discussing property redistribution techniques such as rent determination and field allocation).

in Japan included an amalgam of disenfranchised samurai, hoodlums, and poor peasants. This mismatch between property rights and enforcement mechanisms leads to organized crime—the dark side of private ordering. In order to develop and provide empirical support for this emergent view of organized crime, we thus focus on the institutional environment that provides fertile ground for illicit entrepreneurialism.

Although there is nothing inherently “illicit” about private ordering, there are several reasons to be concerned about the particular brand of entrepreneurialism discussed in this Article. First, the “legitimate” activity of organized criminal firms is often used to launder income from illegal activities and to hide it from tax officials.<sup>33</sup> Second, the activities of organized criminal firms are often accompanied by the threat or use of violence.<sup>34</sup> Third, as a growing body of theoretical literature suggests, private and segmented enforcement of property rights can lead to the entrenchment of small-scale inefficient monopolies, high transaction costs, and a “tragedy of coercion” in which savings from the provision of collective services are dissipated in contests both among firms and between firms and the state.<sup>35</sup> Finally, regardless of efficiency concerns, private ordering by organized criminal firms is qualitatively different from conventional private ordering by contract or arbitration. While both avoid resort to governmental institutions, only the latter operates within constraints that are *inherently* legal, because they are legitimized by the same political theory that supports the governing order generally.<sup>36</sup> Similarly, while the activities of both organized criminal groups and the state are backed by coer-

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<sup>33</sup> See, for example, Kazuaki Morimoto, *Mane-Rōndaringu Kisei no Igi to Dōkō* [Trends in and Significance of Money Laundering Regulation], 1543 *Kin'yū Hōmu Jijō* 6, 9–10 (1999); Hisao Katoh, *Prohibition of the [sic] Money Laundering as a Countermeasure Against Organized Crime Groups (Yakuza or Boryokudan) in Japan*, 7 *Keio L Rev* 21, 34–37 (1994).

<sup>34</sup> See A. Mitchell Polinsky and Steven Shavell, *The Economic Theory of Public Enforcement of Law*, National Bureau of Economic Research Working Paper Series No 6993, 3–4 (Mar 1999) (arguing that private enforcement of the law would require force to “gather information, capture violators, and prevent reprisal,” but that the state generally does not want to allow private parties to use such force). See also William M. Landes and Richard A. Posner, *The Private Enforcement of Law*, 4 *J Legal Stud* 1, 31–33 (1975) (discussing inefficiency of allocating criminal law enforcement to private actors). Compare Gary S. Becker and George J. Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 *J Legal Stud* 1, 16–17 (1974) (suggesting that the quality of law enforcement can be improved by “raising the salaries of public enforcers . . . [and] paying private enforcers for performance, or on a piece-rate basis”).

<sup>35</sup> Thráinn Eggertsson, *Economic Behavior and Institutions* 36 (Cambridge 1990); Kai Konrad and Stergios Skaperdas, *The Market for Protection and the Origin of the State*, Centre for Economic Policy Research Discussion Paper No 2173 (June 1999) (on file with authors). See also Serguey Braguinsky, *Enforcement of Property Rights During the Russian Transition: Problems and Some Approaches to a New Liberal Solution*, 28 *J Legal Stud* 515 (1999).

<sup>36</sup> We are grateful to Gerard Lynch for this insight.

cive force, only the violence of the legal system is rooted in a deeper conception of public order. The means and ends of organized criminal firms, by contrast, are determined solely in the private interest of the members themselves. Pervasive organized criminal involvement in private ordering thus not only increases the level of violence in society, it is also antithetical to the rule of law.

## II. RIGHTS ENFORCEMENT AND ORGANIZED CRIME IN JAPAN

We have suggested a close linkage between flaws in a state's institutional framework for property rights enforcement and the emergence of entrepreneurs who capitalize on opportunities for "illegitimate" private ordering. In this Part, we begin to explore this hypothesis by turning to Japan. As noted in the Introduction, Japan exhibits an institutional environment rife with incentives for the emergence and prosperity of such entrepreneurs. It also has a network of organized criminal firms whose activities closely track the opportunities provided by this institutional environment. Here, we informally examine the linkage between the two phenomena.

### A. Rights Enforcement

Japan has experienced two property rights booms in the past one hundred years. As with the transition economies of today, both periods of property rights transformation in Japan are characterized by a significant expansion in the types of property rights recognized by the state, and major increases both in the number of people owning assets and in the number of economic transactions.

The first Japanese property rights boom occurred in the Meiji Period (1868–1911), when the country made a rapid transition from an agrarian, feudal society to a modern, industrialized economy. Legal reform, which included the transplantation of European codes and the enactment of a written constitution, was seen as one key to the modernization effort. Formally, at least, legal reform limited state intervention in private affairs and brought Japanese citizens a panoply of new property rights and protections under the law.<sup>37</sup> A new land tax system eliminated multiple and community forms of land ownership, thereby establishing a more modern property rights regime.<sup>38</sup> The expansion of property rights led to a significant increase in enforcement-related

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<sup>37</sup> J. Mark Ramseyer and Minoru Nakazato, *Japanese Law: An Economic Approach* 4 (Chicago 1999) (citing an early twentieth-century Japanese court: "[T]he inviolability of the right to property is one of the fundamental principles of the Imperial Constitution").

<sup>38</sup> Brown, 15 Peasant Stud at 15 (cited in note 32).

transactions. For example, a new tax system spawned large increases in debt and mortgage foreclosures.<sup>39</sup>

The second boom took place during the Allied Occupation following World War II. Occupation reformers, like the Meiji oligarchs before them, sought to re-engineer the Japanese political and socio-economic order through a massive transformation of the institutional framework. Occupation reformers designed a new constitution containing a more extensive list of recognized economic rights and more protections against governmental interference in private affairs. They fundamentally revised the system of agrarian land tenure to transfer ownership from absentee landowners to operators, and regulated the relationship between landowners and tenants.<sup>40</sup> Occupation officials forcibly disbanded the family-owned *zaibatsu* conglomerates that had dominated the economy in the early twentieth century and distributed their shares more broadly to the public.<sup>41</sup> They revised the corporate code in a further effort to promote “corporate democracy” by strengthening the rights of minority shareholders.<sup>42</sup> To protect and enforce these new rights, they reorganized the legal profession, granted it a greater degree of independence from government oversight,<sup>43</sup> and instilled its members with a mission to safeguard individual liberties.<sup>44</sup>

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<sup>39</sup> See, for example, Edwin O. Reischauer, *Japan: The Story of a Nation* 123 (Knopf 3d ed 1981) (describing foreclosure of mortgages); R.P. Dore, *Land Reform in Japan* 14–17 (Oxford 1959) (describing the “recurrent pattern” of “[i]ndebtedness, the mortgaging of land, and eventually the transfer of ownership”); Takeo Ono, *Nōson Shi* [*History of Farm Villages*], in Tokyo Keizai Shinbunsha, ed, 9 *Gendai Nihon Bunmei Shi* [*History of Modern Japanese Civilization*] 47, 48 (1941) (stating that in some areas of Japan landowners were forced into debt by a new tax system). More generally, see Ranajit Guha, *A Rule of Property for Bengal: An Essay on the Idea of Permanent Settlement* (Moalton 1963) (stating that class upheaval results from replacement of the feudal system with a property rights regime).

<sup>40</sup> See Section of Special Records, Foreign Office, Japanese Government, Compiler, *IV Documents Concerning the Allied Occupation and Control of Japan: Commercial and Industrial* 109 (1949). At least one of the primary aims of land reform was the suppression of communism. See General Douglas MacArthur, *Reply to Criticism of Economic Policy*, in Supreme Commander, Allied Powers, Government Section, ed, *Political Reorientation of Japan: September 1945 to September 1948* 780 (GPO 1949) (“[T]here will emerge in Japan, from a field heretofore fertile to the spread of communism, a new class of small capitalistic landowners.”).

<sup>41</sup> See Eleanor M. Hadley, *Antitrust in Japan* 20 (Princeton 1970).

<sup>42</sup> Thomas L. Blakemore and Makoto Yazawa, *Japanese Commercial Code Revisions Concerning Corporations*, 2 *Am J Comp L* 12, 19–20 (1953). See also Lester N. Salwin, *The New Commercial Code of Japan: Symbol of Gradual Progress Toward Democratic Goals*, 50 *Georgetown L J* 478, 479–80 (1962) (describing reforms to “bring about widespread distribution of corporate shares in the hands of the Japanese public at large . . . and to promote economic democratization”).

<sup>43</sup> See Richard W. Rabinowitz, *The Historical Development of the Japanese Bar*, 70 *Harv L Rev* 61, 76–77 (1956) (describing postwar reforms freeing the bar associations from government control).

<sup>44</sup> See Richard B. Appleton, *Reforms in Japanese Criminal Procedure under Allied Occupation*, 24 *Wash L Rev* 401, 401 (1949).

The expansion of property rights accompanying these two phases of wholesale institutional transformation, however, was not matched by the development of complementary enforcement mechanisms. This gap did not prove to be wholly problematic, of course, as Japan's subsequent economic success attests. Unlike the experience of Russia to date,<sup>45</sup> the Japanese business community, with support from the state, developed a highly workable set of rules to govern economic exchange that held up without heavy reliance on formal enforcement mechanisms. Indeed, scholars of Japanese law seeking to explain Japan's prosperity and stability often focus on the pervasive and beneficial aspects of private ordering in Japan. John Haley, for example, has argued that the weakness of formal enforcement mechanisms in the hands of the economic regulators has forced the government to bargain with the private sector, allowing market solutions to prevail over bureaucratic fiat.<sup>46</sup>

As in modern transition economies, however, private ordering to overcome property rights defects in Japan can be problematic. In this Part, we analyze several areas of rights enforcement in Japan that provide fertile ground for activity by organized criminal firms. We defer until Part II.B discussion of the ways in which organized criminal firms actually exploit these opportunities. One caveat: Our aim is not to pass normative judgment on Japanese institutions. All countries suffer to some extent from inefficiencies in formal structures. Indeed, this commonality is the basis for the relevance of Japan's experience with organized crime for other countries. To the extent that Japan is unusual, it is so only in the *degree* to which state mechanisms permit or encourage resort to private alternatives. Moreover, as explained below, in many areas bright-side private ordering has provided unusually effective partial substitutes for the Japanese state.

### 1. Bankruptcy.

Financially troubled corporations in Japan face a plethora of legal options. Firms seeking to liquidate may choose either bankruptcy or special liquidation.<sup>47</sup> Firms seeking to reorganize may choose from no

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<sup>45</sup> See Varese, 35 Archives Européennes de Sociologie at 245 (cited in note 22).

<sup>46</sup> See John O. Haley, *Administrative Guidance Versus Formal Regulation: Resolving the Paradox of Industrial Policy*, in Gary R. Saxonhouse and Kozo Yamamura, eds, *Law and Trade Issues of the Japanese Economy: American and Japanese Perspectives* 107, 122 (Washington 1986) (arguing that "administrative guidance [ ] freed Japanese firms from the more restrictive consequence of formal controls and in turn subjected them more fully to the discipline of market forces").

<sup>47</sup> Bankruptcy takes place under the Bankruptcy Code [Hasan hō], Law No 71 of 1923 (1998); special liquidation (*tokubetsu seisan*) under the Commercial Code [Shōhō], Law No 48 of 1899, arts 431–456 (1998).

less than four separate procedures: corporate reorganization, corporate arrangement, composition, and compulsory composition.<sup>48</sup> The multiplicity of legal regimes is the result of a process of continuous borrowing from other countries, without any attempt to eliminate or streamline existing procedures.<sup>49</sup>

While the formal options are plentiful, truly workable procedures are virtually nonexistent. Neither liquidation procedure, for example, is as broad as Chapter 7 of the U.S. Bankruptcy Code in its inclusion of secured claims (particularly significant since virtually all lending in Japan is done on a secured basis), because secured creditors may exercise their rights outside of the liquidation process. Moreover, special liquidation procedures differ little from private settlements, since court supervision is minimal.<sup>50</sup> The reorganization procedures are similarly unappealing.<sup>51</sup> For example, corporate reorganization, which is based on the old Chapter 10 of the U.S. Bankruptcy Act, is a “rigid proceeding for large publicly held stock corporations and almost always entails a change of management.”<sup>52</sup> Corporate arrangement is often unworkable when there are recalcitrant secured creditors because the stay of secured claims in such proceedings is discretionary.<sup>53</sup> Composition, the most frequently used procedure, has *no* provisions to stay the enforcement of secured claims.<sup>54</sup> Compulsory compositions are reorganization plans proposed *after* a bankruptcy adjudication, and are exceedingly rare due to the difficulty of securing agreement following

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<sup>48</sup> Corporate reorganization takes place under the Corporate Reorganization Law, [Kaisha kosei hō], Law No 172 of 1952 (1997); corporate arrangement (*seiri*) under the Commercial Code [Shōhō], Law No 48 of 1899, arts 417–430 (1998); composition under the Composition Law, [Wagi hō], Law No 72 of 1922 (1998); and compulsory composition under the Bankruptcy Law, [Hasan hō], Law No 71 of 1922 (1996).

<sup>49</sup> Patrick Shea and Kaori Miyake, *Insolvency-Related Reorganization Procedures in Japan: The Four Cornerstones*, 14 UCLA Pac Basin L J 243, 245 (1996) (describing reorganization laws adopted from Germany, England, and the U.S. and noting the resulting overlap).

<sup>50</sup> Frank Packer and Marc Ryser, *The Governance of Failure: An Anatomy of Corporate Bankruptcy in Japan* 11, Working Paper No 62, Center on Japanese Economy and Business, Columbia University (1992).

<sup>51</sup> It should be noted that some commentators view favorably those attributes of Japanese bankruptcy laws that encourage private resolution of firm failures, at least in comparison to U.S. law. See, for example, Theodore Eisenberg and Shoichi Tagashira, *Should We Abolish Chapter 11? The Evidence from Japan*, 23 J Legal Stud 111, 154 (1994) (arguing that more stringent screening of Chapter 11 cases analogous to the Japanese model is needed to make the U.S. system viable). See also Robert K. Rasmussen and David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 Am Bankr Inst L Rev 85, 115 (1995) (arguing that private ordering is preferable to court-supervised restructuring of failing firms).

<sup>52</sup> Eisenberg and Tagashira, 23 J Legal Stud at 116 (cited in note 51).

<sup>53</sup> Shea and Miyake, 14 UCLA Pac Basin L J at 246 (cited in note 49) (describing the “classic ‘hold-out’ problem” created by creditors refusing to approve reorganization plans).

<sup>54</sup> *Id.* at 245.

the conclusion of the bankruptcy process.<sup>55</sup> As a result, relatively few reorganizations of troubled firms in Japan take place within the legal system.<sup>56</sup>

Why has this ineffective formal bankruptcy regime not been revised? In part, the answer lies in the availability of two relatively efficient private systems to deal with financially troubled firms. The first is the “main bank” system, in which a bank serves as the largest lender and a principal shareholder of a corporate client. As a central repository of information on the borrower, the main bank has traditionally played an important role in rendering assistance in case of managerial crisis or financial failure.<sup>57</sup> Until recently, there was a strong presumption on the part of the main bank, the troubled firm, other creditors, and even government regulators that the main bank would intervene to initiate an informal restructuring process. Often, such intervention would entail extending financial assistance, issuing guarantees to other creditors, and even absorbing a share of the losses exceeding the bank’s loan share.<sup>58</sup> While this institution typically functioned only with respect to the largest borrowers, it redirected some of the most complex bankruptcies—those involving major creditor coordination problems—away from the legal system.<sup>59</sup> In similar fashion, the traditional operation of the main bank system provided a substitute for the information agents—accountants and credit rating agencies—who specialize in corporate monitoring and disclosure for the benefit of corporate claimants seeking to protect their rights in more capital-market-driven financial systems.<sup>60</sup>

The second mechanism that siphons cases away from the legal system is a private sanction operated by local bank clearinghouses. Under a well-developed informal system, if a firm dishonors two promissory notes within a six-month period, member banks of the local clearinghouse suspend all current account transactions and loans with the firm for a two-year period. This “suspension of bank transac-

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<sup>55</sup> Eisenberg and Tagashira, 23 *J Legal Stud* at 115–16 n 14 (cited in note 51) (stating that compulsory composition was used in only 4 of 12,634 cases in 1990).

<sup>56</sup> See Packer and Ryser, *The Governance of Failure* at 2–3 (cited in note 50).

<sup>57</sup> See, for example, Masahiko Aoki and Hugh Patrick, eds, *The Japanese Main Bank System: Its Relevance for Developing and Transforming Economies* xxv (Oxford 1994).

<sup>58</sup> Paul Sheard, *The Main Bank System and Corporate Monitoring and Control in Japan*, 11 *J Econ Beh & Org* 399, 411–12 (1989).

<sup>59</sup> Paul Sheard, *Main Banks and the Governance of Financial Distress*, in Aoki and Patrick, eds, *The Japanese Main Bank System* 188, 190 (cited in note 57) (“A feature of the main bank system is that, unlike formal bankruptcy, the process is handled informally without recourse to the courts and without a change in the legal standing of the firm: in effect, the main bank replaces the judge and the court-appointed receiver.”).

<sup>60</sup> Hugh Patrick, *The Relevance of Japanese Finance and Its Main Bank System*, in Aoki and Patrick, eds, *The Japanese Main Bank System* 353, 403 (cited in note 57).

tion” procedure, which constitutes a virtual death penalty for firms that experience it, triggers the vast majority of all business failures in Japan. As a result, firms go to great lengths to avoid dishonoring the second note, often by arranging for a main bank to sponsor their obligations.<sup>61</sup> As shown below, however, these are not the only informal mechanisms used to resolve financial distress in Japan.

## 2. Debt collection.

Japan’s Attorneys’ Law indirectly grants a monopoly on debt collection to licensed attorneys.<sup>62</sup> Indeed, debt collection ranks as a bread-and-butter role of the Japanese bar. The monopoly may be lucrative for Japanese attorneys, but it creates problems in the economy. For example, the nonperforming loan crisis afflicting Japanese banks throughout the past decade has been exacerbated by the lack of professionals capable of assisting in the loan foreclosure and collection process. To address this problem, a narrow exception to the Attorneys’ Law was created in 1998, allowing the formation of “servicer” companies to engage in debt collection. Yet even here the law did not completely infringe on lawyers’ turf; the law requires that at least one member of the board of directors of a servicer company be a licensed attorney.<sup>63</sup> Although lawyers have a monopoly within the legal system, as the next section explores, they have dark-side competition.

## 3. Landlord-tenant issues.

Japanese law is exceedingly protective of tenants’ rights. As described by Mark Ramseyer and Minoru Nakazato, “[b]y judicial interpretation, almost all leases in Japan—no matter how many recitals to the contrary—give the tenant an interest close to a life estate.”<sup>64</sup> As a result, redeveloping property can be a nightmare. To be sure, land owners can and do contract around some of the resulting obstacles by

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<sup>61</sup> Packer and Ryser, *The Governance of Failure* at 5–6 (cited in note 50). See also Toshihiro Matsumura and Marc Ryser, *Revelation of Private Information about Unpaid Notes in the Trade Credit Bill System in Japan*, 24 *J Legal Stud* 165, 168 (1995) (noting that the “combined effect of making the names of defaulters public and withholding essential bank services” serves as a powerful “discipline device”).

<sup>62</sup> *Bengoshi hō* [Attorneys Law], Law No 205 of 1949, arts 72–73 (1998). Only licensed attorneys may participate in court proceedings through which monetary obligations are enforced.

<sup>63</sup> *Saiken kanri kaishūgyō ni kansuru tokubetsu sechi hō* [Servicer Law], Law No 126 of 1998, art 5(4) (1998).

<sup>64</sup> Ramseyer and Nakazato, *Japanese Law* at 38 (cited in note 37). For a flavor of the protections granted, consider the Land and House Lease Act [*Shakuchi shakuya hō*], Law No 90 of 1991, arts 11, 32 (1996), which generally allows a rent increase against a tenant’s wishes in only three situations: when land taxes increase, when the value of the building increases, or when surrounding land prices rise.



paying large sums to encourage the departure of unwanted tenants, charging large, nonrefundable fees to initiate a lease, or by simply building properties that encourage short-term tenancies.<sup>65</sup> As shown in the next section, however, the menu of options for developers seeking to dislodge uncooperative tenants is not limited to these relatively benign tactics.

#### 4. Shareholders' rights.

The principal-agent problem in corporate law is well known. Shareholders, who bear the economic risks of their investment, must delegate authority for actually running the firm to a class of professional managers, who typically lack a sufficient economic stake in the company to fully internalize the costs of their decisions. Japanese corporate law attempts to address this problem through the familiar device of the shareholder derivative suit: fiduciary-like duties are imposed on the managers to act in the best interests of shareholders; shareholders, in turn, may enforce these duties in court on behalf of the corporation.<sup>66</sup> While the Japanese derivative suit mechanism is facially similar to its counterpart in U.S. state corporation law, until recently it was virtually moribund.<sup>67</sup> For example, fewer than twenty actions were litigated between 1950, when the current mechanism was instituted, and 1990.<sup>68</sup>

Derivative suits were rare in Japan for the same reason that the bankruptcy regime is not heavily utilized: enforcement problems raised the cost of the procedure relative to private alternatives. Prior to a 1993 amendment to the Commercial Code, Japanese district courts unanimously interpreted the relevant procedural law to require a shareholder-plaintiff to pay a filing fee related to the amount of damages sought in order to initiate a derivative suit. When the damages sought were considerable, as is often the case in derivative litigation, the filing fee requirement could serve as an insurmountable barrier to this type of litigation.<sup>69</sup> In addition, a requirement that a share-

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<sup>65</sup> Ramseyer and Nakazato, *Japanese Law* at 39–41 (cited in note 37).

<sup>66</sup> See Shōhō [Commercial Code], art 254(3) (explaining relationships between managers and the company); id, art 254-3 (providing for duties of managers); id, art 267 (providing a mechanism for shareholders to sue on behalf of the corporation to enforce the duties).

<sup>67</sup> Mark D. West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 Nw U L Rev 1436, 1437–38 (1994).

<sup>68</sup> Id at 1438.

<sup>69</sup> See, for example, *Asai v Iwasaki*, or the *Nikko Case*, Tokyo Chisai [Tokyo District Court], 797 Hanta 285 (Aug 11, 1992) (dismissing shareholder derivative suit for failure to pay filing fee of about \$2.4 million). In a derivative suit, of course, damages are paid not to the suing shareholder, but to the corporation.

holder-plaintiff post a bond as security for expenses<sup>70</sup>—a requirement that has been eliminated from virtually all U.S. state laws—works to chill both meritorious and frivolous actions.

Once again, private ordering works to mitigate the frictions apparent in the formal system by providing effective substitutes for the legal regime. The concentration of large blocks of stock in the hands of banks and other institutional investors, and the organization of many firms into *keiretsu* corporate groups with at least a loosely shared identity of purpose, provides mechanisms of voice for many Japanese shareholders that are far less costly and more effective than shareholder derivative litigation.<sup>71</sup>

Equally true, however, is the fact that bright-side private ordering does not fully satisfy the demand for corporate monitoring services. As shown below, illicit entrepreneurs have emerged to exploit the costly formal structures and lack of state-sanctioned rights-enforcement agents.

##### 5. Rights-enforcement agents and dispute intermediaries.

Lawyers, like accountants, credit-rating agencies, and the press—what one commentator terms “watchdog institutions”—are crucial for rights enforcement.<sup>72</sup> Ronald Gilson has shown, for example, that business lawyers in the United States create value by serving as “transaction cost engineers”: lawyers are the principal architects of a sophisticated transactional structure that constrains uncertainty-based opportunism and alleviates information problems in economic exchange, helping to bridge gaps between buyers and sellers of assets for a broad range of market transactions.<sup>73</sup> Similarly, lawyers perform a key function as reputational intermediaries in settling disputes.<sup>74</sup> Accountants, credit rating agencies, and investment bankers perform roughly comparable roles by producing, evaluating, and certifying data in their own respective specialties.<sup>75</sup>

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<sup>70</sup> Shōhō [Commercial Code], art 267(4).

<sup>71</sup> See Curtis J. Milhaupt, *A Relational Theory of Japanese Corporate Governance: Contract, Culture, and the Rule of Law*, 37 Harv Intl L J 3, 5–7 (1996).

<sup>72</sup> Cheryl W. Gray, *Reforming Legal Systems in Developing and Transition Countries*, 34 Finance & Develop 14, 16 (Sept 1997).

<sup>73</sup> See Gilson, 94 Yale L J at 255 (cited in note 8).

<sup>74</sup> See Ronald J. Gilson and Robert H. Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 Colum L Rev 509, 512, 564 (1994) (arguing that under certain circumstances lawyers “facilitate efficient and fair resolution of conflict when their clients could not do so for themselves”).

<sup>75</sup> For a general discussion, see Ronald J. Mann, *Verification Institutions in Commercial Transactions*, 87 Georgetown L J 2226 (1999).

Japan has only a fraction of the licensed attorneys found in the United States. The dearth of Japanese attorneys is a direct result of the national bar exam, which is graded on a curve that permits only about 3 percent of the roughly 27,000 annual takers to pass.<sup>76</sup> Thus, Japan, with half the population of the United States, has approximately 17,000 licensed attorneys in comparison to their roughly 900,000 American counterparts. While this simple numerical comparison is misleading for a variety of reasons,<sup>77</sup> the small number of attorneys in Japan is significant in those areas such as debt collection and courtroom advocacy where Japanese law grants a monopoly to licensed attorneys.<sup>78</sup>

Perhaps less well known is the scarcity of other sophisticated agents capable of assisting in the rights-enforcement process. The Japanese accounting profession, for example, is reeling from a spate of scandals and improprieties that exposed serious flaws in its disclosure standards and practices.<sup>79</sup> Client relationships often cloud the accuracy of disclosure. Moreover, the independence of the profession has been compromised by its relationship to financial regulators.<sup>80</sup> Similarly, for regulatory reasons, Japan has few independent domestic credit-rating agencies, none of which enjoys a long history of operations.<sup>81</sup> Even

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<sup>76</sup> For figures, see charts attached to Tsuguaki Hori, *Heisei Ky nendo Shihō Shiken Dai Niji Shiken no Kekka ni Tsuite* [Regarding the Results of the 1997 Bar Examination], 1132 *Jurisuto* 69, 80 (1998) (showing pass rates over the ten-year period beginning in 1988 ranging from 2.18 percent (1989 and 1990) to 3.42 percent (1993), with the most recent figure of 2.75 percent in 1997).

<sup>77</sup> For example, on a per capita basis, Japan annually graduates about twice as many law-trained students as the United States. Most of these legal graduates are either employed in governmental ministries and corporations where they perform legal tasks, or serve as specialized quasi-lawyers in such capacities as tax agent, notary, or scrivener. Each of these quasi-lawyer professions is heavily regulated and subject to fee restrictions. See Shingo Miyake, *Bengoshi Karuteru: Girudoku Suru "Zaiya" Hōsō Jitsuzō* [The Attorney's Cartel: The Real Workings of the Organized Bar Guild] 84 (Shinzansha 1995).

<sup>78</sup> Many litigants simply forgo attorney assistance. In 1997, both parties were represented by counsel in only 42 percent of all district court cases. See Saikōsai Minjikyoku, *Heisei 9 Nendo Minji Jiken no Gaikyō* [1997 Summary of Civil Litigation], 50 *Hōsō Jihō* 2667 (1998).

<sup>79</sup> See, for example, *Japanese Accounting*, *Financial Times* 20 (June 4, 1998) (reporting that "only a small number of the largest [Japanese] companies adhere to international accounting standards"); Benjamin Fulford, *Deft Accounting Hides Finance Sector's Ills: Lack of Disclosure of Latent Losses Provides Breathing Room, But Can Mask Danger of Collapse*, *Nikkei Wkly* 3 (Oct 14, 1996) (discussing accounting irregularities in the financial sector). One U.S. lawyer/stockbroker who publishes English translations of Japanese financial statements on the internet found twenty-two mathematical errors—remediable with a calculator—made by public companies and their auditors in 1998 alone. See Eagle Enterprises, Ltd, *Mistakes*, available online at <<http://www.japanfinancials.com/MISTAKE/list.htm>> (visited Nov 11, 1999).

<sup>80</sup> Lee Berton, *Japanese Accounting Bites Back*, *Accounting Today* 7, 44 (Nov 9–22, 1998) (discussing the negative impact of Ministry of Finance ties to the Japanese accounting industry); *Japanese Accounting*, *Financial Times* at 20 (cited in note 79) (reporting that close relations between auditors and their clients impugn the integrity of audited figures).

<sup>81</sup> Japanese law has historically required that all corporate bonds be collateralized, with ma-

bailiffs, the public servants in charge of enforcing civil judgments, have historically been scarce: Japan has only 521 such officers, while England, with a population smaller than Japan, has five times that number.<sup>82</sup>

Thus, most of the institutional inefficiencies in Japan outlined above are exacerbated by a shortage of attorneys and other professionals qualified to function as rights-enforcement or information agents and reputational intermediaries on behalf of property rights holders. Simply put, Japan has relatively few transaction cost engineers sanctioned by the state. Though the scarcity is not intrinsically problematic, we hypothesize that the lack of access to sophisticated professional assistance in Japan at least partially explains the frequency of resort to extra-legal mechanisms of enforcement in that country.

#### 6. Financial repression and entrepreneurial finance.

The state affects economic activity not only by licensing professionals and defining and enforcing property rights, but also by supplying incentives for private actors through regulatory design. Perhaps no area of Japanese economic activity illustrates this principle better than finance, three aspects of which are most pertinent for our purposes. First, for reasons that have been explored exhaustively in the corporate governance literature, the Japanese financial system is bank oriented, with the stock market historically serving a less important role in corporate finance, due at least in part to regulatory constraints.<sup>83</sup> Banks traditionally serviced large firms, which were seen as the engines of economic growth in the post-World War II period. Second, the Bank of Japan's historical policy of low interest rates and credit rationing has resulted in excess demand for business loans, at least in comparison to the United States.<sup>84</sup> Accordingly, many busi-

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nor banks serving as trustees. Banks encouraged the adoption of collateral requirements in the 1930s and blocked the rise of credit rating agencies that could have diminished the importance of secured bond issues. Kazumasa Niimi, *An Analysis of Bond Rating in Japan: Its History, Status, and Future*, Japan Research Q 35, 73, 85 (Autumn 1992).

<sup>82</sup> See Frank G. Bennett, Jr., *Civil Execution in Japan*, 177 Nagoya Univ J L & Pol 1, 1-2 (1999). See also Shinjirō Takagi, *Shikkōkan ni Josei ga Natte Morau tame no Zentei Jōken* [Preconditions for Encouraging Women to Become Bailiffs], 1042 Jurisuto 2, 2 (1994) (noting the lack of a single female bailiff).

<sup>83</sup> See, for example, J. Mark Ramseyer, *Explicit Reasons for Implicit Contracts: The Legal Logic to the Japanese Main Bank System*, in Aoki and Patrick, eds, *The Japanese Main Bank System* 231, 232, 236-39 (cited in note 57).

<sup>84</sup> Takatoshi Ito and Kazuo Ueda, *Tests of the Equilibrium Hypothesis in Disequilibrium Econometrics: An International Comparison of Credit Rationing*, 22 Intl Econ Rev 691 (1981) (noting that Japan's low interest rate policy limits the nation's bond and equity markets and contributes to the disequilibrium in Japan's financial market as a whole). See also Thomas F. Cargill, Michael M. Hutchison, and Takatoshi Ito, *The Political Economy of Japanese Monetary Policy*

nesses that need credit do not receive it, or do not receive it on competitive terms. Finally, the regulatory environment has historically encouraged the use of collateral in corporate finance.<sup>85</sup> A crucial aspect of a bank's credit decision is thus its assessment of the value of collateral offered by a potential borrower. Firms with marketable assets (or *keiretsu* affiliations) get loans; entrepreneurs with good ideas but few tangible assets get turned away.<sup>86</sup> While access to bank funds for start-up firms in the United States is not dramatically different, the problems for Japanese entrepreneurs are compounded by a lack of viable alternatives to bank finance. Heavy regulation of IPOs, restrictions on the issuance of stock options, and antitrust barriers to the formation of desirable business structures have stunted the development of entrepreneurial finance in Japan.<sup>87</sup> Many frustrated entrepreneurs therefore turn either to government-affiliated banks,<sup>88</sup> or, as explored below, to less savory sources of funding.<sup>89</sup>

## B. Japanese Organized Crime

It is useful to examine some of the salient features of Japanese organized criminal firms to facilitate comparison with organized crime in other systems, as well as to begin testing the theories presented in the previous Part.<sup>90</sup> Some observers have found "striking similarities between [Japanese] gangs and La Cosa Nostra groups in the United

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30-31 (MIT 1997) (describing loan market disequilibrium resulting from Japan's low interest rate policy).

<sup>85</sup> For example, until recently, corporate bond issues were required to be collateralized regardless of the size or creditworthiness of the issuer. See Niimi, Japan Research Q at 72-86 (cited in note 81).

<sup>86</sup> Masahiko Aoki, *Monitoring Characteristics of the Main Bank System: An Analytical and Developmental View*, in Aoki and Patrick, eds, *The Japanese Main Bank System* 109, 136 (cited in note 57) (explaining that the lack of monitoring capacity of banks due to collateral requirements and prohibitions on bank underwriting stunts the development of innovative small firms).

<sup>87</sup> On the institutional obstacles to a more active venture capital market in Japan, see Curtis J. Milhaupt, *The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate*, 91 *Nw U L Rev* 865, 874 (1997). See also Alan L. Beller, Tsunemasa Terai, and Richard M. Levine, *Looks Can Be Deceiving—A Comparison of Initial Public Offering Procedures under Japanese and U.S. Securities Laws*, 55 *L & Contemp Probs* 77, 112-13 (Autumn 1992) (IPOs).

<sup>88</sup> Toshihiro Horiuchi, *The Effect of Firm Status on Banking Relationships and Loan Syndication*, in Aoki and Patrick, eds, *The Japanese Main Bank System* 258, 263-266 (cited in note 57) (noting the large percentage of loans from government banks).

<sup>89</sup> Indirectly, this regulatory scheme dramatically increases the importance of land prices to economic health in Japan. Since real estate accounts for a majority of the collateral backing Japanese bank loans, rising land prices permit greater borrowing to finance new and expanded business projects. Conversely, asset deflation, such as Japan has experienced in the post-bubble recession, leads to serious credit contraction and business failures.

<sup>90</sup> A more extensive journalistic introduction is David E. Kaplan and Alec Dubro, *Yakuza: The Explosive Account of Japan's Criminal Underworld* (Addison-Wesley 1986).

States.”<sup>91</sup> Although some of the similarity can be observed in sociological terms—“[b]oth instill a deep sense of obligation, empathy, devotion, and loyalty toward other group members”<sup>92</sup>—the underlying causes of the similarities appear to be largely historical and economic. The basic traits of Japanese organized criminal firms—membership, trademarks, structure, activities, police relations, and enforcement—differ little from the characteristics of firms in other systems. Notwithstanding these core similarities, however, to a remarkable degree Japanese organized crime is a visible, highly structured element of society, carefully attuned to the environment in which it operates.

### 1. Membership and income.

Most new criminal firm recruits are poorly educated, single males around age twenty.<sup>93</sup> Nearly half have lost one or both parents, and nearly one-third come from the ranks of adolescent motorcycle gangs.<sup>94</sup> In his study of these gangs, anthropologist Ikuya Sato reports that firms recruit new members by “[t]hreats and flattery,” inviting prospective members to “visit our office.”<sup>95</sup> He also notes that, at least among motorcycle gang members, joining an organized criminal firm is something one does for economic reasons, and is not regarded as something done for a thrill.<sup>96</sup>

Firm membership has at least one easily identifiable privilege: income. Although skepticism is warranted in evaluating any estimate of income from organized criminal activities, an often-cited figure is that organized crime in Japan is a seven trillion yen (\$56 billion) industry.<sup>97</sup>

<sup>91</sup> Frank F.Y. Huang and Michael S. Vaughn, *A Descriptive Analysis of Japanese Organized Crime: The Boryokudan from 1945 to 1988*, 2 Intl Crim Just Rev 19, 42 (1992).

<sup>92</sup> Id.

<sup>93</sup> Kaplan and Dubro, *Yakuza* at 144 (cited in note 90) (citing National Police Science Research Institute study).

<sup>94</sup> Id.

<sup>95</sup> Ikuya Sato, *Kamikaze Biker: Parody and Anomy in Affluent Japan* 169 (Chicago 1991).

<sup>96</sup> Id at 168–70 (describing joining the *yakuza* as a “job” alternative). See also Joachim Kersten, *Street Youths, Bosozoku, and Yakuza: Subculture Formation and Societal Reactions in Japan*, 39 Crime & Delinquency 277, 288 (1993) (questioning the “systematic recruitment” of motorcycle gang members by organized crime firms but noting linkages between labor markets and membership).

<sup>97</sup> See, for example, Atsushi Mizoguchi, *Urashakai no Seiji Keizaigaku* [*The Political Economy of the Underworld*], in Shinji Ishii, ed, *Yakuza to iu Ikikata: Toshi no Sokoni Sumu Otokotachi no Monogatari* [*The Life of the Yakuza: Stories of Men Living at the Bottom of the City*] 178, 182 (Takarashimasha 1986). See also Mary Jordan and Kevin Sullivan, *A New Mob Mentality in Japan: Families Profit by Going Mainstream*, Wash Post A1 (Apr 11, 1999) (quoting Hiroshi Yamada of the Japan Federation of Bar Associations that “most analysts agree that the 23 major crime syndicates have a combined annual income of about \$45 billion”); Christopher Seymour, *Yakuza Diary: Doing Time in the Japanese Underworld* 18 (Atlantic Monthly 1996) (estimating \$50 billion); Atsushi Mizoguchi, *Yakuza to Kane* [*Yakuza and Money*] 13 (Aipekku 1992) (Police

This equates to gross revenues of approximately \$650,000 per member. We are not aware of any scientific basis for this figure, but it is widely cited and loosely correlates to data on specific crimes as well as legitimate activity, and it is useful in drawing general comparisons.<sup>98</sup> A 1993 survey of 1,440 organized criminal firm made-member arrested suspects<sup>99</sup> shows that the income distribution is skewed to the top. Over 40 percent of the respondents reported annual income of \$30,000 to \$48,000. About 23 percent of the respondents reported less; 37 percent reported more, including 5.9 percent reporting income in excess of \$100,000.<sup>100</sup> The same survey found part of the reason for the income disparity: a progressive tribute system, much like that found in other tournament systems, through which members pay increasingly larger taxes to higher-ranked personnel.<sup>101</sup>

The employment packages offered by organized criminal firms in Japan have lured large numbers of recruits. In 1963, membership of

estimate annual income of Yamaguchi-gumi headquarters at approximately \$13 million.)

<sup>98</sup> See Mizoguchi, *Urashakai no Seiji Keizaigaku* at 182–86 (cited in note 97). These data have been called “a colossal underestimate.” Karel van Wolferen, *The Enigma of Japanese Power: People and Politics in a Stateless Nation* 101 (Vintage 1990) (referring to an estimate of income from illegal activity of 1.5 trillion yen). A 1990 police survey of organized criminal firm members was used to estimate the total income of organized criminal firms at \$10.42 billion, divided into \$2 billion for legal activities and the remainder to illegal and “gray zone” activities. See Hisao Kato, *Soshiki Hanzai no Kenkyū : Mafia, Ra Kōza Nosutora Bōryokudan no Hikaku Keukyū [A Study of Organized Crime: A Comparative Study of the Mafia, La Cosa Nostra, and Japanese Gangs]* 124 (Seibundō 1992); Kozo Tanaka, *Minbō no Teguchi [Extortion Handbook]* 171 (Aipekku 1992). As Mizoguchi points out, these figures probably grossly underestimate amounts earned from “gray zone” extortion, due to the exclusion of income for such activities as financial firm extortion, bankruptcy matters, traffic accident dispute mediation, bill collection, and landlord-tenant transactions—the very factors that account for illicit entrepreneurialism. Mizoguchi, *Urashakai no Seiji Keizaigaku* at 184; Yukio Yamanouchi, *Yamaguchi-gumi Komon Bengoshi no Shuki [Diary of a Yamaguchi-gumi Firm Lawyer]*, *Bungei Shunju* 398, 400 (Nov 1984). One mob boss reports that 70 percent of his firm’s income comes from dealing with bad loans. Fiona Graham, *Yakuza and Sokaiya: Crime Gangs Feel the Pinch*, *Financial Times* 6 (July 14, 1998). The survey also probably overestimated amounts earned from the drug trade. Mizoguchi, *Urashakai no Seiji Keizaigaku* at 184; Yamanouchi, *Bungei Shunju* at 406–07. In any event, using the survey data and 1990 membership figures nevertheless yields an annual income of approximately \$185,000 per member. See Hiroaki Iwai, *Organized Crime in Japan*, in Robert J. Kelly, ed., *Organized Crime: A Global Perspective* 208, 210–211 (Rowman & Littlefield 1986) (noting that official 1979 figures place income at “nearly four times that of an average salaried person”).

<sup>99</sup> 959 responding!

<sup>100</sup> 1993 *Keisatsu Hakusho [White Paper on Police]* 32 (1994). For comparison, the average yearly contract earnings of all employees in 1993 was \$33,504. The average dentist, for example, earned approximately \$65,000; janitors earned about \$30,000. *Nihon Tōkei Nenkan [Japan Statistical Yearbook]* (1996).

<sup>101</sup> 1993 *Keisatsu Hakusho [White Paper on Police]* at 28 (cited in note 100). See Edward P. Lazear and Sherwin Rosen, *Rank-Order Tournaments as Optimum Labor Contracts*, 89 *J Pol Econ* 841, 847 (1981) (describing a theory of compensation where tournament winners are paid high fixed rates rather than a rate based on their marginal output).

organized criminal firms stood at a peak of 184,091. By 1997, the number had fallen to 80,100, still a very large number. For the period 1957–1997, the historical annual average is more than one firm member for every 1,000 of population.<sup>102</sup> In the U.S., a 1986 study estimated 50,229 members and associates of La Cosa Nostra (though not by any means the only organized crime organization in the United States, arguably the closest analogue to Japanese organized criminal firms in scope and function), while FBI figures place that number at only 18,700.<sup>103</sup> Even taking the higher figure, members of La Cosa Nostra account for only about one of every 5,000 persons.

Just as organized criminal firms hire members and affiliates in good times, so do they fire them in bad times. If a member is discharged from the firm, postcards are sent to other firms announcing the member's departure. Only through formal reinstatement may the member rejoin the firm. Until then, he is banned from joining another firm, is "warned against roaming the streets aimlessly, and must refrain from the use of mannerisms and styles of the gangster"<sup>104</sup>—a sensible policy given firms' profitability. Members also quit. Although statistics on exactly how many and how often are unavailable, we calculate from police figures that from 1990 to 1997, an average of 1,668 members quit each year when their firms folded.<sup>105</sup> If conditions are bad enough, organized crime firms, like more conventional firms, merge, reorganize, or dissolve.<sup>106</sup>

## 2. Trademarks and visibility.

Identifying members of Japanese organized criminal firms is not difficult. Members and firms are well versed in the display of what one commentator calls "trademarks."<sup>107</sup> They are easily identified on the streets of Tokyo by their dark glasses, flashy suits, and punch-perm

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<sup>102</sup> On our data source, see text accompanying notes 158–65.

<sup>103</sup> President's Commission on Organized Crime, *Report to the President and the Attorney General, The Impact: Organized Crime Today* 476, 488 (GPO 1986). See also David J. Fried, 79 J Crim L & Criminol at 360–61 n 146 (cited in note 11) (summarizing statistics). Focusing solely on La Cosa Nostra is arguably an imperfect point of comparison, however, because depending on the definition one adheres to, see note 5, it excludes other organized criminal groups operating in the United States, such as Chinatown tongs or Colombian drug gangs.

<sup>104</sup> David Harold Stark, *The Yakuza: Japanese Crime Incorporated* 109 (1981) (unpublished PhD dissertation, University of Michigan).

<sup>105</sup> Data from selected issues of *Keisatsu Hakusho [White Paper on Police]* (covering the years 1991–98). Because the loss of a member often entails economic loss to the firm, members who wish to quit sometimes are required to obtain consent from the firm, and sometimes such consent must be purchased.

<sup>106</sup> See, for example, *Japanese "Yakuza" Syndicate Launches Restructuring Plan*, Japan Econ Newswire (Aug 16, 1997) (describing the restructuring of Japan's largest syndicate).

<sup>107</sup> Gambetta, *The Sicilian Mafia* at 127–55 (cited in note 5).



hair. Whenever possible, they scorn Toyotas and Hondas for Mercedes-Benzes and Lincoln Continentals. As if this were not enough, members are often marked by missing fingers (the result of rituals and punishment) and colorful, often full-body, tattoos.

In the U.S., though members may be recognizable, most firms are not. As Joseph Castellano (the son of reputed mob boss Paul Castellano) put it, "What is a Gambino crime family? . . . Does this Gambino crime family have an office? Does the office have a plaque on the door that says, 'Gambino crime family?'"<sup>108</sup> In Japan, the answers would be, in reverse order, "yes," "yes," and "read our rules and creed." Firms have offices that are indeed adorned with gang emblems and signs. Like employees of traditional firms, members proudly distribute business cards displaying the firm logo. Larger firms have their own banners, publications, songs, and other promotional goods, including New Year's greeting cards and lapel pins. As one academic observer vividly described a local firm's offices:

Then there are the yakuza haunts themselves, the most prominent being that of Kanamachi Ikka . . . , located in a swanky, three-story brick and stucco structure . . . . It is hard to miss. The organization's name is prominently lettered in silver, alongside its gold coat of arms, over the entranceway. This publicity is not at all atypical . . . . The middle floor has a non-descript appearance, at least from the outside; but the top floor is done in the penthouse style with a bubble roof. The windows on the first two floors are glazed and barred.<sup>109</sup>

If the firm emblem, distinctive employees, and golden gates do not reveal identity, actions often will. Like John Gotti's famous Brooklyn fireworks displays, Japanese firms are often engaged in public relations gestures to foster goodwill in the community. When the deadly 1995 earthquake struck Kobe, it was a branch of the Yamaguchi-gumi crime firm, not the government, that was first to bring relief to devastated neighborhoods. Within hours of the quake, the firm reportedly was handing out 8,000 meals a day from the parking lot next to its headquarters, and was distributing uncontaminated mineral water from its private well.<sup>110</sup> These activities, along with the easily recog-

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<sup>108</sup> Jeffrey Goldberg, *The Don is Done*, NY Times Mag 25, 26 (Jan 31, 1999).

<sup>109</sup> Edward Fowler, *San'ya Blues: Laboring Life in Contemporary Tokyo* 20-21 (Cornell 1996).

<sup>110</sup> James Sterngold, *Gang in Kobe Organized Aid for People in Quake*, NY Times 9 (Jan 22, 1995); *Where the Government Fails, the Yamaguchi-gumi Succeeds*, Mainichi Daily News 9 (Feb 5, 1995).

nized trademarks, help to identify firms and firm members both as providers of services and as issuers of credible threats.

### 3. Structure.

Firm organization in Japan, as elsewhere, is complex and hierarchical. Typical is the Yamaguchi-gumi, with approximately 18,000 members, the largest of the Japanese firms. The Yamaguchi-gumi has three groups and five hierarchical levels, all overseen by the boss (*oyabun*). The president presides over underbosses, who preside over lieutenants, member-soldiers, and staff organizations.<sup>111</sup>

### 4. Activities.

Organized criminal firms in Japan focus much of their attention on the traditional underworld trades of gambling, pornography, prostitution, and drugs. Legitimate businesses run by firm members have an underworld aroma as well; one survey finds that the top businesses in which made-members engage are street stalls (managed by 5,552 surveyed members), lending agencies (3,239), bars (3,129), strip clubs and spas (2,692), restaurants (2,596), and construction firms (2,171).<sup>112</sup> But they do more. They also head informal creditors' committees, settle civil disputes, and finance everything from golf courses to resort hotels. In Japan, as in other systems, "boundaries between legitimate and illegitimate activities begin to blur."<sup>113</sup> Police estimate that roughly half of organized criminal firm income comes from such gray-area activity.<sup>114</sup>

Crucially, many of the activities of Japanese organized criminal firms track the institutional problems we identified in Part II.A. The influence of organized crime is readily apparent in bankruptcy and debt collection, property development, dispute settlement, shareholders' rights, and finance. Thus, in many ways, organized criminal firms are the missing transaction cost engineers in the Japanese system. This

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<sup>111</sup> Huang and Vaughn, 2 Intl Crim Just Rev at 30 (cited in note 91). Compare the U.S. structure outlined in *United States v Brady*, 26 F3d 282, 285 (2d Cir 1994) (describing the hierarchical nature of La Cosa Nostra); *United States v Salerno*, 868 F2d 524, 528 (2d Cir 1989) (describing the "Commission," which acts as the ruling body of the La Cosa Nostra mafia families); and discussed in Abadinsky, *Organized Crime* at 9-13 (cited in note 5).

<sup>112</sup> Norikiyo Hayashi, *Sōshiki Bōryoku no Ichi Danmen: Aru Sōsakan no Kiseki* [A Section of Organized Violence: A Track Traced by a Detective] 100 (Tachibana Shobo 1996).

<sup>113</sup> John Owen Haley, *Authority Without Power: Law and the Japanese Paradox* 183-84 (Oxford 1991).

<sup>114</sup> Mizoguchi, *Yakuza to Kane* at 21 (cited in note 97). 34.8 percent of income is said to come from drugs, see id, which is said to yield profit margins of 15,000 percent. Akira Hinago, *Urakeizai Pakuri no Teguchi* 99 [Handbook of 99 Underground Economy Ripoff Artists] 120-21 (Kinki Shuppan 1995).

makes the line between legitimate and illegitimate conduct all the more opaque. As discussed below, so pervasive is the influence of organized crime in these gray areas that special terms have been coined in Japanese to describe the underworld entrepreneurs who exploit each of these opportunities.

Organized criminal firms in Japan, for example, play a pervasive role in the resolution of financial distress.<sup>115</sup> Beginning in 1953, a class of professionals called *seiriya* (“fixers”) emerged to assist in the reorganization and liquidation processes.<sup>116</sup> These professionals operate outside the legal system and are closely tied to organized crime. The Japanese Federation of Bar Associations in 1995 estimated that 100 *seiriya*, not including assistants and staff, offered general bankruptcy services.<sup>117</sup> Fixers can profit from distressed firms in various ways. They might offer protection services to the debtor or insert themselves into a leadership role on the creditors’ committee by demonstrating expertise in corporate reorganizations. Another favored tactic is to obstruct the foreclosure and auction process by leasing space in a building serving as collateral. Because Japanese law heavily favors tenants, this simple act can virtually paralyze foreclosures.<sup>118</sup> For creditors, fixers might extract concessions from debtors, increase the size of the debtor’s estate by engaging in debt collection activities, or provide prompt disposition of assets held as collateral. The only English-language study of the fixers to date concludes that these professionals, with their intimate knowledge of the reorganization and liquidation processes, serve as substitutes for bankruptcy lawyers and for the formal bankruptcy regime in general.<sup>119</sup>

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<sup>115</sup> Packer and Ryser, *The Governance of Failure* at 26 (cited in note 50).

<sup>116</sup> *Id.* at 27.

<sup>117</sup> Nihon Bengoshi Rengokai [Japanese Bar Association], *Minji Kainy Bōryoku: Chinō Bōryoku to Tatakau Bengoshi* [Violent Intervention in Civil Affairs: Attorneys Against “Intellectual” Violence] 14 (Shōji Hōmu Kenkyūkai revd ed 1995). See also David E. Kaplan, *Japanese Organized Crime and the Bubble Economy*, Woodrow Wilson Center Asia Program Occasional Paper No 70, 4 (Dec 13, 1996) (reporting 740 offices at the peak of the bubble economy in Tokyo dealing in “financing, construction, and real estate”); Kanro Miyazaki, *Seiriya no Jittai to Taiōsaku* [The Reality of and How to Protect against Seiriya], 194 NBL 14, 16 (1979) (sixty to eighty companies in the late 1970s). Some *seiriya* have extensive operations including multiple offices. See Hayashi, *Sōshiki Bōryoku no Ichi Danmen* at 240 (cited in note 112) (stating that the leading *seiriya* has eight offices in Tokyo alone).

<sup>118</sup> When a person occupies a building or land that has been mortgaged, he can in most cases contest the mortgage on land for five years, and on a building for three years, unless it is proven that his intent is to obstruct the disposition process. See Minpō [Civil Code], arts 395, 602. Proving specific intent is difficult, and suing members of organized crime has its risks. See Hinago, *Urakeizai Pakuri no Teguchi* 99 at 118–19 (cited in note 114) (noting how so-called *sumikomiya* (“live-in fixers”) often have seemingly legitimate claims of residence).

<sup>119</sup> Packer and Ryser, *The Governance of Failure* at 27–29 (cited in note 50).

These fixers are often preceded or accompanied by *toritateya*, or debt collectors. Debt collectors raise the penalties for nonpayment through the typical tactics of such professionals throughout the world, but they are also known to publicly denounce debtors in their residential neighborhoods from high-decibel soundtrucks.<sup>120</sup> Fearful of threats and intimidation, and unwilling to face complicated bankruptcy laws, some debtors turn for help to the *toritateya*'s white knight counterpart—the *yonigeya*. *Yonigeya* literally means “one who helps another flee in the night.” Such operators—sometimes from organized criminal firms, sometimes not—assist debtors in relocating and establishing new identities.<sup>121</sup>

Closely related to fixers and debt collectors in some of their activities are the *jiageya* (“land fixers”). Real estate developers retain these specialists to convince reluctant landowners or tenants to part with their property interests. Recall that Japanese law makes it virtually impossible to evict tenants, creating major holdout problems. As one leading crime figure puts it (no doubt with some hyperbole), “without [*jiageya*], cities wouldn't be able to develop.”<sup>122</sup> Sometimes the *jiageya*'s tactics are subtle: a phone call, for example, suggesting that a holdout would be well advised to move, can be powerful incentive to vacate the premises. Occasionally they are creative: for example, they may organize a loud motorcycle conference in front of the coveted property. At other times, they are ruthless: smashing windows, dumping garbage, and beating up the truly recalcitrant.<sup>123</sup> For these services, anecdotal evidence indicates that they charge nearly 10 percent of the parcel's sales price.<sup>124</sup>

<sup>120</sup> One commentator found a similar noise-for-hire service provided by ultranationalists with organized criminal firm ties “[f]or a mere \$1,000 per day.” David E. Kaplan, *Yakuza Inc.*, US News & World Rep 41, 47 (Apr 13, 1998).

<sup>121</sup> Richard Lloyd Parry, *Japanese Debtors Do a Vanishing Act*, The Independent 18 (Dec 19, 1998). One such operator explains that only about 10 percent of cases actually involve stealing away in the night—it causes a commotion; daylight is better—but the name sticks. *Fly-by-night Outfit Helps Damsels in Distress*, Mainichi Daily News 11 (Mar 30, 1997).

<sup>122</sup> David Holley, *Japan Mob Muddies Real Estate Loan Crisis: Banking Woes Underline the Key Role Gangsters Play in Land Development. Critics Say Yakuza Could Gain Foothold in Economy if Bailout is Mishandled*, LA Times A1 (Feb 24, 1996). See also Seiji Iishiba, *Nihon Shakai no Kōzō Henka to Bōryokudan* [*The Changing Structure of Japanese Society and Organized Criminal Firms*], 985 *Jurisuto* 58, 63 (1991) (noting that “it does not make economic sense to develop a golf course following legal procedures. A demand for the back-door shortcut of the underworld results”).

<sup>123</sup> See, for example, Gerard Baker, *Mob Rule: Japan's Mafia: Troubled Times for Japan's Financial System Mean a Lucrative Line of Business for Gangsters*, Financial Times 1 (Mar 16, 1996) (describing the escalating scale of harassment and violence employed by the Yakuza).

<sup>124</sup> Mizoguchi, *Urashakai no Seiji Keizaigaku* at 187 (cited in note 97). A typical charge for land transaction services by legitimate providers is 3 percent. *Id.* Of course, legitimate providers merely broker transactions and do not attempt to remove holdouts.

Like fixers and land specialists, *jiageya* have developed expertise on both sides of a transaction. Some operate as *apaatoya* (“apartment fixers”), taking the tenant’s side in landlord-tenant disputes.<sup>125</sup> As with the *seiriya* fixers, years of exploiting the legal system to their own advantage have resulted in levels of expertise among the *jiageya* that surpass that of many lawyers.<sup>126</sup>

While the relative scarcity of lawyers in Japan has been much celebrated in the United States,<sup>127</sup> the situation just described suggests that low lawyer populations can create serious problems. In fact, parties to civil disputes of all types in Japan sometimes turn to organized-crime-linked *jidanya* (“settlement specialists”) to help resolve their problems. Traffic accident victims, for example, may hire a gang member to convince the other driver to provide compensation. Once again, these professionals epitomize entrepreneurialism at the boundary between the legitimate and the illicit. Accounts of *jidanya* by Japanese commentators routinely allude both to the beneficial aspects of their settlement services in the absence of other trained professionals, and to the illegal and even violent nature of their work.<sup>128</sup> Not surprisingly, some members of organized criminal firms view themselves as “lawyers for the dark side of society” [*urashakai no bengoshi*].<sup>129</sup>

The costs of using *jidanya* appear to compare favorably with those of the formal legal system. Although lawyers’ fees vary, most are reasonably close to the fee schedule published by the Japanese Federation of Bar Associations and adopted by local bar associations.<sup>130</sup>

<sup>125</sup> See *id* at 184.

<sup>126</sup> See Richard Lloyd Parry, *Yakuza Settle Bad Debts with a Bullet as Japan Bubble Bursts*, *The Independent* 16 (Feb 4, 1996) (quoting a former policeman and bureaucrat: “The *jiageya* ‘show great creativity. . . . They became specialists on bad debt, more sophisticated than the lawyers who were hired against them.’”). See also Takashi Arimori, *Yakuza Kanpanii: Nihon Keizai o Ugokasu Kigyō Shatei* [*Yakuza Company: How Firms Controlled by the Yakuza Move the Japanese Economy*] 119–38 (Nesuko 1991).

<sup>127</sup> Perhaps the most widely circulated account is Derek C. Bok, *A Flawed System of Law Practice and Teaching*, 33 *J Legal Educ* 570, 573 (1983) (noting that “[a] nation’s values and problems are mirrored in the ways in which it uses its ablest people” and lamenting the comparatively large numbers of U.S. lawyers as compared to Japan).

<sup>128</sup> See, for example, Kazuhiro Yonemoto, *The Shimane Bar Association: All Twenty-One Members Strong*, 25 *Law in Japan* 115, 121 (1995) (Daniel H. Foote, trans); Takeyoshi Kawashima, *Dispute Resolution in Contemporary Japan*, in Arthur von Mehren, ed, *Law in Japan: The Legal Order in a Changing Society* 41, 47–48 (Harvard 1963).

<sup>129</sup> See Kyōji Asakura, *Danchi Ninkyōden* [*A Chivalrous Tale of Neighborhood Protection*], in Ishii, ed, *Yakuza to iu Ikikata* 23, 28 (cited in note 97). The organized bar has little incentive to capture more of the market share that is currently held by organized crime. In fact, it is unlikely that the bar needs to compete with organized criminal firms at all: the bar’s legal monopoly ensures attorneys all the work they can handle, and the cases referred to organized criminal firms are likely to be more time consuming and risky than those handled by attorneys.

<sup>130</sup> Nicliūbenren [Japanese Bar Association], *Hōshū Nado Kijun Kitei* [Standard Rules Regarding Compensation] (Oct 1, 1995), available online at <<http://www.asahi-net.or.jp/~zi3h>>

Using this official fee schedule as a base, for a traffic accident in which a plaintiff requests 20 million yen (\$160,000) in damages and receives 15 million, a plaintiff would pay her attorney a retainer of slightly over 1 million yen and a “success fee” of about 1.68 million, for a total fee of about 2.75 million yen (\$22,000).<sup>131</sup> By comparison, a *jidanya*'s usual fee is said to be 15 percent of the award received—in this case 3 million yen (\$24,000)—minus actual medical damages.<sup>132</sup> Although in this case a *jidanya* might cost as much as \$2,000 more than a lawyer, a plaintiff who hires a *jidanya* avoids paying a lawyer's up-front non-refundable retainer and initial consultation fee, eliminates court costs, and in most cases receives damages much more quickly than formal procedure would allow. These figures are estimates at best; if the estimates approximate actual costs, however, it is not difficult to imagine situations in which a plaintiff rationally would turn to such specialists, particularly in rural areas where licensed attorneys are scarce.

While *jidanya* usually target individuals and small businesses, even large, prestigious Japanese companies sometimes deal with criminal firms. Corporate extortion by *sokaiya* gangster-racketeers appears to be widespread in Japan. While they take several forms, a *sokaiya* (literally, “general meeting operator”) is usually a nominal shareholder who either attempts to extort money from a company's managers by threatening to disrupt its annual shareholders' meeting with embarrassing or hostile questions, or who works for a company's management to suppress dissent at the meeting.<sup>133</sup> As one of us has shown, *sokaiya* flourish in Japan because Japanese institutions foster low levels of corporate disclosure. This creates material for blackmail, and forces investors to rely on substitutes (such as the length of a shareholders' meeting) for signals about a company's prospects.<sup>134</sup> It also results in network-effect nondisclosure, as managers otherwise inclined to make negative disclosures fear a steep market discount of their firm's stock, since their competitors are unlikely to follow suit. Currently some 1,000 *sokaiya* are working in Japan, down from 6,000 in the early 1980s before increased enforcement and disclosure poli-

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[kwrz/law2feenf.html](#)>.

<sup>131</sup> For cases between 3 million and 30 million yen, the Fee Rules specify a retainer of 5 percent of the amount of damages requested plus 90,000 yen, plus a success fee of 10 percent of damages received plus 180,000 yen. *Id.* at art 18. For a case settled out of court, the base damages used for calculating fees may be reduced by up to 30 percent. *Id.* at art 17. In this example, the plaintiff would also be required to pay court fees of 15,600 yen (\$125). *Minji soshō hiyōtō ni kansuru hōritsu* [Law concerning civil litigation costs, etc], Law No 40 of 1971, arts 3–4 (1998).

<sup>132</sup> Tsubasa Aoki, *Jidanya Sh dan* [Settlement Specialist Groups] 15 (1988).

<sup>133</sup> Mark D. West, *Information, Institutions, and Extortion in Japan and the United States: Making Sense of Sokaiya Racketeers*, 93 *Nw U L Rev* 767, 767 (1999).

<sup>134</sup> *Id.* at 769–70.

cies took effect.<sup>155</sup> Whether the *sokaiya* actually monitor management on behalf of shareholders is, of course, open to question.<sup>156</sup> The point is that a problematic institutional environment for the exercise of shareholders' rights in Japan gives rise to this distinctive class of underworld professional.

Finally, Japan's heavily regulated financial markets traditionally left a large unsatisfied demand for capital. As elsewhere, some frustrated entrepreneurs and consumers turn to lenders offering funds at usurious rates.<sup>157</sup> In Japan, the unsatisfied demand for funds has long been partially satisfied by *sarakin* loan sharks. More recently, organized crime affiliates have moved into mainstream areas of finance.

The following table summarizes the institutional problems and corresponding organized crime entrepreneurs in Japan.

**TABLE 1**  
**INSTITUTIONAL GAPS AND ILLICIT PRIVATE ORDERING ENTREPRENEURS**

Service Area	Organized Crime Service Provider	English Translation
Bankruptcy	<i>Seiriya</i>	Fixer
Debt Collection	<i>Toritatelya/Yonigeya</i>	Debt collector/One who helps another flee in the night
Landlord-Tenant Issues	<i>Jiageya/Apaatoya</i>	Land fixer/Apartment fixer
Dispute Settlement	<i>Jidanya</i>	Settlement specialist
Shareholders' Rights	<i>Sokaiya</i>	General meeting operator
Financial Services	<i>Sarakin</i>	Loan shark

Perhaps a 1993 government survey best sums up the relationship between the legal regime and the activities of organized crime in Japan: It found that 12 percent of the Japanese public believes that Japanese organized criminals are a necessary evil. Respondents based

<sup>155</sup> Id at 796. Private estimates are even lower. See Stephanie Strom, *Dead End of Shakedown Street: Crackdown Spurs a Makeover of Japan's Corporate Racketeers*, NY Times C1 (Aug 11, 1999) (estimating 350 to 500).

<sup>156</sup> See, for example, Masahiko Aoki, *Information, Incentives, and Bargaining in the Japanese Economy* 145 & n 41 (Cambridge 1988) (stating that *sokaiya* activity "prompts management to behave ethically"). The same question might be raised with regard to shareholder derivative litigation and class actions. See, for example, West, 93 Nw U L Rev at 791-92 (cited in note 133); Roberta Romano, *The Shareholder Suit: Litigation without Foundation?*, 7 J L Econ & Org 55, 84 (1991) (concluding that "shareholder litigation is a weak, if not ineffective, instrument of corporate governance").

<sup>157</sup> Douglass C. North and Roger LeRoy Miller, *The Economics of Usury Laws*, in Lawrence J. Kaplan and Dennis Kessler, eds, *An Economic Analysis of Crime: Selected Readings* 193 (Charles C. Thomas 1976). 1983 legislation changed the maximum legal interest rate from 109.5 percent to 73 percent annually, and further reduced it to 54 percent in 1986. Yoko Shibata, *Fresh Curbs on Loan Sharks Fail to Satisfy*, Financial Times 10 (Sept 19, 1983).

their acceptance of organized crime in large part on the slowness of the legal system in resolving civil conflicts and the efficiency of the mob.<sup>138</sup>

##### 5. Enforcement and the Anti-Organized Crime Act.

Organized criminal firms in Japan are aided in these activities by a form of what Richard Posner calls “corruption of police.”<sup>139</sup> The relationship in Japan, and elsewhere as well, is not characterized by corruption strictly defined—as illegal payments to a public agent to obtain benefits.<sup>140</sup> Stories of corrupt Japanese police officers—and indeed even bare allegations of Japanese police corruption—are relatively rare.<sup>141</sup> Instead, the relationship is better described as symbiotic. Again Ramseyer and Nakazato are instructive:

Ironically, the lower rates of violent crime in Japan may also result from the way the police have generally failed to imprison the leaders of the organized crime syndicates . . . . For in failing to do so, they have brought an organizational stability to the underworld. That stability, in turn, has kept turf battles far more modest than among the urban street gangs in the United States.<sup>142</sup>

The symbiosis sometimes extends beyond the police into political relations, a realm in which it does give rise to corruption. In the construction industry, Japan appears to be what Brian Woodall aptly terms a “clientelist state” that encourages collusion among politicians, bureaucrats, and influential actors in the private sector—including members of organized criminal firms.<sup>143</sup> Several major scandals, in-

<sup>138</sup> *Twelve Percent of Japanese Consider Mobsters a “Necessary Evil”*, Agence France Presse (cited in note 10).

<sup>139</sup> See Posner, *Economic Analysis of Law* at 243 (cited in note 5).

<sup>140</sup> Susan Rose-Ackerman, *Corruption: A Study in Political Economy* 7 (Academic 1978).

<sup>141</sup> David H. Bayley, *Forces of Order: Policing Modern Japan* 4 (California 1991) (reporting fifteen dismissals in 1988, only five on corruption, fraud, or theft grounds, for 220,000 police officers in Japan, compared with fifty-five dismissals in the New York City police department, which has 26,000 officers).

<sup>142</sup> Ramseyer and Nakazato, *Japanese Law* at 182 (cited in note 37). See also Matoshi Kamata, *Nihon no Chika Teikoku: Jimintō Kaisha Bōryokudan no Toraianguru* [The Japanese Underground Empire: The Triangle among the Liberal Democratic Party, Corporations, and Gangs] (Daisan Shokan 1993) (discussing firm political ties). The lack of severe punishment is a broad characteristic of the Japanese criminal justice system. See, for example, Daniel H. Foote, *The Benevolent Paternalism of Japanese Criminal Justice*, 80 Cal L Rev 317, 317–18 (1992) (arguing that allegations of leniency in the Japanese criminal justice system are true and noting the small percentage of convicts sentenced to prison terms).

<sup>143</sup> Brian Woodall, *Japan Under Construction: Corruption, Politics, and Public Works* 8–9 (California 1996). See also New York State Organized Crime Task Force, *Corruption and Racketeering in the New York City Construction Industry* 20 (ILR 1988) (describing a similar system of collusion and illegal bribes in the New York City construction industry).



cluding one in which the then-presiding vice president of the ruling Liberal Democratic Party issued special favors to a package delivery company in exchange for access to organized criminal firms, exemplify this relationship.<sup>144</sup>

Such scandals led the National Police Agency in 1991 to sponsor the Anti-Organized Crime Act, a measure designed to get tough on organized criminal firms.<sup>145</sup> Pursuant to the Act, prefectural public safety commissions, in consultation with the National Public Safety Commission,<sup>146</sup> have the power to name organized criminal groups as “designated firms.”<sup>147</sup> Members of “designated firms” are prohibited from using the name or insignia of the firm while conducting fourteen types of extortionist acts such as demanding donations, subcontracts, payment for product liability complaints, or loss compensation for securities transactions, each of which previously fell into a liminal region between legality and criminal extortion.<sup>148</sup> If a member of a designated firm conducts such an act, the prefectural public safety commission or chief of police can issue an injunction, the violation of which can result in one year’s imprisonment or a fine of up to one million yen (about \$8,000). As of 1998, twenty-three firms were so designated, and a total of 1,737 injunctions were issued in 1997.<sup>149</sup>

### III. EMPIRICAL ANALYSIS

This Part analyzes empirical data from Japan to examine the relationship between the formal institutions for enforcing rights discussed in Part II and the success of organized criminal firms. Ideally, we would like to examine data on such factors as annual income of firms and members, and the number of civil mediations, private bankruptcy foreclosures, and other activities that are conducted by members. Only with such data could we test with complete confidence the accuracy of

<sup>144</sup> See Jacob M. Schlesinger, *Shadow Shoguns: The Rise and Fall of Japan’s Postwar Political Machine* 246 (Simon & Schuster 1997) (describing the close ties between high-ranking politicians and Japanese yakuza).

<sup>145</sup> Bōryokudan’in ni yoru futōna kōi no bōshi nado ni kansuru hōritsu [Anti-Organized Crime Act], Law No 77 of 1991 (1998). For a general discussion of the Act, see Bōryokudan Taisakuhō Kenkyūkai [Research Committee on Anti-Organized Crime Act], ed, *Bōryokudan Taisakuhō no Kaisetsu: Shinpō ni Yoru Minbō Taisaku* [Commentary on Anti-Organized Crime Act: The New Law Against Civil Violence] (Minjihō Kenkyūkai 1992).

<sup>146</sup> The prefectural commissions are effectively controlled by the police. See, for example, Bayley, *Forces of Order* at 160 (cited in note 141). Members of the National Public Safety Commission are appointed by the Prime Minister and confirmed by the legislature.

<sup>147</sup> The U.S. rejected precisely this approach during deliberations on the enactment of RICO. See note 5.

<sup>148</sup> Bōryokudan’in ni yoru futōna kōi no bōshi nado ni kansuru hōritsu [Anti-Organized Crime Act], art 9.

<sup>149</sup> 1997 *Keisatsu Hakusho* [White Paper on Police] 184–187 (1998).

our hypothesis that organized crime is an entrepreneurial response to institutional shortcomings. Unfortunately, such data are unavailable. Nonetheless, Japan provides a wealth of unexamined data dwarfing that available for other countries with prominent organized crime networks, including the United States, permitting extensive investigation into the origins and role of organized crime in that country.

We divide organized crime activity into two categories for clear analysis. First, we analyze unarguably criminal activity. We then turn to regression analysis to analyze gray zone activities that are not necessarily criminal, but that compete with state-provided enforcement services and other public goods. We estimate a model that is consistent with our hypothesis about the origin and role of organized criminal firms in the civil realm.

#### A. Crime Data

Whatever else they may do, members of Japanese organized criminal firms commit crimes. Table 2 sets forth the number of persons arrested annually in Japan for various violations, with a breakdown of firm members to non-firm members. In 1997, firm members constituted 9 percent of all arrested persons—a strikingly high number considering that members in that year accounted for only .06 percent of the total population.<sup>150</sup>

An examination of individual crimes yields equally interesting results. If arrest rates properly reflect incidence of crime, members are disproportionately involved in prostitution, gambling, extortion, and intimidation,<sup>151</sup> and in illegal purchase and sales of stimulant drugs.<sup>152</sup> By contrast, members are much less likely than non-members to be arrested for larceny or other forms of theft, which are normally against the internal rules of organized criminal firms, and perhaps do

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<sup>150</sup> 80,100 members/126,170,000 persons.

<sup>151</sup> Intimidation occurs when one person threatens or attempts to threaten another with injury to his life, person, liberty, reputation, or property, or to the same of a relative, and carries a maximum penalty of two years imprisonment or a fine of less than 300,000 yen. Keihō [Penal Code], Law No 45 of 1907, art 222 (1995). Extortion occurs when one person causes or attempts to cause another person to surrender property, or when a person gains unlawful profit, and carries a penalty of not more than ten years imprisonment. *Id.* at art 249. The two often overlap, but extortion is generally charged if a person intimidates for the purpose of taking “property,” or “unlawful profit,” which has been broadly defined to include not only real property, see *Japan v [no party name given]*, 765 Shinbun 28 (Dec 4, 1911), but also miscellaneous items such as a small bill in a coffee shop, see *Japan v Ishihara*, 22 Keislu 1469, 545 Hanji 84 (Dec 11, 1968).

<sup>152</sup> The low numbers for narcotics arrests relative to stimulants arrests appears to simply reflect the higher demand for stimulants in Japan. See Masayuki Tamura, *The Yakuza and Amphetamine Abuse in Japan*, in Harold H. Traver and Mark S. Gaylord, eds, *Drugs, Law, and the State* 99, 102–04 (Transaction 1992) (describing the origins of Japanese amphetamine use).

not require the same degree of expertise and organization as more “complex” crimes.<sup>153</sup>

**TABLE 2**  
**PERCENTAGE OF ARRESTED PERSONS AFFILIATED WITH ORGANIZED**  
**CRIMINAL FIRMS<sup>154</sup>**

Crime	Number of Persons Arrested	Number of Members of Organized Criminal Firms Arrested	Ratio of Organized Crime Members Arrested to Total Number of Persons Arrested
<b>1997 Data on General Crimes as Defined by Penal Code:</b>			
Murder	1,284	265	0.21
Robbery	3,152	442	0.14
Arson	749	56	0.07
Rape	1,448	195	0.13
Violence	6,492	1,280	0.20
Bodily Injury	22,826	4,589	0.20
Intimidation	974	557	0.57
Extortion	9,756	2,638	0.27
Larceny	175,632	2,488	0.01
Fraud	8,846	1,572	0.18
Gambling	3,253	1,728	0.53
Total (including others)	353,573	32,109	0.09
<b>1994 Data on Other Crimes:</b>			
Stimulants	17,101	7,375	0.43
Narcotics	444	39	0.09
Prostitution	1,229	223	0.18

When a member is arrested, a prosecutor may either prosecute, not prosecute, or suspend prosecution. For selected offenses, we calculated the percentage of members prosecuted and compared it with the percentage of non-member suspects prosecuted. Our results are in

<sup>153</sup> The rarity of theft among members can also be inferred from a cross-sectional comparison of crime data of Japan's forty-seven prefectures and municipalities. For each prefecture, we calculated the number of reported larcenies per prefecture divided by the total number of crimes reported per prefecture using the latest 1995 data. For the entire country, we calculate that 87.29 percent of all crimes committed are larcenies. Organized criminal firms are concentrated in Tokyo and Osaka. The larceny rate (in this case, larceny as a percentage of total crime) in Tokyo was .794, second to last in the country. The Osaka rate was .872, slightly below the national rate. Two inferences are possible. First, perhaps the numerator differs: less larceny occurs in Tokyo and Osaka. This does not appear to be the case; our data show that Osaka and Tokyo have the second and third highest rates of larceny per person in Japan. The more likely second scenario is that the denominator differs, meaning that the number of other crimes—many of which are committed by members—is higher in those urban areas.

<sup>154</sup> Data from selected issues of *Hanzai Hakusho* [*White Paper on Crime*] (covering the years 1994 and 1997).

Table 3. As the table shows, members of firms are, on average, much more likely than non-members to be prosecuted for penal code offenses. They are, however, slightly less likely than non-members to be prosecuted for certain specific crimes such as violence, extortion, and sales and purchases of stimulant drugs. This evidence, combined with the arrest evidence, tends to show a lack of bias in favor of members for at least some crimes (perhaps due in part to high recidivism among firm members). Although police may turn a blind eye to certain types of offenses, members are more likely than non-members to be arrested and prosecuted for crime, implying, at least, that criminal firm success cannot be attributed solely to non-enforcement of criminal laws.

**TABLE 3**  
**COMPARATIVE PROSECUTION RATES, 1995**

Crime	Percentage of Arrested Members Prosecuted	Percentage of Arrested Non- Members Prosecuted
Murder	71.6	55.3
Violence	67.8	71.3
Bodily Injury	86.3	78.2
Extortion	55.5	59.5
Larceny	72.5	54.9
Gambling	82.5	64.0
Total Penal Code Of- fenses (including others not listed above)	71.6	61.7
Stimulants	84.5	87.5
Prostitution	91.3	73.9
Horse Race Law	82.8	82.5
Bicycle Race Law	96.2	77.2

## B. Regression Analysis

The data presented above confirm that the business of organized criminal firms is—in part at least—crime. Our claim, however, is that there is much more to understanding the origins and role of organized crime than this tautology. We turn now to regression analysis to explore our hypothesis.

### 1. Variables.

In this section, we make use of existing data to construct variables for regression analysis. For each variable, we collected data covering the twenty-five-year period ending in 1997.<sup>155</sup> We make no claim that each variable is perfect; in each case, the variable represents the best available proxy for the concepts discussed earlier in this Article. Sample statistics for each variable, as well as all other substitute variables discussed in this Part, are reported in the Appendix.

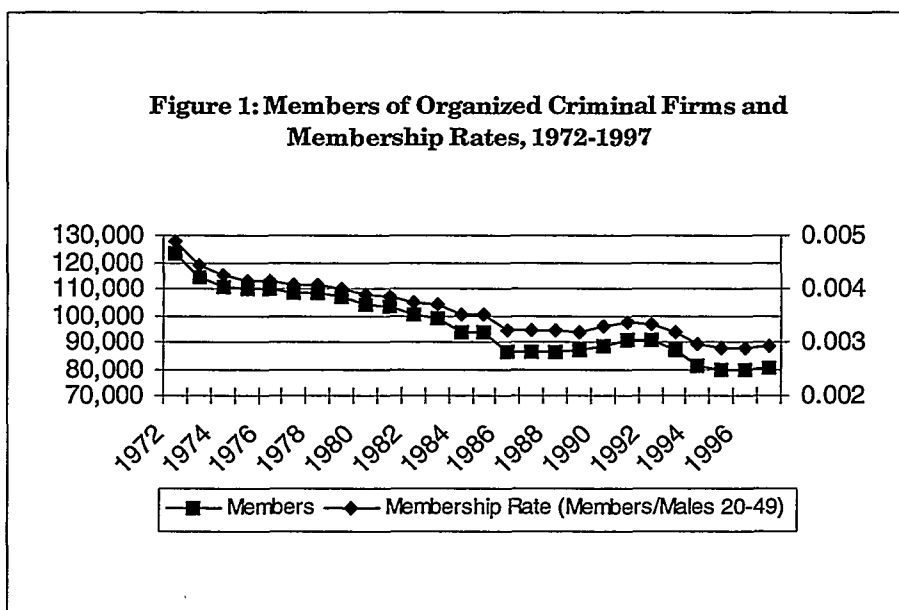
The dependent variable, MEMBERS, is the annual total number of “made” and affiliated members of organized criminal firms, divided by the total annual population of Japanese males ages 20–49. We estimated males in this age group to comprise the approximate relevant supply of MEMBERS, and formulated the variable in this way to account for population variation.<sup>156</sup> Although membership is a less satisfying proxy for success than more direct measures like income, the focus on membership rates is particularly appropriate given our interest in why organized crime emerges and flourishes. In any event, we find it highly unlikely that membership in any organization is impervious to exogenous factors affecting its overall success.<sup>157</sup> Figure 1 shows graphically the data for MEMBERS.

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<sup>155</sup> Unless otherwise indicated, data are from selected issues of two Japanese governmental publications, *Hanzai Hakusho* [White Paper on Crime] (covering the years 1993–98) and *Keisatsu Hakusho* [White Paper on Police] (covering the years 1993–98).

<sup>156</sup> Population data from selected issues of *Kōseishō, Jinkō Dōtai Tōkei* [Ministry of Health and Welfare, Vital Statistics] (covering the years 1993–98).

<sup>157</sup> The history of U.S. organized criminal firms is full of examples of the correlation of membership to financial success. For instance, Albert Anastasia reportedly sold memberships in his family for \$50,000. See, for example, Peter Maas, *Underboss: Sammy the Bull Gravano's Story of Life in the Mafia* 51 (Harper 1997). Also note that among new recruits, membership is an economic decision. See text accompanying notes 96–101. For a similar use of population as proxy for economic success, see J. Bradford DeLong and Andrei Shleifer, *Princes and Merchants: European City Growth Before the Industrial Revolution*, 36 J.L. & Econ 671, 675 (1993) (using population of Europe's pre-industrial cities as a rough indicator of economic prosperity).



The validity of our results depends, of course, on the accuracy of the MEMBERS data. These data are calculated by the National Police Agency (“NPA”), an organization of the central government directed by a “highly educated administrative elite.”<sup>158</sup> Each year, the NPA collects data from the police forces of each of the forty-seven prefectures, the smallest administrative unit in Japan’s police system.<sup>159</sup> As discussed above, the existence and location of organized criminal firms are discernable to any moderately informed observer.<sup>160</sup> The location of a given firm is thus readily known to the prefectural police, who usually assign several officers to monitor its operations. These officers, some of whom work out of offices, some on the street, and some out of Japan’s famed *koban* (“police boxes”), report to their superiors in the prefectural offices on the number of members and affiliates of each firm. Police stationed in *koban* collect a variety of important data, including “persons owning weapons, rented houses and apartments that might serve as hideaways for fugitives, people with criminal records, and the organizational structure and membership of local gangs.”<sup>161</sup>

<sup>158</sup> Walter L. Ames, *Police and Community in Japan* 183 (California 1981).

<sup>159</sup> Unfortunately, these data on individual prefectures, which would be extremely useful for cross-sectional analysis, are not publicly available. In any event, NPA staffing of such prefectural offices leads to high turnover, which may help mitigate deliberate underreporting designed to inflate the perceived efficacy of enforcement.

<sup>160</sup> See text accompanying notes 107–110.

<sup>161</sup> Peter J. Katzenstein, *Cultural Norms and National Security: Police and Military in Postwar*

Rarely if ever is the membership of any firm a secret, and police duly record it with the other information.<sup>162</sup> These membership data are reported by prefectural police to the NPA.<sup>163</sup>

Five factors further bolster our confidence in the accuracy of membership data. First, because the methodology for determining membership has not changed over time, any existing bias will be present for each year and will not affect trend data. Second, the police are arguably in an excellent position to make these calculations, given the close relationship between police and organized criminal firms in Japan. Third, the police data are generally consistent with other measures of membership and are considered to be accurate.<sup>164</sup> Fourth, our on-site investigation of firm records in three separate police stations in Tokyo and neighboring Saitama prefecture, in which we found organized and extremely detailed data (including member photos, license plate numbers, family records (including girlfriends and children born out of wedlock), cellular phone numbers, and in some cases, preferred bars, restaurants, drinks, and barbers), leads us to believe that record-keeping procedures are accurate. Finally, the findings of an in-depth ethnographic survey of Japanese organized crime, the author of which met regularly with members of the firm under study, conform to the national statistics on organized crime, providing independent support for the validity of police data.<sup>165</sup>

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*Japan* 64 (Cornell 1996). Police are also aided by the fact that firms normally control a specific turf.

<sup>162</sup> Two local officers whom one of us interviewed for a separate project stated that firms freely boasted to them of their membership numbers, and that “anybody who hangs around the gates long enough will know who is coming and going, when, and why—it’s no particular secret.” West Interview with Saitama Prefecture Officers Baba and Yasuda (Dec 10, 1997).

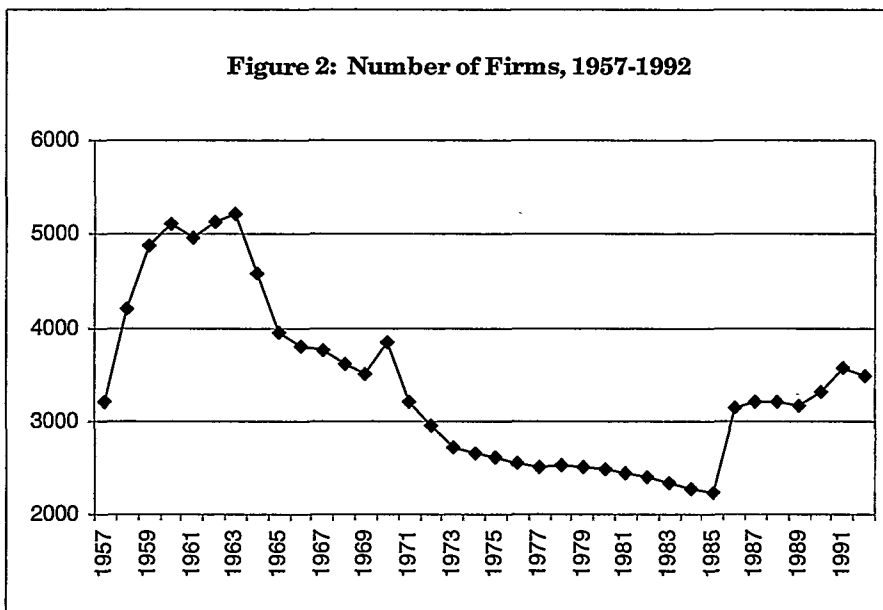
<sup>163</sup> According to Walter Ames, who spent a year with the Okayama police force, “[e]very police box and police station is equipped with a book that lists all of the gangs in the area, their members, organization charts indicating who is linked to whom through fictive kinship bonds, histories of the gangs, their major sources of income, and sometimes even photos of the gang members.” Ames, *Police and Community in Japan* at 107 (cited in note 158).

In a telephone interview with a senior NPA official, we suggested that the data might either be high because of firm boasts, or low because of local police desire to appear effective in controlling firms. The first concern was rebuffed with the same point raised by the local officers—the actual numbers are no real secret, and firm exaggerations would be easily falsified. The second concern, the official explained, was mitigated by (1) officer integrity, (2) additional auditing of local data directly by NPA officials and the National Public Safety Commission, and (3) the fact that the NPA asserts only indirect control over prefectural units, creating little incentive to distort data. West Telephone Interview with Section Vice-Chief of Organized Crime Countermeasures Section 1, Criminal Bureau, National Police Agency (Dec 15, 1998). See also Setsuo Miyazawa, *Policing in Japan: A Study on Making Crime* 29–30 (SUNY 1992) (Frank G. Bennett, Jr., trans) (describing indirect control by NPA over prefectures).

<sup>164</sup> See, for example, Iwai, *Organized Crime* at 209 (cited in note 98) (“Japanese police have not had great difficulty in producing comparatively reliable data.”).

<sup>165</sup> Stark, *The Yakuza* at 10–11 (cited in note 104).

Our decision to quantify success as MEMBERS is further supported by data on the number of organized criminal firms.<sup>166</sup> As Figure 2 shows, the number of organized criminal firms was highest in Japan's postwar growth period and during the bubble economy—further indication that the number of members is a good proxy for firm success.



The independent variables, described in Table 4 along with our results, are of three types: (1) major avenues of state-sanctioned rights enforcement (such as bankruptcy proceedings or civil litigation); (2) a central mechanism of organized crime enforcement (extortion); and (3) general indicators of macroeconomic health having a possible bearing on membership in illicit organizations.

## 2. Hypotheses.

Recall our central claim: organized crime is a substitute for state enforcement institutions. We accordingly advance the following hypotheses regarding our data. First, we predict that MEMBERS will be positively correlated to the number of profitable transactions such as extortion. Second and more importantly, we postulate that the de-

<sup>166</sup> Data on the number of firms are not available after 1992, the year that the Anti-Organized Crime Act took effect; for this reason we did not include it as a variable in our regression analysis.



mand for organized criminal firm services, as evidenced by an increase in firm membership, is negatively correlated to the demand for such services from the state. Four such negative correlations are relatively intuitive: as persons turn to the state or to state-sanctioned intermediaries for services such as dispute settlement, bankruptcy, real estate foreclosures, and financing,<sup>167</sup> we expect MEMBERS to decline. We find no a priori reason to hypothesize the nature of the relationship of the four other variables (gross domestic product per capita, reported crimes, land prices, and the unemployment rate) included in our regression.

The institutional analysis of Part II gives us some confidence in our hypotheses. A breakdown of organized crime services by service area indicates at least anecdotally that long-term decreases in membership and number of firms (see Figures 1 and 2) may be the result of increases in institutional efficacy and in the number of state-sanctioned rights-enforcement agents. The relationship can be seen in the shareholders' rights service area, which we identified in Part II as being the province of *sokaiya*. As corporate disclosure institutions have improved, and derivative litigation rules have eased to encourage a rise in suits to approximately 220 in 1998<sup>168</sup> (up from about twenty

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<sup>167</sup> A positive correlation between MEMBERS and the financing variable might exist if a high percentage of bank loans went to criminal firms. Two official measures of such activity exist. First, the National Police Agency estimates that more than 10 percent of banks' bad loans are to organized criminal firms. See David Lister and Patrick Sawyer, *Gangster Link to £9bn Japan Bank's Collapse*, Evening Standard 4 (Sept 28, 1998). Second, a March 1999 survey by the Housing Loan Administration Company found that organized criminal firms or self-proclaimed rightist groups were involved in 42 percent of the cases in which the collection of nonperforming loans left by defunct *jusen* housing loan companies was disrupted. *Survey: Gangs Stalling Collection of Jusen Loans*, Daily Yomiuri 1 (Mar 31, 1999). Organized criminal firms' share of the 42 percent figure represents some combination of loans to gangs and the hiring of gangs to prevent collection of loans. Private estimates are similar. See Brian Bremner, *Japan: How the Mob Burned the Banks: The Yakuza is at the Center of the \$350 Billion Bad-loan Scandal*, Bus Wk 14 (Jan 29, 1996) ("As much as 10% of the bad loans officially recognized by the Ministry of Finance"); Holley, *Japan Mob Muddies Real Estate Loan Crisis*, LA Times at A1 (cited in note 122) (reporting estimates of bad loans to organized crime at "as high as 80%"). We are skeptical of the accuracy of the highest of these estimates, but in some particularly egregious cases, the role of organized criminal firms can indeed be large. See *Moto Takugin Tōdoriya o Baishō Teiso e* [Case to be Brought Against Former Takushoku Bank Executives], Asahi Shinbun 1 (Feb 4, 1999) (reporting that "billions" of yen financing was supplied by defunct bank to mob-affiliated real estate venture); Benjamin Fulford, *Gangsters Linked to Bad-loan Morass: Officials Say Yakuza Impede Collateral Sale*, Nikkei Weekly 1 (Nov 27, 1995) (reporting 960 billion yen of Kizu Credit Cooperative's 1.31 trillion yen of assets were deemed "irrecoverable" largely because they were controlled by organized crime); James Sterngold, *Ties to Gangsters Hinder Overhaul of Japan Banking*, NY Times D1 (Oct 18, 1994) (reporting \$70 million of Gifu Shogin's \$110 million in outstanding loans were to organized criminal firms).

<sup>168</sup> See <[www.ijnet.or.jp/clc/whats2/wn99-6-8.html](http://www.ijnet.or.jp/clc/whats2/wn99-6-8.html)> (visited Nov 22, 1999) (Supreme Court Secretariat figures).

total suits for the preceding forty years<sup>169</sup>), *sokaiya* numbers have fallen by more than 80 percent.<sup>170</sup> By contrast, in the bankruptcy service area, which has been subject to relatively little institutional change, the number of *seiriya* fixers has varied little or perhaps has even increased.<sup>171</sup> Our regression analysis attempts to quantify these relationships more precisely.

### 3. Methodology.

We constructed a model to examine correlations between the variables selected. Because of the time-series nature of our data, we transformed our variables to mitigate common statistical problems.<sup>172</sup>

<sup>169</sup> See text accompanying note 68.

<sup>170</sup> See text accompanying note 135.

<sup>171</sup> See note 117.

<sup>172</sup> Common problems in regressions using time series data are heteroskedasticity, serial correlation, and multicollinearity. Heteroskedasticity occurs when the error terms of the data do not have constant variance. To produce uniform variability in the series, we took the natural logarithm of each variable. See, for example, Peter Kennedy, *A Guide to Econometrics* 116–21 (MIT 4th ed 1998) (discussing tests for determining whether heteroskedasticity exists); Michael O. Finkelstein and Bruce Levin, *Statistics for Lawyers* 437–42 (Springer-Verlag 1990) (“Transformations are basic mathematical tools for re-expressing relationships between variables in equivalent but possibly more illuminating terms.”). Serial correlation occurs when the values of a time-series variable are not independent and exhibit a natural sequence. To mitigate this problem, we took the first difference of each variable. See, for example, Kennedy, *A Guide to Econometrics* at 121–26 (describing various tests of serial correlation). See also Ramu Ramanathan, *Introductory Econometrics* 462 (Dryden 3d ed 1995); Finkelstein and Levin, *Statistics for Lawyers* at 24–34. We also experimented with Cochrane-Olcutt and Hildreth-Lu procedures; neither produced different results. On multicollinearity and the use of first difference as a remedy, see Ramanathan, *Introductory Economics* at 320.

To analyze the data, we start with the standard time-series regression model  $Y_t = \alpha + \beta X_t + \varepsilon_t$ , where  $Y_t$  is the endogenous variable,  $X_t$  is the exogenous variable,  $\varepsilon_t$  is the random disturbance term,  $\alpha$  and  $\beta$  are the unknown parameters, and the subscript  $t$  indicates that  $X_t$  and  $Y_t$  are a series of observations through time. By then taking the first differences and logging the variables, see Kennedy, *A Guide to Econometrics* at 115–21, the data were transformed using the equation  $\log y_t - \log y_{t-1} = \log(y_t/y_{t-1})$ . See, for example, Charles W. Ostrom, Jr., *Time Series Analysis: Regression Techniques* 18 (Sage 1978) (describing the time series regression model). A methodology similar to ours is used in Jeffrey S. Hill and Kenneth C. Williams, *The Decline of Private Bills: Resource Allocation, Credit Claiming, and the Decision to Delegate*, 37 Am J Pol Sci 1008, 1023–27 (1993), and the use of time-series data for labor market studies generally takes this form, see, for example, David Card and Alan B. Krueger, *Myth and Measurement: The Economics of the Minimum Wage* 179 (Princeton 1995) (discussing regression models including supply-side and demand-side variables and attempts to correct for serial correlation).

We experimented with several more complex models. To account for possible reciprocal relations between our supply and demand variables, we estimated several two-stage least squares (“2SLS”) models, which take the simultaneity of the variables into account. Although separating supply and demand structural equations can often alter results, see Gerald S. Oettinger, *An Empirical Analysis of the Daily Labor Supply of Stadium Vendors*, 107 J Pol Econ 360 (1999), we are skeptical of the advantages of a 2SLS model in this particular case, as our data transformations created variables that did not meet an often-cited 2SLS requirement that each supply variable must be found to have a statistically significant effect on demand. James T. McKeown, *Statistics*

Although the transformations were necessary to specify the model properly, one consequence is that we place high demands on the MEMBERS variable. The data transformation requires correlation of the *rate* of change of the variables, while our claim relates to changes in the numeric values of the variables. Still, such methodology greatly reduces many of the problems of time-series data, and statistically significant results using our strict methodology represent a very robust test of our theory.<sup>173</sup>

#### 4. Results.

The results of the multivariate regression analysis appear in Table 4. For each entry, we show the coefficients, then the absolute value of the t-statistics (conventional two-sided). Statistical significance is further indicated by the asterisks.

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*for Wage Discrimination Cases: Why the Statistical Models Used Cannot Prove or Disprove Sex Discrimination*, 67 Ind L J 633 (1992). We nevertheless estimated several 2SLS models, using various combinations of lagged and instantaneous variables as instruments. The result in each case was slightly higher coefficients and slightly lower t-scores than our ordinary least squares ("OLS") results. Because of our initial concerns about the appropriateness of 2SLS, the acknowledgement that specification of such a model "remains arbitrary to a degree," Thomas H. Wonnacott and Ronald J. Wonnacott, *Introductory Statistics for Business and Economics* 731 (Wiley 4th ed 1990), and the general recognition that OLS provides accurate results, we rely on our OLS model. We also experimented with several OLS models using lagged variables and did not obtain significantly different results.

<sup>173</sup> See Ramanathan, *Introductory Econometrics* at 320–21 (cited in note 172).

**TABLE 4**  
**DETERMINANTS OF MEMBERS OF ORGANIZED CRIMINAL FIRMS**

<i>Variable (<math>\Delta</math> logs)</i>	<i>Coefficient</i>	<i>t-stat</i>	<i>Predicted Sign</i>
BANKRUPT	-.021	-1.117	-
CIVIL	-.470	-2.804**	-
CRIME	-.289	-2.379*	?
EXTORT	.108	.977	+
GDPCAP	1.486	1.310	?
LAND	.196	1.618	?
LOANS	-.703	-4.316***	-
PROPAUCT	.401	3.394**	-
UNEMPLOY	-.091	-.832	?
Intercept	-.014	-.497	
Adjusted $R^2$	.667		
Observations	25		

NOTE: The table is based on the standard regression model  $Y_i = \alpha + \beta X_i + \varepsilon_i$ . We then take the first differences and log the variables, transforming using the equation  $\log y_i - \log y_{i-1} = \log(y/y_{i-1})$ . The dependent variable MEMBERS is the annual total number of “made” and affiliated members of organized crime firms, divided by the total annual population of Japanese males ages 20–49. The independent variables are as follows: BANKRUPT is the total annual yen amount of bankruptcies.<sup>174</sup> CIVIL is the total number of new civil cases filed in district court.<sup>175</sup> With this variable we attempt to capture a host of institutional constraints, including litigation filing fees, attorney availability, and attorneys’ fees. CRIME is the number of crimes reported to the police. EXTORT is the total number of extortion cases reported to the police. GDPCAP is the Gross Domestic Product per capita.<sup>176</sup> LAND is the average price of land in Japan’s 6 largest cities: Tokyo, Yokohama, Nagoya, Osaka, Kyoto, and Kobe.<sup>177</sup> LOANS is the value, in 100 millions of yen, of loans and discounts of major banking accounts outstanding at the end of each year.<sup>178</sup> PROPAUCT is the number of suits brought in district court to force the auction of real estate posted as collateral.<sup>179</sup> UNEMPLOY is the unemployment rate.<sup>180</sup> \*, \*\*, and \*\*\* indicate significance at the 90 percent, 95 percent, and 99 percent levels, respectively.

<sup>174</sup> Data from selected issues of *Nihon Tōkei Nenkan* [Japan Statistical Yearbook] (covering the years 1993–98). We opted for the total amount of liabilities rather than the number of bankruptcy cases so as to mitigate multicollinearity problems. See note 172.

<sup>175</sup> Data from selected issues of *Shihō Tōkei Nenpō* (Minji/Gyōsei Hen) [Annual Report of Judicial Statistics (Civil Cases)] (covering the years 1993–98).

<sup>176</sup> Data calculated from GDP and population data from selected issues of *Nihon Tōkei Nenkan* [Japan Statistical Yearbook] (covering the years 1993–98) (cited in note 174).

<sup>177</sup> Data from selected issues of *Nihon Tōkei Nenkan* [Japan Statistical Yearbook] (covering the years 1973–96), and updated with data from <<http://www.reinet.or.jp/index-e.htm>> (visited Nov 22, 1999). Because organized criminal firms tend to concentrate in large urban areas, reliance on data from the six largest cities is appropriate.

<sup>178</sup> Data from selected issues of *Nihon Tōkei Nenkan* [Japan Statistical Yearbook] (covering the years 1973–98).

<sup>179</sup> Data from selected issues of *Shihō Tōkei Nenpō* (Minji/Gyōsei Hen) [Annual Report of Judicial Statistics (Civil Cases)] (covering the years 1973–98). For the period beginning 1981, we use the data for real estate “forced executions” pursuant to the Civil Enforcement Act [Minji shikkō hō], Law no 4 of 1979 (1998). Due to a change in legal procedures, for the period prior to 1980, we use the data for auctions pursuant to the Auction Law [Keibaihō], Law no 15 of 1898.

<sup>180</sup> Data from selected issues of *Nihon Tōkei Nenkan* [Japan Statistical Yearbook] (1973–98) (cited in note 178), and updated with data from Statistics Bureau, Management and Coordination Agency, available online at <<http://www.stat.go.jp/154a.htm>> (visited Nov 22, 1999).

We first note the adjusted- $R^2$  figure, which measures the explanatory power of our model. The  $R^2$  of .667 means that our model explains nearly 67 percent of the variation in MEMBERS, a satisfying level in regression analysis, but not wholly unexpected given the size of the sample.<sup>181</sup>

As predicted, the model indeed found negative correlations for the civil cases, loans, and bankruptcy variables, although the bankruptcy variable was insignificant.<sup>182</sup> The statistically significant negative

<sup>181</sup> Our model also successfully mitigated the potential problems of heteroskedasticity, serial correlation, and multicollinearity discussed in note 172. We checked for heteroskedasticity using three methods. First, we examined the residuals from our regressions. Plots of the residuals against each of the independent variables did not exhibit obvious heteroskedasticity. Second, we conducted Goldfeld-Quandt tests in which we divided the sample of observations into three parts, discarded the middle part, estimated the model for each of the other two sets of observations, and used an F-test to test for the equality of the variances. See Kennedy, *A Guide to Econometrics* at 120 (cited in note 172) (discussing the Goldfeld-Quandt test); Ramanathan, *Introductory Economics* at 420–21 (cited in note 172). This test failed to reject the null hypothesis of homoskedasticity. Finally, we indirectly checked for heteroskedasticity by analyzing a weighted least squares model in place of our transformed ordinary least squares model, but obtained virtually identical results. The results of a standard Durbin-Watson test (1.973), see Kennedy, *A Guide to Econometrics* at 123–24 (cited in note 172), also cause us to accept the null hypothesis that no serial correlation was present. We also ran a model that included the year as a trend variable (DATE) to control for spurious correlation. The results differed only slightly:  $R^2 = .584$ , BANKRUPT  $\beta = -.002$ ,  $t = -.985$ , CIVIL  $\beta = -.468$ ,  $t = 2.439$ , CRIME  $\beta = -.290$ ,  $t = -2.125$ , DATE  $\beta = -.001$ ,  $t = -.050$ , EXTORT  $\beta = .113$ ,  $t = .730$ , GDPCAP  $\beta = 1.462$ ,  $t = 1.075$ , LAND  $\beta = .205$ ,  $t = .902$ , LOANS  $\beta = -.702$ ,  $t = -3.838$ , PROPAUCT  $\beta = .404$ ,  $t = 2.832$ , UNEMPLOY  $\beta = -.009$ ,  $t = -.724$ , Intercept  $\beta = -.342$ ,  $t = -.052$ . Because no analysis of any two independent variables yielded statistically significant correlations, we conclude that our methodology also was successful in mitigating multicollinearity.

Researchers often exclude the constant (intercept) term if it is insignificant, even though “the practice is discouraged because it may lead to model misspecification.” Ramanathan, *Introductory Economics* at 170–71 (cited in note 172). When we did so, the statistical significance of each of the remaining variables, not surprisingly, improved: LOANS was significant at the 99 percent confidence level, CIVIL, CRIME, LAND and PROPAUCT were significant at the 95 percent confidence level, and GDPCAP was significant at the 90 percent confidence level. The  $R^2$  of the model was .780, but this measure is not directly comparable to the above model.

<sup>182</sup> The variable that we expected to be positively correlated, EXTORT, was positive but not significant. Extortion clearly is a major line of business; our results simply add weight to the crime statistics. Importantly, the extortion conducted by organized criminal firms appears to be not simply deadweight loss extortion in the form of shakedowns of shopkeepers, but “entrepreneurial” extortion. The NPA keeps figures for the number of requests to police and related institutions for counseling related to what it calls “violent intervention in civil affairs” (*minji kainy bōryoku*, often shortened to *minbō*). These requests are related to eight types of intervention: bill collection, loans, bill discounts and other bill-related disputes, bankruptcy, housing rentals and other real estate disputes, out-of-court settlement of traffic accidents, “daily life matters” including “trade,” and “other.”

We did not include this variable in our regression analysis because data are available only from the period beginning in 1980 (at an average of 20,853 cases per year). But to examine the relationships between MEMBERS and “civil intervention” extortion (CIVXTORT), we reran the above regression model using the available data and adding CIVXTORT. The explanatory power of our model ( $R^2$ ) was .753, and the correlation between CIVXTORT and MEMBERS—

correlation between MEMBERS and the civil cases variable is strong support for the theory that organized criminal firms substitute for state-sponsored dispute mediation mechanisms.<sup>183</sup> Similarly, the significant negative correlation between loans issued and MEMBERS indicates that firms' loan sharking business competes directly with loans issued by governmentally licensed and regulated banks.<sup>184</sup> The data clearly suggest a tradeoff between resort to state institutions and the success of organized criminal firms, as measured by membership.

We offer one further note on the findings related to the loans variable. Had the relationship between loans issued and MEMBERS been positive, it might have indicated that loans went to organized criminal firms. That it was not is an indication that although some loans might, as the anecdotes and estimates suggest, be going to organized criminal firms,<sup>185</sup> those loans in fact are going to a small subset of the largest, most sophisticated criminal firms. To test for this, we checked the correlation between the membership rates (members divided by the number of 20- to 49-year-old males) of the three biggest firms—the Yamaguchi-gumi, Inagawa-kai, and the Sumiyoshi-kai—and the loans variable.<sup>186</sup> In fact, the relationship with the loans variable was significantly *positive* ( $r = .94$ ,  $t = 4.96$ ,  $p = .000$ <sup>187</sup>), an indication that although the issuance of loans by banks may, on average, negatively affect firms by competing with them for loan-sharking business, the largest firms may profit from loans quite directly if they are borrowers and not lenders.

The property auction variable, which we predicted would be negatively correlated to MEMBERS, was in fact positively correlated. We interpret this unexpected result as an indication that auctions of

though not statistically significant—was nevertheless more strongly positive than that of the correlation between MEMBERS and EXTORT (for EXTORT,  $\beta = .004$ ,  $t = .404$ ; for CIVXTORT,  $\beta = .853$ ,  $t = .609$ ), but in this case causation is particularly unclear.

<sup>183</sup> Ideally, of course, we would prefer to have complete data on the total number of disputes. See, for example, George L. Priest and Benjamin Klein, *The Selection of Disputes for Litigation*, 13 *J Legal Stud* 1, 30 (1984) (cautioning against assuming that an empirical study conclusively supports the preferred hypothesis because of an inability to obtain definitive measures of important variables).

<sup>184</sup> Compare Richard B. Miller, *The Impingement of Loansharking on the Banking Industry*, in Kaplan and Kessler, eds, *An Economic Analysis of Crime* at 198 (cited in note 137) (describing loan sharks in the U.S. and evidence of their links with banks).

<sup>185</sup> Holley, *Japan Mob Muddies Real Estate Loan Crisis*, *LA Times* at A1 (cited in note 122) (quoting Japan Bar Association representative: “[I]f the banks cave in and write off their losses, abandoning the properties, clear title on 50% to 80% of assets put up as collateral for bad loans will pass to corporations controlled or influenced by yakuza”); Emiko Terazono, *Japan's Loans: The Bad and the Ugly*, *Financial Times* 8 (Dec 12, 1995) (noting the high percentage of loans linked to organized crime). See note 167.

<sup>186</sup> Our data for this variable begin in 1979.

<sup>187</sup> Correlations of untransformed variables.

property are different from ordinary civil suits. Unlike ordinary civil suits (which are significantly negatively correlated to MEMBERS), if a lender chooses to utilize state-provided services, an organized criminal firm can *still* profit by rigging auctions and purchasing foreclosed properties at discounts, or by otherwise disrupting the auction.<sup>188</sup> Simply put, the more property auctions, the more opportunity that exists for organized criminal firms to extort money from the participants. We also note that the property auction variable is not merely a proxy for economic downturn or increased bankruptcies, as the inclusion of the GDP per capita and bankruptcy variables in our regression holds such effects constant.<sup>189</sup>

The crime variable, about which we were unable to form an a priori hypothesis, was significantly negative. Although this relationship may be indicative of reporting trends (victims may be less likely to report crime committed by organized criminal firms), given the relative stability of organized crime statistics, we are inclined to attribute the correlation to the symbiotic relationship between organized crime and the police in Japan. Perhaps police allow firms greater freedom of activity, which leads to more members, when unorganized crime is low.<sup>190</sup> Conversely, when firms do not control unorganized crime, police lack incentives to continue the symbiotic relationship, and tighten enforcement efforts.<sup>191</sup>

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<sup>188</sup> See Hinago, *Urakeizai Pakuri no Teguchi 99* at 30–31 (cited in note 114) (activities of auction operators termed *keibaiya*); *Survey*, Daily Yomiuri at 1 (cited in note 167) (49 of 116 cases of disrupted collection of nonperforming loans involved disruption of land auction proceedings).

<sup>189</sup> On the relationship between crime and the business cycle, see, for example, Antonello E. Scorcù and Roberto Cellini, *Economic Activity and Crime in the Long Run: An Empirical Investigation on Aggregate Data From Italy, 1951–1994*, 18 Intl Rev L & Econ 279 (1998); Dick, 15 Intl Rev L & Econ at 36 (cited in note 27) (theorizing that organized criminal activity increases during periods of recession in the general economy); Philip J. Cook and Gary A. Zarkin, *Crime and the Business Cycle*, 14 J Legal Stud 115 (1985).

<sup>190</sup> Low levels of crime may be attributable to enforcement by organized criminal firms. For example, organized criminal firms “actively cooperate[ ] with the police to keep foreign drugs out, thus protecting [their] own business and keeping Japan’s drug problem manageable.” Katzenstein, *Cultural Norms and National Security* at 67 (cited in note 161). See also Seiji Iishiba, *Soshiki Hanzai Taisaku Manyuaru: Henbōsuru Bōryokudan ni Ikani Taishōsuru Ka [Anti-Organized Crime Manual: How to Deal with Changing Gangs]* 104 (Yuhikaku 1990) (discussing how yakuza firms increase revenues and membership).

<sup>191</sup> See Ramseyer and Nakazato, *Japanese Law* at 182–83 (cited in note 37) (describing the symbiotic relationship in which police reduce violence by refraining from attacking senior criminal syndicate members). It could be that firms control the reporting of crime, and not simply crime. But because most crime in Japan is larceny, a crime in which firm members do not ordinarily engage, members would have little incentive to ask larceny victims to refrain from reporting such crimes. They might reduce reporting through vigilante captures of the suspects, but this, too, seems less likely than the assumption that firms control crime through control of turf. Still, we do not eliminate altogether the possibility that reporting could decrease as a reciprocal show of goodwill between community and firm. For an example of this relationship in another setting, see Sudhir Alladi Venkatesh, *The Social Organization of Street Gang Activity in an Urban*

The correlation of MEMBERS to our three supply-side variables, the unemployment rate, GDP per capita, and land prices, was statistically insignificant, indicating that firm membership is not influenced as much by the supply of personnel or macroeconomic conditions as by the demand-side factors discussed above.<sup>192</sup> Members do not appear to join organized criminal firms simply because there are no other “legitimate” employment options. Nor does firm membership increase solely as a result of macroeconomic growth.

Finally, to test whether our results might simply be a reflection of factors that affect all firms in the Japanese economy, we constructed a new model in which we regressed a new dependent variable, the annual number of employees of Japan’s six largest trading houses, on the same independent variables.<sup>193</sup> Trading houses, which have no equivalent in the United States, provide a rough legal counterpart to organized criminal firms in the sense that they are largely involved in the service industry and specialize as intermediaries between commercial parties.<sup>194</sup> The total number of employees of these organizations—40,000 to 50,000 for each year—is also directly comparable with MEMBERS. The new regression model produced an adjusted  $R^2$  of only .180, and not one of the independent variables was statistically significant. While the comparison is not perfect,<sup>195</sup> the results suggest that our primary model captures factors that are specific to the success of *organized criminal* firms, and not firms as a whole.

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*Ghetto*, 103 Am J Soc 82, 97 (1997) (noting “strong symbolic ties between gangs and (non-gang-affiliated) residents” based on “channel[ing] [of] revenues from drug economies to residents who lacked financial resources or who were simply willing to remain silent in police investigations”).

<sup>192</sup> The specification of MEMBERS as membership rates creates a fourth supply-side variable: population of males ages 20–49. Results did not differ significantly when we substituted MEMBERS with the raw membership data, not accounting for population shifts. As Figure 1 suggests, the number of members tracks membership rates. A model based on raw membership figures yielded an  $R^2$  of .560. LOANS remained significant at the 99 percent confidence level, PROPAUCT remained significant at the 95 percent confidence level, CRIME fell to the 90 percent confidence level, and CIVIL climbed to the 95 percent confidence level.

<sup>193</sup> Itochu, Marubeni, Mitsubishi, Mitsui, Nissho Iwai, and Sumitomo. All data from *Nihon Keizai Shinbunsha, Kaisha Nenkan [Company Annual]* (covering the years 1973–98). Dividing the number of employees by either the total number of males 20–49 or the total population 20–49 did not produce significantly different results. We tried both measures because the older employees are dominantly males, while newer classes are nearly 50 percent female.

<sup>194</sup> See M.Y. Yoshino and Thomas B. Lifson, *The Invisible Link: Japan’s Sogo Shosha and the Organization of Trade* 2–8 (MIT 1986) (discussing the business purpose and structure of Japan’s trading houses).

<sup>195</sup> Our data for trading firms begin only in 1982, and employment practices may differ. See id at 137–38 (discussing “career-long commitment” as well as “circumstances in which core staff members permanently lose their jobs” in trading companies). Similarly insignificant results came from a variety of lag models.



Regression analysis, of course, indicates correlations but cannot prove causation. It is thus possible (though the data suggest otherwise<sup>196</sup>) that causation is reversed: instead of crime, litigation, and lending affecting membership rates, it could be that membership rates are actually driving the rates of crime, litigation and lending. While the first such causal link is plausible, we actually find it unlikely that organized criminal firm membership drives crime levels, because almost 90 percent of Japanese crime is larceny, a crime that members rarely commit,<sup>197</sup> and because the inclusion of the extortion variable holds constant one major type of firm-dominated crime.<sup>198</sup> We find the reverse causal relationship of membership on litigation and lending to be even more implausible, as modest changes in membership are unlikely to change overall litigation and bank lending patterns. Still, even assuming that our model reverses some of the actual causal linkages at work, the findings of negative *correlations* nevertheless support our hypothesis that state enforcement and enforcement by organized crime are substitutes.

### C. Additional Regression Analysis of Law Enforcement Measures

The above analysis does not include one final element that may affect firm success: enforcement of anti-firm measures by the police. We did not include this factor because for each of the variables serving as a proxy for law enforcement efforts, we did not have a complete time-series database, or the variable violated the assumptions of the multiple regression model. In this section we separately analyze those variables.<sup>199</sup> Table 5 displays the results of the separate bivariate regressions.

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<sup>196</sup> In addition to the causal arguments discussed in Part III.B.4, we find further evidence in comparing bivariate regressions on lag MEMBERS, and lead MEMBERS. In the lag model in which we measure the correlations of MEMBERS in year t with other variables in year t+1, only half of the eight coefficients showed the same sign as the unlagged model, and none were statistically significant, a result that implies that MEMBERS is not driving the other variables. But in the lead model in which we measure the correlation of MEMBERS in year t+1 with other variables in year t, only one coefficient sign differed, and two variables (CIVIL and CRIME) maintained statistical significance, a result that implies that the independent variables continue to cause an effect on MEMBERS even after one year. Of course, it is also possible that both dependent and independent variables bear a causal relation to a third, unexamined variable.

<sup>197</sup> See note 153.

<sup>198</sup> See Table 2.

<sup>199</sup> Because of the simple bivariate nature of this analysis and the sparsity of data points, we used untransformed variables, which yield results that are not as robust as those of the multivariate regression. Taking the first difference of each variable yielded identical signs and similar measures of significance.

**TABLE 5**  
**BIVARIATE LINEAR REGRESSIONS OF MEMBERS ON LAW**  
**ENFORCEMENT VARIABLES**

<i>Independent Variable</i>	<i>Coefficient</i>	<i>t-stat</i>	<i>r</i>	<i>p-value</i>
Total Arrest Rate (1972–1997)	0.003	2.88	.26	.008
Arrest Rate of Made Members (1983–1997)	0.003	3.46	.69	.008
Anti-Organized Crime Act Injunctions (1992–1997)	-0.11	-5.407	.93	.005

1. Arrest rates.

Surprisingly, MEMBERS is positively and significantly correlated to the firm member arrest rate (the total number of organized criminal firm arrestees divided by MEMBERS) and the made member arrest rate (the total number of made member arrestees divided by the total number of made members). Several explanations are possible. The correlation may be the result of community crackdown (police must arrest a greater percentage of members as organizations grow larger and more visible), a replacement phenomenon (perhaps more than one new member is needed to replace each jailed experienced member),<sup>200</sup> or even a data-gathering quirk, as new members might replace members who are in prison, while prisoner-members remain on the firms' membership lists.

We also found a significantly positive correlation using a lagged MEMBERS variable ( $\beta = .003$ ,  $r = .40$ ,  $t = 2.09$ ,  $p = .047$ ). We attribute this correlation to a form of iatrogenic effects: arrests in one year lead to an increase in organized crime members in the subsequent year due to the signaling effect that arrests have on risk- and status-seeking potential members.<sup>201</sup>

<sup>200</sup> We note, however, that the number of imprisoned organized criminal firm members, both in raw numbers and as a percentage of total imprisonments, has decreased steadily since the mid-1980s. Elmer H. Johnson, *Criminalization and Prisoners in Japan: Six Contrary Cohorts* 47–51 (Southern Illinois 1997).

<sup>201</sup> For criminology research showing iatrogenic effects of criminal sanctions, see Jeffrey Fagan, *Juvenile Justice Policy and Law: Applying Recent Social Science Findings to Policy and Legislative Advocacy*, 183 *PLI/Crim* 395 n 31 (1999) (listing studies demonstrating higher rates of recidivism among arrestees). We also checked for correlation on a lagged MEMBERS against the other variables: Arrest Rate of Made Members  $\beta = .001$ ,  $r = .078$ ,  $t = .157$ ,  $p = .88$ ; Arrest Rate 3 Largest  $\beta = -.000$ ,  $r = .197$ ,  $t = -.410$ ,  $p = .68$ ; Injunctions  $\beta = -.000$ ,  $r = .86$ ,  $t = -2.92$ ,  $p = .05$ . We also found a positive though insignificant correlation between MEMBERS and arrests of "made" members (senior members; data from 1991–97). We found a negative though insignificant correlation between MEMBERS and arrests of members of the three largest firms (data from 1980–97).

## 2. Anti-Organized Crime Act enforcement.

Pursuant to the Anti-Organized Crime Act, police may issue injunctions to firms that are designated under that law.<sup>202</sup> We have such data only for the six-year period beginning with the Act's 1992 effective date. For that limited period, we found a highly significant negative correlation between such orders and membership in organized criminal firms. We guardedly conclude from these limited data that enforcement of the Act has negatively affected the success of organized criminal firms.

## IV. IMPLICATIONS

The theory on the entrepreneurial origins of organized crime, supported by the empirical evidence developed above, has two closely related implications. First, treating organized crime as *crime* may be a relatively ineffective approach to the problem. Second, state ordering is fundamentally important to private ordering; organized crime flourishes where property rights and enforcement institutions are misaligned.

### A. Law Enforcement Efforts

Our data suggest that targeting members of organized criminal firms for traditional law enforcement efforts may be ineffective and possibly even counterproductive.<sup>203</sup> At least in Japan, the cohesion and appeal of gang life appears to be *enhanced*, rather than diminished, by criminal prosecution.<sup>204</sup> The approach taken under the new Japanese Anti-Organized Crime Act is to address organized crime in quasi-regulatory rather than traditional law enforcement terms. The Act, which authorizes the issuance of injunctions against specific entrepreneurial activities central to the success of Japanese organized criminal

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<sup>202</sup> See text accompanying notes 145–49.

<sup>203</sup> It is possible that this finding is limited to Japan, but we believe it has broader applicability. Many observers feel that organized crime in the U.S. has decreased in the last fifty years. If true, the decline could be the result of increased law enforcement efforts, as some commentators plausibly assert. Indeed, U.S. law enforcement authorities appear to be much more aggressive than their Japanese counterparts in using advanced surveillance methods against organized crime. However, the decline could also reflect a change in the social status of ethnic groups traditionally involved in organized crime, or result from an industry shift from one type of organized criminal firm (mafia-style organizations that thrived under labor regulation and Prohibition) to another (less hierarchical urban street gangs tied to the drug trade), reflecting changes in the economy and incentives created by state institutions.

<sup>204</sup> See text accompanying note 201.

firms, appears promising on some levels and merits further study by other countries.<sup>205</sup>

## B. Reducing Organized Crime through Institutional Engineering

More important than the enforcement data is the conclusion drawn from our inquiry into the origins and role of organized crime. This Article has provided theoretical and empirical support for the claim that private ordering by organized criminal firms is a substitute for state-provided and state-sanctioned enforcement mechanisms. As the Japanese experience illustrates, many private ordering schemes may be beneficial to social cohesion and economic growth. Private ordering in the face of misaligned state structures or inadequate numbers of rights-enforcement and information agents can, however, have a dark side where the state's traditional functions are privatized by groups that are not tethered to the legal norms and political consensus on which state authority is based. While possibly efficient on a transaction-by-transaction basis, dark-side private ordering is harmful because it helps advance undeniably criminal activities such as drugs and prostitution, while corroding the framework for legitimate rights enforcement. We believe one key to reducing organized crime, therefore, is institutional re-engineering to reduce incentives for the formation of rights-enforcement agents operating outside of state and social sanction. To understand this conclusion more concretely, it is instructive to analyze the Japanese situation in greater detail.

The dark side of private ordering emerges in Japan from three closely related factors. First, as shown in Part II, in several key areas of Japanese economic activity, the government, acting through the legislature and the courts, has failed to get the institutions "right," resulting in major transaction costs for private parties seeking to play by the state's rules.<sup>206</sup> We have surveyed obstacles to the smooth enforcement

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<sup>205</sup> Caution is required, however, before an unqualified endorsement of this approach is warranted. Many commentators have argued that the Anti-Organized Crime Act has actually accelerated the movement of criminal firms into areas of economic activity traditionally left to "legitimate" organizations. See, for example, Jordan and Sullivan, *A New Mob Mentality in Japan*, Wash Post at A1 (cited in note 97). We note as well that Japan lacks some of the enforcement tools available in other countries such as specific prohibitions against money laundering, see, for example, Kazuaki Morimoto, *Mane-Rōndaringu Kisei no Igi to Dōkō* [*Trends in and Significance of Money Laundering Regulation*], 1543 *Kin'yū Hōmu Jijō* 6, 9–10 (1999), and wiretapping, which was not legalized until August 1999, *Hanzai sōsa no tame no tsūshin bōju ni kansuru hōritsu* [Law Concerning Wiretapping for Criminal Investigations], Law No 137 of 1999 (1999).

<sup>206</sup> Compare James C. Scott, *Seeing Like a State: How Certain Schemes to Improve the Human Condition Have Failed* (Yale 1998) (documenting rise of informal practices that arise in response to "wrong" institutions in broad range of contexts, including Soviet collectivized agriculture and Brazilian city planning).

of contracts, resolution of disputes, and financing of firms in Japan. Some of the obstacles, such as those found in the financial markets, are the result of conscious policy decisions. Others, such as the problematic formal bankruptcy regime, appear to be largely the result of happenstance. Whatever the cause, in a number of key areas of economic and social governance, playing by the rules of the game as set by the Japanese state is a costly endeavor.

Costly institutional environments may be overcome by Coasean bargaining. Efficient private ordering, of course, is often possible through the spontaneous interactions of community members. This phenomenon is well documented in the literature, and several important examples from Japan were presented above. Indeed, Japan's economic success and social stability are virtually inexplicable without reference to bright-side private ordering. Sometimes, however, costly institutional environments cannot be overcome without the intervention of transaction cost engineers.

Second, the next step in understanding the dark side of private ordering in Japan, therefore, is the recognition that enforcing private bargains as well as state rules often requires coordination, economies of scale or scope, or large investments in human capital and information. Where the state blocks or fails to encourage the development of rights-enforcement agents to navigate complex transactional environments, organized groups operating beyond state and social norms may emerge to satisfy the unmet demand for transaction cost engineering. Thus, in Japan, inefficiencies in the background rules of the game are exacerbated by the shortage of attorneys, accountants, investment bankers, credit rating agencies, and other professional producers and analysts of information crucial to rights enforcement.

In various complex areas of Japanese economic and social governance, organized criminal firms are the only enterprises with the human and monetary capital required to provide alternatives to inefficient state mechanisms. Legitimate firms do not emerge to fill the institutional gaps for several reasons. Precisely because some of the activity is prohibited by the state, legitimate firms rarely enter the market.<sup>207</sup> More importantly, in the absence of workable legal mechanisms, enforcement requires credible threats of physical violence: state coercion must be privatized. Finally, a variety of barriers to entry, including economies of scope, relations with police, and outright intimidation of competition help organized criminal firms maintain increasing returns

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<sup>207</sup> The most obvious historical example in the United States is the domination by organized crime of alcohol markets during Prohibition that had formerly been, and subsequently became again, the province of legitimate firms.

and thwart competition from legitimate sources.<sup>208</sup> These same factors help to explain the persistence of extensive organized criminal activity in an otherwise stable, democratic, and economically advanced society such as Japan.<sup>209</sup> Thus, the stimulation of state-sanctioned rights-enforcement and information agents is a crucial aspect of organized crime eradication.<sup>210</sup>

It is instructive to note that Japanese business groups and conservative politicians have recently mounted a broad-based campaign to increase the number of attorneys and judges, reduce the scope of the monopoly of Japanese attorneys, and adopt other reforms designed to increase the availability of legal procedures and professionals.<sup>211</sup> These conservative groups, which are not a natural lobby for law reform of this type, appear to have coalesced around the issue for precisely the reason indicated by our theory: a shortage of state-sanctioned rights-enforcement and information agents seriously compromises the ability to engage in bright-side private ordering, reinforcing reliance on either the state's informal authority (bureaucratic guidance) or illicit entrepreneurs (organized criminal firms).<sup>212</sup>

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<sup>208</sup> Some of the same factors that tend to limit Japanese venture capital market activity, including labor market rigidity and capital illiquidity, may also play a role.

<sup>209</sup> The Japanese state has historically been inclined or compelled to delegate enforcement power to private agents rather than maintain a monopoly on violence. Moreover, political stability in the form of decades-long rule by a single political party contributed to inertia that blocked changes in property rights inefficiencies and created a climate in which linkages between political actors and organized criminal firms could take root.

It is interesting to note that the Anti-Organized Crime Act was passed during the early stages of political upheaval that led in 1993 to a temporary loss of power by the LDP, which had maintained a monopoly on political power since 1955. This phase of political instability was motivated in large measure by an overwhelming public sense that LDP dominance, in concert with a compliant bureaucracy, had led to an anti-competitive and corrupt business climate out of step with Japan's stature as an economic superpower. The timing of the Act's passage suggests that it emerged in response to a change in the political equilibrium.

<sup>210</sup> A similar conclusion is reached by Schelling, *Choice and Consequence* at 168 (cited in note 17).

<sup>211</sup> For a general discussion, see Setsuo Miyazawa, *The Politics of Judicial Reform in Japan*, Address Delivered at Columbia Law School (Mar 5, 1999) (outline on file with authors). See also Keidanren [Japanese Federation of Economic Organizations], *For the Promotion of Deregulation Aimed at Economic Revival and the Establishment of a Transparent System of Governmental Management: Basic Thinking* (Policy Statement) (Oct 20, 1998), available online at <<http://www.keidanren.or.jp/english/policy/po1091.html>> (visited Nov 22, 1999); The 21st Century Public Policy Institute of the Federation of Economic Organizations, *Toward the Revitalization of the Japanese Civil Justice System* (Policy Statement) (Dec 22, 1998), summary and recommendations available online at <<http://www.keidanren.or.jp/21ppi/english/policy/19981222/summary.html>> (visited Nov 22, 1999); <<http://www.keidanren.or.jp/21ppi/english/policy/19981222/recommendation.pdf>>. In July 1999, the Prime Minister's Office appointed a thirteen-member Judicial Reform Council to address such concerns. See <<http://www.kantei.go.jp/jp/shihouseido/index.html>> (visited Nov 22, 1999).

<sup>212</sup> Excessive bureaucratic power itself may contribute to the growth of organized crime by increasing the potential for corruption and monopolization of industries. See Anderson, *Organ-*

Third, the prevalence of private ordering of all kinds dampens demand for greater state and state-sanctioned enforcement activity, resulting in fewer incentives to rectify the first two problems. Stated differently, Japan illustrates that states can miss out on enforcement network and learning externalities.<sup>23</sup> Laws and enforcement institutions exhibit increasing returns characteristics. Widely used laws are likely to be well serviced by lawyers and judges.<sup>24</sup> The more laws are used, the more they will lead to the development of precedents and the sophistication of legal professionals. The growth of experienced, state-sanctioned rights-enforcement and information agents, in turn, is likely to foster demand for law reform generally.

Conversely, the histories of regions as diverse as Sicily, Russia, and Japan demonstrate that when a state begins institution building with a significant gap between formal legal rights and enforcement mechanisms, it risks missing out on valuable network and learning externalities, creating ample demand for both bright-side private enforcement and dark-side gang enforcement. As one commentator puts it, "when the law has no way of enforcing contract, the underworld provides it: a man submits to the prospect of personal violence as the last resort in contract enforcement. . . . Evidently there is some part of this racket that thrives on a void in our legal and financial institutions."<sup>25</sup>

Although our general prescription is one of institution-building, some studies have found that parties may turn to privately ordered alternatives *despite* the existence of well functioning institutions.<sup>26</sup> But these findings appear to be limited to communities that encourage reliance on group-specific, reputation-based internal rules and norms—a relational structure not likely to dominate transactions between organized criminal firms and consumers of dispute resolution and debt collection services. Accordingly, we suspect that dark-side private ordering cannot effectively compete with efficient state institutions in most service areas. Nevertheless, there is no guarantee that efficient public ordering will supplant highly engrained dark-side private or-

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*ized Crime* at 37 (cited in note 27).

<sup>23</sup> Network externalities are simply the increasing returns nature of products whose value increases with the number of consumers of that product. See, for example, Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 Colum L Rev 1908, 1911, 1923–24 (1998) (describing telephones and cars as paradigm examples of network externalities); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 Va L Rev 757, 772–85 (1995) (discussing network externalities in product markets and corporate contracts).

<sup>24</sup> Kamar, 98 Colum L Rev at 1923–24 (cited in note 213).

<sup>25</sup> Schelling, *Choice and Consequence* at 168 (cited in note 17).

<sup>26</sup> See Bernstein, 21 J Legal Stud at 115–16 (cited in note 6) (discussing practices of diamond merchants).

dering. The point, then, is not to convert private ordering into public ordering, but to set state incentives so that entrepreneurialism is channeled into outlets that reinforce rather than erode legal and social norms.<sup>217</sup>

Institution building, of course, is much easier to prescribe than to accomplish. Despite a state's best efforts at institutional re-engineering, a residual of organized crime may exist in most societies. This is due in large measure to the impossibility of creating frictionless enforcement mechanisms.<sup>218</sup> Some organized crime may even be socially and economically desirable, if the alternative is disorganized crime and dysfunctional state ordering. Indeed, in societies like post-communist Russia, organized crime may be one of the few alternatives to chaos.<sup>219</sup> Thus, the complete eradication of organized crime, at least in the short term, is not a realistic goal for transitional states. Rather, our analysis suggests that transitional states should concentrate their efforts on creating viable financial intermediaries, workable structures for dispute resolution and debt collection, and an adequate supply of state-sanctioned rights-enforcement agents, including, most importantly, a highly trained legal profession. In so doing, they will encourage enforcement network and learning externalities and reduce incentives for the organization of criminal firms.

## CONCLUSION

In this Article, we have established theoretically and empirically a linkage between state institutions and organized crime. Inefficiencies in state property rights structures and a shortage of state-sanctioned rights-enforcement agents are a recipe for illicit entrepreneurialism. As the data from Japan strongly indicate, private ordering in defective formal environments can have a dark side.

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<sup>217</sup> See William J. Baumol, *Entrepreneurship: Productive, Unproductive, and Destructive*, 98 J Pol Econ 893 (1990) (stating that the productive contribution of a society's entrepreneurial activities is determined by the allocation of entrepreneurs among productive activities, such as innovation, and unproductive activities, such as rent-seeking and organized crime).

<sup>218</sup> Douglass C. North, *Institutions, Institutional Change and Economic Performance* 91 (Cambridge 1990) ("Although a wholesale change in the formal rules may take place, at the same time there will be many informal constraints that have great survival tenacity because they still resolve basic exchange problems among the participants, be they social, political, or economic.").

<sup>219</sup> See James A. Leitzel, *Crime and the Political Economy of Russian Reform* 13 (1996), available online at <<http://papers.ssrn.com>> (visited Oct 26, 1999) (unpublished manuscript). But see Katherine Hendly, et al, *Law Works in Russia: The Role of Legal Institutions in the Transactions of Russian Enterprises* 17 (Mar 31, 1999) (unpublished manuscript on file with authors) (challenging the "common wisdom" that private enforcement by the mafia is crucial to the survival of Russian enterprises in the absence of a workable legal system).



To understand organized crime, scholars should shift their attention from defining the phenomenon to distinguishing between its prosaic criminal components and its entrepreneurial enforcement characteristics. To combat organized crime, governments might be well advised to direct their resources not at crime control per se, but at creating, or facilitating, proper property-rights-enforcement institutions. Such a strategy may not completely eliminate organized crime. In the absence of such an approach, however, organized crime will continue to flourish.

**APPENDIX**  
**SAMPLE STATISTICS**

	Mean	Standard Deviation	Minimum	Median	Maximum	Mean 1st Difference
<i>Background Variables</i>						
# of Members	96,485	12,388	79,300	93,712	123,044	
Males 20-49	26,740,115	532,592	25,179,000	26,709,500	27,647,000	
<i>Regression Variables</i>						
MEMBERS	.00367	.00053	.00289	.00351	.00489	-.00008
BANKRUPT	39,910	32,018	4,978	26,383	140,447	5,419
CIVIL	642,786	166,000	379,387	631,727	958,931	22,175
CRIME	1,528,054	221,778	1,190,549	1,579,683	1,899,564	27,041
EXTORT	11,667	1,753	8,873	11,572	16,053	-149
GDPCAP	29.05	6.29	20.28	28.06	38.74	.713
LAND	43.18	26.59	13.20	32.45	103	1.268
LOANS	2,721,167	1,651,352	615,933	2,238,245	4,930,232	172,570
PROPAUCT	35,606	14,874	10,367	36,194	56,156	1,595
UNEMPLOY	2.34	.55	1.3	2.30	3.40	.084
<i>Other Variables</i>						
Arrestees	44,605	9,339	31,257	48,110	58,750	
Arrest Rate	12,275,481	1,506,497	9,277,833	12,481,583	14,357,808	
Made member arrestees	18,178	5,229	10,746	17,028	25,499	
Made member arrest rate	.206	.051	.134	.193	.271	
Injunctions	1,070	558	241	1,189	1,737	