

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

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INTRODUCTION

Organized crime is flourishing. It flourishes in transition economies; it persists in developed nations; it thrives under globalization. More than forty percent of the Russian economy, for example, may be controlled by criminal groups.¹ In Japan, the influence of organized crime extends from prostitution to golf course development, from banking and securities to disaster relief.² In the United States, mob developments continue to make front-page headlines.³ 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.⁴

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

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¹ Louise Shelley, *Paying the Price*, THE RUSSIAN, April 1997, at 14.

² See, e.g., Henry Sender, *Mafia Capitalism: Just the Tip of the Iceberg?*, JAPAN JOURNAL at 25 (1991).

³ See, e.g., Joseph Berger, *Gotti Pleads Guilty to Rackets Charges on Eve of His Trial*, N.Y. TIMES, Apr. 5, 1999, at A1.

⁴ See ORGANIZED CRIME: A COMPILATION OF U.N. DOCUMENTS 1975-1998 (M. Cherif Bassiouni & Eduardo Vetere eds. 1999; Diane Coyle, *The Dark Side of Globalisation where the Black Economy Thrives: Diane Coyle on Why the G8 is Worried About Crime*, THE INDEPENDENT, May 14, 1998, at 24.

consensus exists even on the definition of organized crime,⁵ much less on the 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

⁵ Since 1992, the United Nations Economic and Social Council Commission on Organized Crime Prevention and Criminal Justice has struggled without success toward a definition. See M. Cherif Bassiouni & Eduardo Vetere, *Towards Understanding Organized Crime and its Transnational Manifestations*, in ORGANIZED CRIME: A COMPILATION OF U.N. DOCUMENTS 1975-1998 xxvii (M. Cherif Bassiouni & Eduardo Vetere eds. 1999). The current proposal defines organized crime as “group activities of three or more persons, with hierarchical links or personal relationships, which permit their leaders to earn profits or control territories or markets, internal or foreign, by means of violence, intimidation or corruption, both in furtherance of criminal activity and to infiltrate the legitimate economy” Proposed Convention Against Transactional Organized Crime, Appendix I to United Nations, Economic and Social Council Commission on Organized Crime Prevention and Criminal Justice, Report of Seventh Session, 21-30 April 1998, U.N. Doc. E/CN.15/1998/11 (1998).

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 (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 & JIMMIE C. STYLES, ORGANIZED CRIME: CONCEPTS AND CONTROL 21 (2d ed. 1983). Economists also have attempted to define organized crime; Thomas Schelling focuses on extortion as the primary line of business, and defines organized crime as “large-scale continuing firms with the internal organization of a large enterprise, and with a conscious effort to control the market.” Thomas C. Schelling, *Economic Analysis and Organized Crime*, in TASK FORCE REPORT: ORGANIZED CRIME (President’s Commission on Law Enforcement and Criminal Justice ed. 1971), at 114, 115. 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 POSNER, ECONOMIC ANALYSIS OF LAW 242 (4th ed. 1992). Sociologist 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 (1993).

Neither can law makers agree on a definition. The Racketeer-Influenced and Corrupt Organization Act (RICO), Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 941 (1970), the primary legal weapon against organized crime in the United States, contains no clear definition of its target. Although it initially included an amendment which would have criminalized membership in the “Mafia” or “La Cosa Nostra,” see 116 CONG. REC. 35,346 (1970) (amendment proposed by Rep. 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. See *id.* At 35,344-46; see also Gerard E. Lynch, *RICO: The Crime of Being a Criminal*, 87 COLUM. L. REV. 661 (1987), 87 COLUM. L. REV. 920, 937-945 (discussing “the enterprise offense”).

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.⁶ 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, for example, 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.⁷ 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 theoretical 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 enforcement agents and information agents.⁸ 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."⁹ When property rights and enforcement institutions are misaligned, however, these agents may emerge from sources operating inefficiently and outside the bounds of established legal and social norms. Illicit entrepreneurs, then, substitute for state-supplied or state-

⁶ See, e.g., ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* (1991); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 11 J. LEGAL STUD. 115 (1992); Robert Cooter & Janet T. Landa, *Personal Versus Impersonal Trade: The Size of Trading Groups and Contract Law*, 4 INTL. REV. L. & ECON. 15 (1984); Mark D. West, *Legal Rules and Social Norms in Japan's Secret World of Sumo*, 26 J. LEGAL STUD. 165 (1997).

⁷ See Robert D. Cooter, *Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant*, 255 U. PA. L. REV. 1643, 1678-94 (1996) ("community failures"); Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U.P.A.L.REV. 1697 (1996).

⁸ We distinguish such agents from "norm entrepreneurs," see Cass Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903, 909 (1996), actors "interested in changing social norms."

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.¹⁰ Counter-intuitively, 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. Yet unlike virtually any other country, Japan also provides a wealth of relevant but unexplored data on organized crime.¹¹ 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

⁹ See Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 255 (1984).

¹⁰ See, e.g., JOHN OWEN HALEY, *THE SPIRIT OF JAPANESE LAW* (1998).

¹¹ U.S. data on organized crime is surprisingly sparse. See, e.g., David J. Fried, *Rationalizing Criminal Forfeiture*, 79 J. CRIM. L. & CRIMINOLOGY 328, 360 & n.146 (1988)(noting “extreme scantiness and unreliability of the data available” and “extreme uncertainty of the data”). Data on U.S. street gangs vary widely as well, see, e.g.,

crime rests more on the design of state-supplied institutions than on traditional anti-crime strategies. Our empirical analysis thus supports an unambiguous normative claim: to combat organized crime most effectively, a state should alter its institutional incentive structure and introduce additional enforcement agents. At least where a state's institutional structure generates substantial incentives for dark-side private ordering, attacking organized crime *as crime* may be unsuccessful and possibly even counterproductive.

Although we rely on the Japanese experience for data, our discussion has more universal import. The state acts as an institutional designer in any economy,¹² 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 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.¹³ Importantly, each of these systems features its own brand of organized crime, reflecting the institutional environment in which it evolved.¹⁴ The

G. David Curry et al., *Gang Crime and Law Enforcement Record Keeping*, NAT'L INSTITUTE OF JUSTICE RESEARCH IN BRIEF 1 (Aug. 1994)(detailing problems in definitions, recording, and reporting of gang-related information).

¹² Masahiko Aoki, *The Japanese Firm as a System of Attributes: A Survey and a Research Agenda*, in *THE JAPANESE FIRM: THE SOURCES OF COMPETITIVE STRENGTH* 30 (Masahiko Aoki & Ronald Dore eds., 1994).

¹³ See generally Curtis J. Milhaupt, *Property Rights in Firms*, 84 VA. L. REV. 1145 (1998).

¹⁴ 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, e.g., HUMBERT S. NELLI, *THE BUSINESS OF CRIME: ITALIANS AND SYNDICATE CRIME IN THE UNITED STATES* 143-78 (1976).

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, e.g., STEPHEN HENDELMAN, *COMRADE CRIMINAL: RUSSIA'S NEW MAFIYA* (1995). In post-Soviet Russia, organized crime filled the vacuum created by the disintegration of state control. 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

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.¹⁵

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 briefly 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

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.

¹⁵ 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 with weak government, which leads to public corruption rather than to privately organized crime. See Andrei Shleifer & Robert W. Vishny, *Corruption*, 108 Q. J. ECON. 599 (1993).

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.”¹⁶ 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.¹⁷ 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 restrictions.¹⁸ The primary means for achieving success, economists hold, is extortion.¹⁹

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,”²⁰ and, more generally, that organized criminal firms arise in societies characterized by a lack of trust.²¹ Thus, for example, the rise in organized crime in Eastern

¹⁶ Peter Reuter, *Research in American Organized Crime*, in HANDBOOK OF ORGANIZED CRIME 91, 110 (Robert J. Kelly et al., eds. 1994).

¹⁷ THOMAS SCHELLING, CHOICE AND CONSEQUENCE 162 (1984).

¹⁸ See JOHN E. KWOKA, JR. & LAWRENCE J. WHITE, THE ANTITRUST REVOLUTION: ECONOMICS, COMPETITION, AND POLICY (3d ed. 1999).

¹⁹ See SCHELLING, *supra* note 17.

²⁰ GAMBETTA, *supra* note 5, at 17.

²¹ GAMBETTA, *supra* note 5, at 77; see also Diego Gambetta, *Mafia: The Price of Distrust*, in TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS (Diego Gambetta ed. 1988).

Europe and Russia is explained as an outgrowth of Communism, which is said to have systematically destroyed trust in government.²²

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.²³ Cross-country empirical analyses of trust confirm that characterization and generally cast doubt on the utility of mistrust as a key explanatory variable in the origins of organized crime.²⁴

²² See, e.g., Federico Varese, *Is Sicily the Future of Russia? Private Protection and the Rise of the Russian Mafia*, 35 ARCHIVES EUROPEENNES DE SOCIOLOGIE 225 (1994).

²³ See, e.g., FRANCIS FUKUYAMA, TRUST (1995); see generally JAMES COLEMAN, FOUNDATIONS OF SOCIAL THEORY (1990)(social capital determines performance of societal institutions); ROBERT PUTNAM, MAKING DEMOCRACY WORK (1993)(same, focusing on differences between Northern and Southern Italy); Rafael La Porta et al., *Trust in Large Organizations*, 87 AM. ECON. ASSOC. PAPERS & PROCEEDINGS 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").

²⁴ See, e.g., World Values Study Group, World Values Survey, 1981-1984 and 1990-1993 (ICPSR 6160)(1994) (computer database 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% of Japanese respondents answered that "you can't be too careful," compared with 47.4% in the U.S., a mere 30.6% in Sweden, and relatively high 58.0%, 60.2%, and 61.9% 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 with that of the U.S.

A recent study of World Values Survey data for 23 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. 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 & Philip Keefer, *Does*

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.²⁵ Even more interestingly, he argues that rather than being a monopoly, organized crime competes with the state to provide this service.

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.²⁶ Second, it implicitly suggests that the state's 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.²⁷ Finally, the stylized histories of regions as diverse as post-feudal Sicily and post-Soviet Russia, which

Social Capital Have an Economic Payoff? A Cross-Country Examination, 114 Q. J. ECON. 1251, 1256-63 (1997); 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, but noting differences between natural trust ("lovers' commitment") and strategic trust to reduce transaction costs ("yakuza commitment").

²⁵ GAMBETTA, *supra* note 5. See Barbara Alexander, *The Rational Racketeer: Pasta Protection in Depression Era Chicago*, 40 J. L. & Econ. 175 (1997).

²⁶ In two influential articles, Thomas Schelling proposed that market structures and economic principles generally applicable to all forms of organization lead to illegal markets controlled by "organized criminal firms." Thomas C. Schelling, *What is the Business of Organized Crime?*, 20 J. PUB. L. 71 (1971); Thomas C. Schelling, *Economics and the Criminal Enterprise*, 7 PUBLIC INTEREST 61 (1967), both in SCHELLING, *supra* note 17. 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 THE ECONOMICS OF ORGANIZED CRIME 33, 42-7 (Gianluca Fiorentini & Sam Peltzman eds. 1995); Andrew R. Dick, *When Does Organized Crime Pay? A Transaction Cost Analysis*, 15 INT'L REV. L. & ECON. 25 (1995).

²⁷ See, e.g., Friedrich Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 527 (1945).

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. Even the U.S. experience with organized crime suggests a linkage between ineffective or ill-advised state structures and organized criminal activities.²⁸

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.²⁹ 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.³⁰ The Japanese transition out of feudalism left a void for private transaction-makers and right-enforcers that was filled by a hodgepodge of groups, which 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.

²⁸ See, e.g., Dennis Hevesi, *Study Finds New York City's Home Building Costs are Highest in Nation*, N.Y. TIMES, July 28, 1999, at A19 (reporting on study linking “arcane and byzantine” zoning and building codes with organized crime infiltration of labor unions and construction companies as significant contributing factors to New York City’s high home building costs).

²⁹ See GAMBETTA, *supra* note 5, at 76-81, 252.

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.³¹ Second the activities of organized criminal firms are often accompanied by the threat or use of violence.³² Third, as one scholar recently noted in the context of post-Soviet Russia, private and segmented enforcement of property rights can lead to the entrenchment of small-scale inefficient monopolies and high transaction costs.³³ 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* inevitably legal, because they are legitimized by the same political theory that supports the governing order generally.³⁴ Similarly, while the activities of both organized criminal groups and the state are backed by coercive 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.

³⁰ 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 (1987)(discussing property redistribution techniques such as rent determination and field allocation).

³¹ See 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 (1994).

³² See A. Mitchell Polinsky & Steven Shavell, *The Economic Theory of Public Enforcement of Law*, NBER Working Paper No. 6993, at 3 (March 1999); see also William M. Landes & Richard A. Posner, *The Private Enforcement of Law*, 4 J. LEGAL STUD. 1 (1975)(inefficiency of allocation to private actors); cf. Gary Becker & George Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, 3 J. LEGAL STUD. 1 (1974).

³³ 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).

³⁴ We are grateful to Gerard Lynch for this insight.

Thus, pervasive organized criminal involvement in private ordering 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.³⁵ A new land tax system eliminated multiple and community forms of land ownership, thereby establishing a more modern property rights regime.³⁶ The expansion of property rights led to a significant increase in enforcement-related transactions. For example, a new tax system spawned large increases in debt and mortgage foreclosures.³⁷

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.³⁸ Occupation officials forcibly disbanded the family-owned *zaibatsu* conglomerates that had dominated the economy in the early twentieth century and distributed their shares more

³⁵ RAMSEYER & NAKAZATO, *supra* note x, at 4 (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.”).

³⁶ Philip C. Brown, *‘Feudal Remnants’ and Tenant Power: The Case of Niigata, Japan, in the Nineteenth and Early Twentieth Centuries*, 15 PEASANT STUD. 5 (1987).

³⁷ See, e.g., R.P. DORE, LAND REFORM IN JAPAN 14-17 (1959)(describing the “recurrent pattern” of “indebtedness, the mortgaging of land, and eventually the transfer of ownership”); Takeo Ono, *Nōson Shi [History of Farm Villages]*, in 9 GENDAI NIHON BUNMEI SHI 47 (Tokyo Keizai Shinbunsha ed. 1941)(landowners forced into debt); EDWIN OLDFATHER REISCHAUER, JAPAN: THE STORY OF A NATION 123 (3d ed. 1981)(foreclosure of mortgages). More generally, see RANAJIT GUHA, A RULE OF PROPERTY FOR BENGAL: AN ESSAY ON THE IDEA OF PERMANENT SETTLEMENT (1963) (class upheaval results from replacement of feudal system with property rights regime).

³⁸ See generally, IV DOCUMENTS CONCERNING THE ALLIED OCCUPATION AND CONTROL OF JAPAN: COMMERCIAL AND INDUSTRIAL (compiled by Section of Special Records, Foreign Office, Japanese Government) (1949). At least one of the primary aims of land reform was the suppression of Communism. See SUPREME COMMANDER, ALLIED POWERS, GOVERNMENT SECTION, POLITICAL REORIENTATION OF JAPAN: SEPTEMBER 1945 TO SEPTEMBER 1948 780 (1949)(“there will emerge in Japan, from a field heretofore fertile to the spread of communism, a new class of small landowners”).

broadly to the public.³⁹ They revised the corporate code in a further effort to promote “shareholder democracy.”⁴⁰ To protect and enforce these new rights, they reorganized the legal profession, granted it a greater degree of independence from government oversight, and instilled its members with a mission to safeguard individual liberties.⁴¹

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,⁴² 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.⁴³

As in modern transition economies, however, private ordering to overcome property rights defects in Japan can be problematic. In this section, we analyze several areas of rights enforcement in Japan that provide fertile ground for activity by organized criminal firms. We

³⁹ See ELEANOR M. HADLEY, *ANTITRUST IN JAPAN* (1970).

⁴⁰ See Thomas L. Blakemore & Makoto Yazawa, *Japanese Commercial Code Revisions*, 2 *AM. J. COMP. L.* 12 (1953); Lester N. Salwin, *The New Commercial Code of Japan: Symbol of Gradual Progress Toward Democratic Goals*, 50 *GEO. L.J.* 478 (1962).

⁴¹ See Richard W. Rabinowitz, *The Historical Development of the Japanese Bar*, 70 *HARV. L. REV.* 61 (1956).

⁴² See Varese, *supra* note 11.

defer until the next section 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. 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 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.⁴⁴ Firms seeking to reorganize may choose from no less than four separate procedures: corporate reorganization, corporate arrangement, composition, and compulsory composition.⁴⁵ 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.⁴⁶

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

⁴³ See John O. Haley, *Administrative Guidance versus Formal Regulation: Resolving the Paradox of Industrial Policy*, in LAW AND TRADE ISSUES OF THE JAPANESE ECONOMY 107 (Gary Saxonhouse and Kozo Yamamura eds., 1986).

⁴⁴ Bankruptcy takes place under the Bankruptcy Code [Hasan hō], Law No. 71 of 1922; special liquidation (*tokubetsu seisan*) under the Commercial Code [Shōhō], arts. 431-456.

⁴⁵ Corporate reorganization takes place under the Corporate Reorganization Law, [Kaisha kosei hō], Law No. 172 of 1952; corporate arrangement (*seiri*) under the Commercial Code [Shōhō], arts. 417-430; composition under the Composition Law, [Wagi hō], Law No. 172 of 1952; and compulsory composition under the Bankruptcy Law, [Hasan hō], Law No. 71 of 1922.

⁴⁶ Patrick Shea & Kaori Miyake, *Insolvency-Related Reorganization Procedures in Japan: the Four Cornerstones*, 14 PACIFIC BASIN L.J. 243, 245 (1996).

private settlements, since court supervision is minimal.⁴⁷ The reorganization procedures are similarly unappealing.⁴⁸ For example, corporate reorganization, which is based on old Chapter X of the U.S. Bankruptcy Act, is a “rigid proceeding for large publicly held corporations and almost always entails a change of management.”⁴⁹ Corporate arrangement is unworkable when there are recalcitrant secured creditors, due to the discretionary nature of the stay of proceedings against such creditors.⁵⁰ Composition has *no* provisions to stay the enforcement of secured claims.⁵¹ Compulsory compositions are reorganization plans proposed *after* a bankruptcy adjudication, and are exceedingly rare due to the difficulty of securing agreement following the conclusion of the bankruptcy process.⁵² As a result, relatively few reorganizations of troubled firms in Japan take place within the legal system.⁵³

Why has this ineffective formal bankruptcy regime not been remedied? 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 monitoring the firm’s

⁴⁷ Frank Packer & Marc Ryser, *The Governance of Failure: An Anatomy of Corporate Bankruptcy in Japan*, Working Paper No. 62, Center on Japanese Economy and Business, Columbia University, at 11(1992).

⁴⁸ It should be noted that some commentators view favorably those attributes of Japanese bankruptcy laws that encourage private resolution of failing firms, at least in comparison to U.S. law. *See, e.g.*, Theodore Eisenberg & Shoichi Tagashira, *Should We Abolish Chapter 11? The Evidence from Japan*, 23 J. LEGAL STUD. 111, 116 (1994); *see also* Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. L. REV. 85 (1995) (arguing that private ordering is preferable to court-supervised restructuring of failing firms).

⁴⁹ Eisenberg & Tagashira, *supra* note 48, at 116.

⁵⁰ Shea & Miyake, *supra* note 46, at 245.

⁵¹ *Id.*

⁵² Eisenberg & Tagashira, *supra* note 48, at 116, n.14.

⁵³ *See* Packer & Ryser, *supra* note 47.

management and rendering assistance in case of managerial crisis or financial failure.⁵⁴ 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.⁵⁵ 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.⁵⁶ 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.⁵⁷

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 transaction” procedure, which constitutes a virtual death penalty for firms that experience it, triggers the vast majority of all business failures in Japan.

⁵⁴ See, e.g., THE JAPANESE MAIN BANK SYSTEM (Masahiko Aoki & Hugh Patrick eds., 1994).

⁵⁵ Paul Sheard, *The Main Bank System and Corporate Monitoring and Control in Japan*, 11 J. ECON. BEHAVIOR & ORG. 399, 411-12 (1989).

⁵⁶ Paul Sheard, *Main Banks and the Governance of Financial Distress*, in AOKI & PATRICK, *supra* note 54, at 188, 190 (“A main 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.”).

⁵⁷ *Id.* at 403.

As a result, firms go to great lengths to avoid dishonoring the second note, often by arranging for a main bank to sponsor its obligations.⁵⁸

2. *Debt Collection*: Japan's Lawyers' Law indirectly grants a monopoly on debt collection to licensed attorneys.⁵⁹ 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 lawyers' turf was not completely infringed; the law requires that at least one member of the board of directors of a servicer company be a licensed attorney.⁶⁰

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."⁶¹ 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 paying large sums to encourage the departure of unwanted tenants, charging large, nonrefundable fees to initiate a

⁵⁸ Packer & Ryser, *supra* note 47, at 6; Toshihiro Matsumura & Marc Ryser, *Revelation of Private Information about Unpaid Notes in the Trade Credit Bill System in Japan*, 24 J. LEGAL STUD. 165 (1995).

⁵⁹ Bengoshi hō [Attorneys Law], Law No. 205 of 1949, arts. 72-73. Only licensed attorneys may participate in court proceedings through which monetary obligations are enforced.

⁶⁰ Saiken kanri kaishōgyō ni kansuru tokubetsu sechi hō [Servicer Law], Law No. 126 of 1998, art. 5(4).

⁶¹ J. MARK RAMSEYER & MINORU NAKAZATO, *JAPANESE LAW: AN ECONOMIC APPROACH* 38 (1998). The Land and House Lease Act (Shakuchi shakuya hō, Law No. 90 of 1991) generally allows a rent increase against a tenant's wishes in three situations: when land taxes increase, when the value of the building increases, or when surrounding land prices rise. Shakuchi shakuya hō arts. 11, 32.

lease, or by simply building properties that encourage short-term tenancies.⁶² 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.⁶³ While the Japanese derivative suit mechanism is facially similar to its counterpart in U.S. state corporation laws, until recently it was virtually moribund.⁶⁴ For example, fewer than twenty actions were litigated between 1950, when the current mechanism was instituted, and 1990.⁶⁵

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

⁶² RAMSEYER & NAKAZATO, *supra* note 61, at 39-41.

⁶³ See SHOHON [Commercial Code], arts. 254(3) and 254-3 (providing for duties of managers); art. 267 (providing a mechanism for shareholders to sue on behalf of the corporation to enforce the duties).

⁶⁴ Mark D. West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 Nw. U. L. REV. 1436 (1994).

⁶⁵ *Id.* at 1438.

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.⁶⁶ In addition, a requirement that a shareholder-plaintiff post a bond as security for expenses⁶⁷ -- 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.⁶⁸

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 enforcement agents.

5. *Enforcement Agents and Dispute Intermediaries*: Lawyers, like accountants, credit rating agencies, and the press --what one commentator terms “watchdog institutions”--are crucial for self-enforcement.⁶⁹ Ronald Gilson, has shown, for example, that business lawyers in the United States create value by serving as “transaction cost engineers:” lawyers are the

⁶⁶ See, e.g., Judgment of August 11, 1992 (Asai v. Iwasaki, or the Nikko Case), Tokyo Chisai [Tokyo District Court], 797 Hanta 285 (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.

⁶⁷ SHOH [Commercial Code], art. 267(4).

⁶⁸ See Curtis J. Milhaupt, *A Relational Theory of Japanese Corporate Governance: Contract, Culture, and the Rule of Law*, 37 HARV. INT’L L.J. 3, 57 (1996).

⁶⁹ Cheryl Gray, *Reforming Legal Systems in Developing and Transition Countries*, 34 FINANCE & DEVELOPMENT 14 (1997).

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.⁷⁰ Similarly, lawyers perform a key function as reputational intermediaries in settling disputes.⁷¹ Accountants, credit rating agencies, and investment bankers perform roughly comparable roles by producing, evaluating, and certifying data in their own respective specialties.⁷²

As is widely reported, 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 three percent of the roughly 27,000 annual takers to pass.⁷³ Thus, Japan, with half the population of the United States, has approximately 16,000 licensed attorneys in comparison to their roughly 800,000 American counterparts. While this simple numerical comparison is misleading for a variety of reasons,⁷⁴ the small number of attorneys in Japan has significance in those areas such as debt collection and courtroom advocacy where Japanese law grants a monopoly to licensed attorneys.⁷⁵

⁷⁰ See Gilson, *supra* note 9, at 255.

⁷¹ See Ronald J. Gilson & Robert H. Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM. L. REV. 509 (1994).

⁷² See generally Ronald J. Mann, *Verification Institutions in Commercial Transactions*, __ GEORGETOWN L.J. __ (forthcoming 1999).

⁷³ For figures, see charts attached to Tsuguaki Hori, *Heisei kyunen seidō shihō shiken dai niji shiken no kekka ni tsuite* [Regarding the results of the 1997 system bar examination], 1132 JURISUTO 69 (1998) (showing pass rates over the 10-year period beginning 1988 ranging from 2.18% (1989 and 1990) to 3.42% (1993), with most recent 1997 figure of 2.75%).

⁷⁴ 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 84 (1995).

⁷⁵ Many litigants simply forgo attorney assistance. In 1997, in only 42% of all district court cases were both parties represented by counsel. See Saikosai Minjikyoku, *Heisei 9 nendo minji jiken no gaikyō* [1997 Summary of Civil Litigation] 50 HOSŌ JIHŌ 2667 (1998).

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.⁷⁶ The profession is not truly independent of financial regulators, and client relationships often cloud the accuracy of disclosure.⁷⁷ Similarly, for regulatory reasons, Japan has few independent domestic credit rating agencies, none of which enjoys a long history of operations.⁷⁸ Even bailiffs, the public servants in charge of enforcing civil judgments, are scarce: Japan has only 521 such officers, while England, with a population smaller than Japan, has five times that number.⁷⁹

Thus, most of the institutional inefficiencies in Japan outlined above are exacerbated by a shortage of attorneys and other professionals qualified to function as enforcement or information agents and reputational intermediaries on behalf of property right holders. Simply put, Japan has relatively few transaction cost engineers sanctioned by the state. We hypothesize that the lack of

⁷⁶ See, e.g., *Japanese Accounting*, FINANCIAL TIMES, June 4, 1998, at 20 (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., Oct. 14, 1996, at 3 (discussing accounting irregularities in the financial sector). One U.S. lawyer/stockbroker who publishes English translations of Japanese financial statements on the internet found 22 mathematical errors – remediable with a calculator – made by public companies and their auditors in 1998 alone. See www.japanfinancials.com/MISTAKE/list.htm.

⁷⁷ Lee Berton, *Japanese Accounting Bites Back*, ACCOUNTING TODAY, Nov. 9, 1998 (discussing the negative impact of Ministry of Finance ties to the Japanese accounting industry); *Japanese Accounting*, supra note 70 (reporting that close relations between auditors and their clients impugn the integrity of audited figures); cf. Melody Petersen, *Shortage of Accounting Students Raises Concern on Audit Quality*, N.Y. TIMES, Feb. 19, 1999, at A1.

⁷⁸ Japanese law has historically required that all corporate bonds be collateralized, with major 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 RES. Q. 35 (1992).

⁷⁹ See Frank G. Bennett, Jr., *Civil Execution in Japan*, 177 NAGOYA UNIV. J. L. & POL. 1 (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 (1994) (noting the lack of a single female bailiff).

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 largely political and historical reasons that have been explored exhaustively in the corporate governance literature, the Japanese financial system is bank oriented, with the stock market historically serving as a less important role in corporate finance.⁸⁰ Banks traditionally serviced large firms, which were seen as the engines of economic growth in the post-war 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.⁸¹ Accordingly, many businesses that need credit do not receive it, or do not receive it on competitive terms. Finally, bank lending in Japan is done almost exclusively on a non-recourse basis. 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.⁸² 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

⁸⁰ See, e.g., Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10 (1991).

⁸¹ Takatoshi Ito & Kazuo Ueda, *Tests of the Equilibrium Hypothesis in Disequilibrium Econometrics: An International Comparison of Credit Rationing*, 22 INTL. ECON. REV. 691 (1981); see also THOMAS F. CARGILL ET AL., *THE POLITICAL ECONOMY OF JAPANESE MONETARY POLICY* 30-31 (1997).

⁸² Little of Japan's famed high savings rate can be attributed to corporate savings – perhaps because firms that have savings capability also have borrowing capability. See FUMIO HAYASHI, *UNDERSTANDING SAVING: EVIDENCE FROM THE UNITED STATES AND JAPAN* 305-06 (1997).

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.⁸³ Many frustrated entrepreneurs therefore turn either to government-affiliated banks,⁸⁴ or as explored below, to less savory sources of funding.

Indirectly, this regulatory scheme dramatically increases the importance of land prices to economic health in Japan. Since real estate accounts for approximately sixty percent 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.

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.⁸⁵ Some observers have found “striking similarities between [Japanese] gangs and La Cosa Nostra groups in the United States.”⁸⁶ Although some of the similarity can be observed in sociological terms – “[b]oth instill a deep sense of obligation,

⁸³ 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 (1997); see also Alan L. Beller et al., *Looks Can Be Deceiving – A Comparison of Initial Public Offering Procedures under Japanese and U.S. Securities Laws*, 55 LAW & CONTEMP. PROB. 77 (Autumn 1992)(IPOs).

⁸⁴ Toshiro Horiuchi, *The Effect of Firm Status on Banking Relationships and Loan Syndication*, in AOKI & PATRICK, *supra* note 54, at 258, 266; Masahiko Aoki, *Monitoring Characteristics of the Main Bank System*, in *id.* at 109, 136 (explaining that lack of monitoring capacity of banks due to collateral requirements and prohibitions on bank underwriting stunts the development of innovative small firms).

⁸⁵ A more extensive if somewhat sensationalistic introduction is DAVID E. KAPLAN & ALEC DUBRO, *YAKUZA* (1986).

⁸⁶ Frank F.Y. Huang & Michael S. Vaughn, *A Descriptive Analysis of Japanese Organized Crime: The Boryokudan from 1945 to 1988*, 2 INT’L CRIM. JUSTICE REV. 19, 42 (1992).

empathy, devotion, and loyalty toward other group members”⁸⁷ – the underlying causes of the similarities appear to be largely historical and economic. With several interesting exceptions noted below, the basic traits of Japanese organized criminal firms – membership, trademarks, structure, activities, police relations, and enforcement -- differ little from such firms in other systems.

1. *Membership and Income.* Most new criminal firm recruits are poorly educated, single males around age twenty.⁸⁸ Nearly half have lost one or both parents, and nearly one-third come from the ranks of adolescent motorcycle gangs.⁸⁹ In her study of these gangs, anthropologist Ikuya Sato reports that firms recruit new members by “threats and flattery,” inviting prospective members to ““visit our office.””⁹⁰ She 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.⁹¹

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 7 trillion yen (\$56 billion) industry.⁹² This equates to gross revenues of approximately \$650,000 per member. We are not aware of any

⁸⁷ Id.

⁸⁸ KAPLAN & DUBRO, *supra* note 85, at 144 (citing National Police Science Research Institute study).

⁸⁹ Id.

⁹⁰ IKUYA SATO, *KAMIKAZE BIKER: PARODY AND ANOMY IN AFFLUENT JAPAN* 169 (1991).

⁹¹ Id. at 169-70.

⁹² See, e.g., Atsushi Mizoguchi, *Urashakai no Seiji Keizaigaku (The Political Economy of the Underworld)*, in *YAKUZA TO IJU IKIKATA [THE LIFE OF THE YAKUZA]* 178, 182 (Shinji Ishii ed. 1986); see also CHRISTOPHER SEYMOUR, *YAKUZA DIARY: DOING TIME IN THE JAPANESE UNDERWORLD* 18 (\$50 billion); Mary Jordan & Kevin Sullivan, *A New Mob Mentality in Japan: Families Profit by Going Mainstream*, WASH. POST, Apr. 11, 199, at A1 (“most analysts agree that the 23 major crime syndicates have a combined annual income of about \$45 billion); ATSUSHI MIZOGUCHI, *YAKUZA TO KANE [YAKUZA AND MONEY]* 13 (1992)(police estimate annual income of Yamaguchi-gumi headquarters at approximately \$13 million).

scientific basis for this figure, but it is widely cited and loosely correlates to data on specific crimes as well as legitimate activity, and is useful in drawing general comparisons.⁹³ A 1993 survey of 1,440 organized criminal firm made-member arrested suspects⁹⁴ shows that the income distribution is skewed to the top. Over 40% of the respondents reported annual income of \$30,000 to \$48,000. About 23% of the respondents reported less; 37% reported more, including 5.9% reporting income in excess of \$100,000.⁹⁵ 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.⁹⁶

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

⁹³ See Mizoguchi, *supra* note 92, at 182-86. These data have been called “a colossal underestimate.” KAREL VAN WOLFEREN, *THE ENIGMA OF JAPANESE POWER* 101 (1990). A 1990 police survey of organized criminal firm members was used to estimate the total income to 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 KENKYU [A STUDY OF ORGANIZED CRIME]* 124 (1992); KOZO TANAKA, *MINBO NO TEGUCHI [EXTORTION HANDBOOK]* 171 (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, *supra* note 92, at 184; Yukio Yamanouchi, *Yamaguchi-gumi Komon Bengoshi no Shuki [Diary of a Yamaguchi-gumi Firm Lawyer]*, *BUNGEI SHUNJU*, Nov. 1984, at 398, 400. One mob boss reports that 70% of his firm’s income comes from dealing with bad loans. See Fiona Graham, *Crime Gangs Feel the Pinch*, *FIN. TIMES*, July 14, 1998, at 6. The survey also probably overestimated amounts earned from drug trade. Mizoguchi, *supra* note x, at 184; Yamanouchi, *supra*, at 406-7. 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 *ORGANIZED CRIME: A GLOBAL PERSPECTIVE* 208, 211 (Robert J. Kelly ed. 1986)(noting that official 1979 figures place income at “nearly four times that of an average salaried person”).

⁹⁴ 959 responding!

⁹⁵ 1993 KEISATSU HAKUSHO [WHITE PAPER ON POLICE] 32 (1994).

⁹⁶ *Id.* at 28; see Edward Lazear & Sherwin Rosen, *Rank Order Tournaments as Optimum Labor Contracts*, 89 *J. POL. ECON.* 841 (1981).

population.⁹⁷ In the U.S., a 1986 study estimated 50,227 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 18,700.⁹⁸ Even taking the higher figure, members of La Cosa Nostra account for only about one of every 20,000 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."⁹⁹ 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.¹⁰⁰ If economic conditions are bad enough, organized crime firms, like more conventional firms, merge, reorganize, or dissolve.¹⁰¹

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

⁹⁷ On our data source, see *infra* text accompanying notes 150-158.

⁹⁸ PRESIDENT'S COMMISSION ON ORGANIZED CRIME, *THE IMPACT: ORGANIZED CRIME TODAY* 476, 478, 488 (1986). See also David J. Fried, *Rationalizing Criminal Forfeiture*, 79 J. CRIM. L. & CRIMINOLOGY 328, 360-61 & n.146 (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 *supra* note x, it excludes other organized criminal groups operating in the United States, such as Chinatown tongs or Columbian drug gangs.

⁹⁹ David Harold Stark, *The Yakuza: Japanese Crime Incorporated* 109 (1981)(unpublished Ph.D dissertation, University of Michigan).

¹⁰⁰ Data from selected issues of KEISATSU HAKUSHO. 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.

¹⁰¹ See, e.g., *Japanese "Yakuza" Syndicate Launches Restructuring Plan*, JAPAN ECON. NEWSWIRE, Aug. 16, 1997.

“trademarks.”¹⁰² They are easily identified on the streets of Tokyo by their dark glasses, flashy suits, glossy shoes, and punch-perm 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’?”¹⁰³ 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.¹⁰⁴

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

¹⁰² GAMBETTA, *supra* note 5, at 127-55.

¹⁰³ Jeffrey Goldberg, *The Don is Done*, N.Y. TIMES MAGAZINE, section 6, Jan. 31, 1999, at 25, 26.

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.¹⁰⁵ These activities, along with the easily recognized 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.¹⁰⁶

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 are engaged are street stalls (managed by 5,552 surveyed members), lending agencies (3,239), bars (3,129), strip clubs, spas, and Turkish baths (2,692), restaurants (2,596), and construction firms (2,171).¹⁰⁷ But they do more. They also head informal creditors' committees, settle civil disputes, and finance everything from golf courses to

¹⁰⁴ EDWARD FOWLER, *SAN'YA BLUES: LABORING LIFE IN CONTEMPORARY TOKYO* 20-21 (1996).

¹⁰⁵ See James Sterngold, *Gang in Kobe Organized Aid for People in Quake*, N.Y. TIMES, Jan. 22, 1995, at 9.; *Where the Government Fails, the Yamaguchi-gumi Succeeds*, MAINICHI DAILY NEWS, Feb. 5, 1995, at 9.

¹⁰⁶ Frank F.Y. Huang & Michael S. Vaughn, *A Descriptive Analysis of Japanese Organized Crime: The Boryokudan from 1945 to 1988*, 2 INT'L CRIM. JUSTICE REV. 19, 30 (1992); cf. U.S. structure outlined in *U.S. v. Brady*, 26 F.3d 282, 285 (2d Cir. 1994); *U.S. v. Salerno*, 868 F.2d 524 (2d Cir. 1989), and discussed in ABADINSKY, *supra* note 5, at 9-13.

¹⁰⁷ NORIKIYO HAYASHI, *SOSHIKI BORYOKU NO ICHI DANMEN [A SECTION OF ORGANIZED VIOLENCE]* 102 (1996).

resort hotels. In Japan, as in other systems, “boundaries between legitimate and illegitimate activities begin to blur.”¹⁰⁸ Police estimate that roughly half of organized criminal firm income comes from such gray-area activity.¹⁰⁹

Crucially, many of the activities of Japanese organized criminal firms track the institutional problems we identified in Part IIA. 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 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.¹¹⁰ Beginning in 1953, a class of professionals called *seiriya* (“fixers”) emerged to assist in the reorganization and liquidation processes.¹¹¹ These professionals operate outside the legal system and are closely tied to organized crime. The Japanese Bar Association in 1995 estimated that 100 *seiriya*, not including assistants and staff, offered general bankruptcy services.¹¹² Fixers can profit from distressed firms in various ways. They might offer protection

¹⁰⁸ JOHN OWEN HALEY, *AUTHORITY WITHOUT POWER: LAW AND THE JAPANESE PARADOX* 183 (1991).

¹⁰⁹ MIZOGUCHI, *supra* note 92, at 21. 34.8% is said to come from drugs, see *id.*, which is said to yield profit margins of 15,000%. AKIRA HINAGO, *URAKEIZAI PAKURAI NO TEGUCHI* 99 [HANDBOOK OF 99 UNDERGROUND ECONOMY CON ARTISTS] 120-21 (1999).

¹¹⁰ Packer & Ryser, *supra* note 47, at 26.

¹¹¹ *Id.* at 27.

¹¹² NIHON BENGOSHI RENGOKAI, *MINJI KAI'NYŌ BŌRYOKU* [VIOLENT INTERVENTION IN CIVIL AFFAIRS] 14 (rev'd ed. 1995). One prominent Japanese attorney estimates that as of the late 1970s, sixty to eighty fixer companies offered such services. Kanro Miyazaki, *Seiriya no Jittai to TaiÇsaku* [*The Reality and Enforcement of Seiriya*], 194 N.B.L. 14, 17 (1979). Some *seiriya* have extensive operations including multiple offices. See HAYASHI, *supra* note 107, at 240 (*seiriya* with 8 offices in Tokyo alone).

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.¹¹³ 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.¹¹⁴

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. 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.¹¹⁵

¹¹³ Under the Civil Enforcement Act (Minji shikko hō, Law No. 4 of 1979), a court cannot order an owner to turn over property for auction if there is a short-term occupant of the property, unless it is proven that the occupant specifically intends to obstruct the disposition process. Proving specific intent is difficult, and suing members of organized crime has its risks. See generally HINAGO, *supra* note 109, at 118-19 (noting how so-called *sumikomiya* (“live-in fixers”) often have seemingly legitimate claims of residence).

¹¹⁴ Packer & Ryser, *supra* note 47, at 27-29.

¹¹⁵ One such operator explains that only about ten 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, Mar. 30, 1997, at 11.

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 hold out problems. As one leading crime figure puts it (no doubt with some hyperbole), “without [*jiageya*,] cities wouldn’t be able to develop.”¹¹⁶ 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, organizing 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.¹¹⁷ For these services, they are said to typically charge 3% of the parcel’s sales price.¹¹⁸

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.¹¹⁹ 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.¹²⁰

¹¹⁶ David Holley, *Japan Mob Muddies Real Estate Loan Crisis*, L.A. TIMES, Feb. 24, 1996, at 1. See also Seiji Iishiba, *Nihon Shakai no KÇzÇ Henka to BÇryokudan* [*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.”).

¹¹⁷ See, e.g., Gerard Baker, *Japan’s Mafia: Troubled Times for Japan’s Financial System Mean a Lucrative Line of Business for Gangsters*, FINANCIAL TIMES, March 16, 1996, at 1.

¹¹⁸ MIZOGUCHI, *supra* note 92, at 23-4.

¹¹⁹ See Mizoguchi, *supra* note 92, at 184.

¹²⁰ See Richard Lloyd Parry, *Yakuza Settle Bad Debts with A Bullet as Japan Bubble Bursts*, THE INDEPENDENT, 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* [YAKUZA COMPANY] 119-38 (1991).

While the relative scarcity of lawyers in Japan has been much celebrated in the United States,¹²¹ 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 the illegal and even violent nature of their work.¹²² Not surprisingly, some members of organized criminal firms view themselves as “lawyers for the dark side of society” [*urashakai no bengoshi*].¹²³

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.¹²⁴ 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

¹²¹ Perhaps the most widely circulated account is Derek Bok, *A Flawed System of Law Practice and Teaching*, 33 J. LEGAL EDUC. 570 (1983).

¹²² See, e.g., Takeyoshi Kawashima, *Dispute Resolution in Contemporary Japan*, in LAW IN JAPAN: THE LEGAL ORDER IN A CHANGING SOCIETY 41, 47-48 (Arthur von Mehren ed., 1963); Kazuhiro Yonemoto, *The Shimane Bar Association: All Twenty-One Members Strong*, 25 LAW IN JAPAN 115, 121 (1995) (Daniel H. Foote, trans.).

¹²³ See, e.g., Atsushi Mizoguchi, *Urashakai no Seiji Keizaigaku (The Political Economy of the Underworld)*, in YAKUZA TO IJU IKIKATA [THE LIFE OF THE YAKUZA] 178 (Shinji Ishii ed. 1986). The organized bar has little incentive to capture more of the market share that is currently captured 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.

¹²⁴ Nichibenren, Hosh© Nado Kijun Kitei [Standard Rules Regarding Compensation], Oct. 1, 1995 (hereinafter Fee Rules).

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).¹²⁵ By comparison, a *jidanya*’s usual fee is said to be 15% of the award received minus actual medical damages,¹²⁶ in this case 3 million yen (\$24,000) minus such damages. 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, but if the estimates approximate actual costs, it is not difficult to imagine situations in which a plaintiff rationally would turn to such operators.

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.¹²⁷ As one of us has shown, *sokaiya* flourish in Japan because Japanese institutions lead to low levels of corporate disclosure. This creates material for blackmail, and forces investors to rely on substitutes (such as the length of a shareholders’

¹²⁵ For cases between 3 million and 30 million yen, the Fee Rules specify a retainer of 5% of the amount of damages requested plus 90,000 yen, plus a success fee of 10% of damages received plus 180,000 yen. Fee Rules, supra note x, article 18. For a case settled out-of-court, the base damages used for calculating fees may be reduced by up to one-third. Fee Rules, supra note 124, article 17. In this example, the plaintiff would also be required to pay court fees of 15,600 yen (\$125). Minji Soshō Hiyō Tō ni Kansuru Hōritsu [Law Concerning Civil Litigation Costs, etc.], Law No. 40 of 1971.

¹²⁶ TSUBASA AOKI, *JIDANYA SHODAN [SETTLEMENT SPECIALIST GROUPS]* 15 (1988).

¹²⁷ See Mark D. West, *Information, Institutions, and Extortion in Japan and the United States: Making Sense of Sokaiya Racketeers*, 93 NW . U.L. REV. 767 (1999).

meeting) for signals about a company's prospects.¹²⁸ 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 policies took effect.¹²⁹ Whether the *sokaiya* actually monitor management on behalf of shareholders is, of course, open to question.¹³⁰ 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.¹³¹ 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.

¹²⁸ *Id.*

¹²⁹ *Id.* at 796.

¹³⁰ *See, e.g.,* MASAHIKO AOKI, INFORMATION, INCENTIVES, AND BARGAINING IN THE JAPANESE ECONOMY 145 & n. 41 (1988)(*sokaiya* activity "prompts management to behave ethically"). The same question might be raised with regard to shareholder derivative litigation and class actions. *See, e.g.,* Roberta Romano, *The Shareholder Suit: Litigation without Foundation?*, 7 J. L. ECON. & ORG. 55 (1991); West, *supra* note 127, at 791-92. However, there is a difference between organized criminal intervention in shareholders meetings and strike suits by plaintiffs attorneys: Only the latter takes place within the confines of institutions and procedures sanctioned by the legal order.

¹³¹ Douglass C. North and Roger Leroy Miller, *The Economics of Usury Laws, in AN ECONOMIC ANALYSIS OF CRIME* 193 (Lawrence J. Kaplan & Dennis Kessler eds. 1976). 1983 legislation changed the maximum legal interest

| Table 1. Institutional Gaps and Illicit Private Ordering Entrepreneurs | | |
|---|---|--|
| Service Area | Organized Crime Service Provider | 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>SÇkaiya</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% of the Japanese public believe that Japanese organized criminals are a necessary evil. Respondents based 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.¹³²

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."¹³³ 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.¹³⁴ Stories of corrupt Japanese cops -- and indeed even bare allegations of Japanese police corruption -- are seldom heard.¹³⁵ Instead, the relationship is better described as symbiotic. Again Ramseyer and Nakazato are instructive:

rate from 109.5% to 73% annually, and further reduced it to 54% in 1986. See Yoko Shibata, *Fresh Curbs on Loan Sharks Fail to Satisfy*, FIN. TIMES, Sept. 19, 1983, at 10.

¹³² *Twelve Percent of Japanese Consider Mobsters a "Necessary Evil"*, AGENCE FRANCE PRESSE, April 19, 1993.

¹³³ See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 243 (4th ed. 1992).

¹³⁴ SUSAN ROSE-ACKERMAN, *CORRUPTION: A STUDY IN POLITICAL ECONOMY* (1978).

¹³⁵ DAVID H. BAYLEY, *FORCES OF ORDER: POLICING MODERN JAPAN* 4 (1991 (reporting 15 dismissals in 1988, only five on corruption grounds, for 220,000 police officers in Japan, compared with 55 dismissals in the New York City police department, which has 26,000 officers, and noting that the press and the public "tend to dismiss corruption" and "think it is minor").

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 urban street gangs in the United States.¹³⁶

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.¹³⁷ Several major scandals, including 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 crime firms, exemplify this relationship.¹³⁸

In 1991, the National Police Agency sponsored the Anti-Organized Crime Act, which was designed to get tough on organized criminal firms.¹³⁹ Pursuant to the Act, prefectural public safety commissions, in consultation with the National Public Safety Commission,¹⁴⁰ have the power to name organized criminal groups as “designated firms.”¹⁴¹ Members of “designated firms” are prohibited from conducting fifteen types of extortionist acts such as demanding

¹³⁶ RAMSEYER & NAKAZATO. *supra* note 61, at 182 (1998); *see also* MATOSHI KAMATA, *NIHON NO CHIKA TEIKOKU [THE JAPANESE UNDERGROUND EMPIRE]* (1993)(discussing firm political ties). The lack of severe punishment is a broad characteristic of the Japanese criminal justice system; *see, e.g.*, Daniel H. Foote, *The Benevolent Paternalism of Japanese Criminal Justice*, 80 CAL. L. REV. 318 (1992).

¹³⁷ BRIAN WOODALL, *JAPAN UNDER CONSTRUCTION: CORRUPTION, POLITICS, AND PUBLIC WORKS* 8 (1996); *see also* NEW YORK STATE ORGANIZED CRIME TASK FORCE, *CORRUPTION AND RACKETEERING IN THE NEW YORK CITY CONSTRUCTION INDUSTRY* (1990)..

¹³⁸ *See* JACOB M. SCHLESINGER, *SHADOW SHOGUNS: THE RISE AND FALL OF JAPAN’S POSTWAR POLITICAL MACHINE* 246 (1997).

¹³⁹ Boryokudan’in ni yoru futonaka no boshi nado ni kansuru hōritsu [Anti-Organized Crime Act], Law no. 77 of 1991. *See* BORYOKUDAN TAISAKUHO NO KAISETSU [COMMENTARY ON ANTI-ORGANIZED CRIME ACT] (Boryokudan Taisakuho Keinkyukai ed. 1992).

¹⁴⁰ The prefectural commissions are effectively controlled by the police. *See, e.g.*, BAYLEY, *supra* note 135, at 160. Members of the National Public Safety Commission are appointed by the prime minister and confirmed by the legislature.

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.¹⁴² 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 are so designated, and a total of 1,737 injunctions were issued in 1997.¹⁴³

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 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. In this Part, we first analyze criminal acts, an area in which data can be examined rather easily. We then turn to regression analysis, estimating a model that is consistent with our hypothesis about the origin and role of organized criminal firms in the civil realm.

¹⁴¹ The U.S. rejected precisely this approach during deliberations on the enactment of RICO. *See supra* note 5.

¹⁴² Anti-Organized Crime Act, art. 9.

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 nine percent of all arrested persons – a strikingly high number considering that members in that year accounted for only .06% of the total population.¹⁴⁴

An examination of individual crimes yields equally interesting results. If arrest rates properly reflect incidence of crime, members are more likely than non-members to be involved in prostitution, gambling, extortion, extortion and intimidation,¹⁴⁵ and in illegal purchase and sales of stimulant drugs. By contrast, they 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.¹⁴⁶

¹⁴³ 1997 KEISATSU HAKUSHO 184-187 (1998).

¹⁴⁴ 80,100 members/126,170,000 persons.

¹⁴⁵ 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] Art. 222. 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. KEIHŌ [Penal Code] 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 the refusal to pay a small bill in a coffee shop, see *Japan v. Ishihara*, 22 KEISHU 1469, 545 HANJI 84 (Dec. 11, 1968).

¹⁴⁶ The rarity of theft among members can also be inferred from a cross-sectional comparison of crime data of Japan's 47 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% of all crimes committed are larcenies. As discussed above, 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.

| Table 2. Percentage of Arrested Persons Affiliated with Organized Criminal Firms | | | |
|---|----------------------------|--|--|
| 1997 Data on General Crimes as Defined by Penal Code | | | |
| Crime | Number of Persons Arrested | Number of Members of Organized Criminal Firms Arrested | Ratio Organized Crime Members Arrested |
| 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 |
| 1994 Data on Other Crimes | | | |
| Stimulants | 17,101 | 7,375 | 0.43 |
| Narcotics | 444 | 39 | 0.09 |
| Prostitution | 1,229 | 223 | 0.18 |

Data from various issues of *Hanzai Hakusho* [White Paper on Crime].

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

| 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 Offenses (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 hypothesis, however, is that there is much more to understanding the origins and role of organized crime than this syllogism. We turn now to regression analysis to explore our hypothesis.

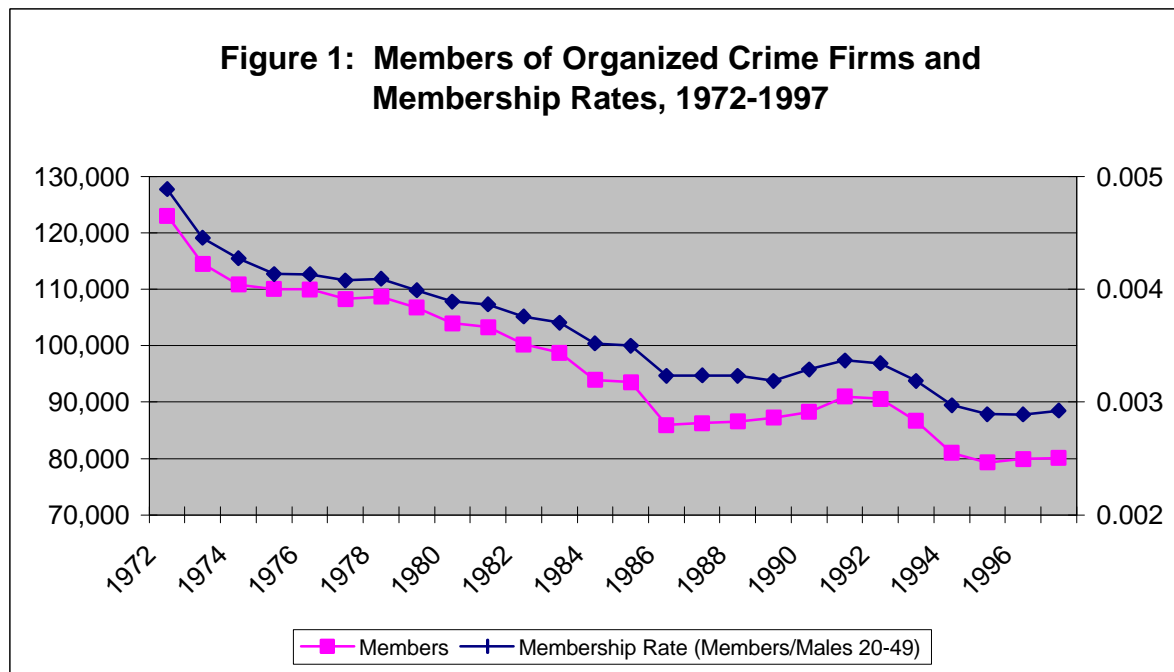
1. *Variables:* In this section, we make use of existing data to construct the following variables for regression analysis. For each variable, we hand-collected data covering the twenty-five-year period ending 1997.¹⁴⁷ We make no claim that each variable is perfect – in each case, the variable represents 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 *infra*, are reported in the Appendix.

¹⁴⁷ Unless otherwise indicated, data is from selected issues of two Japanese governmental publications, *Hanzai Hakusho* (White Paper on Crime) and *Keisatsu Hakusho* (White Paper on Police).

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.¹⁴⁸ 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.¹⁴⁹ Figure 1 shows graphically the data for MEMBERS.

¹⁴⁸ Population data from selected issues of KOSEISHO, JINKO DOTAI TOKEI [MINISTRY OF HEALTH, VITAL STATISTICS].

¹⁴⁹ 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, e.g.,* PETER MAAS, UNDERBOSS : SAMMY THE BULL GRAVANO'S STORY OF LIFE IN THE MAFIA 51 (1997). Also note that among new recruits, membership is an economic decision. *See supra* notes 88-98 For a similar use of population as proxy for economic success, *see* J. Bradford DeLong & Andrei Shleifer, *Princes and Merchants: European City Growth Before the Industrial Revolution*, 36 J L. & ECON. 671 (1993).



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.”¹⁵⁰ 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.¹⁵¹ As discussed above, the existence and location of organized criminal firms are discernable to any moderately informed observer.¹⁵² 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

¹⁵⁰ WALTER L. AMES, *POLICE AND COMMUNITY IN JAPAN* 183 (1981).

¹⁵¹ Unfortunately, these data, 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 systemic underreporting.

¹⁵² See *supra* text accompanying notes 101-104.

offices on the number of members and affiliates of each firm. *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.¹⁵³ Rarely if ever is the membership of any firm a secret, and police duly record it with the other information.¹⁵⁴ These membership data are reported by prefectural police to the NPA.¹⁵⁵

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.¹⁵⁶ Fourth, our on-site investigation

¹⁵³ PETER J. KATZENSTEIN, *CULTURAL NORMS AND NATIONAL SECURITY: POLICE AND MILITARY IN POSTWAR JAPAN* 64 (1996). Police are also aided by the fact that firms normally control a specific turf.

¹⁵⁴ 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 of Saitama prefecture officers Baba and Yasuda, Dec. 10, 1997.

¹⁵⁵ 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, *supra* note 150, at 107.

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 in no uncertain terms, 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 of Section Vice-Chief of Organized Crime Countermeasures Section 1, Criminal Bureau, National Police Agency, December 15, 1998; *see also* Bayley, *supra* note 135, at 155-56 (describing indirect control by NPA over prefectures); SETSUO MIYAZAWA, *POLICING IN JAPAN: A STUDY ON MAKING CRIME* 29-30 (Frank G. Bennett, Jr. trans. 1992) (same).

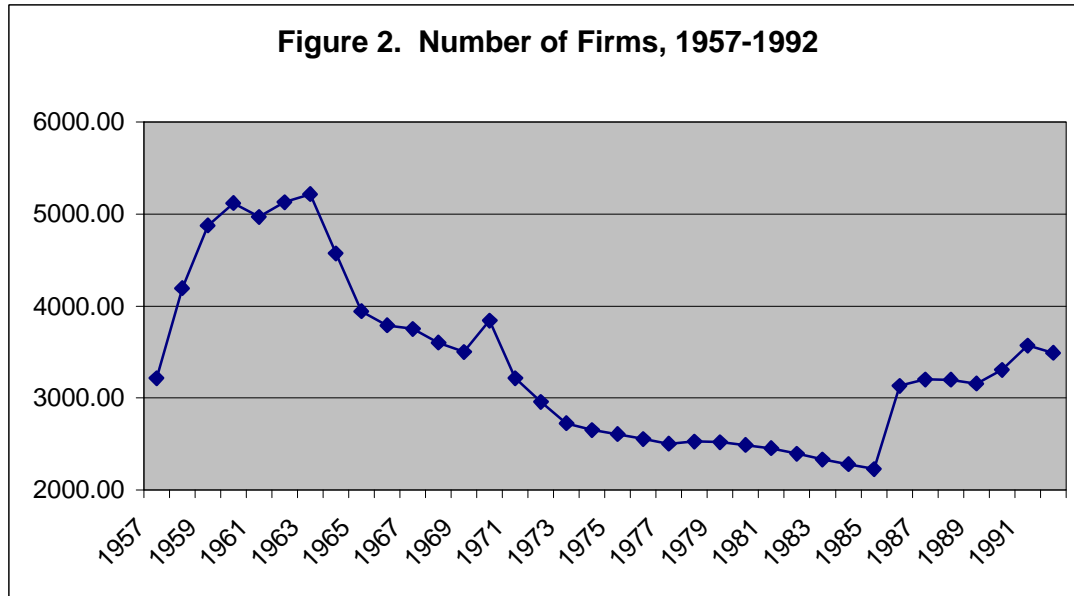
¹⁵⁶ *See, e.g.*, Iwai, *supra* note 93, at 209 (“Japanese police have not had great difficulty in producing comparatively reliable data”).

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, whose author 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.¹⁵⁷

Our decision to quantify success as MEMBERS is further supported by data on the number of organized criminal firms.¹⁵⁸ 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.

¹⁵⁷ Stark, *supra* note 99, at 10-11.

¹⁵⁸ 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.



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

2. *Hypotheses:* Recall our central claim: organized crime is an entrepreneurial response to gaps and inefficiencies in states' 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 (EXTORT). Second and more importantly, we postulate that the demand 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 (CIVIL),

bankruptcy (BANKRUPT), real estate foreclosures (PROPAUCT), and financing (LOANS),¹⁵⁹ we expect MEMBERS to decline. We find no *a priori* reason to hypothesize the nature of the relationship of the four other variables included in our regression.

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.¹⁶⁰ Although the transformations were necessary to specify the

¹⁵⁹ A positive correlation 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 10% of banks' bad loans are to organized criminal firms. See David Lister & Patrick Sawyer, *Japan Bank's Collapse*, EVENING STANDARD, Sept. 28, 1998, at 4. Second, a March 1999 survey by the Housing Loan Administration Company found that organized crime firms were involved in 42% 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, Mar. 31, 1999, at 1. The 42% 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, *The Yakuza and the Banks*, BUS. WEEK, Jan. 29, 1996, at 14 ("as much as 10% of the bad loans officially recognized by the Ministry of Finance"); David Holley, *Japan Mob Muddies Real Estate Loan Crisis*, L.A. TIMES, Feb. 24, 1996, at A1 (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 crime firms can indeed be large. See Benjamin Fulford, *Gangsters Linked to Bad-loan Morass*, NIKKEI WKLY, Nov. 27, 1995 (960 billion yen of Kizu Credit Cooperative's 1.31 trillion yen of assets were deemed "irrecoverable"); James Sterngold, *Ties to Gangsters Hinder Overhaul of Japan Banking*, N.Y. TIMES, Oct. 18, 1994, at D1 (\$70 million of Gifu Shogin's \$110 million in outstanding loans were to organized criminal firms); *Moto Takugin TÇdoriya o BaisÇ Teiso e [Case to be Brought Against Former Takushoku Bank Executives]*, ASAHI SHINBUN, Feb. 4, 1999, at 1 ("billions" of yen financing supplied by defunct bank to mob-affiliated real estate venture).

¹⁶⁰ 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, e.g., PETER KENNEDY, *A GUIDE TO ECONOMETRICS* 115-21 (4th ed. 1998); MICHAEL O. FINKELSTEIN & BRUCE LEVIN, *STATISTICS FOR LAWYERS* 437-42-34 (1990). Serial correlation occurs when the variables are not independent and exhibit a natural sequence. To mitigate this problem, we took the first difference of each variable. See, e.g., KENNEDY, *supra*, at 121-26; see also FINKELSTEIN & LEVIN, *supra*, at 24-34; RAMU RAMANATHAN, *INTRODUCTORY ECONOMETRICS* 462 (3d ed. 1995). 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, *supra*, at 320.

To analyze the data, we start with the standard time-series regression model $Y_t = a + bX_t + e_t$, where Y_t is the endogenous variable, X_t is the exogenous variable, e_t is the random disturbance term, a and b 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 *infra* notes xx, the data were transformed using the equation $\log y_t - \log y_{t-1} = \log(y_t/y_{t-1})$. See, e.g., CHARLES W. OSTROM, JR., *TIME SERIES ANALYSIS: REGRESSION TECHNIQUES* 18 (1978). A methodology similar to ours is used in Jeffrey S. Hill & Kenneth C. Williams, *The Decline of Private Bills: Resource Allocation, Credit Claiming, and the Decision to Delegate*, 37 AM J. POL. SCI. 1008 (1993), and the use of time-series data for labor market studies generally takes this form, see, e.g., DAVID CARD & ALAN B. KRUEGER, *MYTH AND MEASUREMENT: THE ECONOMICS OF THE MINIMUM WAGE* 179 (1995) (discussing regression models including supply-side and demand-side variables and attempts to correct for serial correlation).

model properly, one consequence is that we place high demands on the MEMBERS variable. Our primary claim is not that changes in the *rate* of change in MEMBERS results in changes to the rates of change of the other variables; rather, the claim is to the numeric values of the variables. The data transformation, however, requires correlation of the *rate* of change. 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.¹⁶¹

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.

We experimented with several more complex models. To account for possible reciprocal relations between our supply and demand variables (for instance, GDPCAP and LAND might have a feedback relation), 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 somewhat 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 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 & RONALD J. WONNACOTT, *INTRODUCTORY STATISTICS FOR BUSINESS AND ECONOMICS* 731 (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.

¹⁶¹ *See generally* RAMU RAMANATHAN, *INTRODUCTORY ECONOMETRICS* 320-21 (3d ed.1995).

Table 4. Determinants of MEMBERS of Organized Criminal Firms

| <i>Variable (Delta logs)</i> | <i>Predicted Sign</i> | <i>Coefficient</i> | <i>t-score</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 | | |
| N=25 | | | |

***Statistically different from zero at the 99% level.

**Statistically different from zero at the 95% level.

*Statistically different from zero at the 90% level.

BANKRUPT is the total annual yen amount of bankruptcies.¹⁶²

CIVIL is the total number of new civil cases filed in district court.¹⁶³ 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.¹⁶⁴

LAND is the average price of land in Japan's 6 largest cities: Tokyo, Yokohama, Nagoya, Osaka, Kyoto, and Kobe.¹⁶⁵

LOANS is the value, in 100 millions of yen, of loans and discounts of major banking accounts outstanding at the end of each year.¹⁶⁶

PROPAUCT is the number of suits brought in district court to force the auction of real estate posted as collateral.¹⁶⁷

UNEMPLOY is the unemployment rate.¹⁶⁸

¹⁶² Data from selected issues of *Nihon Tōkei Nenkan* (Japan Statistical Yearbook). We opted for the total amount of liabilities rather than the number of bankruptcy cases so as to mitigate multicollinearity problems, *see supra* note 160.

¹⁶³ Data from selected issues of *Shihō Tōkei Nenpō* (*Minji/Gyōsei Hen*) (Annual Report of Judicial Statistics (Civil Cases)).

¹⁶⁴ Data calculated from GDP and population data from selected issues of *Nihon Tōkei Nenkan* (Japan Statistical Yearbook).

¹⁶⁵ Data from selected issues of *Nihon Tōkei Nenkan* (Japan Statistical Yearbook), and updated with data from <http://www.reinet.or.jp/sigaichi/6daij.htm>. In the postwar era, Japanese nationwide urban land prices show the same upward and downward trends as data for the six largest cities, but during the bubble, prices in the six largest cities rose much higher and much faster than overall urban prices, and in fact correlate more directly with stock prices during that period. *See* KIYOHICO NISHIMURA, *NIHON NO CHIKA NO KIMARIKATA* [THE DETERMINATION OF LAND PRICES] 18 (1995). Because organized criminal firms tend to concentrate in large urban areas, reliance on data from the six largest cities is appropriate.

¹⁶⁶ Data from selected issues of *Nihon Tōkei Nenkan* (Japan Statistical Yearbook).

¹⁶⁷ Data from selected issues of *Shihō Tōkei Nenpō* (*Minji/Gyōsei Hen*) (Annual Report of Judicial Statistics (Civil Cases)). For the period beginning 1981, we use the data for real estate "forced executions" pursuant to the Civil Enforcement Act (*Minji Shikō Hō*, Law no. 4 of 1979). Due to a change in legal procedures, for the period prior to 1980, we use the data for auctions pursuant to the Auction Law (*Keibai Hō*, Law no. 15 of 1898).

We first note the adjusted- R^2 figure, which measures the explanatory power of our model. The R^2 in our example of .667 means that our model explains nearly 67% of the variation in MEMBERS, a very satisfying level in regression analysis.¹⁶⁹

As predicted, the model indeed found negative correlations for CIVIL, LOANS, and BANKRUPT, although BANKRUPT was insignificant.¹⁷⁰ The statistically significant negative

¹⁶⁸ Data from selected issues of *Nihon Tōkei Nenkan* (Japan Statistical Yearbook), and updated with data from Statistics Bureau, Management and Coordination Agency, available at www.stat.go.jp and www.soumochō.go.jp.

¹⁶⁹ Our model also successfully mitigated the potential problems of heteroskedasticity, serial correlation, and multicollinearity discussed *supra* note 160. 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, *supra* note 160, at 120; RAMANATHAN, *supra* note x, at 420-21. 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. As for autocorrelation, the results of a standard Durbin-Watson test (1.973), see KENNEDY, *supra* note 160, at 123-24, also cause us to accept the null hypothesis that no autocorrelation 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 $b = -.002$, $t = -.985$, CIVIL $b = -.468$, $t = 2.439$, CRIME $b = -.290$, $t = -2.125$, DATE $b = .001$, $t = .050$, EXTORT $b = .113$, $t = .730$, GDPCAP $b = 1.462$, $t = 1.075$, LAND $b = .205$, $t = .902$, LOANS $b = -.702$, $t = -3.838$, PROPAUCT $b = .404$, $t = 2.832$, UNEMPLOY $b = -.009$, $t = -.724$, Intercept $b = -.342$, $t = -.052$. As for multicollinearity, because no analysis of any two independent variables yielded statistically significant correlations, we conclude that our methodology also was successful in mitigation.

Researchers often exclude the constant (intercept) term if it is insignificant, even though “the practice is discouraged because it may lead to model misspecification.” See RAMANATHAN, *supra* note 160, at 170-71. When we did so, the statistical significance of each of the remaining variables, not surprisingly, improved: LOANS was significant at the 99% confidence level, CIVILDC, CRIME, LAND and PROPAUCT were significant at the 95% confidence level, and GDPCAP was significant at the 90% confidence level. The R^2 of the model was .780, but this measure is not directly comparable to the above model.

¹⁷⁰ 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 kainyō bōryōku*, 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.”¹⁷⁰ 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 – though not statistically significant – was nevertheless more strongly positive than that of the correlation between MEMBERS and EXTORT (for EXTORT, $b = .004$, $t = .404$; for CIVXTORT, $b = .853$, $t = .609$), but in this case causation is unclear.

correlation between MEMBERS and CIVIL is strong support for the theory that organized criminal firms substitute for state-sponsored dispute mediation mechanisms.¹⁷¹ Similarly, the significant negative correlation between LOANS and MEMBERS indicates that firms' loan sharking business competes directly with loans issued by governmentally licensed and regulated banks.¹⁷² 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 LOANS. Had the relationship between LOANS 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,¹⁷³ 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 LOANS.¹⁷⁴ In fact, the relationship with LOANS was significantly *positive* ($r=.94$, $t=4.96$, $p=.000$ ¹⁷⁵), 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.

¹⁷¹ Ideally, of course, we would prefer to have complete data on the total number of disputes. See, e.g., George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984)

¹⁷² See Richard B. Miller, *The Impingement of Loansharking on the Banking Industry*, in AN ECONOMIC ANALYSIS OF CRIME 198 (Lawrence J. Kaplan & Dennis Kessler eds. 1976).

¹⁷³ David Holley, *Japan Mob Muddies Real Estate Loan Crisis*, L.A. TIMES, Feb. 24, 1996, at A1 (quoting Japan Bar Association representative: "if 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*, FIN. TIMES, Dec. 12, 1995, at 8; see *supra* note 159.

¹⁷⁴ Our data for this variable begin in 1979.

¹⁷⁵ Correlations of untransformed variables.

PROPAUCT, a variable we predicted would be negatively correlated to MEMBERS, was actually positively correlated. The significantly positive correlation indicates that auctions of 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.¹⁷⁶ 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 PROPAUCT variable is not merely a proxy for economic downturn or increased bankruptcies, as the inclusion of the GDPCAP and BANKRUPT variables in our regression holds such effects constant.¹⁷⁷

CRIME, a 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, possibly even due to the enforcement efforts of firms themselves.¹⁷⁸ Conversely, when firms do not

¹⁷⁶ See HINAGO, *supra* note 109, at 30-31 (activities of auction operators termed *keibaiya*); *Survey: Gangs Stalling Collection of Jusen Loans*, DAILY YOMIURI, Mar. 31, 1999, at 1 (49 of 116 cases of disrupted collection of nonperforming loans involved disruption of auction proceedings).

¹⁷⁷ On the relationship between crime and the business cycle, *see, e.g.*, Philip J. Cook & Gary A. Zarkin, *Crime and the Business Cycle*, 14 J. LEGAL STUD. 115 (1985); Dick, *supra* note 26; Antonello E. Scorcu & Roberto Cellini, *Economic Activity and Crime in the Long Run: An Empirical Investigation on Aggregate Data From Italy, 1951-1994*, 18 INT'L REV. L. & ECON. 279 (1998).

¹⁷⁸ For example, organized criminal firms “actively cooperate with the police to keep foreign drugs out, thus protecting its own business and keeping Japan’s drug problem manageable.” KATZENSTEIN, *supra* note 153, at 67; *see also* SEIJI IISHIBA, SOSHIKI HANZAI TAISAKU MANYUARU [ANTI-ORGANIZED CRIME MANUAL] 104 (1990).

control unorganized crime, police lack incentives to continue the symbiotic relationship, and tighten enforcement efforts.¹⁷⁹

The correlation of MEMBERS to our two supply-side variables, UNEMPLOY and GDPCAP, 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.¹⁸⁰ 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 the above variables on a new dependent variable, the annual number of employees of Japan’s six largest trading houses.¹⁸¹ 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

¹⁷⁹ See RAMSEYER & NAKAZATO, *supra* note 61, at 182. 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. See generally Sudhir Alladi Venkatesh, *The Social Organization of Street Gang Activity in an Urban Ghetto*, 103 AM J. SOC. 82, 96-7 (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”).

¹⁸⁰ Results did not differ significantly when we removed our third supply-side variable, the specification of MEMBERS as membership rates. 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% confidence level, PROPAUCT remained significant at the 95% confidence level, CRIME fell to the 90% confidence level, and CIVIL climbed to the 95% confidence level.

¹⁸¹ Itochu, Marubeni, Mitsubishi, Mitsui, Nissho Iwai, and Sumitomo. All data from NIHON KEIZAI SHINBUNSHA, KAISHA NENKAN, selected years. 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% female.

the service industry and specialize as intermediaries between commercial parties.¹⁸² 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,¹⁸³ 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.

Regression analysis, of course, indicates correlations but cannot prove causation. It is thus *possible* (though the data suggest otherwise¹⁸⁴) 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 crime levels drive organized crime firm membership, because almost 90% of Japanese crime is larceny, a crime that members rarely commit,¹⁸⁵ and because the inclusion of the EXTORT variable holds constant one major type of firm-dominated crime.¹⁸⁶ 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

¹⁸² See M.Y. YOSHINO & THOMAS B. LIFSON, *THE INVISIBLE LINK: JAPAN'S SOGO SHOSHA AND THE ORGANIZATION OF TRADE* (1986).

¹⁸³ Our data for trading firms begin only in 1982, and employment practices may differ. See YOSHINO & LIFSON, *supra* note 182, 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.

¹⁸⁴ In addition to the causal arguments discussed *supra*, 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.

¹⁸⁵ See *supra* note 146.

¹⁸⁶ See Table 2.

lending patterns. Still, even assuming that our model reverses some of the actual causal linkages at work, the findings of negative *correlations* are nevertheless significant, as they tend to confirm our hypothesis that tradeoffs between state and criminal enforcement exist.

C. Additional Regression Analysis of 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 enforcement efforts, we did not have a complete time-series database, or the variable violates the assumptions of the multiple regression model. In this section we separately analyze those variables.¹⁸⁷ Table 5 displays the results of the separate bivariate regressions.

| Table 5. Bivariate Regressions of MEMBERS on Enforcement Variables | | | |
|---|--------------------|----------|-----------------------------------|
| <i>Variable</i> | <i>Coefficient</i> | <i>R</i> | <i>t-score (Confidence level)</i> |
| Total Arrest Rate | 0.005 | .58 | 3.45 (.002) |
| Arrest Rate of Made Members | 0.007 | .54 | 1.42 (.21) |
| Arrest Rate of Members of 3 Largest Firms | -.000 | .18 | -.724 (.479) |
| Anti-Organized Crime Act Injunctions | -0.11 | .93 | -5.407 (.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). Several explanations are possible. The correlation may be the result of community crackdown (police must arrest a greater percentage of members as organizations

¹⁸⁷ 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 (Total Arrest Rate $t=3.44$,

grow larger and more visible), a replacement phenomenon (perhaps more than one new member is needed to replace each jailed experienced member), 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 ($b=.003$, $r=.40$, $t=2.09$, $p=.047$). We attribute this correlation largely to “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.¹⁸⁸ We also found a positive though insignificant correlation between MEMBERS and arrests of “made” members (senior members; data from 1991-1997). We found a negative though insignificant correlation between MEMBERS and arrests of members of the three largest firms (data from 1980-1997).

2. *Crime Act Enforcement.* Pursuant to the Anti-Organized Crime Act, police may issue injunctions to firms that are designated under that law.¹⁸⁹ 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.

$p=.002$, Arrest Rate of Made Members $t=.48$, $p=.651$, Arrest Rate of Members of 3 Largest Firms $t=-.036$, $p=.976$, Anti-Organized Crime Act Injunctions $t=-2.96$, $p=.041$).

¹⁸⁸ We also checked for correlation on a lagged MEMBERS against the other variables: Arrest Rate of Made Members $b=.001$, $r=.078$, $t=.157$, $p=.88$; Arrest Rate 3 Largest $b=-.000$, $r=.197$, $t=-.410$, $p=.68$; Injunctions $b=-.000$, $r=.86$, $t=-2.92$, $p=.05$.

¹⁸⁹ See *supra* text accompanying notes 139-143.

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.¹⁹⁰ At least in Japan, the cohesion and appeal of gang life appears to be *enhanced*, rather than diminished, by criminal prosecution. At the same time, however, there is weak evidence from Japan that arrests of *high-level* officers of criminal firms do have an impact on firm success. This finding is intuitively plausible: while rank and file members can be replaced relatively easily, diminishing the human capital of criminal firms at the managerial level has some impact on their growth. 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

¹⁹⁰ 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 wiretaps and other 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.

success of Japanese organized criminal firms, appears promising on some levels and merits further study by other countries.¹⁹¹

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 organized crime flourishes where state-provided and state-sanctioned enforcement mechanisms are ineffective or in short supply. Such an environment creates incentives for private ordering. As the Japanese experience illustrates, many responses to such incentives may be beneficial to social cohesion and economic growth. Private ordering in the face of misaligned state structures or inadequate 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 the key to reducing organized crime, therefore, is institutional re-engineering to reduce incentives for the formation of 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.

¹⁹¹ 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 economy activity traditionally left to "legitimate" organizations. See, e.g., Mary Jordan & Kevin Sullivan, *A New Mob Mentality in Japan: Families Profit by Going Mainstream*, WASHINGTON POST, April 11, 1999, at A1. We note as well that Japan lacks some of the enforcement tools available in other countries such as wiretapping measures and specific prohibitions against money laundering. See, e.g., Kazuaki Morimoto, *Mane-Ro-ndaringu Kisei no Igi to DÇkÇ* [*Trends in and Significance of Money Laundering Regulation*], 1543 KIN'Y© H∩MU JII∩ 6, 9-10 (1999).

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.¹⁹² We have surveyed obstacles to the smooth enforcement 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.

The second 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 enforcement agents to navigate complex

¹⁹² Cf. JAMES C. SCOTT, *SEEING LIKE A STATE: HOW CERTAIN SCHEMES TO IMPROVE THE HUMAN CONDITION HAVE FAILED* (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).

transactional environments, organized groups operating beyond state and social norms may emerge to satisfy the unmet demand for transaction cost engineering. Thus in Japan, flaws 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 in the institutional gaps for several reasons. Precisely because some of the activity is prohibited by the state, legitimate firms rarely enter the market.¹⁹³ 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 and thwart competition.¹⁹⁴ Thus, the stimulation of state-sanctioned enforcement and information agents is a crucial aspect of organized crime eradication.¹⁹⁵

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

¹⁹³ 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.

¹⁹⁴ 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.

¹⁹⁵ A similar conclusion is reached by Schelling, *supra* note 17, at 70.

the availability of legal procedures and professionals.¹⁹⁶ 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 enforcement and information agents seriously compromises the ability to engage in private ordering, reinforcing reliance on either the state's informal authority (bureaucratic guidance) or illicit entrepreneurs (organized criminal firms).¹⁹⁷

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. Network externalities are simply the increasing returns nature of products whose value increases with the number of consumers of that product. Laws and enforcement institutions exhibit increasing returns characteristics.¹⁹⁸ Widely used laws are likely to be well serviced by lawyers and judges.¹⁹⁹ 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 enforcement and information agents, in turn, is likely to foster

¹⁹⁶ See generally Setsuo Miyazawa, The Politics of Judicial Reform in Japan, remarks delivered at Columbia Law School, March 5, 1999 (outline on file with authors). See also Keidanren, Keizai saisei ni muke kisei kanwa no suishin to tameina gyousei un'ei taisei no kakuritsu o matomeru: Kinhonteki kangaekata [Toward Economic Resurgence based on Deregulation and the Establishment of a Transparent Administrative Management System: Basic Thinking] Policy Statement, Oct. 20, 1998, available at <http://www.keidanren.or.jp>; 21st Century Public Policy Institute of the Federation of Economic Organizations, Minji shiho no kasseika ni mukete [Toward the Revitalization of the Civil Procedure Justice System], Policy Statement, Dec. 22, 1998, available at <http://www.keidanren.or.jp>.

¹⁹⁷ Excessive bureaucratic power itself contributes to the growth of organized crime by increasing the potential for corruption and the monopolization of industries. Annelise Anderson, *Organized Crime, Mafia and Governments*, in THE ECONOMICS OF ORGANIZED CRIME 33, 37 (Gianluca Fiorentini and Sam Peltzman eds. 1995).

¹⁹⁸ See, e.g., Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 98 COLUM. L. REV. 1908, 1923-24 (1998); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 80 VA. L. REV. 757 (1995).

¹⁹⁹ Kamar, *supra* note 198.

demand for law reform generally. The point is not to convert private ordering into state ordering, but to set the state incentives so that entrepreneurialism is channeled into outlets that reinforce rather than erode legal and social norms.²⁰⁰

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, leading to a declining spiral from “legitimate” private enforcement to 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.”²⁰¹

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.²⁰² 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.²⁰³ Thus, the

²⁰⁰ See William J. Baumol, *Entrepreneurship: Productive, Unproductive, and Destructive*, 98 J. POL. ECON. 893 (1990).

²⁰¹ Schelling, *supra* note 17, at 70.

²⁰² DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 91 (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.”).

²⁰³ See Jim Leitzel, *Crime and the Political Economy of Russian Reform* 13 (1996) (unpublished manuscript available at www.ssrn.com). *But see* Katherine Hendly et al., *Law Works in Russia: The Role of Legal Institutions in the Transactions of Russian Enterprises* (unpublished manuscript, on file with authors) (March 31, 1999) at 17

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 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 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.

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.

(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).

| Appendix: Sample Statistics | | | | | |
|------------------------------------|------------|------------|------------|------------|-----------------------|
| | Minimum | Median | Mean | Maximum | Mean First Difference |
| <i>Background Variables</i> | | | | | |
| Number of Members | 79,300 | 89,430 | 91,600 | 106,754 | |
| Males 20-49 | 25,179,000 | 26,709,500 | 26,740,115 | 27,647,000 | |
| <i>Regression Variables</i> | | | | | |
| MEMBERS | .00289 | .00362 | .00351 | .00489 | -.00008 |
| BANKRUPT | 12,322 | 31,833 | 46,878 | 140,447 | 5,419 |
| CIVIL | 501,370 | 712,584 | 706,854 | 958,931 | 22.175 |
| CRIME | 1,289,405 | 1,622,163 | 1,617,696 | 1,899,564 | 27,041 |
| EXTORT | 8,873 | 20,557 | 20,854 | 33,374 | -149 |
| GDPCAP | 20.28 | 28.06 | 29.05 | 38.74 | .713 |
| LAND | 20.10 | 46.60 | 50.70 | 103.00 | 1.268 |
| LOANS | 615,933 | 2,371,700 | 2,805,374 | 4,930,232 | 172,570 |
| PROPAUCT | 24,960 | 41,620 | 41,659 | 56,156 | 1.595 |
| UNEMPLOY | 2.00 | 2.50 | 2.54 | 3.40 | .084 |
| <i>Other variables</i> | | | | | |
| Arrestees | 31,257 | 40,329 | 41,968 | 58,750 | |
| Arrest Rate | .34 | .48 | .46 | .54 | .0004 |
| Made member arrestees | 16,301 | 20,944 | 21,107 | 23,861 | |
| Made member arrest rate | .240 | .258 | .263 | .288 | -.0022 |
| 3 largest firm arrestees | 8,307 | 10,887 | 10,708 | 12,191 | |
| 3 largest firm arrest rate | 1.06 | 1.37 | 1.44 | 1.98 | -.0079 |
| Injunctions | 241 | 1,189 | 1,979 | 1,737 | 289.5 |