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**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

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ROUNDTABLE ON COMPETITION IN THE CONSTRUCTION INDUSTRY

-- Note by Japan --

This note is submitted by the Delegation of Japan to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 11-12 June 2008.

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1. Structure of the Japanese construction industry and market trends¹

1.1 Licensing under the Construction Industry Law and Business Evaluation

1. According to the Construction Business Act, the “construction business” is the business of completing contracted construction work, irrespective of its name, including principal contracts and subcontracts. The Law defines “a construction business operator” as a company that engages in the construction business under license. Construction business licenses are classified according to the types of construction works conducted by business operators (28 types of construction works including building construction and civil engineering) and licenses classified in accordance with whether or not business offices are established in two or more prefectures (licenses issued by the Minister of Land, Infrastructure, Transport and Tourism or prefectural governors).

2. For contracting public construction works, business operators are required to undergo a Business Evaluation in addition to acquiring a business license.

1.2 Number of licensed business operators and number of employed workers

3. Licensed construction business operators in Japan numbered 524,273 at the end of FY 2006. Their number decreased by 17,991 from the figure at the end of FY 2005 (with 20,004 business operators entering the market and 37,995 leaving it). The number at the end of FY 2006 was 76,707 less than the peak number at the end of FY 1999.

4. The number of employed workers in 2006 was approximately 5.59 million. The figure fell by more than one million from the peak in 1997.

1.3 Scale of licensed business operators

5. Licensed business operators included 54 major and quasi-major builders affiliated with the Japan Federation of Construction Contractors and approximately 25,000 locally-based medium and small-to-medium size business operators that belong to the National General Constructors Association of Japan. Approximately 500,000 other licensees are small-to-medium and minor business operators, including approximately 300,000 operators that complete less than one million yen of construction work a year.

1.4 Business operators that have undergone the business evaluation

6. As of FY 2005, 178,278 business operators among all licensees have undergone the business evaluation required for contracting public construction works.

1.5 Construction investment

7. Construction investment has accounted for approximately 10% of Japan’s GDP in recent years.

¹ Data sources are (1) reference materials for the first meeting of the special committee on management screening reforms under the Construction Industry Deliberations Committee of the Ministry of Land, Infrastructure, Transport and Tourism (“MLIT”) (March 2007), (2) final report by the Construction Industry Policies Research Group under the Policy Bureau of the MLIT (June 2007), and (3) report titled, “State of the Economic Society Surrounding the Construction Industry,” issued by the Policy Bureau of the MLIT (June 2007).

8. Construction investment was expected to total approximately 52 trillion yen in FY 2007. The figure has declined rapidly to around 60% of the peak, approximately 84 trillion yen, in FY 1992. In particular, public investment was expected to total approximately 17 trillion yen in FY 2007, less than half the roughly 35 trillion yen recorded at its peak in FY 1995.

1.6 Structural oversupply

9. Both the number of licensed business operators and the number of employed workers have been on the decline. However, construction investment has been falling even more sharply than the two business indicators. The construction business is said to remain in a state of structural oversupply.²

1.7 Low productivity

10. Labor productivity for the construction business has been declining since the early 1990s when the index reached its peak. As of 2002, labor productivity for the construction business stood at a level approximately 70% of labor productivity for all businesses.

11. The rapid decline in construction investment outpacing the fall in the number of employed workers and extreme low price bidding which was caused by it have been called major macro factors behind the low productivity. Unnecessary overhead expenses, owing to a large number of companies supported by factors such as the industrial characteristic of a multi-layer subcontracting structure, have been cited as one of the micro factors behind the low productivity.³

2. Bid-rigging in public construction works and the Antimonopoly Act⁴

2.1 Bid-rigging and the Antimonopoly Act

12. Bid-rigging runs counter to a bidding system in which suppliers and prices are decided through fair and free competition among bid participants. It directly restricts competition. Bid-rigging is a quintessential form of cartel and one of the most malicious violations of the Antimonopoly Act (“AMA”).

13. If business operators have participated in bid-rigging, the JFTC orders them to eliminate the bid-rigging and to pay surcharges calculated in accordance with a fixed formula. Moreover, criminal penalties may be imposed on individuals and business operators that have engaged in bid-rigging on the basis of the AMA. Victims (procurement agencies or local residents concerned) may also demand compensation from business operators who have taken part in bid-rigging.

2.2 Bid-rigging in public construction works

14. Public investment accounts for a large proportion (approximately 33% from the perspective of FY 2007) of construction investment. In principle, competitive bids are sought for ordering public construction works. Many bid-rigging activities have taken place in this competitive bid market for public construction works. They have posed problems as violations of the AMA.

² The final report by the Construction Industry Policies Research Group under the Policy Bureau of the M LIT (June 2007).

³ Same as footnote 2, above.

⁴ The data source is, unless extra footnotes are provided, “For the Prevention of Bid-rigging” issued by the JFTC Secretariat (September 2007).

Legal actions the JFTC has taken in recent years in response to bid-rigging are presented in the table below. They have accounted for a generally high percentage of the entire number of legal actions. The JFTC took 129 legal actions during the period from FY 2002 to FY 2006. Of this total, 85 addressed bid-rigging and 66 were on bid-rigging in public construction works.

Legal Actions by the JFTC against Bid-rigging in Public Construction Works

Fiscal Year	2002	2003	2004	2005	2006	Total
Legal Actions	37	25	35	19	13	129
Against Bid-rigging	30 (81%)	14 (56%)	22 (63%)	13 (68%)	6 (46%)	85 (66%)
Against Bid-rigging in Public Construction Works	21 (57%)	8 (32%)	19 (54%)	12 (63%)	6 (46%)	66 (51%)

2.3 *Characteristics of bid-rigging in public construction works, etc.*

2.3.1 *Number of business operators involved*

15. Generally speaking, bid-rigging cases in public construction works involve many business operators. The number of business operators averaged 28 among the 66 legal actions the JFTC took against bid-rigging in public construction works from FY 2002 to FY 2006. The largest number of business operators among these legal actions was 119.

2.3.2 *Geographically relevant markets*

16. On the other hand, the geographically relevant markets in bid-rigging cases in public construction works are generally local. In bid-rigging cases under the AMA, a particular field of trade (relevant market) is defined for certain goods and services procured by certain procurement parties using certain procurement methods. Procurement agencies concerned were restricted to only one municipality in 28 of the 66 legal actions stated above.

17. Local public entities may also establish regional requirements (for business operators to locate in the area) as qualifications for business operators to participate in competitive bids. In these cases, geographically relevant markets are defined as more local markets.⁵

2.3.3 *Restricted ability to compete*

18. In general, bid-rigging in public construction works takes the form of a price cartel, which enables a predetermined supplier to win the contract by (simply) adjusting bid prices among bid participants in advance. This is generally related to the fact that bid price was (overwhelmingly) the most important factor for contracting public construction works.

⁵ The report by the JFTC study group on public procurement and competition policy (November 2003) states that it is necessary to ask, in light of ensuring competition, local public entities to avoid establishing regional requirements in a manner that excessively reduces competition.

2.3.4 *Bid-rigging assisted by procuring sides*

19. Bid-rigging in public construction works includes such bid-rigging in which the officials of procurement agencies are involved. In these cases, it is possible to take actions against business operators by using the AMA. However, no legal administrative action can be taken against procuring sides. In order to address this problem and prevent this type of bid-rigging, the Act Concerning the Elimination and Prevention of Involvement in Bid-rigging etc. (“Involvement Prevention Act”) was enacted in July 2002 and came into effect in January 2003. The JFTC demanded 4 improvement measures based on the Involvement Prevention Act to procurement agencies from January 2003 to March 2007. These bid-rigging cases include a case in which bid-rigging was assisted for the purpose of ensuring that the retirees of the procurement side be reemployed by the business operators.⁶

2.3.5 *Actual condition of the establishment of compliance in the construction business*

20. In light of the frequent cases of bid-rigging, including one assisted by procuring sides, and other factors, the JFTC surveyed 1,700 construction business operators through questionnaires about the actual condition of the establishment of compliance, particularly compliance with the AMA. The results of this survey published in May 2007 revealed that even large companies have a small amount of concern about the possibilities of their violations of the AMA, and the execution of internal audits and other measures were inadequate. Summing up the results, the results noted that substantive compliance improvement is an important challenge for the future.

3. **Policies to eliminate unjust trade such as bid-rigging**

21. The JFTC is eliminating bid-rigging by strictly enforcing the AMA. In addition, the JFTC is aiming to prevent bid-rigging with actions including the publication of guidelines for business operators and trade associations⁷ and attempts to work together and to cooperate with procurement agencies⁸. This strict and proactive enforcement against bid-rigging has served to maintain and promote fair and free competition in public procurement fields, thereby causing decline in prices. For example, following the initiation of investigations by the JFTC, prices decreased by 18.6% on average in 22 bid-rigging cases (not restricted to bid-rigging cases in public construction works) in which legal actions were taken during the period from 1996 to March 2003.⁹

22. In order to improve transparency, objectivity and competitiveness in bidding procedures, the Government of Japan promotes to reform the bidding system including expansion of the competitive bidding and comprehensive evaluation method, which determines the successful bidder through overall

⁶ The Involvement Prevention Act was amended in December 2006 to further eliminate bid-rigging orchestrated by procurement sides. The amendment includes the introduction of penal provisions on procurement officers. It came into effect in March 2007.

⁷ “Guidelines Concerning the Activities of Firms and Trade Associations with Regard to Public Bids” issued by the JFTC (1994).

⁸ For example, directors of accounting affairs and other equivalent officers in procurement agencies have been designated as liaison officers with the JFTC since 1993, and meetings among these liaison officers and the JFTC have been held annually. In addition, the JFTC has cooperated with procurement agencies by dispatching lecturers and providing training materials to their workshops for procurement officers. Furthermore, the Act for Promoting Proper Tendering and Contracting for Public Works, which came into effect in April 2001, requires all public procurement agencies, including national and local government entities and governmental corporations, to notify the JFTC if they have found facts reasonably indicating that bid-rigging was committed.

⁹ JFTC “JFTC’s View on the Draft Amendment of the AMA” (May 2004)

evaluation both of price and non-price factor. On the other hand, since there are issues such as extreme low price bidding and placing unfair burden on subcontractors and their labor workers, the Government of Japan also reinforces policy actions to challenge such issues.

4. Recent major bid-rigging cases in public construction works, involving major construction business operators

4.1 *Case against participants in the bid for subway construction works procured by Nagoya City*

4.1.1 Violation

23. During the period from early to mid December 2005, the 33 business operators that participated in the bid, through communication from an advisor to Corporation O, one of the violators in this case, or other individuals, or through consultation with the above advisor concerning the predetermined winners of the bid for the subway extension works procured by Nagoya City, agreed that the predetermined winners of the bids would become the predetermined winners of the contracts, and that the other bidders would cooperate to ensure that the predetermined winners of the contracts actually won them. Under such agreement, they substantially restrained competition in the field of trade for the subway extension works procured by Nagoya City, contrary to the public interest.

4.1.2 The JFTC's actions

24. In November 2007, the JFTC issued a cease-and-desist order against the 33 business operators and surcharge payment orders to 14 of the business operators, finding they had violated the AMA. Prior to this action, the JFTC made a criminal accusation against the five business operators and five individuals engaging in the sales at the five business operators to the Public Prosecutor General in February and March 2007, deeming their violation of the AMA a crime.

4.2 *Case against participants in the bid for civil engineering and building construction works procured by the Defense Facilities Administration Agency*

4.2.1 Violation

25. The officers of the Defense Facilities Administration Agency (“DFAA”) were “allocating” predetermined winners to some of the specific civil engineering and building construction works procured by the DFAA during and after FY 2004, and this allocation was being conveyed by liaison persons on the industry side. The 60 business operators that participated in the bid agreed that the predetermined winners of bids or the joint ventures that these predetermined winners joined as members would become the predetermined winners of the contracts, and that the other bidders would cooperate to ensure that the predetermined winners of the contracts actually won them. Under such agreement, they substantially restrained competition in the field of trade for the specific civil engineering and building construction works procured by the DFAA, contrary to the public interest. The “allocation” decided the predetermined winners of bids, considering the reemployment of persons who had retired from the DFAA and other entities and additional factors, such as the continuity of the work and relativity with previous works for which the business operators won contracts, and their willingness to win contracts.

4.2.2 The JFTC's actions

26. In June 2007, the JFTC issued a cease-and-desist order against the 56 of the business operators and surcharge payment orders against 51 of them. In addition, the JFTC notified the DFAA that it found the officers at that time had conducted the “involvement in bid-rigging etc.” stipulated in the Involvement Prevention Act.