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Globalization and Harmonization
The Case of Accountancy Services in Japan

Fukunari Kimura

11.1 Introduction

The inclusion of the General Agreement on Trade in Services (GATS) in the Marrakesh Agreement in 1994 was an epoch-making step to expand the scope of international discipline on commercial policies. Among professional services, accountancy services are a particularly promising field for harmonization, and the negotiation in the World Trade Organization (WTO) has set the framework of how to treat domestic regulations. We can draw a number of important lessons from the ongoing story of accountancy service liberalization, particularly in case of Japan.

An important contribution of GATS was to define the scope of services trade and set the framework of liberalization procedure. As policy principles, the GATS first imposes the most-favored-nation (MFN) principle with explicit exemptions and transparency requirements. Then the market access requirements and the national treatment (NT) principle are promoted in the form of each country's specific commitments. Because most of the service sectors are subject to complicated domestic regulations and institutional arrangements, liberalization will inevitably step into the traditional territory of domestic policies.

The borderline between "pure" domestic policies and international commercial policies under the international policy discipline is not clear-cut in many cases. The framework of domestic regulations is deeply rooted in his-

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tory-dependent country-specific institutions and has been regarded as being under the policy discretion of each country. The policies on service industries were mostly treated as a part of domestic indigenous institutions. On the other hand, the wave of globalization of economic activities calls for international policy discipline, and the momentum toward institutional harmonization among countries has intensified. The scope of international policy discipline is not given a priori but depends on the balance between the benefits from having country-specific institutions and the advantage obtained from globalization. The process of liberalization, therefore, is inevitably accompanied with complicated politico-economic conflicts.

Accountancy services are an area with particularly strong domestic regulatory arrangements. The business accounting system is based on the country-specific legal framework and is not often open to foreign firms or natural persons. The accountants qualification system tends to work as an unintentional barrier to foreign penetration. At the same time, the globalization of economic activities has recently called for the international convergence of accounting systems. In particular, the construction of international accounting standards has proceeded in the effort of the International Accounting Standards Committee. The global restructuring of the accountancy service sector has also advanced through megamergers.

In Japan, drastic institutional changes called the “accounting Big Bang” are going on. The disillusion of the Japanese economic system and the wave of globalization accelerate the convergence of the accounting system with international standards. A series of institutional reforms relating to business accounting is likely to change a wide range of economic institutions, including corporate governance, in the near future.

The purpose of the paper is to review the transition of the Japanese business accounting system and to examine the function of market forces affecting the relationship between domestic institutions and international policy discipline. The next section provides the definition of accountancy services and lists their special characteristics. Section 11.3 summarizes the historical legal and regulatory background of the Japanese business accounting system. Section 11.4 examines the wave of globalization with which Japan has been washed out, and section 11.5 reviews the recent reforms in Japan. Section 11.6 summarizes the liberalization effort in the WTO, and the last section draws lessons from the case.

11.2 Characteristics of Accountancy Services

Because the legal and regulatory framework for accountancy services widely differs across countries, it is not even easy to define accountancy services in the international context. The Provisional Central Product Classification (CPC) of the United Nations has “accounting, auditing, and bookkeeping services [CPC 862]" under the category of "business services." The category CPC 862 is further subdivided as follows:[1]

1. Accounting and auditing services (CPC 8621)
   Financial auditing services (CPC 86211)
   Accounting review services (CPC 86212)
   Compilation of financial statements services (CPC 86213)
   Other accounting services (CPC 86219)
2. Bookkeeping services, except tax returns (CPC 8622)
   Bookkeeping services, except tax returns (CPC 86220)

However, the range of services provided by accountants or accounting firms has substantially expanded beyond the traditional definition. In addition to accounting, auditing, and bookkeeping services, they often provide merger audits, insolvency services, tax advice, investment services, and management consulting. Differences in the regulatory environment result in different definitions from country to country.

In case of Japan, at least in a colloquial usage, accountancy services mean professional services provided by accountancy firms that conduct legally required audits as a core service. The government authorizes Japanese Certified Public Accountants (CPAs) under the CPA law. Only accountants with the CPA qualification can conduct legally required audits.

Accountancy services have several special characteristics, which have generated peculiar responses to globalization. First, accountancy services considerably differ across countries. The accounting system is an important component of legal and economic institutions that support market functioning and thus has a strong path-dependent nature. It has historically developed in the country-specific environment of corporate governance. Accountancy services are also prone to be interlocked with other economic institutions. Moreover, there are considerable differences across countries in the form and degree of government involvement. For example, in Japan, legal auditing practices are specified in detail by the government and are conducted by accountants with publicly authorized licenses. On the other hand, in the United States, accountancy services are primarily based on private qualification and follow formats that differ across states while government agencies, particularly the Securities and Exchange Commission (SEC), are strictly monitoring accounting practices.

Second, although accounting practices by themselves are provided on an individual or small-group basis, the operation of accounting firms has strong economies of scale. Particularly in the globalization era, accountancy firms must be ready to provide a wide range of services requested by globalizing client firms, such as tax advice, management consulting, merger

1. The following information is obtained from WTO (1998a).

and acquisition arrangements, investment consulting in both domestic and international operations, and others. The current business environment often makes "one-stop-shopping" services convenient for clients. In addition, typically in the United States, accounting firms must strengthen their financial bases to defend themselves against increasing massive legal claims.

Third, the globalization of economic activities makes international convergence of accounting practices increasingly attractive. It has become troublesome for private companies with international operations to prepare multiple forms of financial statements for country-by-country requirements. In addition, differences in regulatory frameworks across countries have sometimes been an obstacle to raising funds in the international financial market. Of course, the reform of economic institutions requires a lot of energy and momentum. However, the benefit of international convergence has gradually come to outweigh its cost for a large number of globalizing firms. Such a market environment also makes services provided by large accountancy companies with international alliances increasingly attractive.

Fourth, the Anglo-American accounting method has a long history and is now regarded as the most advanced and sophisticated in the world. As a background, we observe that Anglo-American-type corporate culture as well as the system of corporate governance has gradually penetrated into countries all over the world as the globalization of economic activities has proceeded. The technological dominance together with network externalities allows U.S. and British accountancy firms to successfully formulate the global network of alliances.

Fifth, since the accounting system is a part of basic economic institutions, the international convergence inevitably triggers fundamental changes in market functioning in lagged-behind countries. The modern accounting system is an essential part of modern (Anglo-American-type) capitalism. Introducing it results in the emergence of modern corporate culture and corporate governance, which possibly causes serious conflicts with local traditional values. In the process of policy reform, various types of politico-economic pressure may come up.

These characteristics make the case of accountancy services extremely insightful and their relevance to the liberalization of other service sectors worth seeking. The wave of globalization from the market side comes into wild collision with traditional, indigenous values and redefines the borderline of "pure" domestic policies. The institutional convergence or harmonization in the field possibly triggers drastic institutional reform including regulatory framework and corporate governance.

11.3 Historical Background in Japan

The modern business accounting system in Japan has gradually been formed since the end of WWII and has acquired a strong path-dependent nature.[2] The Japanese business accounting system has a "triangle" structure, in which three lines of the accounting system, based on securities and exchange law, commercial law, and corporation tax law, coexist. The original purpose of each law is different; commercial law focuses on the protection of stockholders and creditors, whereas securities and exchange law works to facilitate investment. Commercial law was based on the old German-law tradition, whereas securities and exchange law was written under the heavy influence of the U.S. laws in the occupation period. Commercial law and corporation tax law apply to all firms, whereas securities and exchange law only covers companies participating in the stock market. The required accounting formats as well as accounting procedures are different. The history of the accounting system has been a complicated evolutionary process, coordinating the three systems.

Another important feature is that in Japan the governmental sector has directly conducted the formulation of the accounting system. The starting point of business accounting standards was the Financial Accounting Standards for Business Enterprises, written by the Economic Stabilization Board in 1949. The Business Accounting Deliberations Council has conducted a number of revisions since then. Although the council contains members from the private sector, including professional accountants and others, it is a part of the governmental sector under the supervision of the finance minister.

Business accounting consists of financial accounting (accounting for external reporting), managerial accounting (accounting for internal reporting), and tax accounting as well as external audits. The legally obliged audits in Japan have a dual structure: one is for securities and exchange law, and the other is for commercial law.[3] The Special Law of the Commercial Law legislated in 1974 tried to harmonize the contents of legally required audits for both laws, although there are still a number of differences in required documents, the way of publicizing, and other detailed procedures. Commercial law audits by CPAs are required only for large companies with capital of more than 500 million yen or with liabilities of more than 20 billion yen. Securities and exchange law audits with CPAs, on the other hand, are compulsory only for large companies raising funds in the security market.

The CPA law authorizes the qualification of Japanese CPAs. Only accountants with the CPA qualification can conduct legally required audits. The registration for the Japanese Institute of Certified Public Accountants (JICPA) is virtually compulsory for CPA activities. An auditing firm can be

2. Arai (1999) provides a detailed review of the historical formulation of the Japanese accounting system.

3. In addition, there are special sorts of legally required audits, such as ones for educational institutions, labor unions, and so on. Some companies also have voluntary audits even if no legal audit is required.

Table 11.1 **Membership of the Japanese Institute of Certified Public Accountants (as of March 31, 2000)**

	Members						
Regions	CPAs	Foreign CPAs	Auditing Firms	Total	Submembers (Junior CPAs Registered)	Total	Junior CPAs Not Registered
Hokkaido	177	0	2	179	39	218	2
Tohoku	188	0	2	190	25	215	3
Tokyo	7,694	9	89	7,792	2,585	10,377	158
Tokai	905	0	13	918	225	1,143	14
Hokuriku	147	0	2	149	16	165	2
Kyoto/Shiga	203	0	1	204	61	265	6
Kinki	1,691	0	25	1,716	506	2,222	22
Hyogo	336	0	3	339	80	419	9
Chugoku	234	0	2	236	52	288	7
Shikoku	135	0	1	136	18	154	2
North Kyushu	319	0	0	319	81	400	4
South Kyushu	113	0	2	115	12	127	2
Okinawa	26	1	0	27	7	34	0
Total	12,168	10	142	12,320	3,707	16,027	231

Source: [http://www.jicpa.or.jp].

established only with five or more qualified CPAs. Table 11.1 presents the number of members of the JICPA, which indicates high geographical concentration to the Tokyo region. The number of CPAs has increased over time, but a shortage of supply has long been claimed (figure 11.1).[4] The size of auditing firms as well as the number is also small; only five firms (as of February 1999) have more than 100 partners (figure 11.2).[5] The qualifying exam for CPAs is provided by the Ministry of Finance and is known to be one of the most demanding exams, being a match for a qualifying exam for lawyers. Table 11.2 shows the recent pass ratios in the Japanese CPA exams.

The system of CPA qualification in Japan has been regarded as an obstacle for foreigners. The qualification of CPAs was granted by special examination for foreign accountants in the past, but the exam has not been held since 1975. When the Accountants Law was established in 1948, accountants with foreign CPAs did not need to take any exam (Article 23). In 1950, the article was abolished, and instead the Foreign CPA System was introduced (Articles 16–32), which granted qualification to a foreign CPA with the authorization of the CPA Management Committee and without qualifying exams. The number of foreign CPAs increased throughout the 1960s. In 1977,

4. Japan has only 12,000 accountants, which is a very small number compared with the size of the Japanese economy. The International Accounting Standards Committee (IASC) claims to cover more than 2 million accountants in the world (see [http://www.iasc.org.uk]).

5. The merger between Ota Showa and Century in April 2000 reduced the number of large auditing firms into four. See below for details.

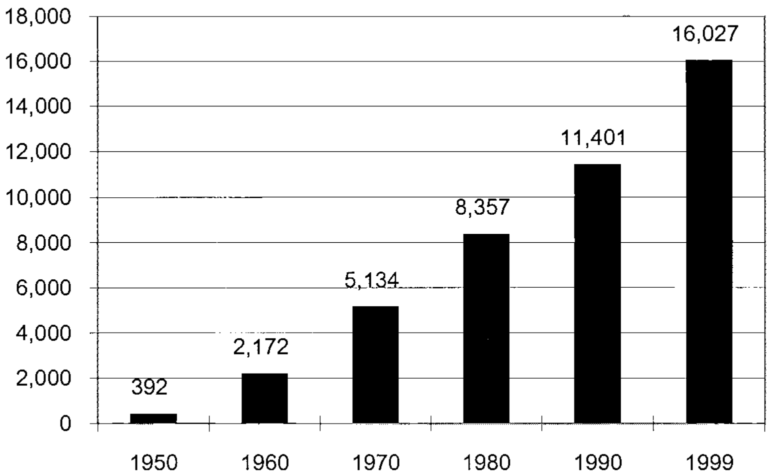

Fig. 11.1 The number of CPAs in Japan including junior CPAs
Source: http://www.jicpa.or.jp.

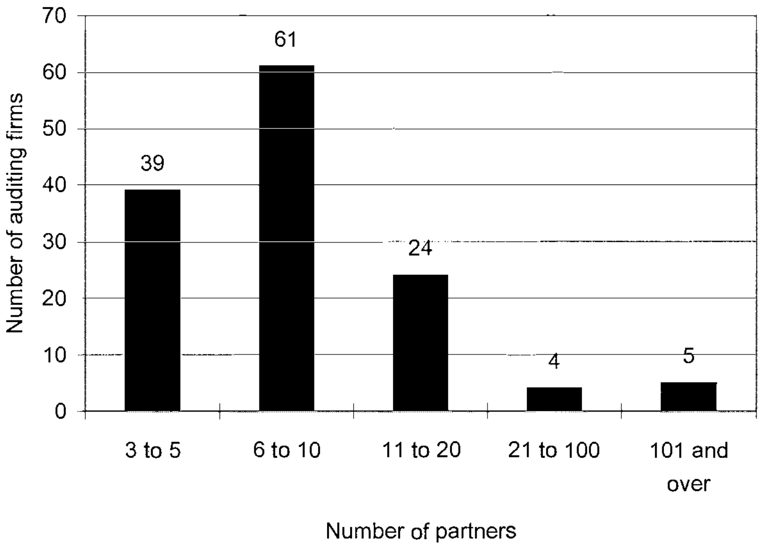

Fig. 11.2 Size distribution of auditing firms in Japan as of 28 February 1999
Source: Data provided by JICPA.

however, JICPA issued a statement. It claimed that foreign accountancy firms should not be legally qualified as auditing firms under CPA law and that it is not appropriate for foreign accountancy firms to conduct tax-related activities that CPA law prohibits a CPA to conduct. In response to it, foreign accountancy firms then in Japan made auditing activities indepen-

Table 11.2 The Results of Japanese CPA Exams

Year	Number of Applicants	Number of Passes	Pass Ratio (%)
1987	4,635	394	8.5
1988	5,205	378	7.3
1989	5,735	596	10.4
1990	6,449	634	9.8
1991	7,157	638	8.9
1992	8,102	798	9.8
1993	9,538	717	7.5
1994	10,391	772	7.4
1995	10,414	722	6.9
1996	10,183	672	6.9
1997	10,033	673	6.7
1998	10,006	672	6.7
1999	10,265	786	7.7

Source: [http://www.jicpa.or.jp].

Note: The results of the second-round exam are shown. Successful applicants become junior CPAs and proceed to the internship period (at least three years) to prepare for the third-round exam.

dent of other services. The Aoyama Audit Corporation with Price Waterhouse was the first approved foreign auditing firm (1983). Foreigners, particularly Americans, have criticized the Japanese CPA system as a barrier.[6]

11.4 The Wave of Globalization

Accountancy services in the world have a peculiar industrial organization. There are several giant firms with a wide range of services operating all over the world. On the other hand, just as in other professional services, there are numerous small firms and individual offices providing accountancy services to local customers. In the latter half of the 1980s, a merger boom occurred in the industry, and the creation of KPMG (1987), Ernst and Young International (1989), and Deloitte Touche Tohmatsu (1990) set the stage for the so-called "Big Six." With the merger of Price Waterhouse and Coopers & Lybrand in 1998, the current "Big Five" regime started. As shown in table 11.3, these five firms have a huge number of employees, including ample professionals, and operate worldwide. They believe that the source of competitive edge is offering clients a wide range of services with wide geographic coverage. Together with their technological superiority, these American-British accountancy firms have established their dominance in the world.

The form of foreign operation, however, is also peculiar. As pointed out by WTO (1998a), accountancy services have "the widespread nature of lo-

6. One of the references is United States Trade Representative (1998).

Table 11.3 "Big Five" in the World

Name of Company	Number of Employees	Operating Countries
PricewaterhouseCoopers	150,000	150+
KPMG	100,000	159+
Ernst and Young International	96,000	132+
Deloitte Touche Tohmatsu	82,000	130+
Arthur Andersen	72,000	84

Sources: [http://www/pwcglobal.com]; [http://www.oscaudit.or.jp]; [http://www.deloitte.com]; and [http://asahi.or.jp] (accessed on 10 June 2000).

cal qualification and licensing requirements, both in regard to individual practitioners and as conditions for the ownership and management of firms" (1). Therefore, foreign direct investment or the direct penetration of professional personnel is not a popular form of international operation. In many cases, the Big Five have business alliances or member firms in foreign countries and provide a franchise for them to use their brand names, often without substantial capital holdings. In many cases, even a profit-sharing contract does not exist with local partners.

In the case of Japan, there are currently four large auditing firms with more than 300 partner CPAs: ChuoAoyama Audit Corporation, Century Ota Showa & Co.,[7] Kansa Houjin Tohmatsu, and Asahi & Co. A brief profile of each firm is presented in table 11.4. Each firm has its own alliance relationship with the world Big Five. Chuo was originally with Coopers & Lybrand, and Aoyama was with Price Waterhouse. These two merged in April 2000 in response to the merger of Coopers & Lybrand and Price Waterhouse in 1998. Century was with KPMG, whereas Ota Showa was with Ernst & Young. However, they also merged in April 2000 to seek the advantage of economies of scale. The reformulation of corporate structure generates four large auditing firms of similar size in terms of the number of professionals, domestic branches, and audit clients. All four of these firms have related companies that conduct business consulting, tax advice, financial advisory, and other services. "One-stop service" is their sales strategy.

These auditing firms took great advantage of alliance relationships as a source of credibility and successfully expanded their operations. However, the current financial crisis in Japan revealed the existence of massive nonperforming loans and lenient financial management, and the quality of auditing services came under strong criticism. In the name of enhancing the quality of accountancy services, the world giants have recently placed more pressure on the management of Japanese accountancy firms. In particular, Japanese accountants were upset when the Big Five requested that Japanese firms add to their audit reports of March 1999 a line saying that the

7. Century Ota Showa & Co. was renamed Shin Nihon & Co. in July 2001.

Table 11.4 Profiles of Large Auditing Firms in Japan

	ChuoAoyama Audit Corporation (PricewaterhouseCoopers)	Century Ota Showa & Co. (KPMG; Ernst and Young International)	Kansa Houjin Tohmatsu (Deloitte Touche Tohmatsu)	Asahi & Co. (Arthur Andersen)
Amount of capital (millions of yen)	1,273	1,744	n.a.	1,242
Number of persons	2,544	2,736	2,154	2,311
Partner CPAs	340	331	312	329
Staff with CPA	961	1,217	766	862
Staff with junior CPA	674	666	659	604
Other	569	522	417	516
Number of domestic branches	26	36	30	37
Number of audit clients	3,846	4,987	2,422	3,846
Statutory audit for SEC and commercial laws	755	2,549	682	608
SEC law audit	87	(included above)	51	74
Commercial law audit	1,071	(included above)	815	1,032
School	226	284	122	295
Labor union	83	201	47	73
Other	1,299	1,953	705	1,764
Data as of:	04/01/2000	04/01/2000	03/31/1999 12/31/1999	03/31/2000

Sources: [http://www.chuoaoyama.or.jp]; [http://www.oscaudit.or.jp]; [http://www.tohmatsu.co.jp]; and [http://www.asahi.or.jp].

Note: Companies in parentheses indicate ally companies. n.a. = not available.

report was prepared along the Japanese standard and thus was not necessarily internationally accepted.[8]

Another wave of globalization has come from the effort of establishing the International Accounting Standards (IAS). The International Accounting Standards Committee (IASC) is an independent private-sector body, and its objective is to achieve uniformity in the accounting principles that are used by businesses and other organizations for financial reporting around the world.[9] It was established by private accountancy groups from nine countries (Australia, Canada, France, West Germany, Japan, Mexico, the Netherlands, the United States, and the United Kingdom) in 1973. Since 1983, the IASC's members have included all the professional accountancy bodies that are members of the International Federation of Accountants (IFAC). Table 11.5 presents the number of member bodies as of June 2000. The IASC board makes decisions on accounting principles and issues them in the form of IAS. Each board member country's delegation consists of two individuals as well as a technical advisor if desired. These individuals include accountants and persons from other business fields.

The support of the International Organization of Securities Commissions (IOSCO) has reinforced the activities of IASC. The IOSCO is an international organization for government agencies that supervise security markets. In 1987, the IOSCO joined the consultative group of the IASC and got involved in formulating the contents of IAS. In 1995, the IOSCO agreed that the IASC would complete "core standards" by 1999 and that on successful completion, the IOSCO would consider endorsing IAS for cross-border offerings. Voices demanding international convergence of accounting systems intensified, and the IASC accelerated the formation of IAS. The core standards were completed with the approval of IAS 39 in December 1998, and the IOSCO started reviewing IAS core standards in 1999. Table 11.6 presents the list of IASC standards. In May 2000, the IOSCO recommended that its members allow multinational issuers to use thirty IASC standards in cross-border offerings and listings. These cooperative movements by the IOSCO have encouraged member countries to conform their accounting systems to the IAS.

Table 11.7 was constructed from the list of companies that declare that their financial statements conform to the IAS without qualification. Nine hundred sixty one companies in seventy three countries (including international organizations) have applied the IAS. This indicates that the IAS is al-

8. In the Asian crisis, the Big Five were criticized for the quality of accountancy services provided by their business alliances in Asian countries. In October 1998, the World Bank issued a request to the Big Five to stop putting their names to accounts published in the Asian economies unless such accounts followed international financial reporting standards (WTO 1998a, 1). The Big Five's request to Japanese firms in March 1999 was made in this context. The criticism has actually provided a great opportunity for the Big Five to strengthen their control over their foreign alliances as well as expanding their consultancy operation abroad.

9. The following information is from [http://www.iasc.org.uk].

Table 11.5 The Organization of the International Accounting Standards Committee (IASC)

Member bodies	
	143 accounting organizations in 104 countries (including 5 associate members and 4 affiliate members)
The IASC Board (two-and-a-half-year term ending 30 June 2000)	
Board members	
	Chairman and Vice-Chairman
	Australia
	Canada
	France
	Germany
	India and Sri Lanka
	Japan
	Malaysia
	Mexico
	The Netherlands
	Nordic Federation of Public Accountants
	South Africa and Zimbabwe
	United Kingdom
	United States
	International Council of Investment Associations (ICIA)
	Federation of Swiss Industrial Holding Companies
	International Association of Financial Executives Institutes (IAFEI)
Observers	
	European Commission
	United States Financial Accounting Standards Board (FASB)
	International Organization of Securities Commissions (IOSCO)
	People's Republic of China

Source: [http://www.iasc.org.uk] (accessed on 10 June 2000).

ready visible in the world business community and is regarded as something useful with which many companies can add credibility to their business practices. Because detailed accounting methods are different across countries, many experts are not optimistic about the complete international convergence of accounting standards. However, it is now very likely that each country's accounting standards will be harmonized in the direction of IAS. The IAS are overall close to the U.S. accounting standard although not identical. Initially the United States was not very positive about the convergence of accounting standards. However, it gradually noticed the strategic importance of convergence and started trying to influence the contents of IAS. The European Commission, on the other hand, announced in June 2000 that all firms in the European stock market should apply the IAS by 2005 (see *Nihon Keizai Shinbun*, 28 June 2000). This announcement would accelerate the worldwide application of IAS as well as possibly intensifying a struggle between the United States and the European Union (EU) over the initiatives establishing the standards.

Table 11.6 List of Current International Accounting Standards (IAS) Committee Standards

IAS 1	Presentation of financial statements
IAS 2	Inventories
IAS 3	No longer effective. Replaced by IAS 27 and IAS 28.
IAS 4	Withdrawn. Replaced by IAS 16, 22, and 38.
IAS 5	No longer effective. Replaced by IAS 1.
IAS 6	No longer effective. Replaced by IAS 15.
IAS 7	Cash flow statements
IAS 8	Profit or loss for the period, fundamental errors, and changes in accounting policies
IAS 9	Research and development costs (will be superseded by IAS 38 effective 1/7/99)
IAS 10	Events after the balance sheet date
IAS 11	Construction contracts
IAS 12	Income taxes
IAS 13	No longer effective. Replaced by IAS 1.
IAS 14	Segment reporting
IAS 15	Information reflecting the effects of changing prices
IAS 16	Property, plant, and equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee benefits
IAS 20	Accounting for government grants and disclosure of government assistance
IAS 21	The effects of changes in foreign exchange rates
IAS 22	Business combinations
IAS 23	Borrowing costs
IAS 24	Related party disclosures
IAS 25	Accounting for investments
IAS 26	Accounting and reporting by retirement benefit plans
IAS 27	Consolidated financial statements and accounting for investments in subsidiaries
IAS 28	Accounting for investments in associates
IAS 29	Financial reporting in hyperinflationary economies
IAS 30	Disclosures in the financial statements of banks and similar financial institutions
IAS 31	Financial reporting of interests in joint ventures
IAS 32	Financial instruments: Disclosures and presentation
IAS 33	Earnings per share
IAS 34	Interim financial reporting
IAS 35	Discontinuing operations (1/1/99)
IAS 36	Impairment of assets (1/7/99)
IAS 37	Provisions, contingent liabilities, and contingent assets
IAS 38	Intangible assets
IAS 39	Financial instruments: Recognition and measurement
IAS 40	Investment property

Source: [http://www.iasc.org.uk] (accessed on 11 June 2000).

Table 11.7 The Number of Companies using International Accounting Standards

Country	Number of Companies	Country	Number of Companies
Australia	6	Korea	2
Austria	10	Kuwait	49
Bahamas	4	Latvia	7
Bahrain	10	Lithuania	5
Barbados	4	Luxembourg	5
Belgium	5	Macedonia	2
Bermuda	2	Malaysia	5
Botswana	4	Malta	8
Brazil	2	Mexico	3
British Virgin Islands	2	The Netherlands	4
Bulgaria	2	Norway	5
Canada	45	Oman	8
Cayman Islands	1	Panama	61
China	121	Papua New Guinea	1
Croatia	8	Poland	7
Curacao	2	Portugal	2
Cyprus	11	Qatar	1
Czech Republic	16	Romania	8
Denmark	12	Russia	17
Egypt	1	Saudi Arabia	2
Estonia	2	Singapore	1
Fiji	1	Slovak Republic	4
Finland	15	Slovenia	6
France	34	South Africa	24
Georgia	1	Spain	1
Germany	161	Switzerland	106
Ghana	1	Tanzania	1
Greece	1	Turkey	19
Guyana	1	Turks and Caicos Islands	2
Hong Kong, China	11	Ukraine	4
Hungary	14	United Arab Emirates	17
India	1	United Kingdom	1
Italy	12	United States	2
Jamaica	1	Venezuela	1
Japan	10	Zimbabwe	15
Jordan	1	International	12
Kazakhstan	1	Total	961

Source: http://www.iasc.org.uk (accessed on 11 June 2000).

Notes: "International" includes African Development Bank, European Bank for Reconstruction and Development (EBRD), Eutelsat, International Accounting Standards Committee, International Bank for Reconstruction and Development (IBRD), International Federation of Accountants (IFAC), International Federation of Stock Exchanges (FIBV), International Finance Corporation (IFC), International Olympic Committee, International Organization of Securities Commissions (IOSCO), Organisation for Economic Cooperation and Development (OECD), and World Bank. "Japan" includes Dai-Ichi Kangyou Bank, Fujitsu Ltd., Kajima, Kansai, Kirin Brewery, Nissan Motor, Sakura Bank, Sanwa Bank, Sasebo, and Toray. "United States" includes American Institute of Certified Public Accountants and FMC.

11.5 The "Accounting Big Bang" in Japan

In the latter half of the 1990s, the Japanese accounting system became increasingly incompatible with modern corporate management, particularly on its usage of the book value of assets, the improper treatment of affiliates, and, as a consequence, the insufficient disclosure of corporate performance. A long-lasting recession in the 1990s gradually eroded public confidence in the Japanese economic system. Particularly since 1997, the bad performance of large construction companies has diluted the credibility of the traditional accounting practices. In addition, incompatibility with the international accounting system generated inconvenience for globalizing firms. Although institutions are interlocked with each other and resist being changed, even accountants with vested interests found themselves being forced to launch a drastic reform. Now the introduction of the new accounting system is ongoing. Because its impact is expected to be substantial, the series of reforms is called the "accounting Big Bang."

The Business Accounting Council under the Ministry of Finance has led the reform.[10] Council members have included academics, accountants, and other private-sector representatives, but the council has maintained the substantial direct involvement of the government. The active stance of the government has made the legislative process and other institutional modification easier. However, it has also reflected the nonexistence of an independent professional body to set up the accounting standard.

Table 11.8 is a list of notes the council submitted to the finance minister in the past few years. These will largely harmonize the Japanese business accounting system with the IAS. In particular, the introduction of the following three elements will generate a substantial impact:

1. Consolidated financial statements (which calculate economic substance by adding the parent company's and subsidiaries' accounts)
2. Market value calculation
3. Statements of cash flows (C/S) in addition to balance sheets (B/S) and income statements (P/L)

The introduction of consolidated financial statements is complemented by the amendment of the competition law in January 1998 allowing the formation of pure stock-holding companies. Major changes in tax effect accounting and corporate pension accounting will be also implemented. All of these will be completed in a few years.

The reform of the accounting system is expected to substantially change the basic structure of Japanese management system and corporate governance. For example, it was a commonly observed practice for Japanese

10. Since July 2000, the Business Accounting Council has been placed under the newly established Financial Services Agency (FSA).

Table 11.8 A Series of Notes by the Business Accounting Council

Date of Announcement	Name of Note	Date of Implementation
6/16/1997	Note on the revision of consolidated financial statements	From F/Y 1999
3/13/1998	Note on the accounting standard for research and development expenditures and others	From F/Y 1999
3/13/1998	Note on the standard of middle consolidated financial statements and others	From F/Y 2000
3/13/1998	Note on the standard of consolidated cash flow statements and others	From F/Y 1999
6/16/1998	Note on the accounting standard for corporate pension	From F/Y 2000 and after
10/30/1998	Note on the accounting standard for tax effect accounting	From F/Y 1999 (or earlier)
10/30/1998	Treatment of affiliates and related companies in consolidated financial statements	From F/Y 1999 (or earlier)
1/22/1999	Note on the accounting standard for financial commodities	From F/Y 2000 and after
2/19/1999	Treatment of the financial statement format	From F/Y 1999

Source: Miyata (1999).

firms to hide their losses by manipulating affiliates' accounts; such practice was called *tobashi* in Japanese. However, consolidated financial statements will make such nontransparent practice difficult to implement. The introduction of market value calculation will eradicate the old style of management based on *fukumi-eki* (unrealized gains or losses from the gap between the book value and market value of assets and liabilities a company holds); in principle, *fukumi-eki* must explicitly be recorded from now on. The market value calculation will also discourage the practice of cross-share holding (*kabushiki mochiai*).[11] In short, the reform of the accounting system will let the market have much clearer signals for corporate performances, which would in turn ignite fundamental corporate reform. Although the presence of foreign traders in Japanese stock exchanges became larger in the 1990s, the wave of cross-border mergers and acquisitions (M&As) has not arrived at Japan yet; although drastically increased in recent years, only 2 percent of world M&As came to Japan in 1999.[12] The modernization of the accounting system, however, may change the pattern of foreign investors.

How far the accounting Big Bang will have an impact is now the subject

11. The cross-share holding practice has steadily subsided since the beginning of the 1990s (see Ito 2000, 8–9 for an example). However, the reason why the introduction of market value calculation discourages cross-share holding is not entirely clear in the academic and nonacademic writing.

12. According to UNCTAD (2000, 108), cross-border M&A sales in Japan in 1999 were $15.9 billion, whereas world total M&A sales were $720.1 billion.

of great debate. Some scholars have a rather pessimistic view; they claim that changes in the accounting system may not necessarily reform the basic attitude of Japanese management. However, it is true that the Japanese accounting system will largely be in accordance with IAS in a few years, although it will not be in complete conformity with it. The author thinks that the overall enhancement of transparency in business accounting will encourage a substantial reform of the corporate governance of Japanese companies.[13]

A recent phenomenon of interest is a big boom in studying for American CPA qualification in Japan. One of the preparatory schools for foreign professional qualifications, Anjo International, is an illustration. Kotaro Anjo, a former worker in Nomura Securities, established it in 1995 with only twenty students. As of March 1999, it claimed to have 8,000 students in ten locations (Anjo 1999). The government also provides tuition subsidies for students in preparatory schools. Although the some professional accountants criticize the for U.S. CPA boom (see, e.g., Kojima 1999), it is now a common practice for auditing firms to treat a U.S. CPA as one of the eligibility qualifications for their recruits. At this moment, young people with U.S. CPAs work mainly as assistants because the Japanese license is required for official auditing services. However, along with the convergence of accounting systems, the qualification system of accountants would be reviewed in the future.

The JICPA has recently requested to the Ministry of Finance (MOF) a drastic increase in successful candidates in CPA qualifying exams (see Fukuda 2000 and *Nihon Keizai Shinbun*, 10 June 2000, evening edition). In the past, the JICPA was rather conservative in expanding the number of CPAs. Since the end of World War II, the Japanese have not had a strong inclination toward individual professionalism in general, but accountants and lawyers have been exceptions. Accountants have long been treated as highly prestigious professionals. Although audit fees have been strictly regulated, accountancy has also been regarded as a high-income profession.[14] The JICPA therefore claimed that a reckless increase in the number of accountants might degrade professional quality. However, the JICPA recently changed its stance in the opposite direction due to the recent drastic increase in the demand for CPAs as well as a sneaking penetration of U.S.

13. A questionnaire survey (Matsuo et al. 1999) reports that security market analysts particularly appreciate the introduction of consolidated financial statements and market value calculation and reveal support for the convergence toward the IAS or the U.S. accounting standard.

14. Despite the regulation on auditing fees, the cost of audits borne by audit firms has drastically increased recently. Chiyoda (1999) points out that Japanese audit firms tend to make up for the increase in auditing cost by providing consultant services to clients. This may be a trend against the current move in the United States, where the SEC announced a policy to separate audit services from consultant services in order to prevent undesirable collusions of audit firms and clients (*Nihon Keizai Shinbun,* 21 June 2000, evening edition).

CPA qualification. In June 2000, the Advisory Group to the Finance Minister on the CPA system made public a drastic reform plan to double the number of successful applicants in CPA exams. Interesting enough, the plan also includes several measures enhancing the quality of accountancy services, such as the three-year periodical update of CPA registration as well as the liberalization of audit fees and the length of audit periods (see *Nihon Keizai Shinbun*, 24 June 2000).

In addition, the JICPA and the MOF (and now the Financial Services Agency [FSA]) have started preparing the establishment of a private body to take care of business accounting standards.[15] So far, the MOF (FSA) has been directly in charge of Japanese business accounting standards. However, quick response to the wave of globalization requires a permanent group of private specialists. Moreover, to participate in the process of constructing IAS, Japan has to send a private group to the IASC. The IASC restructured its organization in January 2001, and Tatsumi Yamada of Japan was elected as one of the board members who will be in charge of constructing IAS. Such movements, however, should be accompanied with stronger monitoring by the public sector, as the SEC works in the United States. A critical private watch over the performance of accounting business must also be fostered in the Japanese business community.[16]

11.6 Liberalization Efforts in the World Trade Organization

Accountancy services were included in the framework of the General Agreement on Trade in Services (GATS) from the beginning. The GATS first requests member countries to obey the MFN principle (Article II) and transparency requirement (Article III) for all sorts of trade in services.[17] Then the market access obligation (Article XVI) and national treatment principle (Article XVII) are imposed on the basis of the Schedule of Specific Commitments (the positive list method). Whereas market access refers to quantitative measures to deter foreign entry, qualitative measures to possibly deter entry are taken care of by Article VI on domestic regulation,

15. A newspaper article reporting an interview with Hiroshi Nakachi, the president of the JICPA (*Nihon Keizai Shinbun,* 8 June 2000) and another article (*Nihon Keizai Shinbun,* 9 August 2000) disclosed the intention of JICPA that a private body for establishing new accounting standards would be organized in the first half of 2001.

16. In the United States, one of the major motivations for big mergers in the industry was to prepare for private suits against accountancy firms. In other words, the performance of accountancy firms is always under potential criticism. On the other hand, there have so far been very few lawsuits against accountancy firms in Japan.

17. The MFN principle is applied with some limited exceptions. In particular, Article II: 2 and the Annex on Article Exemptions admit that member countries can specify sectors temporarily exempted from the MFN obligation (the negative list method). In fact, seven countries—Costa Rica, the Dominican Republic, Honduras, Panama, Thailand, Turkey, and Venezuela—directly specify either accountancy services or professional services in general for MFN exemptions (WTO 1998a, 13).

which loosely states that "unnecessary barriers to trade in services" must be removed.

Because policies related to trade in services are often strongly domestic in nature, the borderline issue between international policy discipline and domestic policies often comes up, particularly for market access obligation and domestic regulation. The WTO often uses the word "impediments" or "barriers" for regulations not conforming to international policy discipline. However, please note that some government regulations not following the market access requirement, for example, may have a good domestic reason for existence.

Table 11.9 is an illustrative list of "impediments" to trade in accountancy services prepared by the WTO. Following a number of general impediments, nine specific impediments are listed. These impediments restrict trade in services conducted in four modes: cross-border (mode 1), consumption abroad (mode 2), commercial presence (mode 3), and natural persons (mode 4). Notably, "residence/establishment requirements" are common barriers for mode-1 service trade. "Professional certification/entry requirements," "restrictions on business structures," and "differences in accounting, auditing, and other standards" can be significant impediments for mode-3 and mode-4 service trade.

Table 11.10 presents the percentage of member countries that declare (a) full commitment, (b) partial commitment, or (c) no commitment for each type of services and for each mode of services trade. In the case of accounting, auditing, and bookkeeping services, a number of countries declare full commitment for mode-2 services trade (for both market access

Table 11.9 **Impediments to Trade in Accountancy Services**

A. General impediments
   - Restrictions on international payments
   - Restrictions on the mobility of personnel
   - Impediments to technology and information transfer
   - "Buy National" public procurement practices
   - Differential taxation treatment/double taxation
   - Monopolies
   - Subsidies

B. Specific impediments
   - Nationality requirements
   - Residence/establishment requirements
   - Professional certification/entry requirements
   - Compartmentalization/scope of practice limitations/incompatibilities
   - Restrictions on advertising, solicitation, and fee-setting
   - Quantitative restrictions on the provision of services
   - Differences in accounting, auditing, and other standards
   - Restrictions on business structures
   - Restrictions on international relationships/use of firm name

Source: WTO (1998a, table 4).

Table 11.10 Commitment Percentage, by Sector and Mode of Supply (professional services)

	Cross-border			Consumption Abroad			Commercial Presence			Natural Persons		
	Full	Partial	No	Full	Partial	No	Full	Partial	No	Full	Partial	No
					A. Market Access							
Legal services	18	67	16	24	67	9	4	87	9	2	91	7
Accounting, auditing, and bookkeeping services	29	41	30	41	45	14	9	89	2	2	86	13
Taxation services	44	44	12	53	44	3	15	82	3	0	88	12
Architectural services	52	26	22	68	20	12	24	72	4	0	92	8
Engineering services	50	28	22	55	28	17	24	72	3	0	85	5
Integrated engineering services	59	22	19	66	22	13	31	59	9	0	94	6
Urban planning and landscape architectural services	45	36	18	52	36	12	24	73	3	0	97	3
Medical and dental services	34	29	37	61	34	5	21	68	11	0	87	13
Veterinary services	54	19	27	69	23	8	31	58	12	4	81	15
Services provided by midwives, nurses, physiotherapists	33	33	33	47	53	0	20	80	0	0	93	7
Other	33	67	0	33	67	0	0	100	0	0	100	0
					B. National Treatment							
Legal services	22	60	18	31	58	11	16	76	9	2	91	7
Accounting, auditing, and bookkeeping services	34	36	30	50	36	14	32	64	4	4	80	16
Taxation services	41	41	18	56	35	9	35	56	9	12	71	18
Architectural services	52	30	18	64	22	14	56	38	6	8	80	12
Engineering services	45	31	24	60	21	19	52	43	5	9	79	12
Integrated engineering services	63	19	19	72	13	16	72	13	16	9	78	13
Urban planning and landscape architectural services	52	30	18	61	24	15	58	33	9	9	85	6
Medical and dental services	47	18	34	66	24	11	45	45	11	3	87	11
Veterinary services	62	12	27	81	8	12	58	35	8	8	77	15
Services provided by midwives, nurses, physiotherapists	40	27	33	53	47	0	53	47	0	0	93	7
Other	33	50	17	33	50	17	33	67	0	17	67	17

Source: WTO (1998a, table 6).

Notes: Full = Full commitment (indicated by "None" in the market access or national treatment column of the Schedule). Partial = Partial commitment (limitations are inscribed in the market access or national treatment column of the Schedule). No = No commitment (indicated by "Unbound" in the market access or national treatment column of the Schedule). Percentages may not add up to 100 due to rounding. Basis of total is listed sectors.

Table 11.11 **Analysis of Types of Measures (number of measures in accountancy services)**

Type of Limitation	Mode 1	Mode 2	Mode 3	Mode 4
A. Market Access				
Number of suppliers	—	—	2	—
Value of transactions or assets	—	—	12	1
Number of operations	—	—	—	—
Number of natural persons	1	1	3	31
Type of legal entity	4	2	22	1
Participation of foreign capital	—	—	17	1
Other measures, n.e.c.	4	4	19	2
B. National Treatment				
Tax measures, subsidies, grants and other financial measures	—	—	—	—
Nationality requirements	1	1	7	6
Residency requirements	4	2	11	8
Licensing, standards, qualifications	6	4	16	12
Registration requirements	2	2	6	2
Authorization requirement	3	1	5	2
Performance requirements	—	—	—	—
Technology transfer requirements	—	—	1	—
Local content, training requirements	—	—	1	—
Other measures, n.e.c.	1	—	4	3

Source: WTO (1998a, table 8).

Note: The number of "Other measures, n.e.c." in part A is large because a number of entries in the Schedules could not be classified into one or the other of the distinct categories of limitations. In some cases, this was due to a lack of specificity in the description of the measure, whereas in others it was because the measure itself did not correspond to any of the categories.

and national treatment), although this mode is not very important for accountancy services. For mode-1 service trade, about one-third of the countries provides full commitment, whereas another one-third gives no commitment. As for mode-3 and mode-4 services trade, most of the countries provide partial commitments. Table 11.11 presents the measures for the cases of partial commitments.

Table 11.12 summarizes the commitment to market access and national treatment made by Japan. For market access, a key impediment for modes 1, 2, and 3 is the specification of accountancy service providers. In addition, the commercial presence requirement inhibits mode-1 service trade. As for national treatment, services trade of mode 1, 2, and 3 does not have any barriers. For mode 4, Japan does not announce any commitment for market access or national treatment. We cannot say that all of these "impediments" must be removed. In fact, some of them—the license requirement, for example—would have good domestic reasons for keeping it. However, the

Table 11.12 Commitment in Japan by Mode of Supply in Accountancy Services

Cross-Border	Consumption Abroad	Commercial Presence	Natural Persons
	A. Market Access		
Partial commitment (services must be provided by natural persons or auditing firms; auditing firms must have commercial presence)	Partial commitment (services must be provided by natural persons or auditing firms; auditing firms must have commercial presence)	Partial commitment (services must be provided by natural persons or auditing firms)	No commitment
	B. National Treatment		
Full commitment	Full commitment	Full commitment (except as indicated in the horizontal section)	No commitment (except as indicated in the horizontal section)

Source: MOFA (1998, 274–275).

commercial presence requirement, for example, may have a much shakier justification in the present globalizing world. The boundary of international policy discipline is again fuzzy in some aspects.

Colecchia (2000) recently tried to quantify the barrier to market access for services, using accountancy services as a pilot case. She constructed a flow chart to check the existence of various types of barriers and provide a formula for calculating aggregate levels of protection. In her calculation, the overall protection index for the United Kingdom, France, Australia, and the United States was 0.0, 0.3, 0.85, and 1.25, respectively. The index for Japan would probably fall between those for Australia and the United States, which indicates that Japan is not at least a very protective country compared with other developed countries. However, direct access to the Japanese market by foreign accounting firms or foreign accountants is very limited so far.

From 1995, the WTO's Council for Trade in Services had the Working Party on Professional Services and sought a way of facilitating international trade in accountancy services as a forerunning case among professional services. In May 1997, the council adopted the working party's report titled "Guidelines for Mutual Recognition Agreements or Arrangements in the Accountancy Sector" (WTO 1997). The purpose of this guideline is to provide "practical guidance for governments, negotiating entities or other entities entering into mutual recognition negotiations on accountancy services." It encourages bilateral agreements for international harmonization of institutions related to accountancy services and provides a guideline for them to convey the information to the WTO for transparency purposes. This guideline is nonbinding in nature.

In December 1998, the council endorsed another report of the working party, titled "Disciplines on Domestic Regulation in the Accountancy Sector" (WTO 1998b). The press release states: "Most professional services, and many others, are heavily regulated, and for good reasons: but it is also true that regulations can be an unnecessary, and usually unintended, barrier to trade in services" (WTO 1998b).

From this view, the disciplines are adopted to ensure that "measures relating to qualification requirements and procedures, technical standards and licensing requirements and procedures, technical standards and licensing requirements do not constitute such barriers." The report explicitly states that the disciplines do not address measures subject to scheduling under Articles XVI (market access) and XVII (national treatment) of the GATS. Rather, they ensure that domestic regulations meet the requirements of Article VI: 4 (removal of unnecessary barriers to trade) of the GATS. The text of the report contains provisions on transparency, licensing requirements, licensing procedures, qualification requirements, qualification procedures, and technical standards. The disciplines did not have an immediate legal effect but would be included in the new round of service negotiations started in 2000. The council, however, decided on a "standstill provision," effective immediately. Then, in April 1999, the Working Party on Domestic Regulation was launched as a replacement for the Working Party on Professional Services.

The formation of GATS as well as additional work by the working party in the Council for Trade in Services has successfully specified the framework of liberalization. The Disciplines on Domestic Regulations may provide some liberalization pressure on member countries. However, the hardcore negotiation for liberalization, particularly on market access and national treatment, has not yet taken place. The WTO so far takes a rather conservative stance and respects country-specific regulations. All the difficult negotiation issues are sent to the new round, where we will start discussing the contents of liberalization commitments.

11.7 Conclusion

The story of the accountancy sector provides a profound opportunity for us to consider the nature of liberalization in the globalization era. Once we go beyond the liberalization of merchandise trade, it is inevitable for us to confront a delicate issue on the borderline between "pure" domestic policies and international commercial policies under international policy discipline. The borderline is not at all clear in many cases. It depends on our feeling of how important the logic of domestic regulations with institutional divergence is and how far globalization provides incentives for accepting international policy discipline. This borderline issue emerges when we step forward the liberalizing of various fields such as services, foreign direct investment, intellectual property rights, environment, labor, and so on.

As for the accountancy services in Japan, we could have treated them as a sector under a "pure" domestic policy twenty years before. The accountancy services were based on a country-specific regulatory framework and were backed up by a pure domestic system of professional qualification. However, the wave of globalization has come since the latter half of the 1980s, and the effort to establish an international accounting standard started bearing fruit in the 1990s. At the same time, the slump in the Japanese economy since the beginning of the 1990s has revealed various structural problems in the Japanese economic system. As a result, a drastic convergence toward IAS has started in Japan as an "accounting Big Bang." Since the accounting system is deeply rooted in the fundamental institutional structure, many experts do not predict complete convergence with the international standards. However, the movement in the direction of international harmonization would change the borderline of "pure" domestic policies, and the scope of international policy discipline would be enlarged.

In Japan, major impediments to accountancy services trade remain in the form of the service provider qualification and residence requirements. The penetration of IAS, however, would erode the justification for having a country-specific institutional structure. The pressure of globalization would also come from the effort of mutual recognition among European countries and others. At least from a not-legally-obliged portion of accountancy services, the liberalization is likely to proceed in the near future. That would in turn encourage the fundamental reform of the legal structure and accountant qualification system. The position of Japanese CPAs would become a delicate one in the liberalization process.

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Comment Edwin L.-C. Lai

This is an interesting paper that describes in detail the historical background of the regulation of accounting services in Japan as well as the current situation and future prospects of trade liberalization in the sector. It is very informative, and it helps people who are unfamiliar with the sector to understand the issues that are involved in liberalization of trade in this area. It highlights how Japanese regulation in accounting services impedes, either intentionally or unintentionally, foreign market access and trade in the services.

One point the author emphasizes is that to allow for free trade in accounting services, Japan needs to adopt the modern accountancy system. The introduction of the modern accountancy system would necessitate the introduction of other institutions of modern capitalism, such as corporate culture and corporate governance. I am not so clear on this point. The big question is to what extent liberalization in accounting services would affect the corporate governance of Japanese firms. Corporate culture and corporate governance are very history- and culture-dependent, and it is hard to imagine a change in the accounting system can change all that. Perhaps it is more likely that, accompanied by other fundamental changes in Japanese capitalism, a reform in the accounting system can set in motion some other

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changes that can have long-term impacts. I suspect that in the near future, Japanese firms can find innovative ways to satisfy accounting rules yet essentially maintain the corporate governance. For example, it is probably that Japanese firms can hide their performance in a more sophisticated way under the new system. As the saying goes, "where there is a will, there is a way." The process of convergence in corporate governance would therefore probably be a long one. Take the case of intellectual property rights protection in less developed countries: the laws can be adopted, yet enforcement is a key problem.

To put the point in another way, if Japanese firms find that they have to change fundamentally their way of doing business, it seems likely that they would resist trade liberalization in accounting services or in other services that impose similar effects, such as legal services. They can then lobby for the use of administrative measures, such as qualification and residency requirements, to block free trade of such services.

This makes me think of a more general question. If countries need to change their systems in a fundamental way so as to allow trade in services, would they be willing to do that? Is this exactly why it is so much harder to liberalize trade in services than trade in goods? If these are important concerns of the countries, should the rest of the world ask the countries to change their system so as to allow freer trade? I think doing this is going beyond the scope of the World Trade Organization's mandate. The role of the World Trade Organization (WTO) is limited to promoting freer trade. The best that free-traders can do in this case is to focus on trade liberalization and try to minimize the impact of trade on other aspects of the country, such as institutional change that is unrelated to trade per se.

It is beyond the power of the WTO to ask Japan to change its corporate systems. It is probably Japan that wants to change its own system. Therefore, in contrast to the author, I believe the direction of causation is just the opposite: globalization, the need for harmonization, and the disillusion in Japan with Japanese corporate governance can help to change the Japanese accounting system to a more internationally accepted standard. Such a movement can give the incentive to the Japanese business community to accept freer trade in areas such as accounting and legal services. It would then help trade liberalization in these sectors.

The author emphasizes that the major impediments to trade in accountancy services remain on service provider qualification and residence requirements. This shows a major difference between trade in goods and trade in services. In the case of trade in goods, the two pillars of liberalization are the "national treatment" and "most-favored nation" principle. In the case of trade in services, these two principles are not enough. As table 11.12 of the paper shows, although Japan has full commitment to national treatment in "cross-border trade," "consumption abroad," and "commercial presence," there is only partial commitment to market access on these aspects. Apparently, major access impediments come from professional certification and entry requirements and differences in accounting and auditing standards. As Richard H. Snape points out (chap. 3 in this volume), a generic principle that governs this aspect of trade liberalization in services should be established by the WTO.

Finally, some international comparison would be enlightening. For example, one could compare the number of foreign certified public accountants and foreign accounting establishments in countries such as Germany, France, and China with those of Japan. Of course, the availability of data could be a problem.

Comment Aaditya Mattoo

The paper contains a wealth of information and numerous valuable insights. In fact, my comments are based mostly on what I have learned from the paper. The main suggestion I have is to step back a little and provide a clearer conceptual structure and a fuller analysis of the policy options. Some of my suggestions are probably beyond the scope of the paper and really subjects for future research. Nevertheless, it may be helpful to focus on three sets of issues.

The Relationship between Accounting Standards and Qualification and Licensing Requirements for Accounting Professionals

It may be useful to clarify the link between the different layers of regulation affecting accountancy services. At the top, and analogous to output standards, are the accounting standards themselves.[1] The precise nature of these standards depends, as the paper nicely shows, on the purpose for which the accounts are prepared—the requirements of securities and exchange law, commercial law, or corporation tax law. At the layer below, and analogous to input standards, are the qualification and licensing requirements for accounting professionals, governed by the law on certified public accountants (CPAs) and the registration requirements of the Japanese Institute of CPAs.

The demand for the services of accountants is a demand derived from the existing business transparency standards (which may be mandatory or vol-

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The author has benefited greatly from discussions with Fukunari Kimura and the comments of Claude Trolliet.

1. Accounting standards are not the only output standards in the sector: there are also auditing standards, management accounting standards or guidelines, and so on.

untary). Hence, the qualification and licensing requirements imposed on accountants depend, in principle, on the nature of these "output" standards. The current segmentation in the market for accountancy services is attributable in part to the heterogeneity of business transparency standards, both within countries and across countries.[2]

Is this heterogeneity inevitable, since transparency objectives necessarily differ—from shareholders to tax authorities, and from country to country? Or can we conceive of a core set of universal transparency requirements that would satisfy everybody? The paper rightly emphasizes the strong link between national standards and the historical and legal context of each country, but it also shows how, in this globalizing world, there is bound to be convergence on business transparency standards. Evidence of this phenomenon are the increasingly successful attempts by the International Accounting Standards Committee (IASC) to develop a set of international accounting standards (IAS) that could constitute such a universal core.

A Conceptual and Empirical Analysis of the Barriers to Trade

The barriers to trade in accountancy services are both explicit (i.e., targeted at foreigners alone) and implicit (i.e., targeted ostensibly at both nationals and foreigners). In order to understand the consequences of the different barriers, a first step would be to identify the stage they affect: qualification, licensing, establishment, or operation. Domestic competition is evidently influenced by the manner in which the CPA qualification examination is conducted. One approach would be to test for a certain essential level of skills that accountants must have and pass everybody who achieves that level. The number of accountants would then be determined by the market. Another approach, and this seems to me closer to actual practice, is to decide first on the number of accountants that are to be qualified and determine the skill threshold accordingly. The exhortations by industry to the Ministry of Finance, which runs the examination, to increase the number of accountants do raise the question: are they suggesting that standards be lowered to an unacceptable level or simply that a quota be relaxed without any serious affect on required standards?[3]

A fundamental restriction affecting the ability of foreigners to enter the sector is the residency requirement, which undoubtedly has a de facto dis-

2. Of course, the segmentation of the input market is not due only to differences in output standards. Input standards can have a life of their own. For instance, in some countries, qualification and licensing requirements for accountants were developed before the accounting standards themselves.

3. Of course, the level of the standards may have little relation to the size of the quotas, because the direction of causality may well be from the degree of competition to the quality of service. Thus, protected markets often have poor standards.

criminatory effect. What, if any, is the rationale for these residency requirements—enforcement? A second restriction, which has an impact at the establishment stage, is the restriction on the use of foreign business names. This could serve to protect national providers from competition by reputable foreigners in a market where reputation provides a crucial competitive edge.

In assessing the impact of these different restrictions, it is important first to identify the binding constraints. Some of the more obvious restrictions may be circumvented: for instance, restrictions on foreign investment have been sidestepped by a system of alliances. In identifying the constraints at different stages, it may be useful to consider the flowcharts developed by Alessandra Colecchia at the Organization for Economic Cooperation and Development (OECD).

Empirical work is bound to be worthwhile but difficult—and beyond the scope of this paper. An obvious approach is to begin with some simple price or cost comparisons. How much do standard accounting activities cost in Japan relative to other markets? How do the earnings of accountants in Japan compare with those elsewhere? Alternatively, it may be possible to look at the costs of the barriers themselves: how much would it cost a foreign accountant to qualify in Japan—in terms of both actual expenses and lost earnings? Some of the costs of barriers are less easily quantifiable: for example, what is the cost to Japanese firms (e.g., in terms of raising finance) of not having access to the most reputable accountancy firms? Then the most difficult question of all: in analyzing the estimated differences in costs between countries, how is one to distinguish between legitimate differences and protection?

The Policy Options in Dealing with Barriers to Trade

There could have been more discussion of how the barriers to trade are best addressed. With regard to the explicit, which include residency requirements and restrictions on the use of foreign names, the solution would seem straightforward: They should be eliminated unless the authorities can demonstrate that some legitimate objective is served by maintaining them.

The implicit barriers arising from the heterogeneity of regulations, both in the form of accounting standards and in the form of qualification and licensing requirements, are more difficult to eliminate. There are in principle three related routes.

Harmonization

As noted above, the work of the IASC in developing international accounting standards would do much to further the liberalization of trade in accountancy services. Once the basic "output" standards are harmonized, there is less basis for segmentation of the market through heterogeneous "input" standards in terms of country-specific qualification and licensing requirements.[4] Efforts are apparently also being made by the International Federation of Accountants (IFAC) to develop international norms for the requirements imposed on professionals. The WTO has little role in this context except to encourage such harmonization by creating a legal presumption in favor of international standards (as in Article VI:5[b] of the General Agreement on Trade in Services [GATS]).

Mutual Recognition Agreements

Such agreements can in principle have a powerful liberalizing impact, but they have proved difficult to conclude where they would matter most.[5] There are, of course, sound policy criteria to conclude such agreements-sufficient similarity in the basic norms and sufficient confidence in trading partners' conformity assessment systems—but these considerations are often secondary to political-economic considerations. Because such agreements must necessarily be concluded at the sectoral level (with the detailed involvement of the regulators and domestic professionals), there is a limited incentive to conclude such an agreement even between countries with similar costs—since the end of market segmentation necessarily means lower rents for the industry in at least one country—and much less of an incentive between countries with significantly different costs. Here, again, the WTO has a limited role. A set of non-binding guidelines for recognition agreements in accountancy has been developed. The main objective (as in GATS Article VII on recognition) is to allow such agreements because of their liberalizing impact but to prevent their being used as a means of discrimination against excluded countries.

Multilateral Disciplines and the Necessity Test

I have discussed the meaning of this test and how it can be given a sound economic interpretation in my paper in this volume (chap. 2). The new WTO disciplines on domestic regulations for the accountancy sector already incorporate such a test. However, the elaboration of the disciplines is somewhat disappointing; for instance, regulators are only required to "take account" of qualifications obtained in other countries. Nevertheless, the scope of application of the test to sift the legitimate from the protectionist

4. Full harmonization may be slow to emerge. Initially, international standards may have an impact only on companies that need international comparability for their financial information. The corner shop, which has only basic accounting needs, may remain unaffected. This output market segmentation may be reflected in a continued segmentation in the accountancy profession, between those providing services to small national businesses and those servicing clients with international needs.

5. Apparently, mutual recognition agreements have had limited impact even within the European Union.

depends on the differences between countries in their basic standards. The more the harmonization and the greater the universal content of the basic standards, the less reason there is for imposing elaborate requalification and relicensing requirements. It is in this sense that the work of IASC and IFAC must be seen as the font of all liberalization efforts in this sector.