

Why Hasn't Deregulation Revived the Japanese Economy?

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The Japanese government has been promoting “deregulation” for almost 40 years. And the Abe administration has continued in this tradition by creating deregulation zones in major cities and perpetuating various deregulation implementation plans.

But has all that deregulation really helped the economy? Takeo Hoshi of Stanford University and Anil Kashyap of the University of Chicago examined Japanese deregulation programs from 1995 to 2005 and found no correlation with improvement in total factor productivity. How could that be?

Standard economics cannot resolve this puzzle because it assumes that less regulation means freer markets, and that is naturally better for the economy.

Japanese leaders have systematically overestimated the benefits from deregulation because they have fallen into the same trap as their American counterparts. They have viewed government and market as alternatives rather than complements. They have interpreted market reform as removing barriers to the free market – deregulation, rather than building institutions to sustain dynamic markets – “marketcraft.”

The marketcraft perspective can unravel this puzzle. It suggests that the appropriate question is not whether regulation increases or decreases, but whether it achieves its policy goal. So if the goal is to enhance competition, then the government should decrease regulations that impede competition and increase regulations that promote it. And in practice, spurring competition often requires more regulation, not less.

In telecommunications, for example, governments have forced incumbent carriers to lease their lines to competitors on favorable terms to jumpstart competition. Or in electricity, governments have designed complex auction systems to make the markets work. From this perspective, it makes perfect sense that deregulation would not raise productivity across the board, because some regulations empower markets while others obstruct markets.

What's more, deregulation never happened – at least not in the literal sense of reducing regulations. The Japanese government reports that the number of regulations such as license and permit requirements increased from 10,621 in 2002 to 15,475 in 2017, a period of successive deregulation programs. This is what I have called the phenomenon of “free markets, more rules.” That is, economic

liberalization has gone hand in hand with regulatory expansion. Research has confirmed this as the dominant trend over the past several decades among OECD countries, not just Japan.

To put this simply, regulations can help the economy or hurt it. So it makes no sense to assume that reducing regulations would necessarily benefit the economy. Japanese authorities should embrace this basic lesson, and aim not for deregulation but for better marketcraft.

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