

Marketcraft Japanese Style: What Japan Tells Us About the Art of Making Markets Work

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Markets are institutions . . .

embedded in particular
laws,
regulations,
practices,
and norms.

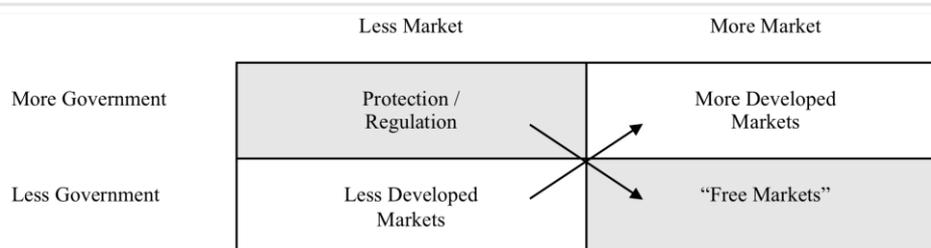
If Markets are Institutions, then . . .

1. There is no such thing as a free market.
2. Markets have to be constructed.
3. Market reform is primarily a constructive enterprise, not a destructive one.
4. There is no single market solution to a policy problem.
5. There may not even be a more market-oriented solution among policy options.

Market Reform (“Liberalization”) = Removing Barriers or Building Institutions?

	Removing Barriers (Market-Liberal View)	Building Institutions (Market-Institutionalist View)
Post-Communist Countries	Shock Therapy <i>“Privatization”</i>	Gradualism <i>Market Transition</i>
Developing Countries	The Washington Consensus <i>“Liberalization”</i>	Building Market Institutions <i>Market Development</i>
Industrialized Countries	Neoliberal Reform <i>“Deregulation”</i>	Marketcraft <i>Market Reform</i>

Market Liberalization versus Market Development



If Markets are Institutions, then . . .

6. Regulation vs. competition is a false dichotomy.
7. Government vs. market is a false dichotomy.
8. A liberal market economy (LME) like the US is just as governed as a coordinated market economy (CME) like Japan, possibly more.
9. A CME like Japan would require more governance, not less, to become an LME.
10. The information economy requires more governance, not less.

Marketcraft: Table of Contents

1. No Free Market
2. How to Make a Market
3. The United States: Why the World's "Freest" Market is Also the Most Governed
4. Japan: Why It is So Hard to Become a Liberal Market Economy
5. Implications for Theory and Practice

What Would It Take to Turn Japan Into a Liberal Market Economy?

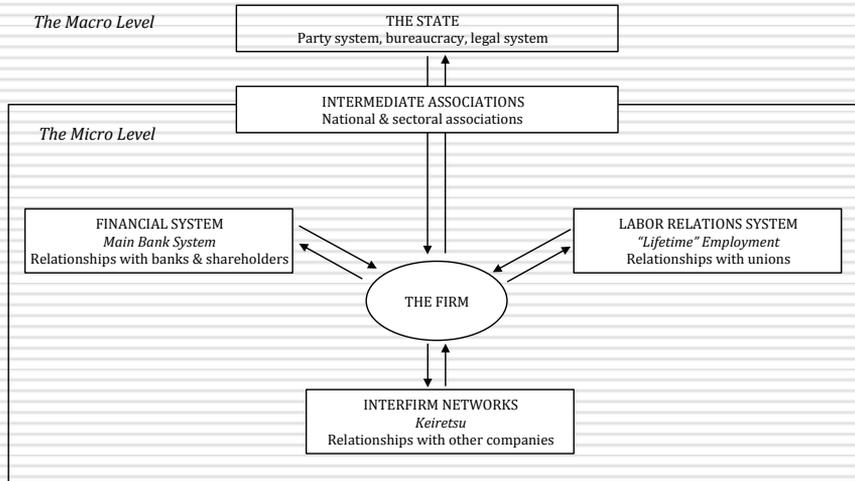
- The Market-Liberal Answer:
Just stop intervening in the market!
- The Market-Institutionalist Answer:
A lot!

	LAWS	REGULATIONS	PRACTICES	NORMS
LABOR	<ul style="list-style-type: none"> • Labor law reform • Corporate law reform • Pension reform • Lift holding company ban • Strengthen social safety net 	<ul style="list-style-type: none"> • Government upgrades information dissemination and job matching • Courts permit employers more freedom with dismissals 	<ul style="list-style-type: none"> • Lay off workers when necessary • Stop favoring new graduates over mid-career hires • Shift from seniority to merit-based pay • Introduce stock options 	<ul style="list-style-type: none"> • The government should not use regulation to preserve employment • Companies should not preserve employment over profits • Employees should pursue labor market opportunities
FINANCE	<ul style="list-style-type: none"> • Financial reform • Corporate law reform • Pension reform • Lift holding company ban 	<ul style="list-style-type: none"> • Financial authorities give financial institutions more leeway with new financial instruments • Financial authorities do not favor domestic financial institutions 	<ul style="list-style-type: none"> • Sell off cross-held shares • Banks make lending decisions and price loans on the basis of risk • Banks stop lending to insolvent firms 	<ul style="list-style-type: none"> • Companies should maximize shareholder value • The government should not protect banks • The government should not manipulate financial markets
COMPETITION	<ul style="list-style-type: none"> • Strengthen antitrust • Regulatory reform • Bankruptcy reform • Strengthen social safety net 	<ul style="list-style-type: none"> • Strengthen antitrust enforcement • Upgrade economic analysis of collusion and anti-competitive practices 	<ul style="list-style-type: none"> • Choose business partners on the basis of price, not relationships • Do not cooperate or collude with competitors 	<ul style="list-style-type: none"> • Firms should compete, not collude • Companies should not favor long-term business partners

Chapter 4: Japan

- The Postwar Model
- Financial Reform
- Corporate Governance Reform
- Labor Market Reform
- Antitrust Reform
- Regulatory Reform
- Intellectual Property Rights
- Crafting the Infrastructure for Innovation
- Crafting the Infrastructure for an IT Revolution

The Japanese Model



Japan's Postwar Model (1945-80)

	LAWS	REGULATIONS	PRACTICES	NORMS
Accounting				
Banking				
Capital Markets				
Corporate Governance				
Antitrust				
Labor				
Electricity				
Airlines				
Telecommunications				
Patents				
Copyrights				

Japan's Market Reforms 1980-present

- Financial Reform
- Corporate Governance
- Labor Markets
- Antitrust
- Regulatory Reform
- Intellectual Property Rights

Japan's Market Reforms 1980 - present

	LAWS	REGULATIONS	PRACTICES	NORMS
Accounting				
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Patents				
Copyrights				

Promoting Innovation: Laws & Regulations

1963 Established three SBICs	2001 Allowed preferred stock
1995 Science and Technology Law	2001 Regional Cluster Plan
1995 Venture Business Support Law	2002 No capital requirements for new firms
1997 Permitted stock options	2003 Revised Industrial Revitalization Law
1998 Limited Partnership Act	2004 Revised Liquidation Law
1999 Venture Business Support Law	2004 National universities privatized
1999 Industrial Revitalization Law	2005 No capital requirements for incorporation
1999 Civil Rehabilitation Law	2005 Created limited liability partnerships
1999 Revised share transfer rules	2009 Innovation Network Corporation of Japan
2000 Corporate Spinoff Law	2013 Japan Revitalization Strategy

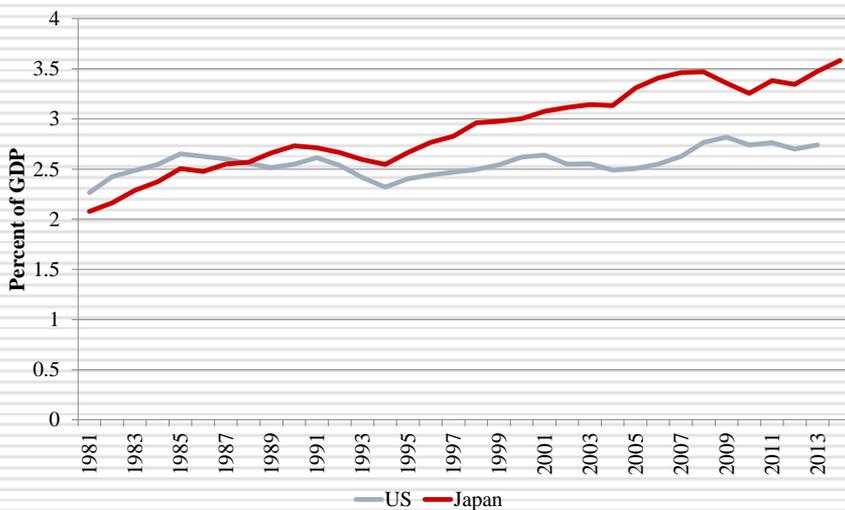
Promoting Innovation: Business Practices

- Firms preserved high R&D investment.
- Firm entry and exit remained relatively low.
- Firms reorganized to cut costs and enhance performance.
- Firms favored a distinctively Japanese approach to labor adjustment.
- Japan's venture capital model evolved, but remained distinct.
- New stock exchanges: MOTHERS (1999), JASDAQ (2000), Hercules (2003)

Promoting Innovation: Social Norms

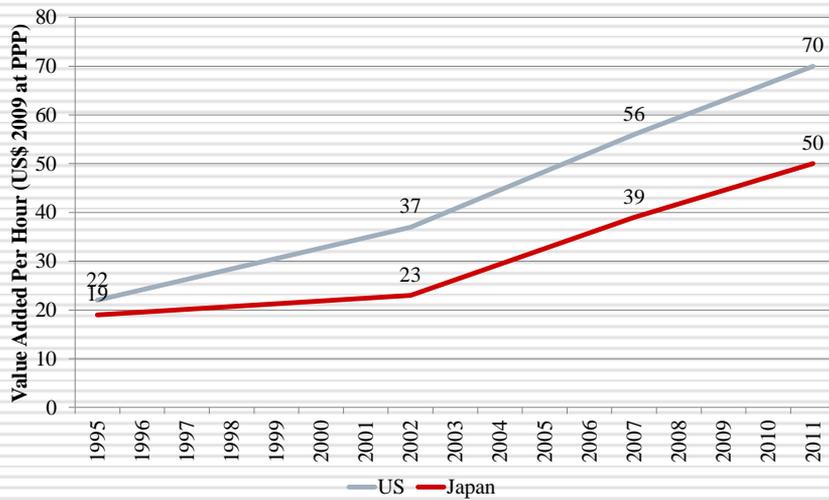
- Government education programs, industry visions, and media campaigns . . .
- Yet modest change:
 - Risk-taking
 - Social status of entrepreneurs
 - Willingness to sell (technology and/or firm)
 - Acceptance of business failure
 - Labor market norms (loyalty)
 - Financial capital norms (shareholder model)

Total R&D Spending



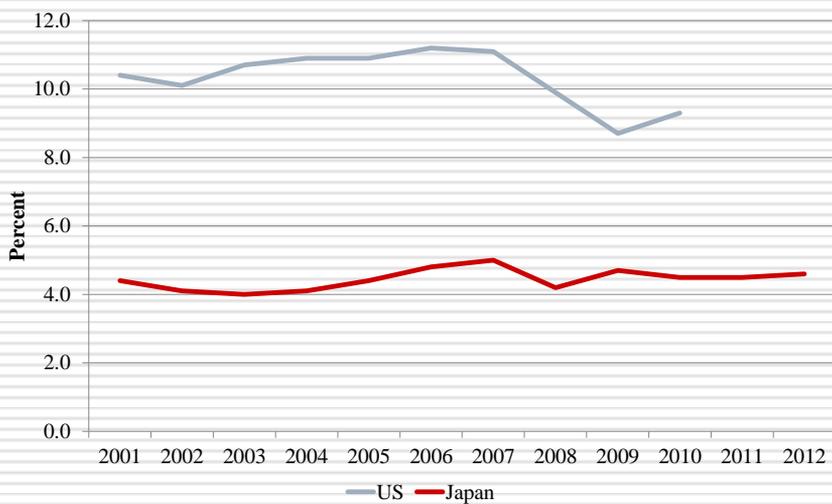
Source: OECD

Labor Productivity (Advanced Manufacturing)



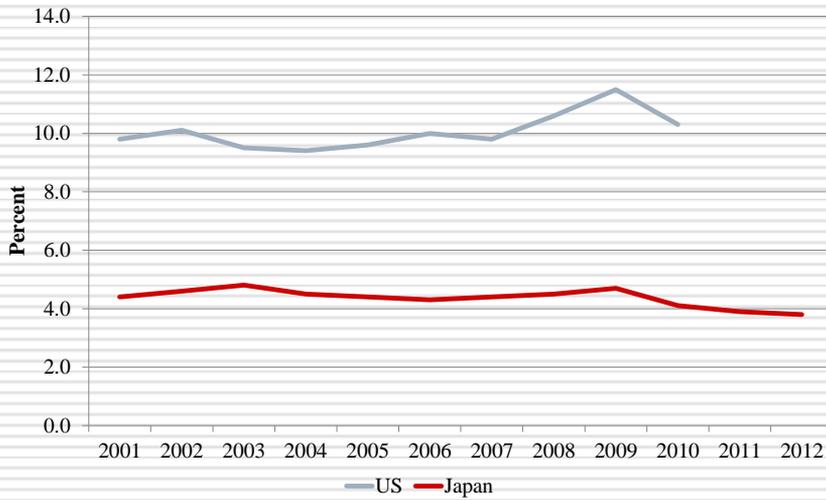
Source: McKinsey Global Institute (2015)

Rate of Firm Entries



Source: METI, White Paper on Small & Medium Enterprises in Japan (2014)

Rate of Firm Exits



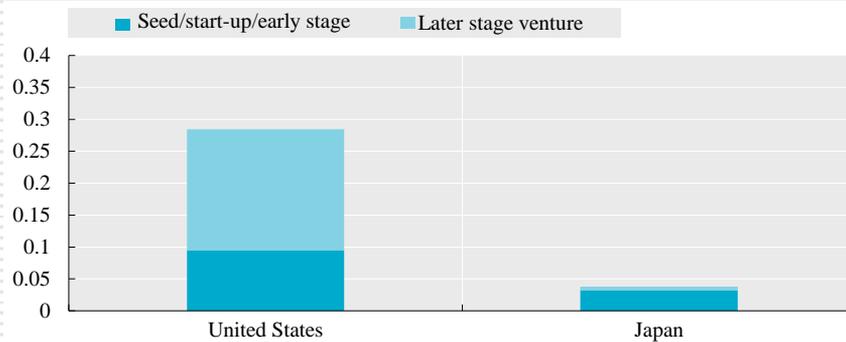
Source: METI, White Paper on Small & Medium Enterprises in Japan (2014)

Trends in Japanese Venture Capital



Source: Venture Enterprise Center (2014)

Venture Capital as a Percentage of GDP



Source: OECD Entrepreneurship at a Glance (2015)

So What Should Japan Do?

Is there a Japanese
system of innovation
appropriate for the digital age?