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**Regulatory Coherence: The Case of Japan**

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**Abstract:** This paper reviews the coherence of the regulatory management system in Japan. Part 1 explores the evolution of regulation in Japan from sector-based regulatory review through the adoption of Regulatory Impact Analysis and the current Special Zone approach. Parts 2 and 3 explore how the regulatory management system was applied to two case studies of regulatory change: Agency Worker Law and Taxi Revitalization Law.

**Keywords:** Regulatory Reform, Regulatory Impact Analysis, Special Zones

**JEL Classification:** K23 L5

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## 1. PART 1: Introduction and Country Context

Japan is a developed country with the third largest gross domestic product (GDP) and 24th in per capita GDP in the world. It has a constitutional monarchy like Britain, and the legislature (Diet) is a bicameral structure, which consists of the House of Representatives (the Lower House) and the House of Councilors (the Upper House). Although the institutions look similar to those of the western democracies, the Japanese political system has unique characteristics. The Diet has less real authority; for example, two-thirds of the bills presented are drawn up by civil servants, whose ratio of passing to introducing is 80 percent compared with 30 percent for those presented by congressmen in the last 5 years.<sup>1</sup> Also, the recent change in government from the Liberal Democratic Party (LDP) to the Democratic Party of Japan (DPJ) in 2009–2012 for the second time in the postwar period has not brought about major policy changes.

The central government has stronger power over the local government – the local governments account for 60 percent of general government expenditure, but 40 percent of revenue, which indicates the dominance of central government through the transfer of money and legislative control over local governments. There have been calls for the decentralisation of public administration for many years, but ministries have retained administrative control over local governments. For example, prefectures and cities can make additional regulations within central government legislation unless prohibited, but local governments cannot deregulate central government regulation. In this sense, reform toward market-based regulatory governance and de-centralisation of central government's authority to stimulate competition between local governments has many things in common with reducing central government's administrative power.<sup>2</sup>

Japan's administrative system in the central government is characterised by decentralised and independent ministries with powerful bureaucracies armed with

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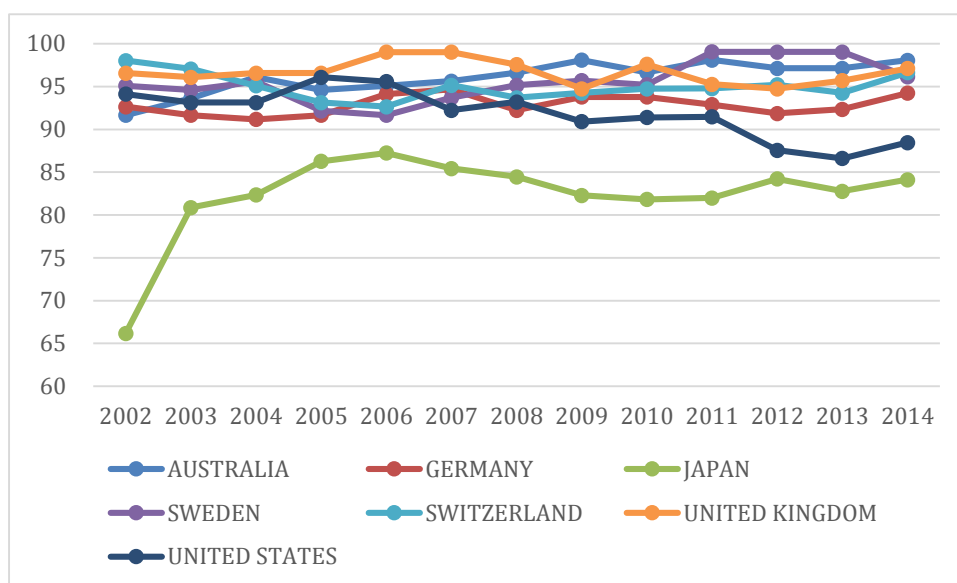
1 Cabinet Legislation Bureau (2014).

2 For example, the Ministry of Labor keeps the public employment matching services, despite a request to shift the authority of the service to local governments to enable coordination with the minimum income maintenance programme. This is in line with the ministry's policy against the opening of the employment matching services to the private sector under the government jurisdiction.

broad administrative discretion and by close and informal links between public servants, producer groups, and political parties (OECD 1999). The power of the bureaucrats is diversified across ministries reflecting various interest groups in the society, which influence the bureaucrats directly or indirectly through politicians. It is one of the major reasons why regulatory reforms against the vested interests of certain producers have been difficult, as the bureaucrats tend to follow their predecessors' examples.

According to the World Bank Governance Indicators, Japan is ranked relatively high for various quality of government indicators. In the percentage rank of regulatory quality, Japan had been catching up with countries with best practice in the first half of the 2000s under the Koizumi government, but the improvement has halted since then (Figure 1).

**Figure 1. Percentage Rank of Regulatory Quality**



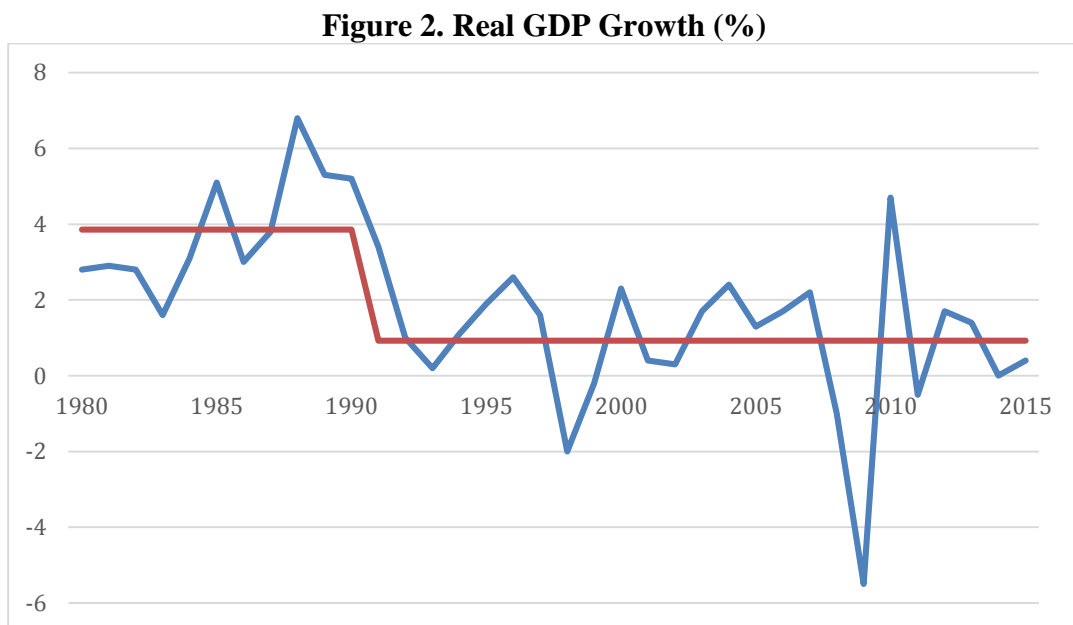
Source: World Bank.

The political leadership of the Prime Minister is usually weaker than his counterpart in other democracies with the exception of Koizumi who oversaw the privatisation of the public postal corporation against strong political resistance in 2001–06. The Liberal Democratic Party (LDP) has been a major ruling party in the postwar history of Japan. The general election of August 2009, which resulted in the

Democratic Party of Japan (DPJ) becoming the ruling party, hardly changed things until the return of the LDP in December 2012

The pattern of Japan's post-World War economic development consisted of three phases – the high economic growth period until the mid-1970s, the modest economic growth period up to the end of 1980, and the long economic stagnation since then. The need for regulatory reform to improve the supply-side of the economy has been urged particularly in the third phase of the so-called 'Lost Decades'. In the next section, we discuss the evolution of regulatory policy since the 1980s up to the most recent 'Abenomics' phase or Prime Minister Abe's New Growth Strategy of Japan.

Japan's economy had been marked by high rates of economic growth of 10 percent on average (at constant prices) with a 2 percent unemployment rate until the mid-1970s (Figure 2). However, with the maturing of the economy the high economic growth pattern gradually changed, and the role of Japanese public administration shifted away from an economic planning oriented style to one supporting market-led economic growth. With increasing government budget deficits, reforming the public sector and improving the regulatory governance system has also become an important policy agenda (Figure 2).

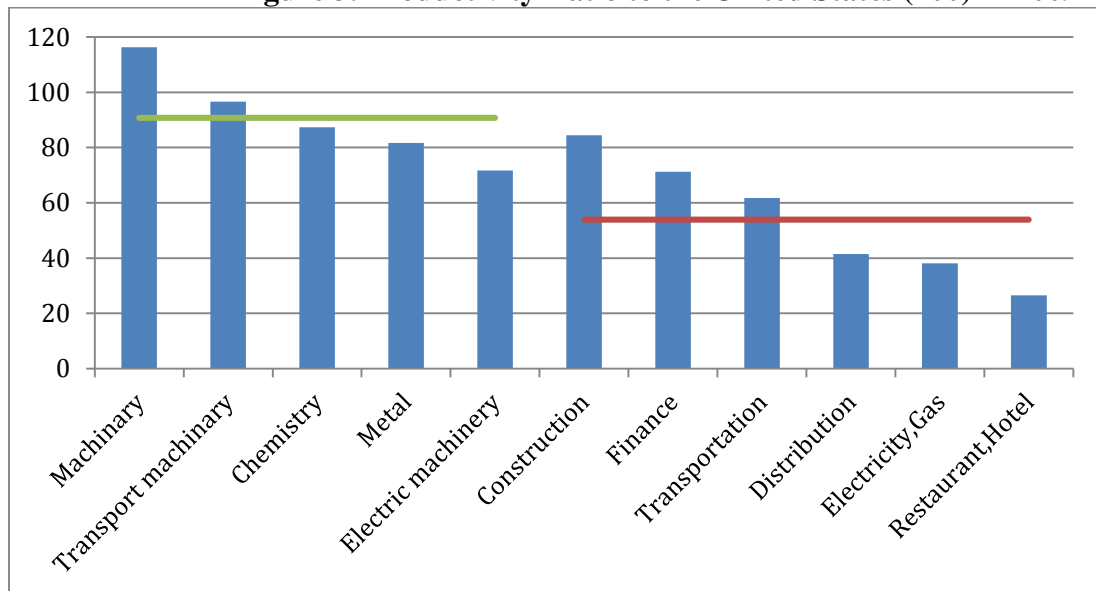


Source: Prime Minister's Secretariat.

The government-led economy had been effective in terms of catching up with the developed economies, but the scheme has become obsolete because of the following factors:

First, as the economy matures with per capita GDP increasing to advanced country levels, it becomes difficult for the public sector to satisfy the diversified demand of the people, and the role of markets becomes more important. Whereas the international competition faced by the manufacturing sector automatically leads to market-based production, the agriculture and service sectors have remained under the protection of the government. Comparing labour productivity of major industries with that of the United States (US), it is on average 91 percent for the manufacturing sectors and 54 percent for the non-manufacturing sectors (Figure 3).

**Figure 3. Productivity Ratio to the United States (100) in 2009**



Source: Ministry of Economy, Trade and Industry

Second, the public corporations had been running large deficits, which had to be financed by the general government budget, leading to an accumulation of public debt. It is mainly due to less efficient business management, strong labour unions, and political pressure against reducing inefficient activities of corporations. For example, National Railways Public Corporation was forced by politicians to maintain local railways despite persistent deficits due to declining passenger numbers.

Thirdly, the regulations on business activities had often lacked transparency and had been arbitrary, in particular for newcomers. Thus, they are *de facto* non-tariff

barriers to foreign firms. With increasing trade and foreign direct investment from abroad, they tend to induce foreign pressure for opening up the domestic markets.

## 2. The Evolution of the Japanese Regulatory Management System

### 2.1. Historical Background

Regulatory reform was initiated by Prime Minister Nakasone, who had set a target of fiscal consolidation without tax increase for preventing expansion of the government sector in 1982–87. The policy was in line with those adopted in the US under President Regan and in the United Kingdom under Prime Minister Thatcher in the 1980s. He set up the Provisional Commission for Administrative Reform consisting of private sector experts. Major steps were taken towards reforming out-of-date regulations and privatising government enterprises in areas such as communications, railways, and tobacco production. This approach of appointing private sector experts including business leaders to major committee members has been passed on to the succeeding organisations for regulatory reform (Table 1).

**Table 1: Significant Events in the Development of Regulatory Reform in Japan From 1982 to Present**

Period	Significant Situation
1982–1987	The Nakasone Government
1984–1987	Privatization of Public Corporations of Telecommunication and Railways
1993	The Administrative Procedure Law
1995–1997	The Deregulation Action Plan
1996–1998	The Hashimoto Government
1998	The Three Year Programme for the Promotion of Deregulation
1999	The Public Comment Procedure
1998–1999	The Deregulation Committee
1999–2001	The Regulatory Reform Committee
2001–2006	The Koizumi Government
2003	Special Zone for Structural Reform
2001–2004	Council for Regulatory Reform
2004	Regulatory Impact Analysis Law
2004–2007	Council for the Promotion of Regulatory Reform
2006	Market Testing
2007–2010	Council for Regulatory Reform
2013	National Strategic Special Zone
	Council for Regulatory Reform (revived)

Source: Author.

Regulatory reform creates private demand, which had been suppressed by the regulation with no additional fiscal costs, though it takes longer before the full effects can be observed (OECD 2010). The mood for regulatory reform returned under the Hashimoto Government from 1996–98 after the Japanese economy had plunged into the so-called ‘Lost Decades’ from the early 1990s. Japan’s average economic growth fell from 4.5 percent on average in 1980–89 to 1 percent in 1990–2014. This was due not only to the bursting of the ‘asset bubble’ in the early 1990s, but also to regulations that were unsuitable for the economic and social circumstances at the time with increasing globalisation of economic activities and rapid aging of the population.

During the 2001–02 recession that followed the ‘dotcom bubble’, regulatory reform became the main focus of the Koizumi government’s economic growth strategy from 2001–06, with a fiscal stimulus package much smaller than those used in Japan’s previous economic crises.<sup>3</sup> Prime Minister Koizumi nominated Heizo Takenaka as the Minister for Economic/Fiscal Policy to coordinate economic policies through use of the Council of Economic and Fiscal Policy. Minister Takenaka played a role in enhancing the privatisation of the Postal Corporation and regulatory reform through the coordinating the decentralised power of various ministers.

Though the regulatory reform was not considered to be an important issue by the succeeding Prime Ministers and the DPJ Government during 2009–12, the current Prime Minister Abe, who had succeeded Koizumi but left within a year due to illness, returned to power at the end of 2012. He adopted a top down policy approach similar to the one under Koizumi, and has been eager to reform regulations, making them more market-based to stimulate economic growth. Abe’s recent economic package includes labour market reforms such as increasing the labour force participation of women, and improving corporate governance and lowering corporate tax to improve Japan’s business environment.

Prime Minister Koizumi had appointed a minister for regulatory reform in 2001, but his power was the same as that of the other ministers in charge of various regulations. This is in contrast with the authority of the Cabinet Legislation Bureau in

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<sup>3</sup> The size of the fiscal stimulus package adopted during the 2001–02 recession was 25 trillion yen, compared with 60 trillion yen on average for the three policy packages adopted between 1992 and 2009 (OECD 2010).

the Prime Minister's Cabinet, which has the power to amend the laws proposed by various ministries to avoid legal inconsistencies.

## **2.2. The Role of Foreign Pressure**

Japan's ministries for protecting the interest of producers have overwhelming political power, particularly compared with the ministry in charge of consumer protection and the Fair Trade Commission, which is supposed to ensure fair market competition. This imbalance of power between producers and consumers was changed by foreign pressure in trade negotiations or peer reviews as part of OECD meetings. Though the foreign government pressure for reforming of Japan's domestic protective measures primarily reflects the interests of foreign producers for increasing their exports to Japan, it will also be beneficial to domestic consumers as it stimulates competition in domestic markets.

Japan had a series of trade disputes mainly with the US, which was its largest trading partner in the postwar period. The US government often requested the Japanese government to remove non-tariff barriers in its domestic markets, to enable US firms to increase their sales, thereby reducing the large bilateral trade deficit of the US with Japan. A typical case was the liberalisation of the cell phone market, which had previously been monopolised by Japan's state company. When the regulatory reform to remove the monopoly had finally been carried out, the share of US firms in the Japanese telecommunications market did not increase, contrary to original expectations. This was mainly due to new entries of the Japanese private firms in the opened domestic markets.

Another case is that of US pressure to remove the barriers to large-scale opening of retail shops, i.e. supermarkets or department stores in Japan's local communities. The law protecting the small retail shops in local communities was revised, but the subsequent entry of US firms was negligible, and the beneficiaries were all Japanese firms that had been denied entry to the local markets. In both cases, foreign pressure was useful for stimulating regulatory reform and enhancing market competition to increase the benefits for Japanese consumers.

Free trade agreements are a systematic way of using foreign pressure toward stimulating market competition, which is otherwise not possible in the distorted power



balance between producers and consumers in domestic politics. In this sense, the Trans-Pacific Economic Partnership Agreement (TPP), which consists of the goal of a minimal tariff and the removal of domestic measures that discriminate against foreign firms, is a step forward for enhancing regulatory reform in Japan.

### **2.3. Economic Versus Social Regulations**

A country's optimal regulatory management system depends on the types of regulations it has. First, there are typical economic regulations such as business permits or the licensing system. Regulatory reform in Japan was originally focused on lowering business costs by removing business regulations that had become obsolete as a result of changed economic circumstances. Such reform of administrative procedures is not difficult as few objections arise against such simplification. However, recent developments in this area have been in the Agricultural Co-operative system, to promote competition despite strong political power, at the initiative of the Prime Minister. Some of the limits on corporate farm ownership have been relaxed to compete with the Agricultural Co-operative.

Second, Japan passed a law liberalising electricity in the retail sector, which is due to be implemented in April 2016. Various companies have entered the regional markets, which used to be monopolised by the electricity companies. The reform will be continued with the separation of the electricity companies between generation and transmission sectors ensuring the neutrality of the distribution through legal unbundling in 2018–20. The regulatory reform should lower the prices of electricity for energy using firms and consumers.

Third, there is the economic regulation on taxis and trucks for avoiding 'excessive competition'. Taking the example of taxis, the ministry in charge of transportation often estimates the consumers' demand for taxis given the current standard prices in the region, and sets the ceiling of the taxi vehicles meeting the estimated demand. It is clear that such a law is a *de facto* 'production cartel' that protects the interests of existing taxi companies. It would be possible, therefore, to remove the regulation if the political pressure reflecting the vested interests can be overcome.

However, regulatory reform becomes more difficult when it has eventually expanded to include social regulations related to lifestyles, concerning labour, health, welfare, or education services. Compared with the cases for economic regulations, the

reform of social regulations are more controversial, and the negotiations with the ministries in charge of the regulation become more time consuming, reflecting the objections of various social groups. These reforms often require alternative measures for protecting workers or consumers. In other words, the quality of the regulations could be improved by minimising the social costs combined with a better safety net.

The Regulatory Reform Plan of 1998 indicated that economic regulations should be removed in principle, but the social regulations have to be at minimum level. Concerning the social regulations, there is a debate about to what extent the market economy is appropriate for the allocation of social resources. For example, the introduction of market competition, which implicitly assumes consumers' sovereignty, should be limited, accounting for asymmetric information between physicians and patients, or between teachers and students. This logic may justify some public intervention to overcome this asymmetry, such as creating an independent organisation for evaluating the quality of professional services.

However, the regulation often goes beyond it, and tends to prohibit the entry of corporate firms for the protection of consumers. The logic behind this is that corporate firms 'exploit' consumers to maximise their profits, whereas non-profit organisations do not. Based on this logic, corporate firms are not allowed to manage hospitals and clinics or buy farmland for cultivation. Also, even when corporate firms are allowed to enter the markets, they are not provided with tax advantages or government subsidies, which are granted to 'non-profit organisations' providing similar services in the field of education or welfare. Such exclusion of corporate firms is *de facto* protection for small 'non-profit organisations.' The better regulation should be a universal one covering both for-profit firms and non-profit organisations in the interest of consumers. For example, the corporate firms providing electric power are obliged to provide 'universal services' under the Law of Electricity Business, i.e. they also have to provide unprofitable areas with electricity.

Recent issues regarding social regulations are closely related to social insurances. Health care services of both public and private hospitals and clinics are covered by the health care insurance controlled by the government. The public health and nursing care insurances officially set the prices for reimbursement of individual care treatments and drugs. A key issue is the implicit regulation that those reimbursement prices should be

the same as market prices. In other words, hospitals or nursing care homes cannot charge consumers higher prices than the officially set ones even though consumers are willing to pay more for the better quality services. This principle of ‘prohibiting the mixed billing of public and private services’ is based on an egalitarian rule. But it actually prevents competition for better quality of services in the markets. Thus, regulatory reforms in health and nursing care services have to cover public insurance reform to give consumers wider choice.

Recent regulatory reform focuses on childcare services, where it is important to stimulate the labour force participation of women at a time of a declining trend in labour force growth. Japan is to increase the number of childcare places, both publicly and privately provided, through regulatory reform to accommodate about 0.4 million children by March 2018. Also, after-school childcare centres are being created to provide care for 0.3 million children by March 2020 (OECD 2016).

#### **2.4. Special Zones for Regulatory Reform**

A major invention in the history of Japanese regulatory reform is the special zone approach. There is strong resistance to regulatory reform by respective ministries. Their argument against reform, in particular of social regulations, is that they cannot take responsibility for the possible negative effects on consumers. Thus, to persuade the ministries in charge of the social regulation, reform takes the form of social experiments in limited geographical areas under the responsibility of the local government accepting the risk voluntarily. Unless there are any problems in the special zone, the regulatory reform will eventually be implemented nationwide.

Various types of special zones were established in the 1990s and beyond. The most significant cases were the special zones for structural reform, which had been formulated in 2003 under an initiative of the Koizumi Government. The basic framework of the special zones was created by the central government, but the establishment was based on an initiative of the local authorities. In this sense, these special zones were also an experiment of decentralisation of governance in the highly centralised government structure of Japan (Yashiro 2005).

This decentralised decision making process of the special zones is based on the idea that competition between local authorities to establish unique special zones would

lead to more efficient outcomes than in the case where the central government imposes them based on political considerations. Examples of the regulatory reforms are those allowing private corporations to manage agricultural businesses, which had previously been limited to family businesses. Also, reforms of the fire regulations accounted for an improvement in technologies for preventing fires. Such regulatory reforms creating new economic activities and employment could not have been realised outside such special zones. The economic impacts are estimated to have increased private investment by 0.6 trillion yen and employment by 18,000. However, interest in the special zones has decelerated with the decline in the Prime Minister's leadership.

The National Strategic Special Zone was established by Prime Minister Abe as a part of his economic growth strategy in 2013. This was based on an assessment of past special zones, which failed to keep up momentum, and thus a small committee for supporting special zone business was established based on private sector proposals. In this new version of the special zone, the ideas for regulatory reform are collected from the private sector, and they are negotiated between the independent regional government organisation in charge of special zones and respective ministries in the relevant council, consisting of selected ministers and private sector experts headed by the Prime Minister. After the regulatory reforms are agreed, the business plans are processed for each special zone by the council members including the local firms and mayors in the area headed by the minister in charge of the special zone. This council is needed for an efficient management of the special zones, as various administrative obstacles arise with the starting up of new businesses utilising regulatory reforms.

In the National Strategic Special Zones, regulatory reform has been proceeding, for example, foreign housemaids have been granted working visas, as an exception to the restriction on foreign unskilled workers. It is also discussing a law to facilitate the establishment of foreign enterprises and promote entrepreneurship.

### **3. The Current State of the Regulatory System (Circa May 2015)**

This section surveys Japan's system for managing regulation development and review over the last decade in terms of improving regulatory quality.

### **3.1. Regulatory Quality**

An important aspect of assessing regulatory quality is ensuring regulatory transparency (OECD 1999). The impact of a regulation does not necessarily arise from the law in itself, but from the way the law is interpreted in detail in actual cases by bureaucrats in their respective ministries. ‘Administrative guidance’ plays an important role in Japan’s regulation. Though this is ‘guidance (often not in written form) to private firms by the ministry in charge of the law, it works as *de facto* strict regulation; for example, a firm’s application would not be accepted without following the ministry’s guidance. The administrative guidance actually constrains the decision making process of private firms, and are often a disadvantage for newcomers including foreign firms intending to start a business in Japan.

To solve these problems, the Administrative Procedure Law was enacted in 1993. It required ministries to publish the objective criteria for judging applications for permissions, and explain the reasons in cases where applications are rejected. At the same time, the law ensures that administrative guidance should be within the legal mandates. Also, in 1999 the government introduced Public Comment Procedures for all government regulations to make public consultation systematic with a standardised commenting period of one month.

However, the Administrative Procedure Law does not always work effectively. The recent banning of sales of most pharmaceuticals through Internet by the Ministry of Health, Labor and Welfare (MHLW) is a good example. Though the Law on Pharmaceuticals has no clause that prohibits Internet sales, the ministry prohibited them through an administrative guidance. It was on June 2014 that MHLW finally revised the law to allow sales of most pharmaceuticals via the Internet based on a judgment of the Supreme Court in support of a private firm that had brought a case against the ministry’s decision.

### **3.2. Flow Policy Tools for Regulatory Reform**

#### **3.2.1. Regulatory Impact Analysis (RIA)**

The history of regulatory reform in Japan started with sector-specific economic regulation such as pertaining to national railways or telecommunications, which were closely related to the privatisation of public corporations in the 1980s. It became more

reliant on general regulatory regimes with the Three Years Regulatory Reform Plan in 1990s. Also, in 2004 a Regulatory Impact Analysis (RIA) was introduced as a trial practice and it was formally adopted in 2007. It covers all the regulations to be established or revised by ministries in a particular year. RIA is a typical method to assess the costs and benefits of new regulations or revision of existing ones on the private sector. The report of the RIA to be prepared by ministries has to include the following items:

- Whether a regulation has any impact on an economic agent;
- Types of the effect of a regulation such as reducing the number of competitors, limiting the choices for competition, or reducing the incentives for competition;
- Description of the effects arising from the regulation.

The object of RIA for assessment is limited to laws enacted in the Diet excluding those presented by congressmen and the supplementary regulations set by each ministry. However, that the assessment of the lower level regulations is exempted is actually a major problem because detailed regulations are more important in terms of restraining actual business activities.

There are major problems with the way Japanese RIAs are implemented. First, RIA is not used in the actual process of establishing a law, but after the basic framework of the regulation has become a formality, so that it does not have much impact on the formation of regulations. Second, there are not enough quantitative cost and benefit analyses of the effects of regulation as estimated by the ministries in charge. In 2013, out of 128 RIA cases reported, quantitative data were provided in only five cases; the others only had descriptive assessments (MIC 2014). Third, there are no effective enforcement mechanisms for each ministry to provide quantitative estimates, and no uniform method for evaluation of the social costs of regulations is indicated. This is mainly due to the fact that the institution responsible for RIA fails to supervise each ministry's assessment, but only publishes those results on the homepage. Thus, the OECD recommended the government develop a common method of evaluating the quantitative effects (OECD 2005), but the effective use of RIA has not in fact been implemented.

### 3.3. Stock Policy Tools for Regulatory Reform

#### 3.3.1. Core institutions for regulatory reform in the 1990s and beyond

There are both permanent and temporary institutions at the core of regulatory reform: The Administrative Evaluation Bureau in the Ministry of Internal Affairs and Communication (MIC) is a permanent institution responsible for improving the process of administrative procedures including regulatory impact analysis and public comments. This bureau, however, is a part of the large ministry covering miscellaneous activities, and regulatory management is not considered a top priority. Also, the ministry is independent of the minister in charge of regulatory reform. This fragmented nature of regulatory management is a factor in its inefficiency.

An independent institution responsible for regulatory reform is the Council for Regulatory Reform (CRR), an ad hoc institution consisting of business leaders and experts in the private sector. CRR was established within the Prime Minister's Cabinet in 2001 on a temporary basis initially for 3 years, and has been succeeded by similar institutions up until the present.<sup>4</sup> The CRR publishes a comprehensive annual report on regulatory reform, which is incorporated into the Three Years Deregulation Plan of the Cabinet in the following fiscal year and is to be implemented in the revision of the laws in subsequent years. The Plan includes only proposals that agreed upon by the ministry concerned, in accordance with Japan's tradition of decentralised policy making by each ministry. The CRR has no enforcement authority and its effectiveness largely depends on the leadership of the Prime Minister. The CRR represents the consumers' interest for the more efficient regulations. For example, ministries favour *ex ante* regulations such as granting firms permission to enter a market, whereas consumers prefer *ex post* regulations such as notification to control the quality of firms' products in the markets. *Ex post* regulations are more transparent and do not deter market competition, but they require more manpower for supervising producers.

The Council on Economic and Fiscal Policy (CEFP) was established within the Cabinet Office in 2001, and is broadly responsible for economic and fiscal policy, including regulatory reform and open market policies. This institution has a dual nature: on one hand, it is officially an 'advisory board' to the Prime Minister consisting of four private sector experts, five ministers, and the governor of the Bank of Japan.

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<sup>4</sup> CRR is the institution established for fixed terms of 3 years, and its actual name changes each time.

On the other, it is a *de facto* decision-making body on major economic policies when the Prime Minister gives clear direction on specific policies, and the record of the discussion is published a few days later. The role of the CEFP in the policy making process was quite important under Prime Minister Koizumi, who often made clear policy directives, but this has not always been the case with other Prime Ministers.

Both the activities of the CEFP and the RRC were halted under the rule of the Democratic Party of Japan, which was supported by the labour unions and not positively disposed toward regulatory reform in 2009–12; hence regulatory reform did not move ahead during this period.

Both organisations were restored by Prime Minister Abe, and he also utilises a new institution, the Industrial Competitiveness Council, which actively pursues economic and industrial policies including regulatory reform. A major purpose of the council's reforms is to make Japan the country where it is easiest to do business in the world. Major reforms being carried out are labour market regulations, corporate governance, corporate tax reductions, and relating to the electric power companies. Since 2013 they have been making a plan for the New Growth Strategy of Japan every June, which is authorised by the cabinet.

Another organisation established by the Abe government is the Council on National Strategic Special Zones (NSSZs). The NSSZs are an initiative to create business-friendly conditions by promoting various regulatory reforms. This initiative was first authorised by the Diet in 2013 and followed by the appointment of six specific zones in May 2014. The process of NSSZs is similar to that of previous initiatives such as CRR and CEFP. The Council collects proposals from local governments and private firms or institutions, negotiates with respective ministries, and makes decisions under the leadership of the Prime Minister. However, existing organisations have overlapping roles and better coordination is needed.

The Three Year Plans for Regulatory Reform was first established in 2001 by the Council for Regulatory Reform and reformed every year, and the most recent plan was published in June 2015. The plan formulates the results of the discussions, negotiations, and public debate on various issues and in various fields of regulatory reform in a particular year. The agreement between the CRR and respective ministries is



confirmed by the Cabinet. Based on this regulatory reform plan, each ministry is obliged to change existing regulations into more market friendly forms.

Public comments procedures were introduced in 1999 as the public consultation mechanism and enforced by law in 2006. Any proposals for forming, modifying, or abolishing the current regulations have to be open to the public at least one month in advance. Each ministry in charge of the regulation has to show them on their home page with the background data, and collect comments and reply to them. Final decisions on regulatory changes would be made based on these comments. However, these procedures are mainly a formality. In reality, cases in which the law was revised based on public comments have been rare. The US government made suggestions for strengthening the Public Comment Procedures, such as lengthening the public comment period; ensuring agencies give public comments ample consideration; seeking views from the public on the effectiveness of the public comment system, and allowing opportunities to suggest improvements (USTR 2008).

Market testing was introduced under the Koizumi Government. It is based on the ‘Law on Reforming the Public Service by Introducing Competition’ of 2006. The idea behind the law is that, unlike the privatisation of public enterprises, the government maintains ownership of public enterprises, but the agency actually providing the services could have either public or private employees. Tendering for public sector contracts is open to private enterprises, and proposals from both private and government agencies are considered on an equal basis. In the cases of United States local government, the result of private and public competition is almost the same, but the performance of the public agency has improved due to competitive pressures from the private sector.

In the case of Japan, this market testing has been introduced only indirectly. For example, the Ministry of Health Labor and Welfare (MHLW) provided a part of the services of the public employment offices like consultation for job seekers or accepting job offers by employers. Rather than putting all the services to the market test, the MHLW offers the services of six local offices for tender to private agencies, and compares the performance with similarly sized local offices managed by government employees. According to this indirect way of market testing, government employees achieved better results. The assessment of this market testing is difficult, partly

because the testing period was 1–3 years for individual private agencies, and public employees are obviously more experienced in their jobs. Also, the target of the market testing is just a part of the function of public employment offices, and private agencies are at a disadvantage vis-à-vis public agencies, which could combine these services with their main job-matching services.

Introducing review clauses was suggested in the Three Years Regulatory Reform Plan in 1998, but they are optional and often introduced as a means of political compromise. Other stock management tools such as sunset provisions, red tape reduction targets, ‘one in, two out’ or ‘one-in, one-out’, regulatory budget, regulatory agenda, and regulatory scans or plans have not yet been implemented.

### **3.4. Evaluation of Effects of Regulatory Reform**

The quantitative effects of regulatory reform from 1990–2005 were estimated by the Prime Minister’s Cabinet. Regulatory reform eliminating entry barriers or price regulations would stimulate market competition and increase demand through falling prices. Thus, the basic method used here is to measure the increase in the consumers’ surpluses due to falling prices, and compare it with the consumer surplus in the base year before the regulatory reform. The net increase in the consumer surplus is considered to be equivalent to the effects of regulatory reform. The estimations for 1997, 2002, and 2005 are shown in Table 2.

Regulatory reform has increased the aggregated consumer surplus by an accumulated amount of 18.3 trillion yen in 2005 from the baseline without the reform, which amounted to 5 percent of National Income. These are broad impacts of reform, and not necessarily those associated with reforms enacted during crisis episodes. This result of the effects of regulatory reform only reflects the first-round effect of an increase in consumer surpluses, and the possible increases in employment arising from a net increase in demand and multiplier impacts are not accounted for.

**Table 2. Consumer Benefits from Regulatory Reform**

		(Billion Yen)		
		1997	2002	2005
Telecommunication	Cell phone	1312	2630	2788
	Domestic airline	192	273	121
	Railway	4	260	484
Transport	Taxi	3	8	13
	Truck	1567	3231	3431
	Car inspection	533	835	864
Energy	Electricity	1054	2641	5663
	Urban gas	31	228	458
	Petroleum products	1513	2266	2141
Finance	Securities commission fees	150	470	529
	Property insurance premium	58	214	316
Food	Rice	170	527	625
	Liquor	315	874	796
Others	Cosmetics and pharmaceuticals	17	81	118
<b>Total</b>		<b>6923</b>	<b>14536</b>	<b>18345</b>
<b>% of National Income</b>		<b>1.8</b>	<b>4.0</b>	<b>5.0</b>

Source: Prime Minister's Cabinet 2007.

## 4. Assessment of Japan's Regulatory Management System

### 4.1. Incrementalism in Regulatory Reform

The recent OECD report on Regulatory Reform in Japan said, 'Although positive incremental changes have taken place across many of the areas, ... most of the general regulatory difficulties relating to the market openness within the Japanese economy still exist today (OECD 2004).' The overall assessment of Japan's regulatory management system is still 'lack of adaptability' in the public administration such as slow decision-making process, allowing special interest groups to block needed change, resulting in 'incrementalism' in policy making (OECD 1999).

Given the strong resistance to reform in various sectors based on the logic that any reform of the current social regulation may risk people's lives, innovative mechanisms were developed to limit the effect on a certain geographical areas of social experiments, such as Special Zones for Structural Reform in 2003 and National Strategic Special Zones in 2013. The former special zones were experiments in not only regulatory reform, but also decentralisation, as they largely depended on the initiatives of local authorities, and did not involve any tax-waivers or subsidies. The latter special zones were more based on the initiatives of the central government with regulatory reform and some fiscal incentives combined. The special zone approach is

key to overcoming the current decentralised regulatory management by independent ministries. It is because they compile the exceptions to the current laws in the special zone law rather than abolishing or revising the current law of respective ministries.<sup>5</sup>

Also, there are protection measures for local small firms for public works. Local governments or public corporations have to provide equal opportunities for tendering for public sector contracts to local small firms. For example, public orders for construction of highways have to be divided into multiple construction areas so that small local firms can take on the work rather than large construction companies who can deploy economies of scale for construction. Such laws for protecting employment by local firms is costly, but has been maintained as a de facto income redistribution policy. Maintaining such protection measures requires strong political leadership and a balancing of all competing interests.

#### **4.2. Improvement of the RIA**

The lack of an effective enforcement mechanism of the Regulatory Impact Analysis is a symbol of Japan's slow adoption of regulatory management. This is mainly due to the lack of a powerful leading agency on meta-regulation, which means there is no external reviewer and individual ministries can get away with poor RIA results, as discussed above. Ideally, we need an independent regulatory review agency like the Productivity Commission in Australia. Another possibility is that the Council of Regulatory Reform plays the role of monitoring the RIA of respective ministries to prevent negative effects on economic activities. If the Council, which currently reviews only the existing regulations, could successfully check the establishment of new regulations with poor RIA, it should be more effective in terms of regulatory management.<sup>6</sup> Also, if it were given the authority to monitor new regulations, the Council would strengthen its bargaining power vis-à-vis the respective ministries to enhance regulatory management.

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<sup>5</sup> These special zones are similar to those in China. The Chinese government takes an incremental approach to introducing a market economy in a specific region while maintaining socialism in the rest of the country.

<sup>6</sup> There are two legislative branches of the Japanese government to check new registration. One is the Ministry of Treasury under budget constraint, and another is the Cabinet Legislation Bureau to ensure consistency with existing laws.

### **4.3. Role of Open Market Policy**

Regulatory reform to move toward market-based regulation in the domestic markets is consistent with open market policies or trade liberalisation. Japan joined the negotiations of the Trans-Pacific Partnership Agreement (TPP) in 2013, where lowering Japan's high import tariffs on agricultural products is a key issue. A major reason why the tariff on rice, which is a major crop in Japan, is set at the extremely high level of 778 percent is the production cartel led by the government to increase farmers' income by keeping the price at a high level. Thus, the regulatory reform in agriculture by shifting the means for protecting the farmers' income from the current price supporting policy to direct income subsidies from the government will make it possible to lower the tariff and benefit consumers. In this sense, foreign pressure through multilateral trade negotiation is an effective means of moving ahead with domestic regulatory reform. However, the recent agreement reached in the TPP negotiations involves a compromise allowing Japan to retain the high tariff on rice but having to accept an import quota at zero tariff as the minimum access or a certain quota for importing at zero tariff from the US and Australia.

### **4.4. Better Coordination between Regulatory Reform and Competition Policies**

For better regulatory governance against the background of the diversified authorities of ministries, the role of competition stimulating policy is important. Japan's Fair Trade Commission (FTR) is an independent government organisation prohibiting cartels or other competition restricting behaviour of firms against consumer interests. A major problem with FTR is that it only covers private firms, and government-led cartels or price setting in specific industrial sectors are excluded. It is mainly because each ministry is assumed to pursue its public interests, whereas in reality they are more biased in favor of protecting producers' interests. Thus, the higher level of organisation under the Prime Minister's leadership is required to coordinate the policies between the government organisations with conflicting interests for the sake of consumers' interests.

Though the majority of the ministries reflect the interests of producers in various fields, the Consumer Protection Agency is an exception. The Agency's basic policy stance is setting sector specific regulations for consumer protection, and not shifting

current regulations toward market-based ones. This is why organisations consisting of private sector members are needed to protect consumer interests through stimulating competition between producers, both domestic and foreign, through regulatory reform.

On the other hand, political leaders tend to establish new organisations to demonstrate their leadership on reform. Prime Minister Abe established the Industrial Competitiveness Council as the headquarters of industrial policy as a part of the Economic Growth Strategy. However, the major role of the Council is regulatory reform, which overlaps with the existing Council of Regulatory Reform. In this sense, the role of the Council of Economic and Fiscal Policy, which had been the headquarters of economic policy under the Koizumi government, should be important for coordinating the various organisations for regulatory governance.

Parts 2 and 3 below outline two recent regulatory reform case studies on Japan. These case studies share a common feature: both regulatory reforms proceeded well in the beginning because they were supported by the strong political leadership of the Koizumi government, but the momentum was gradually lost and eventually reversed. This reversal was due mainly to the absence of rigid oversight institutions or supporting policy practices for regulatory reform. Oversight and support are necessary for a high performing regulatory management system in Japan.

The following section explores the case of the reform of the Agency Worker Law. The tightening of this legislation is considered an overall failure. This case demonstrates the importance of independent institutions that assess the validity of government assessments, as well as better coordination of the institutions that oversee regulatory reform and the institutions in charge of RIA management.

## **PART 2: The Case of the Agency Worker Law**

### Historical background

The Agency Worker Law refers to the law that regulates people's work style through employment agencies. The law was established in 1985 and it basically prohibited agency workers with the exception of certain skilled jobs like translators or information technology engineers. It was based on the historical incidence of exploitation of unskilled workers by employment agencies before World War II.

The law was drastically changed in 1999 and 2004 to open the door for agency workers to all occupations except four specific categories (construction workers, harbor labourers, security guards, and health care workers<sup>7</sup>). This deregulation was consistent with Article 181 of the International Labor Organization (ILO), which Japan adopted in 1999. ILO Article 181 aims to increase job opportunities for those who have suffered persistent unemployment mainly in Europe, and at the same time to protect agency workers from being locked into disadvantageous positions. As a result, the basic policy stance in Japan's regulation of agency workers had changed from a positive list approach to a negative list approach.<sup>8</sup>

However, the liberalisation of agency workers has not been accompanied by job stability for them. This is mainly because their jobs in the company they are dispatched to are limited to less than 3 years except for certain skilled jobs categories. This is to protect the regular workers who may otherwise be substituted by the agency workers in the same companies. In this sense, the law which had been originally conceived for the protection of agency workers actually turned into a law for protecting regular workers in the same job category<sup>9</sup>.

At the end of the first decade of the 2000s, the trend of the liberalisation of agency workers slackened and it came to a halt with the coming to power at the end of 2012 of the Democratic Party of Japan (DPJ), which is supported mainly by the labour unions consisting mostly of regular workers. The opposition to the liberalisation of

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<sup>7</sup> These exceptions in the agency workers are partly a reflection of sectionalism of the bureaucracy. These occupations are under the jurisdiction of ministries other than the Ministry of Health, Labor and Welfare (MHLW) in charge of agency workers.

<sup>8</sup> Negative list here means that the agency workers are allowed in all the occupations except for those prohibited.

<sup>9</sup> For details of Japan's labour market practices, see Yashiro (2011).

agency workers arose mainly as a result of a trend increase in non-regular workers including agency workers, which was considered to be a source of the increasing income disparities in the labour markets. Thus, the law was revised in 2012 to limit the contracts of the agency workers who are employed less than 30 days, based on the logic that their jobs are particularly unstable. Such legislation was not favorable for agency workers as it reduced their job opportunities. It was also not consistent with the Agency Worker Law at that time, which limited the length of employment contracts to 3 years, based on the logic that the longer the period of the contract, the more likely regular employees would be substituted by agency workers.

The revised version of the Agency Worker Law that was passed by the Diet in 2015 eliminated the negative list of the occupations that cannot be taken on by agency workers with a regular employment contract with an employment agency with no time limit. This implies the equal treatment of agency workers with long-term contracts and regular workers. Agency workers who have a temporary contract with an employment agency, however, are subject to a 3-year limit with no exception.

Japan's labour markets are different from other developed countries in that labour unions are not organised by occupations or industries but on a firm basis. Most of the regular employees – those guaranteed to be employed up to the mandatory retirement age, which in most cases is 60 years – belong to a single union, i.e. both the white-collar and blue-collar workers are members of the same company labour union. A firm-based labour union tries to protect its members' jobs from competition in the labour markets, including agency workers.

The actual number of agency workers is not significant, accounting for only 6 percent of total non-regular workers. The majority of them are part-time workers and fixed-term employment contract workers (Table 3). Nevertheless, agency workers are the focus of labour market reform, mostly because they belong to the occupational labour markets rather than the typical firm-based internal labour markets. Also, since their skills are relatively high among the non-regular workers, they have a greater chance of replacing regular workers in the firm.



**Table 3: Composition of Non-regular Workers**

	2014		2002	
	(1000 persons)	(%)	(1000 persons)	(%)
Part-time workers	13470	68.6	10530	72.6
Contract workers	4110	20.9	2300	15.9
Agency workers	1190	6.1	430	3
Others	860	4.4	1250	8.6
Total non-regular workers	19630	100	14510	100
Regular workers	32780		34890	

**Source: Labor force Survey.**

The labour unions try to prevent an increase in agency workers who have skills comparable with the labour union members. Thus, in exchange for accepting the deregulation of job categories for agency workers, the 3-year limit on the duration of work was applied to all agency workers in a particular firm. This reflects the insider-outsider conflicts of interest between agency workers and regular workers, though the interests of agency workers are not reflected in the firm-based labour unions, and thus not in the Council on Labor Policy (Yashiro 2011).

The increase in non-regular workers, in particular agency workers, has become a social issue in Japan. It is said that agency workers easily lose their jobs during recessions, and that their wages are lower than those of regular workers in similar occupations. The labour unions claim that the increase in agency workers has been the major source of widening income disparity and that it has to be limited. However, it is also true that regular workers' jobs are secured by laying off agency workers during recessions. The employment adjustment over the business cycle in Japan is heavily biased against non-regular workers, including agency workers. The real problem with the Agency Worker Law is that it does not accommodate the conflict of interests between regular workers and agency workers.

#### Key players in the regulatory reform

The legislation process of the Agency Worker Law is as follows: The first step is that the Council on Labor Policy, consisting of the representatives of the firms' associations, labour unions, and academic experts, accommodate the conflicts between the social partners. The council subsequently makes a proposal based on such consultation, which is sent to the minister for Health, Labor and Welfare (MHLW).

Based on this proposal, a bill is drafted by the ministry and is presented to the Diet. As the major issues of conflict in the labour markets have already been addressed by the Council on Labor Policy, there are usually no major changes made at the Diet.

Concerning the Good Regulatory Practices (GRPs) for Internal Coordination of Rulemaking Activity, formal procedures of the regulatory impact analysis and public comments are required by the Policy Evaluation Act of 2001. However, the content of the RIA of the Agency Worker Law in 2013 was just a formality, and included only the administrative costs for the public relations of the reform of the Law. The ‘social costs’ associated with the reform of the Law such as the possibility of an increase in unemployment, which is the most important part of the RIA, were simply ‘considered to be zero’. The Ministry of Internal Affairs and Communications, which is responsible for RIA management of respective ministries, simply accepts the result with no comments.

#### The Role of the RIA

Although the RIA framework exists in Japan, it is based on self-reporting by ministries and no independent institutions check the validity or make an assessment of the content of the reports provided by the ministries. The case of the revision of the Agency Worker Law in 2012 is a typical example. Quantitative analysis of the revision of the law may not be easy, but private research organisations asked the major firms that use agency workers for their expected reactions to the tightening of the regulation. A few firms reported they would increase regular workers, and others would simply substitute agency workers with other types of non-regular workers.

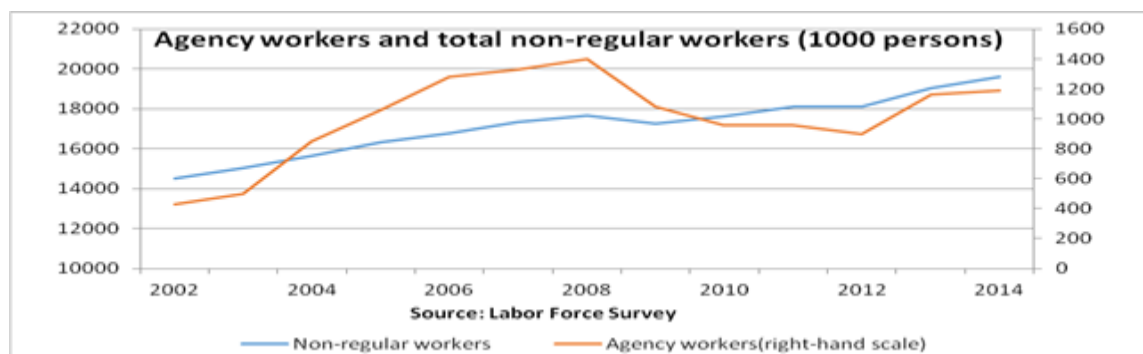
The Council for Regulatory Reform (CRR), which is the most important regulatory reform body, is not a permanent oversight institution, but an ad hoc organisation with a limited operation time of 3 years. The organisation has played a role in enhancing regulations through review of existing ones. In the case of the Agency Worker Law, the Council made a report arguing for the reduction of the negative list of occupations allowed for agency workers. Also, the current rigid rule that the agency workers’ jobs are classified into certain job categories, and any additional work carried out outside these categories is considered as a violation of the law, needs to be revised.

Through the negotiation with the MHLW in charge of the regulation, the resulting agreement would be included in the Three Years Regulatory Reform Plan, which is usually compiled at the end of the year. The ministries are obliged to follow up on the agreement in the Plan. In the negotiation process, all CRR can do is try to persuade the ministries as it has no authority over them. Each ministry has veto power over the proposals put forward by the CRR. The regulatory reform works only when the ministry's view is close to that of the CRR, as the CRR cannot take an initiative on its own, mainly due to political pressure.

#### The Impact of the Revisions of the Agency Worker Law

Up until 2008, the number of agency workers increased more rapidly than that of other non-regular workers, reflecting the regulatory reform of agency workers. However, it declined sharply reflecting the Lehman Shock in 2009–10, which is not surprising as demand for agency workers tends to fall during recessions. With the end of the recession demand for agency workers quickly recovered in many countries. In Japan demand for agency workers stagnated and has not recovered to the previous peak level, unlike the other categories of non-regular workers. From 2008–14, the number of agency workers declined by 0.2 million compared with a 2.2 million increase in other types of non-regular workers (Figure 4). This contrasting pattern can be partly attributed to the regulation on agency workers introduced in the first half of 2010.

**Figure 4. Agency Workers and Total Non-regular Workers (1,000 persons)**



Source: Labor Force Survey.

- **What Difference Could an Enhanced RMS have Made?**

In the final section, we pose a hypothetical question ‘What role could an enhanced RMS have played in the case of the Agency Worker Law?’ If the mandate of RIA had been rigorously imposed on the MHLW in charge of the Agency Worker Law, the tightening of the regulation in 2012 could have been avoided, as it was not based on a quantitative RIA. Also, stock management provisions would have revised the Agency Worker Law toward the international standard. It is meant for the protection of agency workers and their efficient utilisation in the labour markets rather than the protection of regular workers.

Three components are needed for a highly performing regulatory system – a quality policy cycle, supporting policy practices like consultation, and capable oversight institutions (Gill 2015). In the case of Japan, a lack of efficient oversight institutions that review new regulations and stock management provisions are major reasons why the regulatory system is inadequate.

For example, the current provision of limiting the period of engagement for agency workers in the same company to 3 years to avoid replacing regular workers in the same job would be substituted with the basic provision of the ‘same wage for same job’, so that the employment of more costly agency workers would be limited to exceptional cases. The role of the RMS should be to provide prior consultation by the CRR to the respective ministry to create a better regulation, rather than the current *ex post* nominal consultation after the regulation has been set politically between the various interest groups involved.

The following section examines the case of the Taxi Revitalization Law. Overall this case is considered an unsuccessful reform and demonstrates the need for systems to forecast potential costs and benefits such as an effective RIA mechanism.

## **PART 3: Taxi Revitalization Law – The Law for Controlling the Supply and Fares of Taxis**

### Historical background

The regulation of taxis in 1955 set a uniform fare structure for each region. It also controlled the number of vehicles to meet officially estimated potential demand. The justification for such regulation is the prevention of ‘excessive competition’ between taxi companies. The policy was a *de facto* government-led price cartel reducing the supply of taxis in a region for the benefit of taxi companies and at the expense of consumers. The logic of the regulation was such that an excess supply of taxis would lead to lower wages and longer working hours for taxi drivers, which is likely to risk passengers’ safety. This is partly due to the fact that most of the wages of the employed taxi drivers are not fixed monthly, but based on a certain share of their revenue. Thus, it is suggested that there are ‘social costs’ arising from the entry of excessive numbers of taxis in the regional market. An example of such costs is the congestion on city roads due to a large number of taxis waiting for passengers, or the degradation in air quality in urban areas.

Nevertheless, the taxi regulation was liberalised in 2002 along with other similar transport regulations based on the idea that market intervention by the government to control supply should be abolished. This regulatory reform was initiated by the Council of Regulatory Reform (CRR) under the Koizumi government, which pursued market-based policies. The Road Transport Vehicle Act was revised by the Ministry of Land, Infrastructure, Transport and Tourism (MLITT) to abolish the supply control of taxis, though taxi fares remained limited within a certain range. As a result, there were new entries of taxi companies and an increase in the taxi fleets of existing companies – more than 10,000 taxi vehicles were added in the nationwide market, which created new employment opportunities and a better service for consumers (Figure 5).

**Figure 5. Number of Taxis and Average Income of Drivers**



**Source: Ministry of Land, Infrastructure, Transport and Tourism.**

However, demand for taxis has hardly increased, which is not surprising because the regulation on price control has basically remained unchanged. Taxi fares were allowed to fluctuate within a range of 10 percent above and below the original price level. As a result of this ‘unbalanced deregulation’ between quantity and price, most of the added taxi vehicles became underutilised, and the revenue of the average taxi companies and the income of taxi drivers has continuously declined. This has created strong political pressure against regulatory reform from the association of taxi companies.

In 2009, the Taxi Revitalization Law was established by the MLITT to restore the policy for controlling the number of taxis in specific areas where competition was considered to be particularly excessive. These specific areas accounted for about a quarter of total taxi areas in the country, covering 90 percent of corporate taxis, which are concentrated in urban areas. The law introduced an incentive mechanism for taxi companies to reduce their vehicles and temporarily strengthen price control by narrowing the range in which fares were allowed to fluctuate from 10 percent to 5 percent.

In 2013, the regulation was further tightened based on the recognition that the previous incentive mechanism for reducing the number of taxis had not been effective. This time, the law was presented by congressmen of both the government and opposition parties. This new law directly controls the number of taxi vehicles; not only the new entry of taxi companies is prohibited, but uniform reductions of existing taxi vehicles are enforced in specified regions. It also stipulates additional areas where there is a risk of excessive competition, and discourages companies from expanding

their fleets. In both areas, taxi fares are limited within a certain range by the administration.

### Effects of the legislation

The trend of the taxi drivers' average annual income has not necessarily been affected by the tightening of the regulation. The taxi drivers' wages had already started to decline before the deregulation in 2002, reflecting the slowing of economic growth in the early 1990s. It is mainly because the elasticity of demand for taxis with respect to income is relatively high as it is for other luxury services, that taxi drivers are much affected by the economising behaviour of consumers. Also, tightening of the regulation in 2009 could not have reversed the declining trend of taxi drivers' wages compared with average wages.

Legislation initiated by Diet members is not a common occurrence in Japan, as most bills are prepared by ministries. However, once a congressmen-led law has been passed, the Regulatory Reform Committee does not have the authority to revise it through negotiation with the MLITT in charge of taxi administration.

### Policy making for road transport including taxi

The government justified its intervention in the taxi market by calling it 'social regulation' for protecting passengers' safety, but in reality it is economic regulation to protect the revenues of the existing taxi companies by limiting the new entry of competitors. Policies on road transportation including taxis are basically set by the Council on Transportation in the MLITT. The Council makes a proposal to the minister, and a bill based on the proposal will be made by the ministry and presented to the Diet. As for any bill, within the government there are checking systems for new legislation, but this only pertains to the aspects of budget constraint and consistency with previous laws; there are no remarks from the viewpoint of GRP.

Empirical research on the effects of the establishment or revision of the law is not done systematically. Concerning the abolishment of the supply control of taxis in 2002, a study examining the effects on the local taxi market indicated the negative impact on taxi drivers' wages, though no analysis was undertaken of the effect in terms of consumers benefits in that research. Also, there are other positive effects resulting from

an increase of competition in the taxi markets arising from regulatory reform. For example, the introduction of a new fixed taxi fare scheme between the airport and downtown avoids the risk of an unexpectedly high fare due to heavy traffic congestion. Another example is the introduction of valued added taxi services for handicapped passengers or escorting services for children.

A major reason for the unbalanced deregulation of the taxi market is that it allowed an unlimited increase of taxi vehicles on one hand, while constraining the taxi fare was a political compromise. It has brought about excess supply of taxi vehicles with no matching demand through price adjustments. Had there been an adequate RIA on measuring the price elasticity of demand for taxi services, the MLITT may have been persuaded to accept greater price flexibility.

In the past, there have been cases for raising taxi fares in several regions, and the impact on demand varied by region. In urban areas with various alternative modes of public transportation, a higher taxi fare was not an effective way to increase the revenues of taxi companies. However, the opposite was found to be the case in rural areas, where the demand for taxis is inelastic to prices as there are few alternatives. Hence, had the fare been allowed to be lowered in urban areas, where excess supply of taxis is high, it would have increased demand for taxis, so the damage to taxi companies could have been limited.

Although taxi companies may fear lower fares would result in a further decline in their revenue, there are various ways to lower prices while keeping the current basic taxi fare schedule constant. One is to lower the minimum fare for short distances. For example, the current minimum taxi fare in the Tokyo metropolitan area is 730 yen for the first 2 kilometres. If the price were set at 350 yen for the first 1 kilometre, and it would subsequently be raised to 730 yen for the first 2 kilometres, demand for taxis over short distances would be stimulated without the risk the total tax fare being lowered. The same logic could be applied to longer distances. The Osaka region has a taxi fare system that reduces the fare beyond 5,000 yen by half, a system intended to stimulate passenger demand for travelling longer distances.



## **What Difference Could an Enhanced RMS have Made?**

It is clear that taxi services should be regulated to a certain degree. Under the better RMS, the best mix of regulatory reform will be to tighten the social regulation of taxi drivers while removing the economic regulation on entry and price setting at the same time. An example of social regulation is to oblige taxi drivers to take a minimum of 11 hours rest between working overnight shifts for the safety of passengers. The role of RIA and prior consultation of the CRR with the MLITT should be important for providing useful information based on economic logic.

An accumulation of the case studies on related transportation sectors could be utilised for the better RMS. For example, the liberalisation of the regulations for highway buses brought about a 20 percent increase in passengers from 2003 to 2012. It was due mainly to the removal of the regulation on both fare and numbers of highway buses in 2002, which was in contrast with the remaining price controls for taxis. Also, changing bus drivers is mandatory after driving for 9 hours or over a distance of 600 kilometres a day for the safety of passengers.

The Japanese example also illustrates the importance of considering an adequate safety net for the various categories of the unemployed, as part of a condition to create a common understanding and acceptance of reform. For example, many part-time or temporary workers are not originally covered under the unemployment insurance scheme, even if some reforms have been made to improve the situation. Thus, an enhanced RMS may well implement additional regulations for maintaining the safety net for employees and consumers.

## **5. Conclusion**

This paper has explored the evolution of regulation in Japan, from sector-based regulatory review through to the adoption of Regulatory Impact Analysis and the current Special Zone approach. This paper has identified that Japan's regulatory management system is still not sufficiently adaptable and various sectors strongly resist reform. Japan does not have an effective enforcement mechanism for the RIA

and lacks coordination between regulatory reform and competition policies. A major problem of Japan's RMS is a divergence of the institutions, between the CRR as a core of the regulatory reform and the ministry in charge of the RIA management. Also, various councils for regulatory reform co-existed without replacing the previous ones by new organisations preventing efficient regulatory management.

Parts 2 and 3 explored two case studies of regulatory change: the Agency Worker Law and the Taxi Revitalization Law. These cases studies had at first been considered successes due to strong political leadership, but as such leadership faded eventually became overall failures. It demonstrates the lack of effective oversight institutions and supporting policy practices for regulatory reform. An enhanced RMS should have made a significant difference to the outcome of these cases.

Overall, the Japanese experience suggests that the RMS requires adequate supporting measures, such as enforcement by the respective ministries to be effective. However, this experience also suggests that RMS provisions, such as the RIA, could significantly benefit policy-making by providing sound economic analysis of potential reform. To sum up, the Japanese government already has various tools for regulatory reform by international standards, though the utilisation of them is currently just a formality. An exception is the Council of National Strategic Special Zones, which was established in 2013.

An answer to the hypothetical question of what difference an enhanced RMS could have made is the following: First, it would substitute the need for strong political leadership on individual items of regulatory reform, and establish more sustainable regulatory management over time regardless of changes in government. Second, one could estimate the consequences of the policy changes by utilising economic analysis for RIA, so that the same mistakes are not repeated. Third, a better RMS could contribute to the economic growth strategy through the better allocation of human resources in the medium term.

The Japanese experience suggests that a better RMS is like an insurance policy for the government (Gill 2016). Each ministry tends to move towards what it considers 'national interests', but the outcome might be quite costly to the people. The RMS suggests more effective policies to achieve the coordinated national interest within the government.

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