Plenary Session I

Images of the Market: Is Competitive De-regulation Inescapable?

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ABSTRACT

With the end of the cold war, governments of the leading countries, with their citizenries no longer exposed to the threat of nuclear war, were released from the duty to improve the material well-being of all of their citizens. Instead, states now aim to maximise opportunity for their people, to privatise state activities, and to make government more responsive to the market in its function. However, it is worth asking whether states really have no choice but to engage in competitive de-regulation. The argument that this is the case is premised on the view that, in a market composed of numerous players, the players are unable to co-ordinate their courses of action to realise their common interests. This paper argues that there is ample possibility for the governments to collaborate for the common interests of the global society.

Keywords: *Regulation, Market, Cold War, Collective Action, Co-ordination*

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Although the current global economic crisis is having a severe impact on Japan, with GDP tumbling by 4.0% compared to the previous period (15.2% per year) in the first quarter of 2009, and with Japan's economic growth expected to fall farther than that of any other developed country in 2009, the responses of both the government and the Bank of Japan to the crisis have not yet raised constitutional concerns. The efforts of the government to stimulate the domestic market with a massive Keynesian financial package,[1] and of the Bank of Japan both to maintain bank rates close to zero and to increase the money supply,[2] are unusual in scale but do not exceed the legal competence of the government or the Bank.

I do not expect that either will resort to extraordinary measures with constitutional implications any time soon. Whether or not the unusual measures already taken will lead to recovery remains to be seen, but if they do not, their failure would be the result of a lack of confidence in the ability of the government to turn the economy around and set it on a sustainable footing. That is, if the current measures do not prove sufficiently credible, people may view the current government borrowing as a precursor to higher tax payments in the future, and both households and corporations may save their gains from the stimulus package instead of spending them. In such a scenario, extraordinary measures would offer no advantages over the sort that have already been tried.

In my talk today, therefore, I do not plan to address constitutional questions arising from the current global economic crisis. Instead, with the gracious consent of the organiser of this symposium, my subject will be the fundamental underlying issue of economic regulation, and in particular, the question of how constitutional scholars should think about "regulation," "markets," and "globalisation." In recent years, many people from diverse sectors of society in Japan have argued strongly for de-regulation, and the government has actively pursued it as a policy goal. Calm discussion of the advisability of de-regulation as such, however, has been scarce. While most would agree that globalisation enhances economic efficiency and productivity, it is far from settled that globalisation is even consistent with the fair distribution of wealth between and within states. To understand and evaluate the pertinence of government policies and measures such as those being pursued to address the current crisis, constitutional scholars must re-examine the basic concepts and assumptions from which they derive.

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1. In April 2009 the government of Japan declared that it would inject 15 trillion yen into its economy with a stimulus package. In the era of financial crisis of 1990s, the government temporarily nationalised a few big banks, including Long-Term Credit Bank, and injected huge amount of public money to most of the big banks in Japan.

2. So we have a monetarist policy and a Keynesian fiscal policy at the same time.

I. MULTIPLE MEANINGS OF "REGULATION" AND "LIBERTY"

A number of difficulties arise in undertaking such a re-examination, one of which is the diffusion of the concept of "regulation." Traditionally, regulation has been understood as a "sustained and focused control exercised by a public agency over activities that are valued by a community."[3] Beyond the command-control type of regulation reflected in this definition, however, self-regulation by private corporations and industries, the function of markets,[4] and even the architecture of real and virtual spaces[5] have come to be regarded as mechanisms of regulation. With regard to market function, market prices, as signals, are understood to guide both consumers in seeking to maximise utility, and corporations in seeking to maximise profit; the market provides different incentives from those that would be pursued if there were no market. With regard to the architecture of real and cyber-space, speed bumps are understood to make people drive their cars more carefully, and filtering software to lower the probability of adolescents coming across indecent content on the internet. The diffusion of the concept of regulation to encompass this range of mechanisms has made it difficult to determine whether a given means of influencing behaviour is or is not regulation. If one cannot with confidence say what regulation is, one cannot characterise de-regulation either.

The diffusion of the conception of regulation relates to the multiplicity of meanings associated with the word "liberty."[6] Proponents of de-regulation often seem to presuppose the classical utilitarian conception of liberty, that is, the notion of liberty as the absence of '"restraint, constraint, compulsion, coercion, duty, obligation."[7] If one is free from interference or constraint, one is at liberty. If the range of choices available to one is restricted by the coercive power of the government, then one's liberty is suppressed. It is understandable that classical utilitarians aimed for a minimal state as that which would best realise their ideal of genuine liberty.[8]

However, the classical understanding is not the sole legitimate

3. Philip Selznick, *Focusing Organizational Research on Regulation*, *in* REGULATORY POLICY AND THE SOCIAL SCIENCES 363 (Roger Noll ed., 1985). *See also* ANTHONY I. OGUS, REGULATION: LEGAL FORM AND ECONOMIC THEORY 1 (Peter Cane, Tony Honore & Jane Stapleton eds., 2004) (1994).

4. *Cf.* Lawrence Lessig, *The Law of the Horse: What Cyberlaw Might Teach*, 113 HARV. L. REV. 501, 501-07 (1999).

5. *Id.* at 507-08.

6. For more on the multiplicity of conceptions of liberty, see Quentin Skinner, *States and the Freedom of Citizens*, *in* STATES AND CITIZENS: HISTORY, THEORY, PROSPECTS 11 (Quentin Skinner & Bo Strath eds., 2003).

7. JEREMY BENTHAM, OF LAWS IN GENERAL 253 (H. L. A. Hart ed., 1970).

8. It should be noted that utilitarianism can also function as a legitimating principle for a welfare state. Given the principle of diminishing marginal utility, an equal distribution of a good will usually bring about greater total utility than a less equal one.

conception of liberty. From the neo-Roman viewpoint of seventeenth-century English revolutionaries, for whom liberty meant freedom from the dominion of others,[9] as well as from the Hegelian view of liberty as consisting in fulfilling our highest potentialities,[10] regulation through state power can be understood not as the deprivation of but as the provision of liberty, or as the means of eliminating hindrances to it. Like the Benthamite conception of liberty, these viewpoints are supported by consistent ideas with strong traditions.

II. GROUNDS FOR REGULATION AND DE-REGULATION

The notion that de-regulation promotes liberty is only one of the grounds that its proponents offer in arguing for it; an argument they seem to pursue more vigorously is that de-regulation furthers public interests. In the traditional, public-interest theory of regulation, regulation is "justified as a corrective to perceived deficiencies in the operation of the market."[11] While the market system is supposed to be self-supporting, it is understood to be imperfectly so, sometimes failing to provide efficient resource allocation due to so-called "market failures" such as natural monopolies, external effects, information deficits, and bounded rationality. Moreover, in the absence of regulation, the market does not solve problems involving non-economic values such as distributive justice and communal values.[12] From this viewpoint, the validity of arguments for de-regulation depends on the inefficacy of concrete regulatory measures as correctives to deficiencies in the market.

The recent global rush to de-regulation is patently difficult to justify from this public-interest theory viewpoint. The status of a given industry as a natural monopoly, the external effects some goods may have, the prevalence of information deficits in a given market—none of these are subject to dramatic change in the short term. The potential for market failure does not disappear suddenly. And no one has credibly shown that market mechanisms can ensure minimum levels of income or universal medical services.

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9. Quentin Skinner points out that the conception of liberty that Sir Edward Coke and his followers embraced can be traced back to the analysis of freedom and slavery at the outset of the *Digest of Justinian.* Skinner, *supra* note 6, at 13. The *Digest* asserts that "the great divide in the law of persons is this: all men are either free men or slaves," and that "[s]lavery is an institution of the *jus gentium*, whereby someone is against nature made subject to the [dominion] of another." *Cf.* 1 THE DIGEST OF JUSTINIAN 15 (Alan Watson ed., 1985). Watson uses the expression "ownership" instead of "dominion."

10. As to Hegel's conception of freedom, see CHARLES TAYLOR, HEGEL AND MODERN SOCIETY (1979) (esp. ch. 2, sec. 3 & ch. 3, sec. 3); ALEXANDRE KOJEVE, INTRODUCTION A LA LECTURE DE HEGEL [INTRODUCTION TO THE READING OF HEGEL] 11-34 (1947).

11. OGUS, *supra* note 3, at 15.

12. *Id.* at 29-54.

Rather, the trendy argument among proponents of de-regulation has been that regulation of economic activities is inherently inefficient because of the structure of democratic political processes. In this view, democracy is seen as an arena wherein numerous players seek to advance their individual goals. Players in this arena both compete and make alliances with one another for the purpose of achieving their goals as fully as possible. The political process is just another market, one in which players buy political advantage with financial contributions and votes. Understood thus, the political market tends to produce laws that reflect not genuine public interests but rather the private interests of particular groups or corporations, since the benefits of any proposed bill that would genuinely serve some wider public interest would be spread too thinly for individuals to be incentivised to fight for its enactment. Rather, it is more rational for individual citizens to free ride, hoping to benefit from the efforts of others, since each citizen's individual efforts make little difference to the final results. In contrast, particular groups or corporations whose interests a proposed bill promises to advance are likely to devote substantial resources and energy to promoting its enactment. Since doing so offers tangible benefits only to the interested groups or corporations, no one else is likely to make such efforts.

Thus, more often than not, regulatory measures produced by democratic processes reflect particular rather than general interests, and serve to generate profits for the industries or firms which they are intended to regulate. It follows that society as a whole would be better off if such measures were abolished or at least eased.[13]

Though this line of argument sounds plausible, its limitations must be noted. First, this theory, interpreted strongly, entails that every regulatory measure be understood to benefit the regulated industries or firms. If this is the case, however, every de-regulatory measure must also be understood to reflect the particular interests of the industries or firms concerned; if a de-regulatory measure genuinely reflected wider benefits to consumers or to the populace as a whole, no one would have sufficient incentive to support it actively. A strong interpretation of this theory is thus self-undermining. In order to justify de-regulation, one must rather presuppose (1) that democratic political processes sometimes produce regulatory measures that promote public interests, and (2) that such measures can be distinguished from those serving merely private interests.

Second, this trendy line of argument presupposes a view of political processes that is congruent with an image of markets as highly autonomous;

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13. Yasuo Hasebe, *Constitutional Borrowing and Political Theory*, 1 INT'L J. CONST. L. 224 (2003). I suggest that the case law of the Supreme Court of Japan in the area of economic liberties can be explained from this pluralist viewpoint.

the notion is that if inefficient regulatory measures are eliminated, an ideal market will appear that optimally allocates resources, accurately reflecting all available information about economic conditions. However, the market system is not freestanding. It cannot function without legal institutions to enforce contracts, protect property, and recover unlawful damages. Moreover, there is no clear line demarcating the border between minimal constituting rules and excess regulatory rules;[14] at most, advocates of de-regulation can argue that we should be in favour of rules respecting autonomous choices on the part of private citizens, rather than rules that "unnecessarily specify end-states."[15] Voices of some authority are sceptical of the very notion that market systems are inherently self-correcting and tend towards equilibrium.[16] The current global economic crisis seems to corroborate this scepticism.

III. THE END OF THE COLD WAR AND THE WITHDRAWAL OF STATES

Whereas a valid argument for the recent global rush towards large-scale de-regulation may be found neither in traditional public-interest theory, nor in the recently popular private-interest theory, the foundations of this trend are evident in modern history.

Philip Bobbitt argues that the trend is the result of the transformation of "nation-states" into "market-states" as a consequence of the end of the cold war. The "nation-state," the dominant constitutional order of the twentieth century, emerged as a result of changes in how states waged war. Following the military successes of Bismarckean Prussia, many countries adopted German-style systems of intensive conscription to supply the enormous manpower required for modern warfare.[17] When a state coerces a large part of its citizenry to go to war, its people naturally demand greater participation in politics in return, and furthermore demand that the state enhance their

14. *Cf.* CASS R. SUNSTEIN, THE PARTIAL CONSTITUTION 40-67 (1993). For example, opinions would differ as to whether anti-trust statutes are constitutive rules or regulative ones.

15. *See* CASS R. SUNSTEIN, LEGAL REASONING AND POLITICAL CONFLICT 159 (1996).

16. According to George Soros, contrary to the premises of rational expectations theory, financial markets "provide a picture that is always biased or distorted in one way or another," and "the distorted views held by market participants and expressed in market prices can under certain circumstances, affect the so-called fundamentals that market prices are supposed to reflect." This two-way circular connection between market prices and the underlying reality in Soros's view, occasionally "gives rise to financial crises." *See* George Soros, *The Crisis and What to Do About It*, 55(19) N.Y. REV. BOOKS 312 (2008); *see also* GEORGE SOROS, THE NEW PARADIGM FOR FINANCIAL MARKETS: THE CREDIT CRISIS OF 2008 AND WHAT IT MEANS 52-58 (2008).

17. PHILIP BOBBITT, THE SHIELD OF ACHILLES: WAR, PEACE, AND THE COURSE OF HISTORY 185 (2002). Although conscription had been adopted in most European countries, it amounted to the drafting of the poor in countries other than Prussia since the hiring of substitutes for military service was allowed *Id*.

welfare more equally and fairly.[18]

As Carl Schmitt has observed, this brought about the contest of three constitutional models, fascism, communism, and parliamentary democracy, each of which was claimed to be the sole legitimate framework for the nation-state in the modern era.[19] Fascism was the first of these models to be eliminated in this contest, through the defeat of the Axis Powers in the Second World War. The rivalry between communism and parliamentary democracy brought about the cold war, and the question of which model could best improve the material welfare of a populace remained at issue.

With the end of that war, however, the governments of the leading countries, with their citizenries no longer exposed to the threat of nuclear war, were released from the duty to improve the material well-being of all of their citizens. Instead, states now aim to maximise opportunity for their people, to privatise state activities, and to make government more responsive to the market in its function. The promise of the state in the post-cold war era is to create a "new world of choice."[20]

The emerging "market-states" that Bobbitt describes subscribe to views such as the following[21]:

> that capital markets have to become less regulated in order to attract capital investment and the capital has to become more global in order to achieve the maximum returns on investments; that labour markets have to become more flexible in order to compete with other, foreign labour markets and to keep jobs at home that depend upon producing products at a cost that can compete with the products of states that have lower labour costs; that if the world economy is to grow, access to all markets has to be assured and trade has to become more free if that state's goods are to be able to penetrate foreign markets and thus participate in this growth; that government subsidies, spending, and welfare programmes have to be managed in order to permit more investment in infrastructure

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18. It was not the coincidence that Bismarck championed the first state welfare systems in modern Europe, including social insurance legislation. A warfare state should offer welfare state services to its people in return for military sacrifice. Similarly we can explain why Japan has become "the world's first welfare superpower." *See* NIALL FERGUSON, THE ASCENT OF MONEY: A FINANCIAL HISTORY OF THE WORLD 255 (2008). By its aim that "a healthier populace would ensure healthier recruits to the Emperor's armed forces," see *id.* at 208.

19. Carl Schmitt, *Preface to the Second Edition*, *in* THE CRISIS OF PARLIAMENTARY DEMOCRACY 8-17 (Ellen Kennedy trans., 1985).

20. BOBBITT, *supra* note 17, at 233. In other words, "[w]heras the nation state justified itself as an instrument to serve the welfare of the people (nation), the market state exists to maximise the opportunities enjoyed by all members of society." *Supra*, at 229. *See also* PHILIP BOBBITT, TERROR AND CONSENT: THE WARS FOR THE TWENTY-FIRST CENTURY 44-45 (2008).

21. BOBBITT, *supra* note 17, at 667.

> and to allow greater private savings; and that tax policy has to provide incentives for growth in order to attract enterprise and to maximise innovation and entrepreneurship.

Leading states now compete in their efforts at de-regulation, privatisation, and tax-cutting in order to attract global capital investment. With the emergence of a global market for capital, there is no room for any one government to maintain welfare-state policies that entail higher costs for its corporations. Governments now promise to enhance the opportunities available to their citizens, rather than to improve their material well-being; they have been unable to avoid reducing their scope of activities and handing over responsibility for managing risk to individuals.

The mass media, dependent on advertising revenues from corporations, have little incentive to report on the dark side of this competitive de-regulation, and this has increased the difficulty of putting the brakes on this development through political processes. Placed in a kind of prisoners' dilemma,[22] states cannot but continue to compete in this race towards an equilibrium point, though no one knows where it is. Whether there is good reason to de-regulate or not, states seem irresistibly compelled to do so.

Nonetheless, it is worth asking whether states really have no choice but to engage in competitive de-regulation. The argument that this is the case is premised on the view that, in a market composed of numerous players, the players are unable to co-ordinate their courses of action to realise their common interests—a view introduced at the outset of many economics textbooks as a description of perfect competition in the market. The cogency of this premise, however, is subject to question. If players in global markets can collaborate to realise their common interests, states may indeed have alternatives to the race to the bottom of competitive de-regulation.

IV. Difficulty of Collaboration

In the middle of the twentieth century, Mancur Olson argued that it is difficult for members of a large group to co-ordinate their courses of action to realise common interests.[23] His argument is widely accepted among social scientists.[24]

Public goods, the benefits of which are shared by the entire populace of

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22. It should be noted that this is not a typical prisoners' dilemma since no government's choice of action in this scenario has an influence on the end-results. Thus, there is no room for strategic decision-making.

23. Mancur Olson, The Logic of Collective Action: Public goods and the theory of groups (1971).

24. The private-interest theory of regulation, discussed in section 2 is an example of reasoning based on Olsonian analysis.

a society, involve interests common to the members of a large group; let us consider the difficulty of realizing one in view of Olson's argument. Suppose that if every citizen raised the thermostat on her air-conditioner by one degree in the summer, the greenhouse effect would be significantly mitigated. Even if this were the case, the effects of my setting the thermostat on my own air conditioner one degree higher would nonetheless be negligible in view of the number of air conditioners in the whole society, to say nothing of the whole earth. It would not be rational for me to raise the thermostat setting on my air conditioner, since doing so would cause me to suffer from higher temperature and humidity. Moreover, the aim of curbing greenhouse gasses could still be achieved if a sufficient number of people raise their settings by one degree; I can enjoy the benefits, even if I do nothing. The most rational course for me to pursue is clearly to hope for a free ride, relying on the efforts of others.

Even if the public good is not realised because too many people, thinking similarly, defect from the project, then it would still makes no sense for me to set the thermostat higher, since my doing so would not influence the result of the collective action. Thus, whether the undertaking is successful or not, it would not be rational for me to make an effort to contribute to it for the benefit of the entire populace. As this example demonstrates, the action or non-action of one member of a group composed of a large number of people cannot make any significant difference in the achievement of common interests, and it is therefore always the most rational course for individual members of a large group to free ride.[25]

As Richard Tuck points out,[26] this Olsonian argument is a generalisation of the economic analysis of perfect competition in the market. In a perfectly competitive market, in contrast to a monopoly or oligopoly, there are so many suppliers that the decisions of each on the quantities and prices of the goods it supplies can have no influence on market prices. There is no possibility of strategic calculation to maximise profit on the part of individual suppliers. Each perceives the market price as given, and makes decisions accordingly on whether or not, and to what extent, to supply the good to the market.

The cases of both perfect competition in the market and the pursuit of collective goods described by Olson entail the supposition that, first, a large number of players participate, and therefore that, second, the influence of each player's action on a given result is negligible. As in the example

25. This argument is applicable to rational agents irrespective of whether they were self-interested or not. Olson points out, "A man who tried to hold back a flood with a pail would probably be considered more of a crank than a saint, even by those he was trying to help." *See* OLSON, *supra* note 23, at 64.

26. RICHARD TUCK, FREE RIDING 196-204 (2008).

discussed above, it is thus not rational for individual players to make efforts to affect results for the entire group.[27]

Voting in elections may be understood along similar lines. In an election in which thousands or even millions of other citizens are eligible to vote, my ballot, for instance, has no influence on which candidate will be elected. As Anthony Downs points out, "each man's ballot is only one drop in a vast sea."[28] It is therefore not rational for me to make the effort of going to a polling station. If I stay home and enjoy myself instead, then the aggregate utility of the society as a whole will increase with the addition of my enjoyment. Since my staying home will make no difference to the result of the election, this seems to be Pareto-superior as a course of action.

V. Possibility of Collaboration

However, as Richard Tuck argues, it is doubtful that individuals never have an influence on the results of collective actions in which a large number of people participate. According to Tuck, it is not infrequently rational for one citizen to cast her vote with the aim of affecting the outcome of an election. For instance, suppose that in the electoral district in which I live, the threshold to be elected is 20,000 votes, and there is a candidate whom I want to be elected. The question that I face in deciding whether or not to vote is whether it is probable that there are more than 20,000 voters who will vote for my candidate. If so—because, for example, she is quite famous, or is supported by a powerful interest group—casting my vote for her will contribute to her successful election. In this case, my voting is rational as a means to realising my objective. I have a good reason to contribute if enough other people are going to do likewise.[29]

However, the notion of there being a determinate threshold for my participation in an election raises a question: if I am confident that a great enough number of other people will vote for my candidate for her to be elected, is my vote not redundant, and is it therefore not still irrational for me to make the effort of going to the polling station? In Tuck's view, the problem amounts to a game of chicken. The candidate whom I support will be elected only if enough voters who support her actually cast votes. If a great enough number of supporters conclude that their votes are redundant and stay home, my candidate will not be elected. With this in view, it is rational for me, as well as for other supporters of the candidate, to err on the

27. In Tuck's account, the modern economic idea that numbers are critical to the question of whether economic agents will collaborate or not first clearly appeared in the 1920s. *See* TUCK, *supra* note 26, ch. 5.

28. ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY 244 (1957).

29. TUCK, *supra* note 26, at 30-44.

side of safety and go to the polling station.[30]

The perception of a determinate threshold, at least *ex post facto*, makes voting in an election a special case; the thresholds for success are indeterminable in the cases of efforts to realize many public goods. However, as Tuck argues, we can in general treat such cases as if they involve thresholds for success, but ones that cannot be detected determinately.[31] We cannot determine, for example, exactly how many people must raise the thermostat settings on their air-conditioners to mitigate global warming. Yet if I am confident that a sufficient number of people intend to collaborate on the project, and that they will actually do so, it is rational for me to collaborate as well. My doing so is instrumentally conducive to bringing about the desired result.[32]

VI. CONCLUSION

The same argument applies to the question of whether states in the post-Cold War era have no alternative but to rush to competitive de-regulation. There is no logical necessity requiring competition; the states of the world are free to collaborate for their common interests. If a great enough number of governments choose to do likewise, it would be rational for each government to regulate its financial sector, provide a safety net for its labourers, and promote the material well-being of its citizens. However, if the governments of the world are captured by the Olsonian view of global markets, they will remain subject to the imperatives of competitive de-regulation.[33]

30. *Id.* at 46.

31. *Id.* ch. 3.

32. Tuck's argument is that sometimes my collaborating with a lot of people is instrumentally conducive to bring about some common objects. It should not be confounded with the idea of civic humanism that active participation in political life is the main locus of our good. As John Rawls points out, "in a modern democratic society, taking a continuing and active part in public life generally has, and may indeed reasonably have, a lesser place in the conceptions of the (complete) good of most citizens." JOHN RAWLS, JUSTICE AS FAIRNESS: A RESTATEMENT 143 (2001).

33. Another factor that drives governments towards competitive de-regulation may be the fact that market-states are still to a large extent nation-states. If a market-state is sufficiently de-nationalised, there would be little reason why it should compete to enhance the opportunities of its own people. States are conscious of their economic data because, as Joan Robinson points out, "[t]he very nature of economics is rooted in nationalism." JOAN ROBINSON, ECONOMIC PHILOSOPHY 177 (1964).

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