

International Games with National Rules: Competition for Comparative Regulatory Advantage in Telecommunications and Financial Services

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INTRODUCTION

Commentators from the popular press to business reviews have gleefully heralded the advent of "globalization," yet few offer a clear sense of what this actually means. For many authors, globalization implies a triumph of international markets over national governments: the sheer force of these international markets overwhelms national regulators, while mobile multinationals simply outrun them.¹ Yet in some of the most global of industries, such as telecommunications and finance, international competition remains powerfully conditioned by national regulation. Markets in these sectors have become more global in the sense that technology has reduced the costs of international transactions, cross-border flows of goods and money have expanded, and national markets have become more integrated with international markets.² But these markets remain governed primarily by national rules: that is, the fortunes of "global" firms remain tied to home-country regulation, host-country regulation, and the interaction of the two.

Furthermore, the mismatch between international markets and national regulation has some rather profound implications for competition within these markets. With multiple national regulators governing international markets, the regulators themselves come to compete.³ But where does this competition between regulators lead us? Two prevalent schools of thought suggest contradictory answers. On the one hand, works on comparative economic systems imply that differences in regulatory regime may increasingly determine the winners and losers within the global marketplace.⁴ As nations reduce the most overt forms of industrial protection and

¹ Kenichi Ohmae, *The Borderless World: Power and Strategy in the Interlinked Economy* (New York: Harper Business, 1990); Richard B. McKenzie and Dwight R. Lee, *Quicksilver Capital: How the Rapid Movement of Wealth Has Changed the World* (New York: Free Press, 1991); Walter B. Wriston, *The Twilight of Sovereignty: How the Information Revolution is Transforming Our World* (New York: Scribner's, 1992); Richard O'Brien, *Global Financial Integration: The End of Geography* (London: Royal Institute of International Affairs, 1992).

² For evidence of internationalization, see Helen V. Milner and Robert O. Keohane, eds., *Internationalization and Domestic Politics* (Cambridge: Cambridge University Press, 1996).

³ On regulatory competition in general, see Joel P. Trachtman, "International Regulatory Competition, Externalization, and Jurisdiction," *Harvard International Law Journal* 34 (Winter 1993), pp. 47-104, and Dale D. Murphy, "Open Economies" Competition for Comparative Regulatory Advantage, paper for the Harvard-MIT Seminar on International Security, November 1993; for economic analysis of its costs and benefits, see Wallace E. Oates and Robert M. Schwab, "Economic Competition Among Jurisdictions: Efficiency Enhancing or Distortion Inducing?," *Journal of Public Economics* 35 (1988), pp. 333-54, and Jeanne-Mey Sun and Jacques Pelkmans, "Regulatory Competition in the Single Market," *Journal of Common Market Studies* 33 (March 1995), pp. 67-89.

⁴ Michael Porter, *The Competitive Advantage of Nations* (New York: The Free Press, 1990), Eisuke Sakakibara, *Beyond Capitalism: the Japanese Model of Market Economics* (Lanham, MD: University Press of America, 1993), Lester Thurow, *Head to Head: the Coming Economic Battle Among Japan, Europe, and America* (New York: Warner Books, 1993), and Michel Albert, *Capitalism vs. Capitalism: How America's Obsession with Individual*

promotion, domestic regulatory systems become an even more critical element in the competitive advantage of national firms.⁵ In this view, national authorities engage in a competition in regulatory subsidy (or competitive reregulation): that is, they compete to design regulatory systems that favor their own firms.⁶ They may do so either by trying to lower the regulatory burden on domestic firms, or by trying to rig regulations to favor domestic firms (strategic reregulation).⁷ Over time, this competition is likely to produce a stalemate as national authorities engage in a zero-sum game in which their respective regulatory subsidies roughly offset each other.

On the other hand, those more enamored with the benefits of globalization suggest that the very competition between regulators may erode differences between national regulatory regimes, rendering them obsolete as a source of comparative advantage.⁸ These authors stress that in a world of international markets governed by national regulations, corporations can engage in regulatory arbitrage: that is, they can shift their capital or their business activity to jurisdictions with a lighter regulatory burden. As a result, national authorities compete to design regulations to attract capital and business activity, and to prevent their flight, and this generally means reducing the regulatory burden. They engage in a competition in regulatory laxity (or competitive deregulation). Therefore, the competitive dynamic between regulators is fueling a global wave of deregulation, producing a convergence toward a more liberal regulatory model.⁹

Achievement and Short-Term Profit Has Led It to the Brink of Collapse (New York: Four Walls Eight Windows, 1993).

⁵ Trachtman, "International Regulatory Competition," pp. 52-53.

⁶ Paul Krugman has written a provocative critique of the very notion of national "competitiveness in Competitiveness: A Dangerous Obsession," *Foreign Affairs* 73 (March-April 1994), pp. 28-44. For present purposes, I simply note that while perhaps national authorities should be less obsessed with 'competing' with each other, the reality is that they think in these terms and will continue to do so for the foreseeable future. For rebuttals to Krugman's argument, see *Foreign Affairs* 73 (July-August 1994), pp. 186-97.

⁷ The concept of strategic reregulation first appeared in Michael Borrus, Francois Bar, Patrick Cogez, Anne Brit Thoresen, Ibrahim Warde, and Aki Yoshikawa, *Telecommunications Development in Comparative Perspective: the New Telecommunications in Europe, Japan and the U.S.*, Berkeley Roundtable on the International Economy (BRIE) Working Paper No. 14 (May 1985). For an interesting case study from the electric utility industry, see Peter Navarro, "Creating and Destroying Comparative Advantage: the Role of Regulation in International Trade," *Journal of Comparative Economics* 13 (1989), pp. 205-26.

⁸ McKenzie and Lee, *Quicksilver Capital*, Wriston, *Twilight of Sovereignty*.

⁹ Philip G. Cerny, "The Dynamics of Financial Globalization: Technology, Market Structure, and Policy Response," *Policy Sciences* 27 (1994); Alfred C. Aman, Jr., "A Global Perspective on Current Regulatory Reforms: Rejection, Relocation, or Reinvention?," *Indiana Journal of Global Legal Studies* 2 (1995), pp. 429-64.

In this paper, I test these two models of regulatory competition by looking at telecommunications and finance--the two sectors most strongly associated with "globalization."¹⁰ I compare and contrast regulatory reforms in Britain and Japan in order to determine whether national authorities are competing in a strategic game of regulatory subsidy or regulatory laxity, or some combination of the two, and to ascertain how this game is playing out over time.

TELECOMMUNICATIONS

Throughout the industrialized world, the traditional telecommunications regime incorporated several fundamental principles. First, telecommunications was a "natural monopoly," meaning that economies of scale were so great that a single operator could provide service more efficiently than two or more competing operators. Second, the government, whether as the regulator or as the operator itself, should insure that the telecommunications sector serves the public interest broadly defined. In practical terms, this meant that the telecommunications operator should provide universal service at a uniform price irrespective of geographical variations in the cost of providing the service. Third, the telecommunications system should be managed as a single integrated network in order to maintain uniform technical standards and to maximize interconnection--that is, to ensure that any telephone would be able to connect to any other.

Among the many technological changes that have transformed the sector, three were particularly critical: the development of advanced terminal equipment, the advent of microwave and satellite transmission, and the creation of sophisticated "value-added" services combining data processing with communications. New possibilities for terminal equipment made it increasingly difficult for a single operator to provide the full range of equipment that users required. Electronics firms wanted to be able to provide terminal equipment, and users wanted the opportunity to buy this equipment. New transmission technologies provided an even more fundamental challenge because they offered a means of contesting the monopoly in basic telephone service. Corporations could bypass the monopoly carrier by creating their own private lines using these technologies. Microwave technology had an advantage over wired communications in that it required less investment in infrastructure, it was not dependent on securing a right-of-way on land, and it could be transmitted from mobile terminals. At the same

¹⁰ The case studies build upon a larger work: Steven K. Vogel, *Freer Markets, More Rules: Regulatory Reform in the Advanced Industrial Countries* (Ithaca, NY: Cornell University Press, 1996).

time, it could only offer a cost advantage in selected niches of the market, and it relied on the limited resource of the radio spectrum. Satellite technology provided a further challenge, with the added complication that it could easily cross national borders and thus defy the ability of any single national regulator to control it. Satellite technology had the benefit of being able to transmit signals even to remote or mountainous areas, but it had the disadvantage of greater cost.

Meanwhile, the advance of microelectronics and the transition from analog to digital transmission technology made it easier to send large quantities of information rapidly and inexpensively, and to interface between computers and communications channels. Regulators were then confronted with two basic questions. First, to what extent should they allow data processing companies to use the public network to deliver their services? If they allowed these companies to interconnect with the network, they would have to find some way to make an artificial distinction between data services and communications even though many advanced services actually combine the two. Otherwise, companies claiming to be data service providers could "resell" lines, in effect competing with the monopoly carrier as telecommunications operators using the carrier's own lines. And second, to what extent should they allow the dominant operator to offer data communications services? In many countries, the debate over the regulation of data communications services has set the stage for broader reform.¹¹

All of the major industrial countries have faced the same basic regulatory challenges brought on by advances in terminal equipment, transmission technologies, and value-added services--and yet they have responded to these challenges in distinct ways. To sort out the elements of convergence and divergence in these responses, we must first recognize that none of these countries has really deregulated the telecommunications sector in the sense of reducing or eliminating regulation. Rather, they have combined liberalization (the introduction or promotion of competition) with reregulation (the reformulation of old rules or the addition of new ones). In fact, liberalization has required reregulation. Because of the dominant position of the incumbent carriers, governments have increased regulation to enhance the new carriers' ability to compete. That is, they have used regulation to create competition. For example, they have constrained the

¹¹ Other accounts of the technological forces behind telecommunications reform include Jill Hills *Deregulating Telecoms: Competition and Control in the United States, Japan and Britain* (Westport, CT: Quorum, 1986); and Francois Bar and Michael Borrus, "From Public Access to Private Connections II: Network Strategy and National Advantage in U.S. Telecommunications," in Organization for Economic Cooperation and Development and the Berkeley Roundtable on the International Economy, *OECD-BRIE Project on Competitiveness and Telecommunications Policy, Information Networks and Business Strategies* (Berkeley, CA: BRIE, 1989).

dominant carrier's ability to "rebalance" rates--to raise local call rates so that they can lower long-distance rates more rapidly--in order to beat out competitors in long-distance service. Thus telecommunications reform has never taken the form of a competition in laxity (i.e. less regulation), but has sometimes tended toward a competition in liberalization (i.e. more competition). National authorities have liberalized in order to lower telecommunications costs and stimulate the expansion of new services, thereby making domestic firms throughout the economy more competitive and making the country more competitive as a business center. Their policies have converged in the sense that they have all liberalized the telecommunications sector, but they have differed substantially in the degree of liberalization and the mode of reregulation. To illustrate this variation, let us look more closely at telecommunications reform in Britain and Japan. These two countries provide a good comparative fit because they enacted reforms under similar circumstances at about the same time. Both governments initiated telecommunications reform as part of a neo-conservative reform movement; both acted partially in response to U.S. reforms begun in the 1970s; both started working seriously on legislation to liberalize the use of telephone lines in 1980; and both passed legislation to privatize the telecommunications carrier in 1984. And yet they produced strikingly different regulatory regimes.

The British Case

In the space of five years, from 1980 through 1984, the British government enacted the most radical pro-competitive reform of telecommunications in the world. Prior to 1979, the British telecommunications regime had closely resembled the Continental PTT (postal, telegraph and telephone administration) model, except that the Post Office had changed status to a public corporation in 1969. By the time Margaret Thatcher took office in 1979, however, the regime already faced some daunting challenges. In some ways the British system represented the worst of all worlds, for political interference and Treasury oversight prevented it from following the U.S. market-led model of infrastructure development, and yet it lacked the strong government coordination and financial support necessary for a French or Japanese state-led approach.¹² A government commission reviewed problems at the Post Office in the late 1970s, and recommended major changes, including the separation of the telecommunications function from

¹² Douglas C. Pitt, *The Telecommunications Function in the British Post Office: a Case Study of Bureaucratic Adaptation* (Westmead, U.K.: Saxon House, 1980). This parallels Zysman's argument with respect to the British dilemma in industrial policy more generally. See Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Ithaca, NY: Cornell University Press, 1983).

the postal service.¹³ Thus when Thatcher's team took over, it did not have to convince anyone of the need for reform.

Furthermore, Thatcher and her colleagues were convinced that the government should stop trying to prop up ailing manufacturing industries and allow Britain to move further in the direction of its comparative advantage as a multinational business center for Europe and a leader in service industries such as finance. Thatcher's new secretary of state for industry was none other than Keith Joseph, a trusted ally and ideological soulmate. Joseph assigned his civil servants a reading list which combined a wide range of readings on conservative philosophy plus a few selections on telecommunications.¹⁴ Joseph was profoundly disdainful of industrial policy, so much so that he sought to dismantle entire divisions of his own department. He had no qualms about abandoning the British telecommunications equipment industry and focusing on the wider community of telecommunications users. Thus when the new administration came in, corporate user representatives suddenly found that government officials not only welcomed their input but actively solicited it.¹⁵ Department of Industry (DoI) civil servants had already begun to consider the possibility of liberalizing the use of Post Office lines so as to facilitate the development of value-added networks (VANs), but Joseph pushed them further. "Why not allow network competition?," he asked. The civil servants were initially horrified by the very suggestion, but eventually began investigating the prospects. In 1983, the government decided to allow one and only one competitor because this would enable the new entrant to compete with BT more effectively and because the lone candidate, Mercury, insisted on this as a condition of entry. The duopoly policy was to run 7 years, and then be reviewed in 1990.

The 1981 bill failed to clarify how BT and the DoI would share regulatory responsibilities, so DoI civil servants immediately began working on a second reform bill. Then in May 1982 the government decided to privatize BT, leading it to combine this effort into a comprehensive reform bill which ultimately passed in 1984. With respect to the new regulatory regime, the first question was who would do the regulating. Unlike Japan, where two ministries fought an epic battle for the job, the obvious candidates in the British case--the DoI and the Office of Fair Trading (OFT)--wanted nothing to do with it. Furthermore, City of London

¹³ Department of Industry, *Report of the Post Office Review Committee* (London: HMSO, July 1977) and *The Post Office* (London: HMSO, July 1978).

¹⁴ Interviews with Department of Trade and Industry officials (1990-91); N. Bosanquet, "Sir Keith's Reading List," *Political Quarterly* 52 (July-September 1981), pp. 324-41.

¹⁵ Interviews with user group representatives (1990-91).

financial advisors were concerned that investors would not purchase BT shares unless the regulator was distanced from the central government. The Conservative Party was somewhat reluctant to create yet another regulatory body, for it had attacked the Labour Party for its propensity to create more and more quasi-autonomous non-governmental organizations, popularly known as quangos. Nevertheless, the government chose to set up a new independent regulatory agency, the Office of Telecommunications (OfTel). This subsequently became the model for other sectors, and Britain now boasts an Office of Gas Supply (OfGas), an Office of Water Services (Ofwat), an Office of Electricity Regulation (OfReg), and an Office of the Rail Regulator (ORR).

Stephen Littlechild, a leading economist (subsequently appointed director-general of OfReg), invented the new price regulation regime, a price-cap system whereby BT would not be allowed to increase its rates by more than the retail price index minus a certain percentage (RPI-X).¹⁶ The "X" would be fixed at a set percentage (initially three percent) and then revised every five years. Littlechild designed this system to rely primarily on neutral criteria and therefore limit the regulator's discretion and make implementation more straightforward. In practice, OfTel has leaned in favor of competition in its rulings. In a critical ruling in October 1985, OfTel's first director-general Bryan Carsberg set out terms of interconnection that strongly favored Mercury. Under the 1990 review, the government decided to end the duopoly and open the telecommunications market to new entrants. Unlike Japanese authorities who recruited many of the new competitors and continue to micro-manage the competition since liberalization, British regulators chose to issue licenses to any qualified applicants and then simply let the market decide from there.¹⁷ Since this decision more than 130 new competitors have poured into the market, with the greatest new threat to BT coming in the form of cable companies that use discounts on telephone service to lure cable TV subscribers. With Britain being the first country in which cable companies could offer telephone service, American firms have invested billions to get a piece of the action. BT executives and sympathetic members of Parliament now fear that American firms are gaining altogether too strong a toehold in the British market.

¹⁶ Stephen Littlechild, *Regulation of British Telecommunications Profitability* (London: Department of Industry, February 1983).

¹⁷ Department of Trade and Industry, *Competition and Choice: Telecommunications Policy for the 1990s* (London: HMSO, March 1991).

The Japanese Case

The Japanese telecommunications case most blatantly violates common assumptions about the meaning and purpose of "deregulation." Not only did the lead ministry fail to deregulate, but it greatly increased the level of regulation and dramatically augmented its own regulatory power. Prior to reform, the Ministry of Posts and Telecommunications (MPT) actually had very little regulatory authority over the telecommunications sector. In 1952, the Ministry of Communications had split into two parts, forming the MPT and the Nippon Telegraph and Telephone Public Corporation (NTT). The MPT operated the post office and the postal savings system, while NTT ran the telecommunications system. MPT "supervised" NTT through a small regulatory office, but one of the two top officials within the office was actually seconded from NTT. Critics of the arrangement suggested that NTT simply ran its own affairs and regulated itself through its "Kasumigaseki Branch Office" (i.e. MPT).¹⁸ MPT officials in the telecommunications supervisory office increasingly became frustrated with this indignity and a group of young officials drafted a plan for fundamental reform in 1971. They recommended introducing competition into telecommunications markets and reorganizing NTT, although they stopped short of explicitly recommending privatization. Even at this early date, they saw reform as a way to reinstate the ministry in its proper role as the lead agency in the telecommunications field.¹⁹ Competition would force NTT to relinquish its regulatory and policy responsibilities to MPT and would create more market players for the newly-empowered ministry to oversee. When study group members gather at occasional reunions, one member reports, they congratulate themselves on realizing all of their major goals--only about 15 years after the fact.²⁰

Since the privatization of NTT and the liberalization of the telecommunications market in 1985, the MPT has seized control over the new regime with a singularly heavy-handed approach to regulation. The proponents of administrative reform had advocated a light rein of regulation, but MPT officials left themselves considerable discretion in the reform laws and have thoroughly undermined the "deregulatory" pretense of the reform in practice. When Socialist politician Sanji Muto asked Liberal Democratic Party (LDP) heavyweight (and current prime minister) Ryutaro

¹⁸ Chalmers Johnson, "MITI, MPT, and the Telecom Wars: How Japan Makes Policy for High Technology," in Johnson, Laura D'Andrea Tyson and John Zysman, eds., *Politics and Productivity: the Real Story of Why Japan Works* (Cambridge, MA: Ballinger, 1989), pp. 177-240.

¹⁹ Ministry of Posts and Telecommunications, Telecommunications Policy Issues Study Group, *Tsushin gyosei no tembo (yosetsu)* [The Future of Telecommunications Policy (Summary)] (Tokyo: MPT, June 1971).

²⁰ Interview with former MPT official (March 1991).

Hashimoto why the LDP let MPT expand its regulatory powers so much, Hashimoto's response was less than impressive.

Well I have forgotten the details, but you [Muto] certainly did bring a great number of matters to my attention, and at the time I would think "well that really is terrible," and then I would put in a call [to MPT]. But they would give their own reasons for these regulations, and while we did have some of them corrected, clearly some have remained.²¹

The ministry has been directly involved in selecting and sometimes actually creating the new market entrants in the various segments of the market. It uses highly discretionary entry and price regulation to balance competition within the market and to generate leverage over the market players. It has carefully orchestrated the lowering of long-distance telephone rates, and has only gradually approved new services. In particular, the ministry has been slow to approve services that might help NTT to snuff out its new competitors. Market players complain that ministry officials demand unreasonable quantities of documentation to support applications for price or service changes, and often delay action for a year or more.²² Far from being "captured" by the regulated company, MPT officials have shown a strong anti-NTT bias in their regulatory decisions that dates back to their frustration under the prior regulatory regime.²³ As well as supporting NTT's competitors, the new MPT-led regime also serves the interests of equipment manufacturers by requiring NTT to perform "public interest" R&D that effectively subsidizes NTT "family" suppliers and by retaining high technical standards that keep out cheap imports. When NTT's status was up for review in 1990, MPT pushed strongly for breakup, but lost out in the face of resistance from the Ministry of Finance, the Federation of Economic Organizations (Keidanren), NTT, the NTT union (Zendantsu), and influential politicians. MPT made an even stronger push for breakup during a second review in 1995-96, but the coalition government decided to postpone any decision until 1997 at the earliest, ensuring that they would not have to take a stand prior to the upcoming general election. The Social Democratic Party of Japan (SDPJ) feared that breaking up would cost it electoral support from NTT's union, and many Liberal Democratic Party (LDP) members feared that it would cost it financial support from NTT

²¹ Quoted in Masao Komori, *Denden mineika no butaiura* [Behind the Scenes of NTT's Privatization]. (Tokyo: Godo Tsushinsha, 1988), p. 98.

²² Interviews (1991-95). One executive noted that requests for documentation are typically measured in kilograms, not pages.

²³ I refer here to the literature on regulatory capture. See, for example, George Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science* 2 (Spring 1971), pp. 3-21.

"family" manufacturers. Even so, MPT officials remained hopeful that they could eventually push through legislation that would mandate NTT's dismemberment.²⁴

Thus British and Japanese authorities have adopted dramatically different approaches to telecommunications reform. The British have leaned toward a strategy of competition in liberalization, whereas the Japanese have leaned more toward a strategy of regulatory subsidy. British regulators have aggressively promoted competition, even if it meant decimating domestic equipment manufacturers and encouraging an influx of new foreign competitors in telecommunications service markets. In contrast, Japanese authorities have carefully screened new market entrants and micro-managed the competition between them and NTT. British authorities have opened the market to free entry and exit, whereas Japanese authorities continue to manage entry and prevent exit. The British approach has rewarded large corporate users, whereas the Japanese approach has served the interests of domestic equipment manufacturers. British officials have delegated regulatory responsibility to an independent agency, and have established neutral criteria for regulation according to a fixed formula. Yet Japan's MPT not only refused to delegate regulatory responsibilities to an outside agency, but consolidated authority which it had not previously enjoyed. MPT officials continue to make regulatory decisions in a highly discretionary fashion, maximizing their leverage over industry players and preserving their ability to enforce administrative guidance.

Remarkably, these same basic national patterns of regulatory reform are relatively consistent across a wide range of sectors beyond telecommunications, such as financial services, broadcasting, transport, and public utilities.²⁵ That is, British authorities have consistently favored open market entry and exit, independent regulatory agencies, and a highly codified and legalistic approach to regulation, whereas their Japanese counterparts have preferred managed market entry and the prevention of exit, the fusion of regulatory and policy responsibilities within central ministries, and a highly discretionary approach to regulation (See Table 1).

²⁴ Interviews (April 1996).

²⁵ Vogel, *Freer Markets, More Rules*.

TABLE 1
COMPARING PATTERNS OF REGULATORY REFORM IN
BRITAIN AND JAPAN

BRITAIN	JAPAN
1. The government aggressively promotes competition, not managing entry or exit.	1. The government selectively promotes competition, controlling entry and exit.
2. The government fragments regulatory authority.	2. The government retains centralized regulatory authority.
3. The government codifies and juridifies regulation.	3. The government maintains bureaucratic discretion.
4. The government implements reform in an uneven and adversarial manner.	4. The government implements reform in a smooth and coherent manner.

EXPLAINING NATIONAL RESPONSES

The wide gap between the British and Japanese approaches to telecommunications reform naturally begs the question: "Why the difference?" While a full analysis is beyond the scope of this paper, let us briefly review four possible explanations.²⁶

1. *Interest groups.* Differences in the organization of interest groups, the alignment of these groups (coalitions), or the balance of power among these groups might explain distinct reform outcomes. In fact, interest-group explanations are the most common models of the politics of regulation, and some sort of interest-group or coalition model has frequently been applied to telecommunications. Most typically, these authors argue that a pro-reform coalition of users, potential entrants and computer manufacturers gradually overpowers an anti-reform coalition of the dominant carrier, favored suppliers, and the unions.²⁷ However, I contend that this approach cannot account for the difference in reform outcomes for at least two compelling

²⁶ Numerous authors have explored a similar set of competing explanations for national differences in economic policies. See, for example: Zysman, *Governments, Markets, and Growth*; Peter Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca, NY: Cornell University Press, 1986); and Peter Hall, *Governing the Economy: the Politics of State Intervention in Britain and France* (New York: Oxford University Press, 1986).

²⁷ On the politics of regulation in general, see Stigler, "Theory of Economic Regulation;" Sam Peltzman, "Toward a More General Theory of Regulation," *Journal of Law and Economics* 19 (August 1976), pp. 211-240, and "The Economic Theory of Regulation after a Decade of Deregulation," in *Brookings Papers: Microeconomics 1989* (Washington D.C., Brookings, 1989), pp. 1-59; Roger G. Noll and Bruce M. Owen, eds., *The Political Economy of Deregulation: Interest Groups in the Regulatory Process* (Washington D.C.: American Enterprise Institute, 1983); and Theodore E. Keeler, "Theories of Regulation and the Deregulation Movement," *Public Choice* 44 (1984), pp. 103-145; on telecommunications more specifically, see Eli Noam, "International Telecommunications in Transition," in Robert W. Crandall and Kenneth Flamm, eds., *Changing the Rules: Technological Change, International Competition, and Regulation in Communications* (Washington D.C.: Brookings Institution, 1989) pp. 257-97.

reasons. First, this account does not match the actual process of reform. That is, users and potential entrants were not major players in the political process in either Britain or Japan until reforms were well under way, and they did not advocate some of the most important regulatory changes such as privatization and network competition. They were beneficiaries after reform, but not the primary advocates prior to reform. Second, the alignment of interest groups was actually similar in the two countries, and therefore cannot account for the differences in reform outcomes. In Britain and Japan, as well as in the United States, France and Germany, the telecommunications operators were willing to accept liberalization but wanted to maximize their own freedom and minimize that of their new competitors. Favored equipment suppliers opposed reform because it threatened their relationship with the dominant operator, although they recognized that it might expand the overall market. And unions opposed it because they knew that reform implied layoffs.

2. *Production profile.* The gap in reforms may also reflect differences in the production profiles of the two countries, which in turn shape distinct goals for reform. This explanation is particularly promising for Britain and Japan because Britain's comparative advantage lies much more heavily in the service sector whereas Japan's still lies primarily in manufacturing. Thus we should not be too surprised that the British approach caters to corporate users whereas the Japanese approach generally favors suppliers. One could also express this in terms of interest groups: the British government caters to users more than the Japanese government because users are a more important group in Britain. Yet this cannot explain why the British Conservative Party would so brutally abandon manufacturers, an even more powerful support group. In any case, this factor alone cannot account for the variance between the two countries. It cannot explain, for example, why Britain shifted to a much more formal approach to regulation whereas Japan maintained a more discretionary approach.

3. *Institutions.* One could imagine a wide range of institutional explanations, but at least three deserve mention here. First, the Japanese bureaucracy is more insulated from political pressures than the British bureaucracy, and thus was able to influence the content of reform more powerfully. The Japanese bureaucracy certainly cannot ignore societal interests or politicians' demands, but it is better positioned to filter in its own agenda as it tries to satisfy these

demands.²⁸ In contrast, the British bureaucracy, while reputed to be relatively autonomous, was easily infiltrated and manipulated by the Thatcher administration. I would contend that the British bureaucracy's seeming autonomy prior to 1979 was more a product of consensus politics than of underlying institutional strength.²⁹ Second, Japanese government officials, unlike their British counterparts, are tied into tight networks of close working relationships with industry. Thus one should not be surprised that they try to limit those types of neo-liberal reforms which might undermine these relationships. In particular, they rely heavily on informal "administrative guidance" and they require discretionary power over industry in order to enforce this guidance. Without these powerful ties, British officials are much less reluctant to further disengage from industry. Third, Japanese ministries centralize governmental power within a given sector, and "fuse" responsibilities of industrial promotion and regulation. Thus bureaucrats are more inclined to link regulation with promotion, and are better positioned to manipulate regulation for industrial policy purposes. In Britain, responsibilities for regulation and promotion are diffused through a broader range of agencies, so bureaucrats are less likely to link regulation with promotion and less capable of using it as a tool of industrial policy. As a result, Japanese officials have been more insistent on maintaining this fusion of powers, whereas British officials have accepted a further devolution of power to new independent regulatory agencies. And this devolution of power, in turn, has made it even more difficult for British authorities to play the game of regulatory subsidy.

4. *Ideas*. Finally, one cannot fully understand these distinct responses without looking at ideas.³⁰ We can understand this point more clearly by reformulating the notion of competitive deregulation in telecommunications as a distinct proposition: *The telecommunications revolution compels a liberal response*. Governments must deregulate because failure to do so will invite corporate flight, as corporations relocate their activities to countries with more competitive telecommunications regimes.

28 See Steven K. Vogel "The Bureaucratic Approach to the Financial Revolution: Japan's Ministry of Finance and Financial System Reform," *Governance* 7 (July 1994), pp. 219-43.

29 On consensus politics, see Dennis Kavanagh, *Thatcherism and British Politics: the End of Consensus?*, 2nd ed. (Oxford: Oxford University Press, 1990).

30 On the role of ideas in shaping economic policy, see Peter A. Hall, ed., *The Political Power of Economic Ideas: Keynesianism across Nations* (Princeton: Princeton University Press, 1989); Judith Goldstein, *Ideas, Interests, and American Trade Policy* (Ithaca: Cornell University Press, 1993); and Goldstein and Robert Keohane, eds., *Ideas and Foreign Policy: Beliefs, Institutions, and Political Change* (Ithaca: Cornell University Press, 1993).

I would suggest that this is not a universal law of the marketplace but a subjective interpretation of it. It does not necessarily describe how governments have actually responded so much as how some people think they should have responded. British authorities have embraced the logic of this proposition, but Japanese authorities have not, and these ideological differences have powerfully influenced their respective reform policies. In part, of course, these differences may reflect the differences in production profile noted above. That is, British officials have to be more sensitive to Britain's role as a business center than Japanese officials do because this is more critical to the British economy. Yet ideas play an independent role as well: ideas provide the filter through which decision makers interpret market forces. The notion of regulatory competition was so prevalent in Britain that it animated debates about regulatory reform, whereas the Japanese rarely even framed the debate in this way.

This then has some rather powerful implications for life in our world of international games played by national rules. For while the nations (players) may be engaged in a single game, the players have different ideas (strategies) of how to win. If there were only one optimal strategy, then one might expect feedback from the marketplace to push the players toward a common strategy over time. But I would suggest that feedback from the marketplace is usually ambiguous enough to allow countries to pursue distinct strategies for a very long time. The question then becomes: How do these different strategies interact? And how does this interaction shape competition?

NATIONAL STRATEGIES FOR INTERNATIONAL GAMES

For those most enamored with globalization, national variations in telecommunications regimes are of minor significance in comparison to the global trend toward liberalization. After all, all of the major industrial countries have restructured the dominant operator, and introduced competition in satellite, mobile, and value-added services. So why does it really matter that they have adopted distinct regulatory regimes? I contend that it actually matters a great deal, for by favoring particular modes of regulation, governments set the terms of competition in newly liberalized markets. The mode of regulation affects which companies enter the market, what services they offer, what investments they make, and what strategies they pursue.³¹ While regulatory reforms have unleashed both British Telecom and NTT on international markets, the

³¹ See Johannes M. Bauer, "The Emergence of Global Networks in Telecommunications: Transcending National Regulation and Market Constraints," *Journal of Economic Issues* 28 (June 1994), pp. 391-402.

behavior of these firms in overseas markets still reflects the distinct context of regulation within their respective home markets. For example, they will have more funds available to invest abroad to the extent that the domestic regulatory regime allows them to reap high profits at home. And while regulatory reforms have allowed AT&T to invade both the British and Japanese markets, AT&T's strategy and its prospects remain powerfully shaped by the context of regulation within these two distinct host markets. For example, AT&T's strategy with respect to expanding abroad will not only reflect its estimate of potential demand, but also its assessment of whether the local regulatory authorities will try to stunt its expansion. And its decisions about how to play the new game of global alliances will reflect its judgments about how these alliances will help it to receive more favorable regulatory treatment in its partners' home countries. Moreover, corporate strategy not only reflects home-country and host-country regulations, but also the interaction of the two. For example, telecommunications equipment manufacturers' fortunes depend on whether their own home market is open or closed relative to other markets. They are most likely to profit when their own market is relatively closed and export markets are more open.

Thus regulation, and national patterns of reregulation, critically affect competitive advantage in the telecommunications industry. But this does not make it easy to design regulation to maximize this advantage. To illustrate this point, let us look at three possible strategies for maximizing competitive advantage in a world of strategic interaction between national regulatory systems, and then let us see how the apparent simplicity of these principles quickly bogs down in the complex reality of the telecommunications sector today.

1. *The first to liberalize wins.* British officials have largely proceeded according to this principle. They have stressed that telecommunications competition benefits domestic industry as a whole, and therefore they have tried to accelerate the liberalization process. Liberalization generally has delivered better service and lower prices across a wide range of countries, so for telecommunications users this principle generally applies. Furthermore, more open and competitive telecommunications markets generally encourage innovation and greater flexibility in applications, so early liberalization can accelerate the sector's development as a whole. In Japan, in contrast, government officials have felt that too much competition could make domestic carriers or manufacturers vulnerable to foreign competition in the short run, so they have tried to phase in competition more gradually.

2. *The second to liberalize wins.* Japanese officials have at least partially adhered to this principle. The chairman of the administrative reform committee that recommended the liberalization of telecommunications and the privatization of NTT recalls that debates within the committee often centered on the question of whether or not the U.S. experience represented the beginning of a global trend. "We really were not sure whether this was an isolated case, or the start of a trend," he explains. "If it were the latter, we certainly would not want to be left behind."³² And yet Japanese authorities were happy that the United States had gone first so that they could learn from its mistakes. Following the leader also provided another, perhaps more important, benefit. By liberalizing their own market later, Japanese officials allowed domestic equipment manufacturers to take advantage of a window of opportunity in which their home market remained closed, while the huge U.S. market was open. If we can take trends in market share as any indication, then the early "deregulators" have lost decisively in the strategic game of telecommunications reform. U.S. and British producers faced an onslaught of imports while they still lacked reciprocal access abroad. Table 2 shows how the U.S. and British telecommunications equipment trade balances deteriorated sharply in those years when the U.S. and British governments had liberalized these markets and their trade partners had not. While slowness may be strategic in some cases, however, in others it may just be slow. The Japanese have shown signs of political immobility in formulating telecommunications policy that could be a real liability in the long run.

3. *The country best able to rig reregulation to the advantage of its own firms (to "strategically reregulate") wins.* Japanese authorities have also incorporated elements of this principle, whereas their British counterparts have not. From the British perspective, attempts to rig regulations to favor domestic producers only backfire by hurting domestic users. And in any case, the primary goal is to attract business to Britain and not to offer regulatory subsidies to British equipment manufacturers. Yet from the Japanese perspective, regulation is a powerful tool of industrial policy. In fact, Japanese authorities have only been so insistent on retaining regulatory and sponsorship functions within the same central ministries because they recognize that the fusion of these powers allows them to employ regulation for industrial policy purposes. The Japanese have been accused of playing a game of strategic reregulation in telecommunications on many occasions, particularly with respect to cellular telephones. There is

³² Interview with Hiroshi Kato, dean, faculty of policy management, Keio University (May 14, 1991).

certainly some evidence that MPT delays enabled NEC to catch up with Motorola in cellular telephone hardware, and that technical regulations have helped NTT's subsidiary to beat out competitors using the Motorola standard in certain regions of Japan.

In practice, however, it is becoming increasingly difficult for national authorities to design telecommunications regulations to maximize competitive advantage, for they face a series of complex trade-offs.³³ They not only have to weigh the competition between domestic and foreign firms, but they have to consider hybrid categories such as foreign firms based domestically, domestic firms based abroad, and international joint ventures and partnerships. And they must choose whom they are trying to make competitive: telecommunications users, equipment suppliers, dominant carriers or new competitors. If they seek to use telecommunications as a tool to make industry as a whole more competitive, then they should favor liberalization to lower prices and stimulate a wider range of services. If they wish to promote domestic equipment suppliers, then they should delay liberalization because these suppliers generally enjoy privileged relationships with the dominant carriers. They should also try to "rig" technical specifications to favor domestic firms. And if they really want to support the dominant carrier, of course, they should delay liberalization or forestall it altogether.

In fact, national authorities are now confronting a conflict between stimulating competition at home and promoting the dominant carrier as a national champion abroad. In both Britain and Japan, the dominant carriers are lobbying for regulatory relief so that they can compete more effectively abroad. Meanwhile, their domestic competitors counter that only competition at home can make former monopolies into more efficient enterprises. Surprisingly enough, in this case the British authorities seem to be doing more to support BT than the Japanese are doing to promote NTT. If we look back at the political history of reform, however, this peculiar situation starts to make more sense. In Britain, the initial regulatory settlement did not do enough to handicap BT, so Oftel's efforts at pro-competitive reregulation were not sufficient to make Mercury into a real threat to BT dominance. In Japan, however, the MPT left itself plenty of discretion to continuously fine-tune the regulatory balance so as to keep up the pressure on NTT. And given MPT officials' historic animosity toward NTT, they have gone out of their way to do so. While they are no less oriented toward the protection and promotion of domestic industry than other Japanese officials, they are more sympathetic with the more

³³ See Trachtman, "International Regulatory Competition," especially p. 77.

compliant international carrier, KDD, or the new competitors than with NTT itself. "The problem with NTT is not regulation," retorts one MPT official, "but management."³⁴

Finally, regulators face a tradeoff with regard to the style of regulation, for an independent regulator maximizes the ability of the authorities to regulate in a neutral and fair manner whereas the fusion of regulatory and sponsorship roles allows a single agency to balance conflicting policy goals more effectively and to employ regulation as a tool of industrial policy.

FINANCE

A brief turn to financial services should help us to separate out unique features of the telecommunications sector from more general trends in international markets. As in telecommunications, a complex combination of technological advances and market developments produced a global wave of regulatory reform, yet common market pressures have not necessarily produced similar responses.³⁵ All financial centers have liberalized, but they have liberalized at different speeds and have reregulated in strikingly different ways. To illustrate this variation, let us again turn to Britain and Japan.

The British financial reforms of the 1980s embodied two seemingly contradictory movements: bold liberalization with the "Big Bang" of 1986 and massive reregulation under the Financial Services Act of the same year. The road toward the Big Bang began with an Office of Fair Trading (OFT) case against the London Stock Exchange for restrictive practices such as fixing brokerage commissions. Stock Exchange leaders tried to stop the case, but the OFT refused to negotiate and the government declined to come to the Exchange's rescue. Meanwhile, the financial authorities grew increasingly worried about London's status as a major financial center, as they noted that London was losing business to New York due to the lower commission rates there. In particular, Bank of England officials feared that the OFT case was unduly disruptive, and that it might actually delay critical reforms. Thus senior Bank officials intervened to help negotiate a bargain that emerged as the Goodison-Parkison agreement of 1983. Under this agreement, the government dropped the case and the Exchange pledged to eliminate its most egregious restrictive practices, including fixed commissions. The Stock Exchange liberalized

³⁴ Interview (August 1995).

³⁵ On the economic forces behind financial reform, see David M. Meerschwam, *Breaking Financial Boundaries: Global Capital, National Deregulation, and Financial Services Firms* (Boston: Harvard Business School Press, 1991). For a good review of recent work on the political economy of international finance, see Benjamin J. Cohen, "Phoenix Risen: the Resurrection of Global Finance," *World Politics* 48 (January 1996), pp. 268-96.

commissions in a single "Big Bang" in 1986. This decimated the British brokerage industry, as most British firms were quickly gobbled up by larger financial institutions, mostly foreign ones.

In a separate development, the government began to review its regulatory apparatus for the securities industry in the early 1980s as a series of scandals made it painfully clear that the existing system was hopelessly outmoded. The Department of Trade, the sponsoring department, appointed a legal scholar by the name of L.C.B. Gower to devise a new regulatory scheme. Despite belated efforts by some City institutions to reduce the regulatory burden imposed by the new legislation, the FSA produced a new regime of daunting complexity and enormous cost.³⁶ It created a whole new layer of regulation by establishing a Securities and Investment Board (SIB) to oversee a new set of self-regulatory organizations (SROs). The FSA replaced the traditional informal style of regulation with a much more highly codified and legalistic approach.³⁷ City firms were so disgruntled with the new regime that they arranged to oust the SIB's first chairman, Sir Kenneth Berrill, who was then replaced by a much more acceptable candidate from the Bank of England, Sir David Walker. Walker attempted to simplify the regulatory regime, with only partial success. As the regime faced continued attacks for high compliance costs and a failure to prevent scandals, Walker's successor Andrew Large responded with a comprehensive review of the regime and yet another wave of regulatory revisions.

In Japan, the Ministry of Finance (MoF) orchestrated a much more deliberate process of regulatory change. MoF officials began liberalizing the largest-denomination time deposit interest rates in 1985 and moved forward in a painstakingly slow yet carefully orchestrated process that continued through 1994 with the liberalization of rates for demand deposits. At each stage, the ministry monitored the impact on domestic financial institutions before proceeding to the next step. In 1985, MoF officials began to confront the stickiest of regulatory problems, the strict segmentation of the financial system into different types of banks (city banks, trust banks, long-term credit banks, etc.), securities houses, and insurance firms. Over the course of seven years, the ministry sculpted a multi-layered deal which managed to appease the different segments of the financial industry, establish a framework for meaningful desegmentation, and satisfy the ministry's own interest in servicing the national debt and guarding its leverage over

³⁶ See Arthur Seldon, ed., *Financial Regulation--or Over-Regulation?* (London: Institute of Economic Affairs, 1988).

³⁷ Michael Moran, *The Politics of the Financial Services Revolution: the U.S.A., U.K. and Japan* (New York: St. Martin's, 1991).

financial institutions. The ministry would allow the various groups of financial institutions to enter other segments of the industry through separate subsidiaries, but these subsidiaries would only be able to engage in selected lines of these businesses. For example, bank subsidiaries would be able to enter the securities business, but they could deal in bonds and not stocks. Or banks or securities house subsidiaries could enter the trust business, but they could offer estate trusts and not pension trusts. The ministry left itself the discretion to permit entry on a case-by-case basis and to gradually revise the terms of cross-entry so as to allow financial institutions to move further into each other's main lines of business. This created a powerful new source of leverage over the financial institutions, which are now perpetually at the ministry's mercy with respect to the extent to which they can engage in new businesses and to which other firms can invade their own sacred turf.

Meanwhile, the ministry has confronted a stock and real estate market crash, a prolonged recession, and a series of financial scandals. Initially, the economic downturn appeared as a blessing in disguise, as ministry officials felt that it would be easier to lower barriers between different groups of financial institutions at a time when these institutions were less eager to expand. And they felt that the economic crisis could help them orchestrate a consolidation of the industry. But the financial scandals soon backfired on the ministry, as the press and the public held the ministry responsible. A group of LDP members even proposed breaking up the ministry and setting up a new independent securities regulator on the model of the American Securities and Exchange Commission (SEC). Instead, the government set up a new securities regulator within the ministry, leading the press to accuse the ministry of "getting fat after the fire" (*yakebutori*)--that is, profiting from misfortune. As the financial crisis deepened in 1996, political leaders once again called for a dismantling of the ministry. Regarding brokerage commissions, the Japanese have felt no need to follow the "Big Bang" approach to liberalization: in fact, they only began the process in 1994 by liberalizing commissions on very large denomination trades.

Thus once again we find that British and Japanese authorities have responded to common pressures in distinct ways. In dynamic international markets where one would expect British finance to look more like Japanese finance than British telecommunications, national predispositions remain surprisingly resilient. British financial authorities combined bold liberalization with massive reregulation, creating a new independent regulator and several new

self-regulatory organizations. They were perfectly willing to abandon small British stockbrokers in the interest of the prosperity of the City as a financial center. In contrast, Japanese authorities liberalized much more cautiously and focused more on protecting and supporting domestic financial institutions than in promoting Tokyo as a financial center. They also guarded their own interests, using the reform process to generate new sources of leverage over the industry.

As in telecommunications, these differences can be explained by interest group alignments, production profiles, institutions and ideas. Although each of these explanations has some merit, I stress institutions and ideas. Once again the interest alignments are similar: in both countries, for example, large international firms favored liberalization while smaller firms resisted it.³⁸ Thus an interest group argument alone cannot explain the very different reform outcomes. The production profile clearly applies, for the City as a financial center is much more important to the British economy than Tokyo as a financial center is to Japan. Yet this does not explain why British authorities were less concerned than their Japanese counterparts about the fate of their own domestic bankers and brokers. With respect to institutions, British authorities were less reliant on a close working relationship with the finance industry and were less wedded to centralized power, and thus were more willing to diffuse regulatory power. Japanese authorities were far more reluctant to cede regulatory power to independent agencies or to further codify and legalize the regulatory process. Once again, we cannot fully understand the distinct outcomes without extending the analysis to the realm of ideas, for British authorities were more convinced of the logic of competitive deregulation than their Japanese counterparts. The British framed the debate about regulatory reform in the language of competing financial centers, whereas the Japanese approached the same debate in terms of the balance of interests between different segments of the industry and between different bureaucratic agencies.

Thus the two governments have employed very different strategies in trying to craft national rules to "win" at the international game of finance. The British combined bold liberalization with substantial reregulation because they thought this would preserve London's competitive advantage as a financial center. Meanwhile the Japanese forestalled interest rate liberalization in part because they felt that fixed rates gave Japanese banks a competitive advantage in the form of a massive base of low-cost funds from depositors. Interestingly enough,

³⁸ See Jeffrey Frieden and Ronald Rogowski, "The Impact of the International Economy on National Policies: An Analytical Overview," in Milner and Keohane, eds., *Internationalization*, pp. 25-47

the U.S. government made this same argument in pushing the Japanese to accelerate interest rate liberalization, suggesting that fixed rates represented an unfair advantage in international competition--albeit one that punished Japanese depositors. Japanese officials recognized, however, that maintaining fixed rates too long would be counterproductive, for Japanese banks would find it harder to attract funds as depositors shifted funds to securities firms or foreign banks in a search for higher returns. Likewise, when it came to stock commissions, the Japanese have been more concerned about retaining a buffer for brokers' profits, especially in light of their poor performance in the 1990s, than in liberalizing commissions to attract more trading activity to Tokyo. And whereas the British have seen the transparency of their regulatory regime as a source of comparative advantage for London as a financial center, the Japanese have retained discretion in part as a tool to support Japanese financial institutions. They have used this discretion to help Japanese institutions to hide their losses, to help weaker firms to recover, and to engineer a consolidation of the industry. The clash between the Japanese approach to financial regulation and U.S. practice came to the surface dramatically in 1995 when it was disclosed that MoF officials had known about a Daiwa Bank trader's massive losses in the U.S. market for months before they passed this information to American regulators.

Thus the essentials of the competitive regulatory game in finance are similar to those in telecommunications, although the specific market dynamics differ. In neither case do we see a simple competition in regulatory laxity or subsidy. In both sectors, British officials essentially followed the logic of the competitive deregulation argument. But of course this "deregulation" does not imply less regulation, but requires more. In telecommunications British officials liberalized in order to benefit telecommunications users, whereas in finance they focused more on London's status as a financial center. In telecommunications they used price regulation as a means to achieve liberalization, whereas in finance they viewed strong prudential regulation as a benefit in and of itself.³⁹ Likewise, in both sectors Japanese officials leaned more toward the regulatory subsidy model. In telecommunications they manipulated the regulatory process to

³⁹ In different contexts, Edward J. Kane and Henry Laurence both stress that regulatory competition in finance does not necessarily lead to a competition in laxity, and may actually produce higher standards of prudential regulation: Kane, "Competitive Financial Regulation: an International Perspective," in R. Portes and A. Swobosa, eds., *Threats to International Stability* (Cambridge: Cambridge University Press, 1987), pp. 111-49, and Laurence, "Regulatory Competition and the Politics of Financial Market Reform in Britain and Japan," paper for the Annual Meeting of the American Political Science Association, August 31-September 3, 1995, Chicago, IL.

promote domestic equipment suppliers, and in finance they orchestrated the liberalization process so as to soften the impact on weaker domestic financial institutions.

In other sectors, the dynamics of regulatory competition differ more widely. Environmental regulation, for example, is more vulnerable to a straightforward competition in laxity, whereby national authorities try to minimize the regulatory burden so as to make domestic corporations more competitive and to attract business activity. Yet this need not always be the case: David Vogel argues that strong environmental standards can actually enhance firms' competitive advantage.⁴⁰ In pharmaceuticals regulation, he sees little danger of a competition in laxity, some danger of a competition in subsidy, and considerable potential for international regulatory cooperation.⁴¹ Dale Murphy finds that the U.S. government engaged in regulatory subsidy in the infant formula market by regulating advertising so as to protect the dominant American producers in their home market.⁴² And Joel Trachtman cites the example of antitrust, in which U.S. negotiators have accused Japanese officials of giving domestic firms a regulatory subsidy through lax enforcement of antitrust regulation.⁴³

INTERNATIONAL GAMES WITH NATIONAL RULES

While this paper has focused on two sectors, it should suffice to provide some tentative conclusions about the nature of regulatory competition in international markets that could be further tested in other sectors. First, there has been no single trend toward competition in regulatory laxity or regulatory subsidy, and thus there has not been an overall convergence among regulatory regimes. National governments are biased toward different modes of regulation by specific configurations of interest groups, production profiles, institutions and/or ideas. In addition, their range of regulatory options may be limited from the outset by institutional constraints. For example, the British government cannot play the game of competition in regulatory subsidy effectively because it separates the functions of sponsorship and regulation across multiple agencies. Thus it would have trouble integrating regulation into a broader industrial policy. Likewise, the Japanese government cannot play the game of

⁴⁰ David Vogel, *Trading Up: Consumer and Environmental Regulation in a Global Economy* (Cambridge: Harvard University Press, 1995).

⁴¹ David Vogel, "Regulatory Interdependence in a Global Economy: the Globalization of Pharmaceutical Regulation," paper for the Annual Meeting of the American Political Science Association, August 31-September 3, 1995, Chicago, IL.

⁴² Murphy, "Open Economies' Competition."

⁴³ Trachtman, "International Regulatory Competition."

competitive deregulation effectively because government and industry are bound into relationships that both sides perceive as beneficial, and thus they tend to undermine any true disengagement.

Second, national regulations still matter for competition within international markets. The particular dynamics differ by sector, but in both telecommunications and financial services regulation remains a critical component of corporate strategy.⁴⁴ A single government may have less control over market competition than it did 20 years ago, but the overall regulatory environment is as important as it ever was. Thus we should not be too surprised that telecommunications operators and banks continue to commit enormous resources to lobbying governments, interacting with regulators, and managing regulatory compliance. And in international markets governed by national regulators, as noted above, the interaction between different national regulatory regimes is particularly critical.

Third, the game of regulatory competition is so complex that it is difficult to "win" with any strategy. Governments face complex trade-offs between favoring producers versus favoring users, promoting competition at home versus promoting national champions, and designing regulation that is fair and neutral versus maintaining the capacity to strategically intervene. Thus while differences between national regulatory systems matter, it has become very difficult to translate this insight into a specific set of policies that will meet all of the regulator's goals at once. In the face of this complexity, governments are likely to act with "bounded rationality": that is, they will adhere to existing predispositions in sorting out these trade-offs. Thus British authorities will lean toward bolder liberalization whereas the Japanese will opt for managed liberalization; the British will favor users whereas their Japanese counterparts will favor producers; and the British will strive for neutral regulation whereas the Japanese will try to retain an institutional fusion of regulation with promotion. The resilience of these national predispositions suggests the possibility that both countries could "win" at the game of competitive regulation, but only when defined in their own terms. That is, Britain might win a competition in laxity while Japan wins a competition in subsidy. Or both might lose by some objective standard and yet still think they are winning, for their definition of winning would naturally reflect their respective interpretations of what the game is all about.

⁴⁴ On telecommunications, see OECD-BRIE, *OECD-BRIE Project*; on finance, see Hervé de Carmoy, *Global Banking Strategy: Financial Markets and Industrial Decay* (Cambridge, MA: Basil Blackwell, 1990).

Fourth, national regulators will continue to have difficulty in shifting regulation to the international level. Despite some successes at international coordination, such as the 1988 Basle agreement on bank capital adequacy standards, national regulation remains dominant.⁴⁵ Even in the European Union, authorities have been moving more toward mutual recognition of national regulations than toward full harmonization. National governments' willingness to surrender regulatory responsibilities to international organizations will depend on the strategic dynamics of regulatory competition. Governments that accept the logic of competitive deregulation may see no need for regulatory harmonization, because they will feel that regulatory competition is healthy. Governments biased toward competitive reregulation may also resist so long as they feel that they can create advantage for their own firms by rigging regulations differently from those of other countries. That is, they will guard their right to formulate distinct regulations so long as they think they can win at the game and do not see it as a zero-sum enterprise. And because different governments perceive the game differently, there is reason to expect that many countries will think they can benefit from the game. In those cases where governments do view regulatory competition as a zero-sum game, they just may be willing to cooperate. This suggests a promising area for further research, to determine if and when these international games will start to be played by more international rules.⁴⁶

⁴⁵ Ethan B. Kapstein argues that in finance the world is moving toward a norm of international cooperation based on home country rule: *Governing the Global Economy: International Finance and the State* (Cambridge: Harvard University Press, 1994).

⁴⁶ On the prospects for international coordination, see Trachtman, "International Regulatory Competition," OECD, *Regulatory Cooperation for an Interdependent World* (Paris: OECD Publications, 1994), and David Vogel, "Regulatory Interdependence."