

Impacts of Deregulation on Economic Growth*

– Centering around Impacts on Total Factor Productivity –

Countries around the world including advanced countries have been making proactive efforts to expand growth potential through deregulation since the 1990s. Korea also underwent intense regulatory reform right after the Asian Financial Crisis and has recently moved toward deregulation once again. Despite the implementation of such deregulation policies, there do not seem to be enough theoretical studies on deregulation situations and effects, which may be a foundation for such policies. Against this backdrop, this paper compiles regulatory indices by industry to examine the developments and status of overall deregulation in Korea, provides an empirical analysis as to how deregulation may contribute to Korean economic growth based on the indices and comes up with implications for deregulation policies.

First, the development of deregulation in Korea has shown that there has been hardly any progress in deregulation, since overall deregulation took place right after the Asian Financial Crisis in 1999. In reflection of this situation, regulatory indices fell sharply from 1.0 in 1998 to 0.49 in 1999, but then rose slightly to 0.51 in 2006. This shows that the overall regulatory level, the regulatory level for each stage of business activities and the regulatory level of major non-manufacturing industries in Korea are all higher than those of major advanced countries.

The paper undertakes an empirical analysis of the impact of deregulation on total factor productivity based on a Japanese Cabinet Office model (2006) in an effort to examine the impact of deregulation on economic growth in detail. The results of the analysis show that deregulation of 10 percent on an industrial average leads to an increase of around 0.3%p in total factor productivity. This suggests that a deregulation of 30% for the next five years, achieved by conducting deregulation at an average of 6% per year, may generate an increase of 1%p in total factor productivity in five years from

now.

Meanwhile, the impacts of deregulation on total factor productivity are found out to differ by the characteristics of the regulation and by industry. In other words, the easing of regulations subject to strong government intervention and of crucial regulations on industries whose share of value added is high has been found out to cause improvement in total factor productivity. Meanwhile, the easing of weak regulations and non crucial regulations has not led to growth in total factor productivity. By industry, deregulation of most service industries, including financial and medical sectors, has turned out to improve total factor productivity greatly.

Last, not only changes in the regulatory level, but also the pace of deregulation are found to have a significant influence on total factor productivity.

Deregulation seems to have the potential as a very useful policy alternative in the Korean economy, whose growth engine is weakening, in that it is very effective for the enhancement of growth potential through growth in total factor productivity. The results of the empirical analysis indicate the following directions for deregulation. First, a de-regulatory policy needs to focus on the easing of regulations with strong government intervention and of crucial regulations, both of which have a great influence on the growth of total factor productivity. Second, priority needs to be given to the easing of the service-sector-related regulations, since regulations are concentrated on the service sector and deregulation of services has been found to have a highly positive effect. Third, the effects of deregulation need to be maximized through the dramatic and swift easing of regulations. Fourth, the organizations in charge of deregulation need to be improved to properly reflect the voice of the public and the regulatory legal system should be shifted to a negative list system to create an institutional environment where the establishment of unnecessary regulations is fundamentally ruled out.