

Excess Capacity and Effectiveness of Policy Interventions: Evidence from the Cement Industry*

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Abstract

Excess production capacity has been a major concern in many countries, in particular, when an industry faces declining demand. Strategic interaction among firms might delay efficient scrappages of production capacity and policy interventions that eliminate such strategic incentives may improve efficiency. This paper empirically studies the effectiveness of policy interventions in such an environment, using plant-level data on the Japanese cement industry. Our estimation results show that a capacity coordination policy that forces firms to reduce their *excessive* production capacity simultaneously can effectively reduce excess capacity without distorting firms' scrappage decisions or increasing the market power of the firms.

JEL Classification: D24, L13, L52, L61.

Keywords: Excess Capacity, Capacity Coordination, Cement, Industrial Policy.

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