

Boosting the Economy

Special Economic Zones or Nationwide Deregulation?

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In times of economic distress, governments will usually endeavor to stimulate investment, business activities and economic growth. Their measures will often include an increase in public spending designed to augment consumption, in particular through investments for the improvement of the country's infrastructure. Other measures are of a structural nature and purport to catalyze production by private actors. They consist of amendments to existing legislation intended to unleash private initiative and investment and, thus, produce a multiplier effect. To this end, states may subsidize certain activities, reduce and decentralize bureaucratic procedures or deregulate certain markets.

All of these measures can be adopted on a nationwide scale or can be confined to certain regions. In this respect, a comparative glance at economic policy in Europe and Asia discloses a surprising result: while European countries usually adopt measures applying to the whole national territory, so-called special economic zones or free economic zones are very popular in Asia. They designate geographical regions where the economic, labor, tax and other laws in force are more free-market oriented than those in the rest of the respective country.¹

¹ See the entry Sonderwirtschaftszone in GABLER, *Wirtschaftslexikon* (16th edn., Wiesbaden 2004) 2684.

The following paper aims to shed light on the situation in some Asian countries, *infra* I., and will try to explain and assess the general trend towards a geographical limitation of economic policy measures, *infra* II. As a counter-model the variations of nationwide deregulatory policies will be outlined, *infra* III. One variant is market deregulation, the foundations of which will subsequently be explained, *infra* IV. Parts V and VI will provide a survey of the deregulation of markets conducted in Germany since the 1980s in the areas of services and labor, respectively.

I. Special Economic Zones in Asian Countries

1. Survey

Over the last 50 years or so, the creation of Special Economic Zones (SEZ) has become a popular device of economic policy in a number of Asian countries. Since the mid-1960s, India has established several so-called Export Processing Zones designed to facilitate the export of Indian products; they are regarded as the precursors of the subsequently established Special Economic Zones in that country.² The first and most successful example of a Special Economic Zone is usually considered to be Shenzhen in South China, where an SEZ was established in 1980.³ Meanwhile SEZs have proliferated and comprehensive legislation has been adopted in India in 2005⁴ and also in South Korea in 2003.⁵ China, which has equally established several new economic zones including more recently that of Shanghai,⁶ appears to proceed on a case-by-case basis.

Japan began to flag out Special Economic Zones during the government of *Junishiro Koizumi* between 2001 and 2006, when hundreds of SEZs were established.⁷ The main purpose of the Japanese SEZ programme appears to be a

² See the website operated by the Government of India, Ministry of Commerce and Industry on Special Economic Zones in India: <<http://sezindia.nic.in/about-introduction.asp>>.

³ MADELAINE MARTINEK, Special Economic Zones in China and WTO: Bleak or Bright Future? *Zeitschrift für chinesisches Recht* 2014, 41–51 at 41; a short survey is also provided by Y. BU, *Einführung in das Recht Chinas* (München 2009) 195 et seq.

⁴ See the Special Economic Zones Act, 2005 (no. 28 of 23 June 2005), the Gazette of India, part II – section I, no. 31.

⁵ Special Act on Designation and Management of Free Economic Zones of 30 December 2002; an English translation of the Act as amended by Act no. 11396 of 21 March 2012 can be found on the website of Korea Legislation Research Institute: <http://elaw.klri.re.kr/eng_service/main.do>; see also the website for Korean Free Economic Zones: <<http://www.fe.z.go.kr>>.

⁶ See NICOLAUS SCHMIDT, Die neue Freihandelszone in Schanghai, *Recht der Internationalen Wirtschaft* 2014, Issue 9, I.

⁷ “Abenomics – Zoning out – Can Japan finally make Special Economic Zones work?”, *The Economist*, 10 August 2013, where “almost a thousand” SEZs are mentioned.

decentralization of administrative decisions. The local administrations, being closer to the needs of local business, are thought to be more suited to take decisions concerning the legal framework needed for economic success. However, the central government in Tokyo has retained the power to reject proposals for economic law reform made by the local administrations.⁸

According to observers, most of these zones failed, however, because attempts at liberalization made by the local administrations were rejected or watered down by the central government.⁹ This may be due to the fear of spillover and free-rider effects inherent in special legal regimes confined to specific locations. The existing SEZs have a remarkable extent and cover: according to informed estimates, they are responsible for nearly 40% of Japan's gross domestic product.¹⁰ Nevertheless, their stimulating impact on the national economy as a whole has so far not met expectations. The current Prime Minister, *Shinzo Abe*, has therefore announced the revitalization of the SEZ programme. He has thereby procured the subject of this conference, which is also closely linked with its venue since *Fukuoka* is one of the more important SEZs.¹¹

2. Comparative observations

The laws and regulations enacted in the countries mentioned above deal with a great variety of subjects which differ from country to country and sometimes also from SEZ to SEZ within the same state. No comparative evaluation of the various national laws on SEZs appears to exist.¹² It might be promising for future research to engage in such a comparative law investigation of the matter in view of the effectiveness of the numerous national laws and regulations. However, such an inquiry would presuppose a prior assessment of the general economic, labor and tax laws that are in force in the various countries, since the SEZ legislation is meant to provide, by making a difference to those general laws, an incentive for businesses to intensify economic activities within the respective country in question.

Moreover, such an inquiry would have to take into account the more specific objectives pursued by the national economic policies. While economic growth appears to be a broad enough target shared by all the countries, the states men-

⁸ The objective of decentralization emerges very clearly from the article by HIROKI HARADA, *Special Economic Zones as a Governance Tool for Policy Coordination and Innovation*, *Journal of Japanese Law* 31 (2011) 205–221.

⁹ See “Abenomics – Zoning Out”, *supra* note 7.

¹⁰ “Economic Zones for Japan – Some more special than others”, *The Economist*, 31 March 2014.

¹¹ *Id.*

¹² Economists have apparently started to compare the economic effects of SEZ legislation and to draw some conclusions with regard to the type of legislation involved, see CHEE KIAN LEONG, *Special Economic Zones and Growth in China and India: An empirical investigation*, *International Economics and Economic Policy* 10 (2013) 549–567.

tioned before depart from specific national situations and consequently differ in respect of the particular policy goals pursued. Thus, in India, the promotion of exports, at least initially, was the main goal. The Korean legislation, which contains ample provisions on the status of foreigners and even on the establishment of private schools and hospitals for them, gives evidence of the lawmakers' intention to attract foreigners and foreign investment to the Korean Free Economic Zones.¹³ In China, the Shenzhen SEZ rather constituted an experiment within the programme of economic opening initiated under the leadership of DENG Xiaoping; the SEZs were intended to pursue reforms "one step ahead" of other regions in the country, paving the way from socialist central planning to a market economy.¹⁴

The point of departure and the goals of economic reforms in Japan appear to be quite different again. For many decades Japan has been a highly industrialized country, one of the major players in world trade with a high share of foreign capital invested in Japanese business.¹⁵ While it employs, just as the other Asian countries mentioned, the legal vehicle of Special Economic Zones, the objective of its current economic policy is not primarily directed towards the boosting of international trade and of foreign investment, but rather towards a stimulation of economic activities at home using funds that are basically available in the country. There is an ongoing exodus of domestic capital to foreign countries; in 2013 more than 135 billion US-Dollars of Japanese capital were invested abroad while foreign investment in Japan amounted to not more than 2.3 billion US-Dollars.¹⁶ This trend is meant to come to a halt, which can best be achieved by offering attractive investment opportunities in Japan. The promise of a high rate of return to a large extent depends on the opportunities available for further economic activity within the country.

To summarize these observations it can be said that Special Economic Zones may appear to be a common form of economic legislation in Asian countries. But the commonality of the form conceals far-reaching differences: the starting

¹³ The Korean Act, *supra* note 5, contains a whole chapter on the "Improvement of living conditions for foreigners" (Chapter V, Articles 20 to 24-3); it deals with the provision of foreign language services, the use of foreign currency, the establishment of foreign educational and medical institutions, the operation of casinos for foreigners, the supply of construction sites for rental houses for foreigners, and immigration).

¹⁴ See the references provided by MARTINEK, *supra* note 3 at 41.

¹⁵ The market value owned by foreigners at Japanese stock markets has reached the height of 30% in 2013, see: "Abenomics picks up speed – The Battle for Japan", *The Economist*, 28 June 2014.

¹⁶ United Nations Conference on Trade and Development (UNCTAD), *World Investment Report* (New York and Geneva 2014) 205. According to Figure 3 on p. XV, Japan is in second place in terms of outflows of foreign direct investment in 2012 and 2013, but according to Figure 2 on page XV, Japan was not within the top 20 countries receiving foreign direct investment in 2012 and 2013.

point designed by the general laws, the policy objectives, and the effects to be expected from the establishment of an SEZ, differ widely from country to country. Nevertheless, the use of the SEZ as a common form is in clear contrast to the situation in Europe. Except for the Russian Federation¹⁷, Special Economic Zones are almost non-existent in European countries. In the Member States of the European Union, deregulatory measures have generally been applied to the whole of the given territory. Former geographical exemptions from economic laws have even been repealed over time. Under the impact of a growing uniform economic law for the whole of the Internal Market of the European Union, there was no reason anymore to maintain such special zones.

Our findings raise the question of why countries in Asia prefer the geographical limitation of economic reform legislation and do not embark upon the road to nationwide amendments.

II. Reasons for the Geographical Confinement of Reform Legislation

As pointed out above, states may pursue very different objectives when implementing Special Economic Zones. Only economic growth and the decentralization of administrative decisions could at best be considered common denominators; the latter may result from the particular strength of central government in some countries, while it may also be a reaction to the factual weakness of central government – as compared with local or regional entities – in others.

Apart from these goals, there are considerable divergences. Where a country, such as China back in 1980, contemplated a fundamental change of its economic order it may have been a command of prudence to start in a local or regional setting what at the time appeared to be a revolutionary innovation, and to cautiously test the new ideas on a trial-and-error basis.

There are also good reasons for a geographical limitation of economic legislation providing incentives to business where a government aims at the development of a specific town or region. Thus, the establishment of a Free Economic Zone at Incheon in Korea pursued the target of creating what has been called a “knowledge location”, i.e. a new center of higher education and knowledge-based industry.¹⁸ The local development strategy was meant to relieve the bur-

¹⁷ For Russia see A. KOMISSAROV, Die neue russische Gesetzgebung über Sonderwirtschaftszonen, in: Boguslawskij/Trunck (eds.), Rechtslage von Auslandsinvestitionen in Transformationsstaaten – Festgabe für *Wolfgang Seiffert* zum 80. Geburtstag (Berlin 2006) 341–352.

¹⁸ See W. VAN WINDEN/L. DE CARVALHO/E. VAN TUIJL/J. VAN HAAREN/L. VAN DEN BERG, Creating Knowledge Locations in Cities: Innovation and Integration Challenges,

den on the nearby mega-city of Seoul by the creation of a new center that would attract people and capital in the long run.

Of a different nature is the objective of the Japanese government to stimulate the national economy as a whole. This goal does not seem to be confined to particular parts of the national territory and it is therefore difficult to understand why the country uses policy tools that are selective in a geographical sense. In fact, the goals set by the present government seem to be much more in line with the nationwide objectives pursued by deregulatory policies in Europe from the late 1980s onwards. If the present Japanese government aims at a deregulation of sectors such as health care, farming and the labor market,¹⁹ why should the implementing measures not apply to the whole country?

The reason, instead of being rooted in the substance of the respective area of the law, may rather be a political one: some measures are said to be so controversial that politicians may believe they are more likely to be adopted if confined to certain regions where they can be tested before being extended nationwide at a later stage.²⁰ But, if political caution is the reason, how can the actual selection of the SEZs be reconciled with this approach? The Japanese government has included in the list of SEZs regions such as Greater Tokyo, Kansai, Narita and Fukuoka,²¹ which are not only important business centers with a high share of the country's gross domestic product; they are also likely centers of political influence and debate in the country. Thus, the political opposition aroused in these regions against local deregulatory measures may be more determined and more forceful than elsewhere. Moreover, the result of this selection could be quite the opposite of what the proponents of the new SEZ programme expect. Vested interests will resist such local deregulation from as early as the experimental phase and they may be inclined to lobby for the exercise of the remaining supervisory powers of the central government in order to produce a leverage effect diluting intended policy reforms.

The economic assessment of Special Economic Zones is not very favorable to this policy tool either. In a comparative inquiry into the SEZ programmes of China and India, the author concluded "that increasing the number of SEZs has negligible impact on economic growth. Taken together, these results suggest that what contributes to greater growth is greater scale of liberalization, rather than increasing the number of SEZs".²² Another inquiry focusing on the slowdown of growth of the economy in Japan reaches similar conclusions. The authors identify three major reasons for the Japanese stagnation; one of them is

EURICUR – Department of Regional, Port and Transport Economics, ERASMUS University (Rotterdam 2010) 94–126.

¹⁹ See "Abenomics picks up speed – The Battle for Japan", *supra* note 15.

²⁰ "Japan's Economy – Out of the Zone", *The Economist*, 5 April 2014.

²¹ See the list in *id.*

²² C. K. LEONG, *supra* note 12.

the lack of deregulation, in particular in the non-manufacturing industries. They conclude: “In the non-manufacturing sector, the industries that had the most deregulation grew fastest. On average starting in the late 1990s regulatory barriers to new entrants were actually increased.”²³

These inquiries raise some doubts about the SEZ approach in general and the Japanese reforms in particular. Would a nationwide deregulation policy not be more promising? Japan has apparently tested such a structural policy reform only in few sectors in the years after 1998: in the financial markets,²⁴ and in the labor market where attempts were made to liberalize the posting of temporary workers and to deregulate the limitation in time of employment contracts.²⁵ In view of the ongoing policy debate in Japan, it may be useful to take a closer look at the development of deregulation in Europe and in particular in Germany, where a comprehensive and nationwide deregulation policy was pursued from the beginning of the 1980s.

III. Variants of Deregulation in Europe and Germany

The concept of deregulation as employed in Western countries is not a single, coherent one. On closer inspection it essentially relates to three very different policy designs, which have one thing in common: they are meant to encourage private business activities.²⁶ But they address very different impediments to such activities.

The first concerns the review and where possible the repeal of provisions imposing unjustified or exorbitant costs on businesses; such cost-generating

²³ T. HOSHI/A. KASHYAP, Why did Japan stop growing? NIRA Report of 21 January 2011, 35. The report can be accessed on the website of the National Institute for Research Advancement: <<http://www.nira.or.jp/english/papers/index.html> →NIRA Reports →Why did Japan stop growing?>. Other major reasons of stagnation identified by the authors are a tight monetary policy and the tendency of banks to keep heavily indebted “zombie” firms alive by granting additional credit.

²⁴ See T. KUBOTA, Regulation of Banking Services: The Japanese Perspective, in: Basedow/Baum/Kanda/Kono (eds.), *Economic Regulation and Competition – Regulation of Services in the EU, Germany and Japan* (The Hague 2002) 75–96 at 80 et seq.; H. KANDA, Regulation of Exchanges and Investment Services: A Japanese Perspective, *ibid.*, 151–163 at 156 et seq.; see also H. ODA, *Japanese Law* (2nd edn., Oxford 1999) 32, 268 et seq., 290 et seq.

²⁵ S. NISHITANI/H.-P. MARUTSCHKE, Arbeitsrecht, Sozialversicherung Geschäftstätigkeit von Ausländern in Japan, in: Baum/Bälz (eds.), *Handbuch Japanisches Handels- und Wirtschaftsrecht* (Köln 2011) 403–459 at 407. The Japanese labor law in force prior to these cautious reforms is outlined in ODA, *supra* note 24, 354 et seq.

²⁶ B. MOLITOR, Deregulierung in Europa (Tübingen 1996) 7 (Walter Eucken Institut, Vorträge und Aufsätze, no. 150); MOLITOR, a former assistant secretary of state in the Federal Ministry of Economic Affairs, refers to an additional meaning, i.e. the reform of legislative procedures in order to allow for early input of proposals by citizens and business.

provisions are usually adopted for non-economic reasons: e.g. greater safety, the promotion of public health, the protection of the environment, or the preservation of historical landmarks or other cultural property. The implementation of this policy requires a careful analysis of the historical rationales of the various regulations on a case-by-case basis and a balancing of the conflicting objectives and costs. Most regulations are initially adopted for plausible reasons; sometimes, however, their effects or later changes in the social or economic environment deprive those provisions of their *raison d'être* or make them appear to be disproportionate.²⁷

A second variant of deregulation relates to the simplification of administrative procedures, sometimes also designated as a reduction of bureaucracy. It targets slow or complicated planning and authorization procedures, the decentralization of administrative decisions, reporting duties for statistical purposes, bookkeeping obligations, the periods for the retention of records and the like. Such obligations often impose a particular burden on start-ups and other small and medium enterprises.²⁸ Bureaucracies tend to extend existing obligations of the kind mentioned above, thereby increasing the burden for businesses. Therefore, the reduction of bureaucracy nowadays is considered a permanent task of governmental economic policy. After attempts to solve the problem by independent *ad hoc* advisory committees in Germany²⁹ and the European Union³⁰ since the 1980s, Germany³¹ has created, in 2006, a permanent body called the

²⁷ MOLITOR, *supra* note 26, p. 15–16 refers to the Directive 89/392/CEE providing for regulations relating to machinery which would for example have required about 300,000 butchers in Germany to adjust their meat slicers at a total cost of 150 to 300 million Euros.

²⁸ MOLITOR, *supra* note 26, p. 15 cites a Dutch inquiry which concluded that the average cost per employee in the Netherlands in 1993 amounted to 3,500 Euros in small undertakings with less than 10 employees, but only 600 Euros per employee in larger undertakings with a workforce exceeding 100 employees. For a similar and very recent political assessment see “Gabriel bläst zum Kampf gegen Bürokratie”, *Frankfurter Allgemeine Zeitung*, 4 November 2014, 15.

²⁹ See Bundesministerium des Inneren (ed.), *Unabhängige Kommission für Rechts- und Verwaltungsvereinfachung des Bundes 1983–1987 – Eine Zwischenbilanz* (Bonn 1987); Bundesministerium des Innern (ed.), *Unnötiger Aufwand durch Vorschriften? Bericht und Empfehlungen der Unabhängigen Kommission für Rechts- und Verwaltungsvereinfachung zur Entlastung der Unternehmen, Bürger und Verwaltungen von administrativen Pflichten* (Bonn 1994). See also MOLITOR, *supra* note 26, 25–26.

³⁰ See Commission Decision (2007/623/EC) of 31 August 2007 setting up the High Level Group of Independent Stakeholders on Administrative Burdens, Official Journal of the European Union (O.J.) 2007 L 253/40; Commission Decision (2012/C 382/08) of 5 December 2012 amending Commission Decision 2007/623/EC setting up the High Level Group of Independent Stakeholders on Administrative Burdens, O.J. 2012 C 382/9; the mandate of the Group expired in October 2014 and has not been prolonged.

³¹ Gesetz zur Einsetzung eines Nationalen Normenkontrollrats of 14 August 2006, *Bundesgesetzblatt I*, 1866 as amended; which requires the newly established body to assess the costs generated by compliance with new regulations. It has to prepare confidential assess-

Normenkontrollrat (norms control council) which submits proposals for the reduction of bureaucracy at regular intervals.

The third variant of deregulation aims at the liberalization of markets, in particular the abrogation of laws and regulations which limit market access and market exit, and which prescribe prices, the quality of products and the quantities of production. Contrary to the other two variants, the point of departure of this approach is not the structure and operation of state bureaucracies but the functioning of markets, i.e. the responsiveness of offer and demand for the price mechanism. This is deregulation proper and will be further discussed below. But all three variants have an impact on private business activities and are intended to allow private initiative to unfold more easily. All three overlap to a certain extent. They can and should be kept separate, however.

IV. Market Deregulation – Foundations

Markets can provide beneficial effects for economic welfare because an imbalance of supply and demand will lead to an adjustment of prices, which sends signals to both sides of the market. Where demand exceeds supply a rise in prices will make investment in supply lucrative and on the other side generate the willingness to reduce demand or to look for substitutes. Where supply exceeds demand prices will decline, thereby making production less profitable, sometimes down to the point of market exit; on the other side, a decline in price will stimulate additional demand. A continuous adjustment of supply and demand follows from the role of market prices as indicators of the scarcity of the products in question. This operation of the market depends on a number of economic peculiarities, and on basic market freedoms ensured by the legal system (in particular through the absence of market regulation).

1. Constitutive and restrictive regulations

Not all regulations are detrimental to the operation of markets; some are even necessary. Except for barter (i.e. the immediate exchange of goods between persons present on the same spot), market operations even need regulation: rules on proprietary rights and the binding force of contracts may be considered constitutive of markets. On the other hand, there are numerous laws that hamper the operation of markets. They may restrict market access: by the requirement of personal qualifications, by stipulating a certificate of public conven-

ments for the legislature with regard to proposed legislation and submits an annual report to the Federal Chancellor. See the website: <www.normenkontrollrat.bund.de> where for example the 2013 Annual Report is published – also in English – under the heading “Transparency of Costs Improved – Focus on further Burden Reduction”.

ience and necessity to be issued by an administrative authority, by the establishment of maximum quantities, for example. They may also make market exit more difficult: by excluding insolvency for certain categories of businesses or prescribing a minimum level of supply, thereby prohibiting a gradual phasing out of certain services. Regulations on prices are not uncommon either, specifying fixed prices, maximum prices, or price margins. The myriad of such regulations existing in all countries has the effect of rendering the adjustment of supply and demand more difficult.

Market regulations often have historical reasons, and some have economic reasons rooted in the particular features of the respective market, which are labelled, in the theory of competition, as market failure or market imperfection. They include the occurrence of external effects which are not taken into account by the parties to any transaction (e.g. the damage to the environment); the existence of natural monopolies linked to high fixed costs that have to be incurred before the production of the first unit (e.g. the construction of a railway line); the asymmetry of information and motivation as between the parties to a transaction (e.g. between a trader and a consumer); and the opportunistic behavior which is common in long-term transactions such as labor relations. Market imperfections of this kind require some regulatory measures designed to ensure the positive overall welfare effects of a transaction.³²

In addition, there are also reasons for regulation that emerge from policies and values outside the economic field and which conflict with economic targets. For example, many regulations in the medical and pharmaceutical sector are due to considerations of public health, and the closing of shops on Sundays in many European countries takes account of the religious commands of Christianity.

2. Consequences of (de-)regulation

a) *Repeal of outdated regulations.* – The flexibilization of markets in the interest of increased welfare and the reasons for regulation listed above require a balancing exercise for each single market. Sometimes the result is the complete repeal of a regulation; this may be the case where the historical reasons for its enactment have disappeared. An example are the former restrictions on long-distance coach lines in Germany. They were essentially prohibited after World War I when Germany had to pay reparations to the victorious Allied Powers and expected to receive funds for that purpose from the monopoly rents earned by the German railway company; the government therefore protected the railway against competition from road transport.³³ Although the Allies did not

³² For a broader treatment of these justifications of market regulation, see J. BASEDOW, Economic Regulation in Market Economies, in: Basedow et al. (eds.), *supra* note 24, 1–24 at 6–11.

³³ For the background see J. BASEDOW, Wettbewerb auf den Verkehrsmärkten (Heidelberg 1989) 54 et seq., 61, 69.

insist on the payment of reparations after World War II, the restriction was in place for 90 years before Germany repealed it in 2012.³⁴

b) *Search for less restrictive alternatives.* – The result of the balancing exercise is not necessarily a confirmation of existing regulations or their complete repeal. As shown by a number of examples, it may also be the search for a less restrictive alternative. One example is the former monopoly in the telephone sector and mail delivery market which came down to a prohibition of market access for all interested companies. It was initially intended to grant financial protection to a new technology and to ensure a nationwide provision of mail delivery services even in sparsely populated regions. The complete elimination of the monopoly might have jeopardized the latter objective; the market entrants could have indulged in cherry-picking, leaving the unattractive regions without an appropriate service. The solution implemented by the German legislature lifted the restrictions on access to the market, but at the same time allowed the supervisory authority to impose an obligation on all market entrants to provide so-called universal services, i.e. basic mail delivery services to all clients in the country.³⁵

A similar example of downsizing an existing regulation in the interest of more flexibility can be seen in the area of health care insurance. Before deregulation the supervisory authority had to approve the general policy conditions before they could be used in the market. The authority made use of its powers *inter alia* by compelling insurers to offer cover to their policyholders' newborn children, regardless of whether they were healthy, sick or handicapped. Deregulation put an end to this practice, and insurers are now allowed to employ many policy conditions without prior approval, but subject to the judicial oversight of standard conditions of contract in civil courts. In order to maintain protection for sick and handicapped children, however, the legislature put insurers under a duty, laid down in the statute on insurance contract law, to offer cover for their policyholders' children.³⁶

Thus the regulation no longer applies across the board, but is more focused on the needs of a specific group while allowing for more flexibility where that group is not involved. Moreover, that regulation has been toned down from prior administrative control to mandatory private law.

c) *Geographic scope of markets and regulations.* – Because of particular economic characteristics, some markets are local or regional; examples can be found in services such as catering or in the sale of liquid concrete. In both sec-

³⁴ See Gesetz zur Änderung personenbeförderungsrechtlicher Vorschriften of 14 December 2012, Bundesgesetzblatt (BGBl.) I, 2598; see, in particular, nos. 5 and 16 containing the amendments of § 13 (2) and the new § 42a of the Personenbeförderungsgesetz.

³⁵ See §§ 5 et seq. and 11 et seq. of the Postgesetz of 22 December 1997, BGBl. I, 3294 as amended.

³⁶ The rule is now contained in § 198 of the Versicherungsvertragsgesetz of 23 November 2007, BGBl. I, 2631 as amended.

tors long-distance transportation is excluded for economic reasons; the costs of keeping food fresh and concrete liquid are simply too high. In the course of modern developments many markets have been enlarged to a national or even international size.

The market's size affects the geographical scope of market regulation. Local markets can effectively be ordered by local regulations (e.g. those of a Special Economic Zone or – vice versa – those of the remaining part of the country that could also be regarded as a Special Economic Zone with a reversed approach to regulation). Where from an economic perspective markets are much larger, a local regulation will however remain ineffective unless it is protected by appropriate additional regulations (customs, import quota, non-tariff barriers) against competition from outside, i.e. from other areas not subject to the local regulation. The Japanese SEZ programme in part addresses markets such as health care and the labor market, which extend far beyond the local boundaries of the single SEZ. This appears questionable since it leads to the co-existence of, and arbitrage between, different market regulations within the same geographical market.

V. Market Deregulation – Implementation in Germany

The implementation of deregulation usually encounters determined resistance from incumbents of the targeted market. They expect more intense competition and fear a decline in profits. It is essential to take account of that opposition from the very beginning.

Deregulation started in the US in the late 1970s; the first major steps concerned domestic air transport and motor carriers.³⁷ In Europe, the United Kingdom took the lead in the field of road transport; further steps followed under Prime Minister *Margaret Thatcher* in the early 1980s.³⁸ The German government embarked on the road towards deregulation shortly after the election of Chancellor *Helmut Kohl* by the new coalition of Christian Democrats (CDU) and Liberals (FDP) in 1982. In fact, the Minister of Economic Affairs of the previous government of Social Democrats (SPD) and Liberals (FDP) Count *Lambsdorff* had fatally undermined that coalition when he published a paper entitled “Concept for a Policy to Overcome Weak Growth and to Combat Un-

³⁷ Airline Deregulation Act, Public Law 95-504 of 24 October 1978, 92 Statutes at large 1705; Motor Carrier Act, Public Law 96-296 of 1 July 1980, 94 Statutes at large, 793; further references in J. BASEDOW, *Common Carriers – Continuity and Disintegration in United States Transportation Law*, *Transportation Law Journal* 13 (1983) 1–42 (I) and 159–188 (II) at 169 et seq.

³⁸ The deregulation of road transport was implemented as early as 1970 under the Transport Act 1968 Ch. 73; see BASEDOW, *supra* note 33, 240 et seq.; for domestic air transport in the United Kingdom see *id.*, 204.

employment”, a manifesto for a policy of deregulation.³⁹ This turned out to be unacceptable for the Social Democrats, and the Liberals left the government. In the successor government several liberal Ministers of Economic Affairs pursued the deregulation policy.

After encouraging academic activities in the early years after the change of government,⁴⁰ the cabinet, in 1988, appointed a committee of ten experts – four academics and six practitioners – to analyze the macroeconomic costs caused by market regulation and elaborate proposals for deregulation. According to the mandate, the Deregulation Committee could freely choose the subjects it wanted to deal with. It was expected to take into account foreign experience with deregulation and to assess the possibility of a transfer of foreign deregulatory models to the German context.⁴¹

Three years later, in 1991, the Deregulation Committee submitted its final report to the government.⁴² It dealt with seven sectors and a large number of sub-sectors: insurance; transport including railways, road transport of both goods and passengers, taxis, internal waterways and maritime shipping, and carriage by air; the supply of electric power; technical inspection and monitoring; legal and economic advice including the services of lawyers and notaries, tax consultants and accountants; the various trades of craftsmen; and the labor market. The variety of subjects reflects the basic idea inspiring the work of the Committee: the greater the number of sectors of the economy affected the greater is the prospect of political success, because all stakeholders will expect not only to lose, but also to win through regulation and greater competition. With this perspective, almost 100 proposals for deregulation measures were suggested. Some of them, such as those relating to the supply of electricity, aimed at a price decrease for the manufacturing industry; others, such as the deregulation of taxis, coach lines and crafts, were expected to immediately create new jobs.

³⁹ O. GRAF LAMBSDORFF, Konzept für eine Politik zur Überwindung der Wachstumsschwäche und zur Bekämpfung der Arbeitslosigkeit, 9 September 1982. The manifesto is known as the “Lambsdorff-Papier” and ranked among the most important documents of German 20th century history; it can be accessed at: <<http://www.1000dokumente.de/index.html> →100(0) Schlüsseldokumente zur deutschen Geschichte im 20. Jahrhundert> where a chronological list of the documents will appear.

⁴⁰ Results of those activities are, among others, R. SOLTWEDEL et al., *Deregulierungspotentiale in der Bundesrepublik* (Tübingen 1986); M. KRAKOWSKI (ed.), *Regulierung in der Bundesrepublik Deutschland* (Hamburg 1988).

⁴¹ See DEREGULIERUNGSKOMMISSION – *Unabhängige Expertenkommission zum Abbau marktwidriger Regulierungen*, Marktöffnung und Wettbewerb (Stuttgart 1991) V (preface) with the mandate, and 187 with a list of the members. The author of this article was the only professor of law among the members of the Committee.

⁴² See the previous note. An English translation of the report was prepared by the Ministry of Economic Affairs, but never published; it is on file with the author.

The next step on the road leading to deregulation was the screening of the Committee proposals by a small working group of influential members of the *Bundestag*, the German parliament, representing the coalition parties. It was only after the approval of the proposals by that group that the competent departments of the government were instructed to draft legislation for the implementation of the proposals.

Throughout the various stages the deregulation policy received much tail wind from the European Union. In the political arena proposals made by the European Commission for the establishment of the Internal Market pushed in the same direction as the deregulation policy. The opening of national markets for suppliers from other Member States in fact required some deregulation at home. Moreover, from the mid-1970s, the European Court of Justice turned to a new interpretation of the basic freedoms enshrined in the Rome Treaty.⁴³ In particular, the free movement of goods and the freedom to provide services were now understood as allowing a seller or supplier of services to offer its products in other Member States in accordance with the law of its country of origin.⁴⁴ Only mandatory requirements of the public interest could entitle a host state to interfere with the country-of-origin rule – again an important backing of deregulation in the host country. These political and legal pressures from outside are peculiar to the European Union. Other countries, such as Japan, would have to compensate for their absence through an autonomous will to increase competition on the domestic market by admitting foreign suppliers.

Within five years of the presentation of its final report, more than half of the Deregulation Committee's proposals were actually implemented.⁴⁵ The regulatory changes of this early phase concerned insurance and transport markets in particular, but also technical inspection and monitoring. In more recent years, additional liberalization measures have been adopted with regard to the supply of electric power, legal services and various trades of craftsmen. Even the liberalization of coach lines in 2012 was inspired by the Committee's 20-year-old report.⁴⁶ The policy of deregulation, initiated in 1982, achieved a remarkable number of its goals. However, its success cannot be measured by the rate of

⁴³ Treaty on the Establishment of the European Economic Community, agreed at Rome on 25 March 1957, United Nations Treaty Series vol. 298, p. 14; the current version of the version adopted at Lisbon in 2007 consists of two treaties: Treaty on European Union (TEU), consolidated version in Official Journal of the European Union (O.J.) 2012 C 326/13, and the Treaty on the Functioning of the European Union (TFEU), consolidated version in O.J. 2012 C 326/47.

⁴⁴ See for the free movement of goods (now arts. 34 and 35 TFEU) ECJ 20 February 1979 – Case 120/78 (*REWE-Zentrale AG v. Bundesmonopolverwaltung für Branntwein*), [1979] ECR 649 para. 14; for the freedom to provide services (now art. 56 TFEU) see ECJ 3 December 1974 – Case 33/74 (*van Binsbergen v. Bedrijfsvereniging voor de Metaalnijverheid*), [1974] ECR 1299 para. 12: “public good”; ECJ 25 July 1991 – Case C-76/90 (*Säger v. Denemeyer*), [1991] ECR I-4239 para. 15: “imperative reasons relating to the public interest.”

⁴⁵ MOLITOR, *supra* note 26, 26.

economic growth since the development of Germany's gross domestic product has been overshadowed by Germany's reunification in 1990.⁴⁷ The implementation of the deregulatory policy required considerable staying power. Until its very end in 1998 (i.e. over a period of 16 years), the coalition of Christian Democrats (CDU) and Liberals (FDP) kept on transposing the ideas of deregulation.

VI. Flexibilization of the Labor Market

Contrary to the other sectors, the rigid regulation of labor markets in Germany resisted any attempts at flexibilization during the 1990s; hardly any proposal of the Deregulation Committee was implemented. Unemployment kept rising to almost 5 million and the rate bypassed the threshold of 10% of the total workforce after the turn of the new millennium.⁴⁸

In 1998 a new government under the social democratic Chancellor *Gerhard Schröder* took power. In 2002, it finally put the problem on its agenda and charged another expert group, the so-called *Hartz* Committee (named after its chairman *Peter Hartz*) to submit proposals for the reorganization and flexibilization of the labor market.

Within a period of six months the *Hartz* Committee finalized its report and suggested a comprehensive package of measures affecting all segments of the labor market. The proposals concerned retirement programs, the promotion of self-employment and part-time jobs, public unemployment insurance, social security payments and the reorganization and operation of employment agencies.⁴⁹ The reform cannot be explained here in detail. It was implemented in not less than four long statutes with hundreds of legislative amendments.⁵⁰ Next to

⁴⁶ See *supra* notes 33 and 34; see proposition 28 of the Deregulation Committee, DEREGULIERUNGSKOMMISSION, *supra* note 41, 53 advocating an experimental liberalization of specific coach lines as a precursor of the complete deregulation to be adopted later on.

⁴⁷ The growth rate of the West German gross domestic product, as compared with the previous year, was boosted to 3.9% in 1989 when the Berlin Wall fell, and even to 5.3% and 5.1% in 1990 and 1991, see STATISTISCHES BUNDESAMT (ed.), *Statistisches Jahrbuch Deutschland 2014*, 321. Such rates have not since been achieved.

⁴⁸ The peak of unemployment was reached in 2005 when 4.571 million people were registered as unemployed. Given the total workforce of 43.441 million persons in that year, the unemployment rate was 10.5%; see the data in *Statistisches Jahrbuch Deutschland 2014*, *supra* note 47, 346.

⁴⁹ "Moderne Dienstleistungen am Arbeitsmarkt" (Modern Services on the Labor Market). The report is available on the website of the Federal Ministry for Labor and Social Matters: <<http://www.bmas.de> → Service, → Publikationen, → Moderne-Dienstleistungen-am-Arbeitsmarkt>. On that site the summary is translated into English.

⁵⁰ Erstes, Zweites, Drittes und Viertes Gesetz für moderne Dienstleistungen am Arbeitsmarkt of 23 December 2002, BGBl. I, 4607; of 23 December 2002, BGBl. I, 4621; of 23 December 2003, BGBl. I, 2848; of 23 December 2003, BGBl. I, 2954.

increased flexibility, the reform was intended to reduce workers' incentives to be registered as unemployed and receive, in that capacity, some kind of public support. Moreover, it pursued the objective of helping young people to get their first job and of reducing long-term unemployment of older workers.

With regard to the goal of greater flexibility in contracting, two measures should be mentioned. The posting of workers by temporary staffing firms to employers in need of additional manpower was further liberalized. It is now lawful for a period of up to one year. The posting of workers by an employer located in another Member State of the European Union for the purposes of a consortium agreed upon with a German employer is even completely exempted from the mandatory regulations of the statute.⁵¹ This opens the German labor market to a certain extent for low-cost labor from other Member States. A further measure intended to reduce the risk for employers of hiring long-term unemployed workers above the age of 52 is the permission to enter into employment contracts of a limited period of time.⁵²

The *Hartz* reforms have made substantial contributions to the reduction of unemployment in Germany, which is only little more than half of what it was before those reforms were implemented.⁵³ It should be noted that the new jobs have been created in an uneven manner in the various sectors: ever since the 1990s the number of new jobs in services has constantly been growing while fewer and fewer people are working in manufacturing and agriculture.⁵⁴ This observation connects the labor market reform to the deregulation of various services sectors in the 1990s. While the latter has increased the capacity of the services sectors to absorb more and more workers, the former has shaped the conditions of the labor market such as to encourage unemployed persons to accept jobs.

Whether the current trend will continue is an open question. The present German government, composed of Christian Democrats and Social Democrats, favors a certain reregulation of the labor market (as can be inferred from the recent

⁵¹ See Art. 6 of the first implementing statute, previous fn., BGBl. 2002 I, 4607, 4617.

⁵² See § 14 (3) of the Gesetz über Teilzeitarbeit und befristete Arbeitsverträge of 21 December 2000, BGBl. I, 1966; art. 7 of the first implementing statute, *supra* note 47, BGBl. 2002 I, 4607, 4619 had lowered the relevant age from 58 to 52. The European Court of Justice had held that this rule is incompatible with EU law, see ECJ 22 November 2005 – Case C-144/04 (*Mangold v. Helm*), [2005] ECR I-10013; thereafter the German legislature, while keeping the age threshold of 52 years, added the requirement that the person in question must have been unemployed for a period of at least four months preceding the new employment.

⁵³ For the year 2013 only 2.770 million persons were registered as unemployed out of a total workforce of 44.053 million people; thus the unemployment rate was down to 6.3%, see the data in Statistisches Jahrbuch Deutschland 2014, *supra* note 47, 346. In November 2014 the total number of unemployed persons had further declined to 2.717 million, see “Erstmals arbeiten mehr als 43 Millionen”, Frankfurter Allgemeine Zeitung, 28 November 2014, 19–20.

⁵⁴ See Statistisches Jahrbuch Deutschland 2014, *supra* note 47, 348.

introduction of mandatory minimum wages).⁵⁵ This may curtail the absorption capacity of some segments of the labor market. It also shows that deregulation in the labor market is a continuous task which cannot be regarded as accomplished once some deregulatory measures have been implemented. The situation is similar to that in other markets: there are constant, successful efforts to renew restrictions on the operation of market forces by regulation.⁵⁶ Consequently, deregulation efforts are necessary from time to time to reduce regulation.

VII. Conclusion

Japanese governments have concentrated their efforts to stimulate economic activity on the establishment of Special Economic Zones. As far as the formal use of this policy tool is concerned this is in line with the approaches taken in other Asian countries. The SEZ policy appears adequate where governments intend to develop specific locations, in particular by subsidizing investments. From a more general perspective, the economic assessment of the SEZ tool is, however, not very positive. Moreover, it is doubtful whether it makes sense to pursue nationwide economic objectives through policy tools confined to specific areas of the country; the expected contagion of other areas is far from ensured. Finally, flagging out a major part of the country as a SEZ is difficult to reconcile with the goal of uniform living conditions.

A counter-model that is however not exclusive of the SEZ program is constituted by a nationwide deregulatory policy targeting existing regulations in a variety of markets, in particular for services. Such a policy would facilitate competition and absorb unemployed workers. A comprehensive reform of the labor market could simultaneously encourage unemployed workers to accept those new jobs. Deregulation splits up into several variations. Market deregulation as discussed in this paper requires a careful analysis of the specific sectors and may often lead to less restrictive alternatives, and not only to a simple repeal of existing regulations. Given the tendency of economic policy-makers towards more regulation, deregulation appears to be a task that is here to stay.

⁵⁵ Gesetz zur Regelung eines allgemeinen Mindestlohns of 11 August 2014, BGBl. I, 1348.

⁵⁶ The Directorate General for Trade of the European Commission monitors these efforts in countries which are key trading partners of the EU; in its Eleventh Report on Potentially Trade-Restrictive Measures it has recently identified 170 new potentially trade-restrictive measures adopted in a twelve-month period while only twelve previously imposed measures were repealed; the report is available on the website of the Directorate General for Trade: <http://www.ec.europa.eu/trade/policy/policy-making/index_en.htm, → Trade policy and you, → News archive, → Press release of 17 November 2014> with a link to the full report; see also “Protektionismus schreitet voran”, *Frankfurter Allgemeine Zeitung*, 18 November 2014, 18.