

Special Economic Zones

Law and Policy Perspectives

Edited by

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Mohr Siebeck

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I. Introduction

Economic downturn puts pressure on governments to act. In the economic crises of the early 1930s as well as after World War II, many industrial countries decided to regulate economic activity heavily. Governments viewed regulation and market foreclosure as legitimate tools to ensure so-called “fair prices and profits”. Many of these restrictions remained unchanged over the next decades – even though it slowly came to be understood that overregulation has high costs and impedes the generation of efficiencies. Finally, in the late 1970s the pendulum swung towards market liberalization in many competition-oriented economies.¹

Since then many industrialized countries have taken important steps to deregulate their economies, a process that often went hand-in-hand with a pri-

¹ The first industrial countries that implemented comprehensive deregulation programs were the United States of America (US) and Great Britain.

vatization of state-created monopolies.² The possibilities of creating dynamic economic effects through deregulation were however not fully seized, and often new forms of regulation were put into effect. It does, therefore, not come as a surprise that in the current economic crisis many argue for further deregulation measures to spur private economic activities. This approach follows the firm belief that open markets will yield better economic results for everyone.³

Deregulation can, of course, not mean that economic activity should be entirely free of state control and state rules. The legislature has to ensure a proper balance between the economic freedom of private actors and rules limiting this freedom for the benefit of the community at large. Thus “smart regulation” is the key to sustainable economic growth.

Against this background, a closer look shall be taken at two forms of liberalization: The Japanese concept of special economic zones (the “SEZs”) and the deregulation of former monopolistic markets in Europe. The contribution aims to offer some thoughts on the role of competition law and policy (or in the terms of US law: antitrust law) in the context of deregulation. The paper will first highlight the basic concepts of deregulation and competition law (II.). As second step, the Japanese SEZs will be analyzed from a competition policy perspective (III.). As the deregulation measures to be adopted for these zones might be a starting signal for a deregulation at a national scale, the next part will turn to Europe to discuss the lessons Europe has learned from its efforts to deregulate markets dominated by (state-protected) monopolies (IV.). I want to show that without strong competition law, any attempt to open markets will be very burdensome and might even fail in a short and medium run; I think that this message might be of interest for Japanese lawmakers.

² On the development in Germany and Japan see the contributions in Z. KITAGAWA/J. MURAKAMI/K. W. NÖRR/T. OPPERMAN/H. SHIONO (eds.), *Regulierung – Deregulierung – Liberalisierung: Tendenzen der Rechtsentwicklung in Deutschland und Japan zur Jahrhundertwende* (Tübingen 2001) and G. LENNARTZ, *Regulierung der japanischen und deutschen Telekommunikationsmärkte im Vergleich – Wettlauf im weltweiten Deregulierungsprozess*, *Zeitschrift für Japanisches Recht* no. 2 (1996) 20–41.

³ DEREGULIERUNGSKOMMISSION – UNABHÄNGIGE EXPERTENKOMMISSION ZUM ABBAU MARKTWIDRIGER REGULIERUNGEN, *Marktöffnung und Wettbewerb* (Stuttgart 1991) no. 1: “Deregulierung der Wirtschaft zielt auf mehr wirtschaftliche Freiheit, mehr Markt, mehr Wettbewerb, mehr Wohlstand. Der Wert dieser Ziele liegt in ihnen selbst und in besseren wirtschaftlichen Ergebnissen für die Handelnden, für andere, für alle”.

II. Market Regulation and Competition Law

1. Constitutional and special regulation

Regulation theory, as understood in this paper, defines regulation as every rule that limits private activity.⁴ So even contract law rules are a form of regulation. It goes without saying that the abolishment of such rules would not increase economic welfare as they ensure an orderly community life. Useful rules for the cohabitation of individuals concern, for example, the protection of life, health, freedom and property. General rules on contract, tort and property law as well as sound rules on administrative procedures are thus indispensable for a functioning society.⁵ Such kind of regulation can be described as “constitutional regulation”, as these rules lay down the general framework for economic activity.⁶

When we talk about the usefulness of deregulation, we are not talking about an alteration of these constitutional rules. Rather we are talking about rules that apply only to market activities of certain groups in society. These rules can be labeled “special” or “restrictive regulation”.⁷ They restrict private action to ensure certain policy goals set forth by the legislature, e.g. to safeguard a given division of labor or certain social standards. Special regulation in essence restricts the freedom of contract of certain groups, sometimes even at a very early phase as it may prohibit economic activities for certain persons entirely.⁸ Often such rules restrict competition on a market, but there might be cases in which those rules complement or even supplement rules that aim to preserve free competition.⁹

2. Regulation needs justification

Special regulation is not *per se* alien to market economies. However, regulation needs justification. It can, for example, be justified if on a particular market competition is not possible or would lead to negative (external) effects.¹⁰ Every legislature must therefore decide to which extent regulation is necessary for the protection of the society at large and the functioning of the

⁴ DEREGULIERUNGSKOMMISSION, *supra* note 3, no. 2: “Regulierung ist jede staatliche oder staatlich sanktionierte Beschränkung der Handlungsmöglichkeiten, der Verfügungsmöglichkeiten des Menschen.”

⁵ J. BASEDOW, Economic Regulation in Market Economies, in: *idem*, Mehr Freiheit wagen: Über Deregulierung und Wettbewerb (Tübingen 2002) 3–22 at 4.

⁶ DEREGULIERUNGSKOMMISSION, *supra* note 3, no. 4.

⁷ DEREGULIERUNGSKOMMISSION, *supra* note 3, no. 4.

⁸ BASEDOW, *supra* note 5, 4.

⁹ See ICN ANTITRUST ENFORCEMENT IN REGULATED SECTORS WORKING GROUP, Report to the Third ICN Annual Conference (Seoul, April 2004) Chapter 2, available at: <<http://www.internationalcompetitionnetwork.org/uploads/library/doc379.pdf>>.

market. There are three golden rules in assessing the necessity of regulation. They can be summarized as follows:

First, in a market economy, the general rule should be that individuals are free to pursue the goals they have set themselves. The law should therefore give as much freedom as possible to market actors. Competition is thus the rule and special regulation restricting it must be regarded as the exception, which can only be upheld if there is a sound justification for it.¹¹ Those who want to maintain rules that restrict competition have thus to prove that these rules are benevolent for the society at large, whereas those who advocate in favor of more deregulation can rely on the (rebuttable) presumption that open markets will yield benevolent economic effects.

Second, regulation must be shaped in a way that the restrictions of the competitive process flowing from its rules are limited as far as possible. So, if a rule restricts competition, one should look for ways to replace it with a rule that fulfils the regulatory goal in a similar way but with less negative impact on the competitive process.¹² It does, for example, not make sense to exempt certain industries, such as the insurance industry or the sport sector, in their entirety from the scope of competition law. Peculiarities of these industries can be fully respected by adapting the competition law prohibitions. Such an approach hampers competition to a much lesser extent than a complete exemption of certain branches from the reach of the competition rules.

Third, every government has the obligation to review the legal framework at regular intervals to check whether the justification for those rules still holds.¹³ As market conditions are constantly changing, regulation that was justified years ago might have to be relaxed today, whereas in other markets the regulatory framework needs to be tightened. One can therefore applaud the Japanese government for launching an initiative to eliminate unjustified regulation. Often changes are necessitated by new products or services. In Germany, an example of the need to review the regulatory framework became visible with the advent of the ridesharing service Uber. Uber arranges (among other services) taxi-like transport agreements between drivers and riders via a smartphone application in exchange for a commission. This ridesharing concept enlarges the choices for consumers in need of transport. They can decide to call a traditional taxi to get from A to B or to book a ride with Uber. The mode of operation differs across the globe. In Tokyo, Uber offers a taxi ap-

¹⁰ N. ECONOMIDES, Competition policy in network industries: an introduction, in: D. Jansen (ed.), *The New Economy and Beyond* (2006) 96–121 at 97. For a more detailed overview of factors justifying regulation see DEREGULIERUNGSKOMMISSION, *supra* note 3, nos. 8–13.

¹¹ DEREGULIERUNGSKOMMISSION, *supra* note 3, no. 5.

¹² DEREGULIERUNGSKOMMISSION, *supra* note 3, no. 34.

¹³ DEREGULIERUNGSKOMMISSION, *supra* note 3, no. 15.

plication, by which you can call a traditional cab via your smartphone.¹⁴ In Germany, Uber started its operation in a different way. Via the App “Uber Pop”, Uber arranged for rides from independent drivers who had no taxi licenses as they offered rides in their private cars. Booking a ride with Uber was cheaper than taking a taxi. Under German law, the Uber drivers provided commercial taxi services and had therefore to comport with the strict standards set forth for commercial passenger transport.¹⁵ Thus, in most cities, the Uber drivers had to acquire a concession, which restricts market access. Moreover, every driver had to acquire a special driver’s license by which a driver proves a solid knowledge of the city routes, and each car has to comport with certain safety standards. These and other regulatory requirements brought Uber’s original “shared economy” concept to an end.¹⁶ In my opinion, the German legislature is now under the obligation to adapt the legal framework to allow for more competition in the taxi sector. From a competition perspective, it makes sense to abolish the license requirement and review the system of fixed taxi prices in order to enhance competition for transport services.¹⁷ Alternatively, the requirements for drivers that occasionally conduct passenger transport services on shorter routes should be relaxed. These measures will help consumers to book rides in cities at times when the demand for rides cannot be served by traditional taxis.

Putting these three principles into effect is hard work. Interest groups benefiting from closed or monopolistic markets fiercely oppose any changes in order to retain their benefits.¹⁸ Their chorus can be summed up as follows: “Competition is really great – but it does not work in our market.” Very often, however, this reasoning cannot be justified on economic grounds. Every debate on the necessity of deregulation must therefore thoroughly analyze whether a regulatory rule is really justified for the benefit of the society as a

¹⁴ <<http://www.japantimes.co.jp/news/2014/11/02/business/corporate-business/app-based-car-hire-service-uber-making-waves-tokyo/>>.

¹⁵ In the city of Hamburg the authority for the transport industry (Verkehrsgewerbeaufsicht) ordered Uber to halt its services, see OVG Hamburg, BeckRS 2014, 5679 (confirming the enforceability of the prohibition order).

¹⁶ Uber therefore rearranged its services. It offered in some cities rental car services which include drivers (“Uber X”). In addition “Uber POP” was downsized to arrange shared rides for which the customers pay the driver a fair share of the actual cost for the transport (consumed fuel, wear and tear on the car) as such arrangements are not seen as passenger transport for commercial purposes, see: <<http://www.sueddeutsche.de/wirtschaft/taxi-konkurrent-uber-startet-neuen-mietwagen-dienst-1.2485350>>. Later “Uber POP” completely retreated from the German market.

¹⁷ On possible reforms to stimulate competition in the German taxi market see MONOPOLKOMMISSION, Eine Wettbewerbsordnung für die Finanzmärkte – Hauptgutachten XX (2014), paras. 218–265, available at: <<http://www.monopolkommission.de>>.

¹⁸ DEREGULIERUNGSKOMMISSION, *supra* note 3, no. 21.

whole or whether it just fills the pockets of a certain interest group at the expense of consumer choice.

3. *The role of competition law*

A properly functioning market economy presupposes the existence of a competition law that is also vigorously enforced. History has shown that individuals may use their economic freedom to restrict competition by entering into anticompetitive agreements or by engaging in other anticompetitive practices. As result, large corporate concentrations could monopolize many markets in the United States at the end of the 19th century.¹⁹ Germany was a “country of cartels” until the end of the Second World War,²⁰ and similar things are said about Japan.²¹ Rules against restraints of competition by private market actors are part of the body of “constitutional regulation”.

Today, all modern competition laws essentially prohibit (i) anticompetitive agreements, (ii) abuses by firms with some form of market power and (iii) mergers as far as they substantially lessen competition. Competition law ensures a level playing field for all market actors.²² Usually competition rules are drafted as general clauses²³ as – in the words of Senator Sherman –

¹⁹ See H. B. THORELLI, *The Federal Antitrust Policy: Origination of an American Tradition* (1954) 61–96.

²⁰ See J. BASEDOW, *Kartellrecht im Land der Kartelle: Zur Entstehung und Entwicklung des Gesetzes gegen Wettbewerbsbeschränkungen*, *Wirtschaft und Wettbewerb* 2008, 270–273 at 270 referring to an estimation according to which 2,500 cartels could be counted in Germany in the year 1925. On the legal history of the German Act Against Restraints of Competition and its historical roots see D. J. GERBER, *Law and Competition in Twentieth Century Europe: Protecting Prometheus* (2003) 115–153 and 232–287; L. MURACH-BRAND, *Antitrust auf deutsch: Der Einfluß der amerikanischen Aliierten auf das Gesetz gegen Wettbewerbsbeschränkungen (GWB) nach 1945* (Tübingen 2004), *passim*; K. W. NÖRR, *Zwischen den Mühlsteinen: Eine Privatrechtsgeschichte der Weimarer Republik* (Tübingen 1988) 143–157; *idem*, *Die Leiden des Privatrechts: Kartelle in Deutschland von der Holzstoffkartellentscheidung zum Gesetz gegen Wettbewerbsbeschränkungen* (Tübingen 1994), *passim*. On the development of the European competition regime see the contributions in H. SCHWEITZER/K. K. PATEL (eds.), *The Historical Foundations of EU Competition Law* (Oxford 2013).

²¹ On the legal history of Japanese competition law see D. J. GERBER, *Global Competition: Law, Markets, and Globalization* (Oxford 2010) 210–213; C. HEATH, Japan, in: J. P. TERHECHTE (ed.), *Internationales Kartell- und Fusionskontrollverfahrensrecht* (Bielefeld 2008) § 59 paras. 2–5; H. IYORI, *Das japanische Kartellrecht: Entwicklungsgeschichte, Grundprinzipien und Praxis* (Köln 1967) 17–33; H. IYORI/A. UESUGI, *The Antimonopoly Laws and Policies of Japan* (3rd edn. New York 1994) 1–29; M. MATSUSHITA, *International Trade and Competition Law in Japan* (Oxford 1993) 76–81; W. PAPE, *Das Japanische am Kartellrecht Nippons*, *Wirtschaft und Wettbewerb* 1992, 482, 483–491; A. NEGESHI/U. EISELE, *Recht der Wettbewerbsbeschränkungen*, in: H. Baum/M. Bälz (eds.), *Handbuch Japanisches Handels- und Wirtschaftsrecht* (Köln 2011) § 17 para. 10.

²² DEREGULIERUNGSKOMMISSION, *supra* note 3, no. 5.

“[...] it is difficult to define in legal language the precise line between lawful and unlawful combinations. This must be left to the courts to determine in each particular case. All that [...] lawmakers [...] can do is to declare general principles, and [...] courts will apply them so as to carry out the meaning of the law.”²⁴

Even though the goals of competition law are subject to an intense debate in the international arena, many would agree that in industrialized countries competition law should protect open markets. Free and unfettered competition is the best driver for innovation and economic welfare.²⁵ There is also a wide consensus that competition law prohibitions must be interpreted in line with sound economic principles.²⁶ Slightly less accepted – but not of minor importance – is that the application and interpretation of competition rules should be submitted to the rule of law.²⁷

Competition rules usually apply to private market actors and do not prevent states from engaging in anti-competitive behavior. Given that, additionally, firms with market power might defend their position against newcomers in certain markets, competition on deregulated markets may not develop instantly. Striking certain rules out of the statute books alone is frequently not sufficient to revive competition. Opening markets to competition often presupposes changes in the legal framework so as to establish a fertile ground for the development of future competitive action.²⁸ Once the decision has been taken to deregulate a certain market, the rules of competition law or rules in related fields of law might have to be adapted in order to ensure a smooth transition from regulation to competition.

²³ W. MÖSCHEL, *Japanisches Kartellrecht – von außen gesehen*, *Zeitschrift für Japanisches Recht* 4 (1997), 50, 52; W. WURMNEST, *Competition Law and Policy in Europe and Germany: Current Issues*, in: Rosenau/Tang Van (eds.), *Economic Competition Regime: Raising Issues and Lessons from Germany (Contributions to Vietnamese-German Symposia)* (Baden-Baden 2014) 61–77 at 63.

²⁴ 21 Cong. Rec. 2457, 2460 (1889) cited by *United States v. Topco Associates, Inc.*, 405 U.S. 596, 621 (1972), per Chief Justice Burger (dissenting).

²⁵ On the normative foundations of competition law see the contributions in D. ZIMMER (ed.), *The Goals of Competition Law* (Cheltenham 2011).

²⁶ There is, however, some controversy over the question as to which economic principles courts should rely on and how economic principles can be translated into the legal analysis. On this dispute see W. WURMNEST, *Marktmacht und Verdrängungsmisbrauch: Eine rechtsvergleichende Neubestimmung des Verhältnisses von Recht und Ökonomik in der Missbrauchsaufsicht über marktbeherrschende Unternehmen* (2nd edn. Tübingen 2012) 112–256.

²⁷ MÖSCHEL, *supra* note 23, 52–53 (noting with regard to the Japanese approach that it resembles more a “rule of authority” than a “rule of law” given the strong tradition of an administrative steering of the economy).

²⁸ BASEDOW, *supra* note 5, p. 15.

III. Creating Economic Zones (Japan)

1. Concept and implementation

a) A brief history of Special Economic Zones in Japan

The creation of special economic zones is not new in Japan, although those zones have never reached the importance of SEZs in other Asian countries such as China or South Korea. The first SEZ on Japanese territory was installed on the Island of Okinawa under US occupation. After the return of Okinawa to Japanese administration in 1972, this zone was further developed. The government granted, *inter alia*, customs exemptions and tax breaks to certified companies to stimulate economic growth in that region.²⁹ The economic effect of this program was however rather limited. Very few newcomers relocated to the Island, as the certification process was burdensome and the benefits apparently were not that attractive.³⁰

In 2002 the Koizumi administration spread the idea of an SEZ throughout the entire country. It enacted legislation which allowed for the designation of local zones in which certain exemptions from national rules could be implemented at the request of the local government.³¹ In practice, these zones served two functions:

First, they offered the possibility to develop the local economy by introducing market liberalization measures, for example by abolishing the requirement that certain alcohol brewers had to produce a minimum quantity each year to receive a license necessary for the production of sake.³²

As a second and main function, these zones served as a testing ground for future law reforms. If a deregulation measure withstood the practical test at the local level, the government could introduce this measure at a national scale. Introducing such measures first at a regional level was thus seen as a tool to soften economically unfounded resistance to deregulation raised by interest groups.³³ Due to the experiences gained in a local SEZ, for example, the license requirements for passenger transport were modified at the national level. Prior to the reform, each person who wanted to transport passengers for non-private purposes needed to acquire a license. This requirement made it difficult for certain non-profit organizations to organize transports for welfare purposes. As a local SEZ which allowed such organizations to carry out transport under less strict conditions did not result in taxi drivers and

²⁹ HIROKI HARADA, Special Economic Zones as a Governance Tool for Policy Coordination and Innovation, *Journal of Japanese Law* 31 (2011) 205–221 at 206–208.

³⁰ HARADA, *supra* note 29, 208.

³¹ HARADA, *supra* note 29, 208.

³² HARADA, *supra* note 29, 209.

³³ HARADA, *supra* note 29, 208.

transport companies being driven out of the market, the license requirement was modified for the entire country.³⁴

b) The economic zones of the Abe administration

The SEZs to be implemented by the Abe administration build upon the experiences gathered with the zones established by the Koizumi administration. The Abe administration seems, however, far more ambitious in its desire to use these zones as a tool to lay the groundwork for broad deregulation measures. In comparison to the old SEZs, the new zones are much larger in size and encompass important commercial centers. Each zone aims to deregulate or stimulate a particular economic sector: Whereas Tokyo, for example, will put forward proposals to promote foreign investments, the zone around Osaka will focus on medical innovation and Fukuoka should become a hub for fast-growing start-up companies by providing tax breaks and – at least as originally planned³⁵ – relaxed labor standards.³⁶ The Abe administration hopes that the negotiations between the central government and the local governments of each zone will abolish unjustified regulation so as to boost the economy.³⁷

From a competition policy perspective, the idea of the Prime Minister raises various issues. This paper focuses on the crucial question whether regional deregulation makes sense from a competition policy perspective. As the precise content of the SEZ concept is still subject to political discussion and therefore evolving, my findings can only be of a preliminary nature.

2. Regulatory competition and regional deregulation

a) Effects on competition

Competition policy aims to ensure a level playing field. The new SEZs will abolish unjustified deregulation at a regional level. As the regions are not allowed to compete for the best regulation, the SEZ concept may lead to distortions on the Japanese market.

Limiting deregulation to certain geographic areas of a country does not pose a threat to the level playing field if the firms that are located in the SEZ do not compete with other firms from this country on the national market. So if, for example, a country creates a special economic zone to attract foreign

³⁴ HARADA, *supra* note 29, 209.

³⁵ C. PEJOVIĆ argues in his paper (p. 175 in this book) that this goal has been abandoned by the government.

³⁶ K. UJIKANE/M. TAKAHASHI, Abe Names Special Strategic Zones in Bid to Boost Japan's Allure, <<http://www.bloomberg.com/news/2014-03-28/abe-names-special-strategic-zones-in-bid-to-boost-japan-s-allure.html>>.

³⁷ *Ibidem*.

car manufacturers, there is no distortion of competition on the national market if there are no other car manufacturers present in that country.

But given the size of the new Japanese SEZs, it is rare that the firms within these zones will not have competitors from other parts of Japan. In these cases, regional deregulation may lead to distortions on the market. To give a simple example: Assume that the government relaxes labor standards considerably for the Fukuoka zone and gives Fukuoka firms significant tax privileges. These measures give those firms cost advantages over competitors. The Fukuoka firms can offer lower prices and will attract more business acumen at the expense of Japanese competitors from outside this SEZ. As the central government does not allow other prefectures to implement similar measures, regulatory competition, i.e. competition among the different lawmakers for the best legal framework for firms, cannot take place. Put simply: the SEZs are benevolent for firms inside their borders, but they may have a negative effect on the competitiveness of firms outside these zones.

Japanese firms outside the SEZs with business models targeting the entire national market will thus have to make a choice: Either they try to compete with their cost disadvantages or they decide to relocate their headquarters and/or production facilities to an SEZ in order to benefit from the proposed deregulation measures. The latter will only take place if the cost benefits gained by the relocation are significant and the general business conditions in the SEZ are comparable to the present location of the firm, for example with regard to the availability of trained personnel, transport facilities, office space etc.

Summing up, the result of the creation of SEZs can be an unlevelled playing field for actors competing on the entire Japanese market given that the SEZ concept does not allow for a proper regulatory competition among the regions. This raises the question of which implications have to be drawn from this finding.

b) SEZs as useful laboratories

The opponents of deregulation will certainly argue that regional deregulation without the possibility of engaging in regulatory competition does not make economic sense as it creates tensions between regions.

In my opinion, this objection cannot be raised against regional deregulation as such. It goes without saying that the first best solution would be a nationwide deregulation program to avoid arbitrage. Such a program would also stimulate the economy to a larger effect than deregulation measures that are limited to a certain geographic area.

As a second best solution, regional deregulation is however not *per se* wrong from a competition perspective. The SEZ concept creates useful laboratories to study the effects of deregulation measures to overcome interest-driven resistance against economically justified deregulation. So the SEZ

concept is a useful first step on the path to deregulation. Another question is, however, whether the zones in their current shapes will help to overcome interest-driven resistance. They are rather large and it is difficult to see how the shaping of the zones makes it easier to overcome this resistance.

c) Possible limitations to ease the effects of distortion

If it can be assumed that the SEZs are helpful in overcoming interest-driven resistance, the Japanese government should however find ways to limit the negative side effects of its regional deregulation policy.

aa) A first idea for limiting possible distortions is to apply deregulation measures to start-ups or newcomers only. Accordingly, only firms in new and emerging markets or those with little market power will profit from deregulation. Strengthening those firms may intensify competition. Limiting deregulation measures to such firms is, however, a rather complex endeavor. From an economic perspective, it is very onerous to precisely define for just how long firms should be qualified as newcomers as this position differs across markets. Similar issues arise with the classification of firms as “start-ups”. In sum, an economically sound implementation of this limitation might be rather burdensome. These difficulties counsel against the use of this approach as a general concept for all SEZs in Japan.

bb) A second approach is the creation of zones in which only foreign investors may benefit from relaxed standards. This approach aims at the generation of more foreign investment and is, for example, pursued by Korea with its eight “Free Economic Zones”. It seems that some administrators in Japan have a similar concept in mind for the Tokyo zone. The creation of such zones will however not help to unleash the market forces in the entire country as firms outside these zones will still suffer from unjustified regulation. Such zones can therefore merely complement a national deregulation program that abolishes unjustified regulation for the entire market in order to give Japanese companies the opportunity to become more competitive and innovative.

cc) A third – and very traditional – approach for restricting distortions of competition resulting from regional deregulation is to place economic zones in areas of the country that are in need of development. Economic logic dictates that not many firms will move to such a zone in the short and medium run if, for example, essential market factors important for the provision of goods or services to customers are not well developed in those areas. So there is little distortion of competition. The experiences with the existing SEZ in Okinawa proves this point. Despite certain tax benefits, not many companies have relocated to this detached island.³⁸ In addition, limiting deregulation to

³⁸ HARADA, *supra* note 29, 208.

selected underdeveloped areas in an industrialized country will barely stimulate the economy as a whole considerably as only few individuals and firms will benefit from the positive effects of the deregulation. For the zones designed by the Abe administration, however, this limitation is obviously not an option as the Prime Minister wants to include Japan's commercial centers within the zones.

dd) Therefore a fourth limitation should be implemented. The best option to limit unwarranted spill-over effects is to pursue the policy of regional deregulation only for a limited time period. The length of the period depends on the deregulation measures taken. The more complex these measures are, the longer the time frame must be. Otherwise it is not possible to meaningfully evaluate the effects of the deregulation policy. Generally speaking, a workable period seems to be five to seven years. After that time, the central government should evaluate the effects of the various deregulation measures implemented in the SEZs and decide which of these measures should be introduced at the national level. After such a step – which levels the playing field for all market actors – the individual SEZs could be either dissolved or used as laboratory to test other deregulation concepts.

Restricting the intended regional regulation to a certain time period will limit possible distortions flowing from this type of deregulation significantly. Market actors located outside the SEZs can expect that competitive advantages will be leveled within the near future. Having this in mind, they will carefully consider whether moving into an SEZ will make economic sense given that moving is not free of cost. It can be expected that moves into the SEZs will be less frequent under the proposed limitation than in the case of regional deregulation with no expiry date. When firms can expect that certain competitive advantages will be granted for long periods of time in the SEZs only and not in their present location, they will be much more willing to move than under the scenario in which they are expecting that economically sound deregulation will be expanded to the entirety of Japan in the near future.

3. *Summary*

The concept of regional deregulation as pursued by the Abe administration might be a useful first step for overcoming interest-driven opposition hindering regulation even in cases in which it would be economically justified and beneficial for the society as a whole. After a period of five to seven years, the government should, however, review the legal framework and expand the deregulation benefits to the entire country to restore the level playing field for firms competing on the Japanese market.

IV. Deregulation of Monopolistic Markets (Europe)

1. Deregulation in Europe

The deregulation process in Europe has different layers. Not only have the EU Member States adopted national deregulation programs, there is also a strong push by the EU to unlock foreclosed national markets. The EU pressure for deregulation stems from a variety of instruments, which cannot be dealt with here in their entirety. A short and incomplete survey must suffice.

First, the European freedoms, especially the freedom to provide services (Art. 57 TFEU), has forced the Member States to open markets to competitors from other Member States. Second, the European Court of Justice applies the competition rules not only to private but to a certain extent to public undertakings also to ensure that those undertakings cannot monopolize markets by anticompetitive means.³⁹ Third, the Member States are under the obligation to abolish legal rules allowing public undertakings – with the exemption of undertakings that are entrusted with the operation of services of general economic interest – to act contrary to the prohibitions of European competition law (Art. 106 TFEU).

The most visible push for deregulation stems however from various European directives adopted since the 1990s aiming at a liberalization of markets controlled by (state-created) monopolies. These directives have concerned, for example, the telecommunication and energy sectors and the provision of postal services.⁴⁰ The deregulation targeted the entire EU market and was not restricted to certain zones. As the opening of those markets is a complex endeavor, market liberalization was implemented in various steps, thus creating a mix of regulation and liberalization. To ensure a smooth transition from regulation to competition, regulation authorities were installed to monitor the market and control business practices of former monopolists, especially their pricing policies, *ex ante*. In addition, monopolists had to respect the prohibitions of competition law which apply *ex post*.

2. Complementing the competition rules

The European deregulation did not necessitate a general change in the European competition rules. These rules were sufficiently broad and flexible to take into account the peculiarities of deregulated markets. Special legislative attention was however given to the important question of market access in liberalized network industries. In these industries, the former monopolists usually kept control over the network. To ensure non-discriminatory access to

³⁹ For more details see E.-J. MESTMÄCKER/H. SCHWEITZER, *Europäisches Wettbewerbsrecht* (3rd edn. München 2014) § 9 para. 32.

⁴⁰ For more details see MESTMÄCKER/SCHWEITZER, *supra* note 39, § 1 paras. 68–101.

the network, which is essential to stimulate competition, the EU enacted special rights of access for third parties to the network on a nondiscriminatory basis.⁴¹ These special provisions, however, only complemented the European competition rules and did not supplant them.

3. *Importance of rigorous enforcement of unilateral conduct rules*

Even though the European legislature has removed many important barriers which restricted competition on the European internal market, the legislature did not opt for a divestiture of the (national) monopolists, hoping that with the emergence of efficient newcomers, the market power of the former monopolists would vanish in the near future. Faced with the prospect of competition, the (former) monopolists obviously try to defend their strong market position, sometimes by having recourse to anticompetitive practices.

From a competition policy perspective, there is usually little danger that a former monopolist will enter into an anticompetitive agreement with a newcomer. An efficient newcomer usually wants to acquire a certain market share to profit from economies of scale and has therefore no interest in agreeing on prices or related parameters as this would make it more difficult for the new player in the market to seize market shares from the monopolist. A monopolist can also not simply restrict competition by merging with the newcomer. Such a merger needs to be notified and can be halted by competition authorities if it significantly impedes the competitive process on a given market. Thus, monopolists have difficulties in restraining competition by anticompetitive agreements or mergers.

This is not so with regard to the third pillar of competition law, i.e. exclusionary practices of dominant firms (Art. 102 TFEU) or market monopolization in the language of US antitrust law (Sec. 2 Sherman Act). Recourse by dominant firms to unilateral conduct to restrict competition may effectively foreclose newcomers. Practices such as predatory pricing may therefore be effective weapons for the maintenance of monopoly power. The detection of such conduct is rather difficult. To prove the (potential) anticompetitive effect of abusive strategies, many economic factors have to be evaluated. Unless a state has a civil procedure law like those in the United States,⁴² such abusive practices are very difficult to stop by private actions as a private plaintiff is often not in a position to collect all relevant economic data to prove the anticompetitive nature of the dominant firm's business strategy. In Europe, as in Japan, private actions against exclusionary practices of dominant firms are therefore rare.

⁴¹ For more details see MESTMÄCKER/SCHWEITZER, *supra* note 39, § 19 paras. 97–102.

⁴² On the peculiarities of the US system as compared to the continental-European approach D. POELZIG, *Normdurchsetzung durch Privatrecht* (Tübingen 2012) 65–74.

Given that private enforcement cannot stop the former monopolists from defending their strong market position by exclusionary practices, public enforcement organs have to safeguard competition in liberalized markets. If these authorities do not have the resources and/or the legal means to vigorously enforce the prohibition of exclusionary conduct, any deregulation process will remain incomplete.

In Europe, the EU Commission has learned that lesson. A look at cases in which the Commission has opened proceedings over the last 15 years to end abusive practices reveals a large number of high profile cases against former state-protected monopolists. Law enforcement efforts concerned in particular abusive pricing conduct by dominant market players, which can be a very effective strategy for a dominant firm seeking to foreclose newcomers from the market. The Commission targeted, for example, predatory pricing, i.e. pricing policies in which dominant firms price their products below a certain measure of cost.⁴³ It also opened proceedings to halt anticompetitive margin-squeezes⁴⁴ by which a vertically integrated firm with market power supplies a key input to both its downstream entity as well as to its competitors at a price that makes activities of (non-vertically integrated) downstream rivals unprofitable.⁴⁵ In addition, on a partly liberalized market the Commission stopped a dominant firm from cross-subsidizing its business on the deregulated market with revenues generated on the market that was not yet liberalized.⁴⁶ Obviously, the Commission did not limit itself to pricing abuses but also investi-

⁴³ Commission Decision of 16 July 2003, Case COMP/38.233 – *Wanadoo Interactive*; affirmed by Case T-340/03 (*France Télécom v. Commission*), E.C.R. 2007 II-107, and Case 202/07 P (*France Télécom v. Commission*), E.C.R. 2009 I-2369. See also Case C-209/10 (*Post Danmark v. Konkurrencerådet*), ECLI:EU:C:2012:172 – this case concerned a proceeding initiated by the Danish competition authority before a Danish court.

⁴⁴ For details of this abuse see R. O'DONOGHUE/A. J. PADILLA, *The Law and Economics of Article 102 TFEU* (2nd edn. Oxford 2013) 364–422.

⁴⁵ Commission Decision of 21 May 2003, Case COMP/C-1/37.451, 37.578, 37.579, O.J. 2003 L 263/9 – *Deutsche Telekom AG*; affirmed by Case T-271/03 (*Deutsche Telekom v. Commission*), E.C.R. 2008 II-4777 and Case C-280/08 P (*Deutsche Telekom v. Commission*), E.C.R. 2010 I-9555; Commission Decision of 4 July 2007, O.J. 2008 C 83/05 – *Wanadoo España v. Telefónica*, affirmed by Case T-336/07 (*Telefónica and Telefónica de España v. Commission*), ECLI:EU:T:2012:172, and Case C-295/12 P (*Telefónica SA and Telefónica de España SAU v. Commission*), ECLI:EU:C:2014:2062; Case C-295/12 P (*Telefónica SA and others v. Commission*); Commission Decision of 5 March 2014, Case COMP/AT.39.984 – *Telekomunikacja Polska*. See also Case C-52/09 (*Konkurrensverket v. TeliaSonera Sverige AB*), E.C.R. 2011 I-527 – this case concerned a proceeding initiated by the Swedish competition authority before a Swedish court.

⁴⁶ Commission Decision of 20 March 2001, Case COMP/35.141, O.J. 2001 L 125/27 – *Deutsche Post AG*.

gated other exclusionary practices, which cannot be described here for reasons of space.⁴⁷

To protect emerging competition, the Commission tackled pricing abuses in, inter alia, the markets for telecommunication services,⁴⁸ postal services⁴⁹ and rail services.⁵⁰ Additionally, a former national air carrier that foreclosed the market by offering travel agents special rebates was sanctioned.⁵¹

It is not possible to give a precise number of cases or a percentage of how many cases in the overall enforcement activities concerned deregulated markets, as the European competition rules are also enforced by national competition authorities and I do not have the means to analyze the case law of 28 EU Member States. It is, however, possible to say with certainty that the competition enforcers in Europe have dedicated considerable resources to the enforcement of Art. 102 TFEU for the protection of competition on freshly deregulated markets.

4. Implications for Japan

Against this background, I want to evaluate what Japan could learn from the European experiences. This analysis has to start with the consideration that even though Japan introduced the Antimonopoly Law (AML) under US pressure in 1947, this statute did not gain much prominence over the next decades

⁴⁷ See Commission Decision of 25 July 2001, Case COMP/C-1/36.915, O.J. 2001 L 331/40 – *Deutsche Post AG* (German postal services provider condemned for intercepting, surcharging and delaying incoming international mail); Commission Decision of 22 June 2011, Case COMP/39.525 – *Telekomunikacja Polska* (Polish telecommunication firm condemned for preventing entry of competitors onto Polish broadband markets).

⁴⁸ Commission Decision of 16 July 2003, Case COMP/38. 233 – *Wanadoo Interactive*; affirmed by Case T-340/03 (*France Télécom v. Commission*), E.C.R. 2007 II-107, and Case C-202/07 P (*France Télécom v. Commission*), E.C.R. 2009 I-2369; Commission Decision of 4 July 2007, O.J. 2008 C 83/05 – *Wanadoo España v. Telefónica*, affirmed by Case T-336/07 (*Telefónica and Telefónica de España v. Commission*), ECLI:EU:T:2012:172, and Case C-295/12 P (*Telefónica SA and Telefónica de España SAU v. Commission*), ECLI:EU:C:2014:2062.

⁴⁹ Commission Decision of 20 March 2001, Case COMP/35.141, O.J. 2001 L 125/27 – *Deutsche Post AG*; Commission Decision of 5 December 2001, Case COMP/37.859, O.J. 2002 L 61/32 – *De Post v. La Poste*.

⁵⁰ Commission Decision of 18 December 2013, Case COMP/AT.39678 and AT.39731 – *Deutsche Bahn I, II*. See on these cases T. STEINVORTH, *Deutsche Bahn: Commitments End Margin Squeeze Investigation*, *Journal of European Competition Law & Practice* 5 (2014) 628–630.

⁵¹ Commission Decision of 14 July 1999, Case IV/D-2/34.780, O.J. 2000 L 30/1 – *Virgin v. British Airways*; affirmed by Case T-219/99 (*British Airways v. Commission*), E.C.R. 2003 II-5917, and Case C-95/04 P (*British Airways v. Commission*), E.C.R. 2007 I-2331.

as there was little enforcement by the Japanese Fair Trade Commission (“JFTC”).⁵²

The first version of the AML was too strict as the US – similarly as in Germany⁵³ – wanted to see certain industrial conglomerates abolished which were deemed responsible for the war. After the end of the US occupation, the AML was softened by various reforms over the next years, with the exception of certain prohibitions having been reinforced after the oil crisis in the 1970s.⁵⁴

Despite these amendments, the enforcement of the AML rules remained weak. Industrial policy aiming to boost exports was given priority over the creation of competitive structures on the Japanese market. When undertaken to enhance exports, state-sponsored cooperation among firms was regarded as a major tool to create economic growth and welfare.⁵⁵ It was only in the 1990s that the importance of a proper competition order gained significant support and the administrative ordering⁵⁶ of the economy was slightly pushed back. This development was fostered by the economic stagnation that hit Japan at that time,⁵⁷ by the increasing awareness of consumers of the social

⁵² On this development see H. FIRST, *Antitrust Enforcement in Japan*, *Antitrust Law Journal* 64 (1995) 137–182 at 142–157; E. KAMEOKA, *Competition Law and Policy in Japan and the EU* (Cheltenham 2014) 10–16; S. VANDE WALLE/T. SHIRAISHI, *Competition law in Japan*, in: Duns/Duke/Sweeney (eds.), *Research Handbook on Comparative Competition Law* (Cheltenham 2015) 415–442 at 415–416; M. MARQUIS/T. SHIRAISHI, *Japanese Cartel Control in Transition*, CEU San Pablo University Madrid, Working Paper no. 47/2014 (Competition Policy Series), available at <<http://ssrn.com/abstract=2407825>>, 5: “[The] enforcement of Japan’s Antimonopoly Act (‘the AMA’) began with a bang in the late 1940s, but the bang gave way to a long whimper, with only a few short episodes where the AMA showed signs of life, notably around 1960 and in the 1970s when high-profile cases were won by the JFTC and when the AMA was amended and reinforced.”

⁵³ On the early ideas of the US occupation forces on the deconcentration and decartellization of the German economy after World War II see E.-J. MESTMÄCKER, *50 Jahre GWB: Die Erfolgsgeschichte eines unvollkommenen Gesetzes*, *Wirtschaft und Wettbewerb* 2008, 6–22 at 6–9; MURACH-BRAND, *supra* note 20, 28–58.

⁵⁴ HEATH, *supra* note 21, § 59 paras. 2–5.

⁵⁵ GERBER, *supra* note 21, 212–213.

⁵⁶ On the common practice of ministries exempting certain agreements from the application of competition rules see C. HEATH, *Bürokratie und Kartellkultur in Japan*, *Wirtschaft und Wettbewerb* 1993, 474–482 at 475 (referring to an estimation of the JFTC according to which, in 1989, around 50% of Japanese industry benefited from administrative measures restricting competition).

⁵⁷ On the economic background of the stagnation see M. HEMMERT/R. LÜTZELER, *Landeskunde und wirtschaftliche Entwicklung seit 1945*, in: *Deutsches Institut für Japanstudien* (ed.), *Die Wirtschaft Japans: Strukturen zwischen Kontinuität und Wandel* (Berlin/Heidelberg 1998) 1–18 at 15–16.

cost of state intervention and regulation,⁵⁸ and by external pressure mainly exerted by the US⁵⁹ on the Japanese government to enforce competition rules more vigorously.⁶⁰

As consequence, the JFTC gained more resources, a better organization⁶¹ and a better standing within the Tokyo bureaucracy, and more enforcement took place, often in informal proceedings.⁶² However, in his latest book on the development of competition law in various parts of the world, *David Gerber*, notes:

“The [...] enforcement efforts in areas other than vertical relationships have varied but, in general, they have been less intensive. Although the AML contains provisions prohibiting monopolies, they have proven difficult to enforce effectively. Moreover, incentives for the JFTC to confront dominant firms have been limited, especially given the traditional reliance on dominant firms to lead Japanese economic growth.”⁶³

As the book was published in 2010, the efforts of the JFTC will certainly have increased over the last years.⁶⁴ In 2010 the Japanese Supreme Court, for example, upheld a JFTC cease and desist order against a dominant telecom operator (NTT East) which tried to exclude competitors from the market for high speed internet access.⁶⁵ In any event, it is not the intention of this paper to comment on the effectiveness of the Japanese competition law enforcement system. One important lesson we have learned in Europe should, however, be highlighted: Without a rigorous application and enforcement of the rules restricting the *marge de manœuvre* of dominant firms to have recourse to anticompetitive practices, the development of the competitive process in freshly deregulated markets might be hampered. As consequence, the fruits of the deregulation process, i.e. the beneficial economic effects, cannot be har-

⁵⁸ M. SCHAEFER, *Wettbewerbsrecht in Japan und Europa: Eine rechtsvergleichende Studie ausgewählter Aspekte* (Hamburg 2001) 72.

⁵⁹ It was essentially argued that anticompetitive practices in Japan foreclosed US firms from the Japanese market. On these allegations and their legal consequences in Japan see GERBER, *supra* note 21, 213–214; M. KOTABE/K. W. WHEELER, *Anticompetitive Practices in Japan* (Westport/Connecticut 1996) 141–148; MATSUSHITA, *supra* note 21, 84–85; SCHAEFER, *supra* note 58, 72–75.

⁶⁰ GERBER, *supra* note 21, 213–215.

⁶¹ On the re-organization of the JFTC see W. M. VISSER 'T HOOFT, *Japanese Contract and Anti-Trust Law* (London 2002) 57.

⁶² HEATH, *supra* note 21, § 59 para. 20.

⁶³ GERBER, *supra* note 21, 216.

⁶⁴ KAMEOKA, *supra* note 52, 94 notes in a more recent publication: “Whereas in the US the enforcement of antitrust rules against dominant companies has been comparatively lenient, in particular owing to key judgments of the US Supreme Court, the EU and Japan generally assume a more vigilant posture with regard to dominant firms”.

⁶⁵ *Saikō Saiban-sho* [Supreme Court], 17 December 2010, Heisei 21 (gyō-hi) no. 348, 57(2) Shinketsushu 215, cite taken from VANDE WALLE/SHIRAIISHI, *supra* note 52, 421 (footnote 25).

vested in due time. Thus, any deregulation must be supported by proper competition law enforcement; otherwise the deregulation process will remain incomplete. The Japanese legislature should have this finding in mind when implementing its deregulation program at the national level.

V. Conclusion

1. The deregulation campaign initiated by the Abe administration might be a useful first step. Each state should revise its regulatory framework at regular intervals.
2. Special regulation restricting competition must be regarded as an exception in a market economy and should be abolished as far as possible.
3. The creation of various economic zones with deregulation programs in different areas of the law can unlevel the playing field for firms competing for the entire national market.
4. To limit the effect of distortion, all deregulation measures implemented in the SEZs should be evaluated after five to seven years. If a deregulation measure has stood the practical test at the local level, it must be implemented nationwide to create a level playing field.
5. It must be ensured that dominant firms in deregulated markets will be sanctioned if they have recourse to anticompetitive means. Otherwise the deregulation process will be incomplete. If necessary, a major deregulation program should be accompanied by measures to improve competition law enforcement.