PART II*

Regulatory Policies and Outcomes

* The background material used to prepare this report is available on the Web site: *www.oecd.org/regreform/backgroundreports*.

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PART II

Chapter 3

Competition Policy*

* For more information see: Background Report on "The Role of Competition Policy in Regulatory Reform" available on the Web site: *www.oecd.org/regreform/backgroundreports*.

Context and history

The roots of Germany's competition policy lie in its highly cartelised industrial past

Competition law and policy occupy a central position in Germany's economic and political framework, and have deep roots in the country's history. Vigorous economic growth accompanied industrialisation and re-unification in the second part of the 19th century, underpinned by a strong belief in the merits of the free market. As the economy started to experience the "boom and bust" of industrial cycles, the perception of competition changed. It needed to be controlled, and in response to crisis, firms started to co-operate by entering agreements on production and capacity. By 1900 there were 400 established cartels, an apparently permanent feature of the economy: larger, more numerous and more durable than elsewhere in the industrialised world. The political leadership did not fundamentally object (cartels helped to bind the newly integrated German State together), and economic thinkers tended to support the cartel movement, stressing the importance of institutions in managing industrialisation so as to mitigate the damaging effects of market processes on producers. A landmark legal case in 1897 (the *Saxon Wood Pulp* decision) found that cartels were generally beneficial, by preserving firms from ruin and maintaining adequate prices. The basic legal rule was established that cartel agreements were valid and enforceable, although a cartel to establish an actual monopoly or exploit consumers might be struck down.

There was, however, increasing concern about the harmful effects of cartels, not least on consumers and SMEs. After the First World War, the government enacted Europe's first general laws and institutions aimed specifically at protecting competition and controlling abuse. The 1923 Regulation against Abuse of Economic Power Positions was part of a set of emergency measures to control inflation by promoting market freedom, and was also aimed at promoting firms' social responsibility. An administrative body (the Cartel "Court") was created to decide cases. Though these developments were controversial, they upheld for the first time the need to protect competition in the interests of consumers, and became the model for competition policy across Europe.

The post-war social market economy made competition policy a cornerstone of the new order

A new system was designed to meet Germany' s special needs in the wake of the second world war, though it drew inspiration from the practical experiences and political thinking of the past (Box 3.1). Competition law and policy were made a centrepiece of the new "social market" political economy which aimed, successfully, to establish a coherent and comprehensive framework for management of the economy, politics and society.

The legal basis for the new system was the *Act against Restraints on Competition* (ARC), which took effect in 1958, following ten years of contentious debate which eventually softened the purist ordo-liberal position, which favoured a law that would clearly prohibit cartels.

Box 3.1. **Competition policy as the economic Constitution: the ordo-liberal foundation of the social market economy**

Germany's post-war conception of the "social market" political economy is a distinctive, comprehensive approach to corporate management, industrial relations, social welfare, and government policies, including notably competition policy. Companies are held to social as well as economic account, being responsible to stakeholders in the community as well as to shareholders, employees, customers, and suppliers.

The intellectual energy for this system and for post-war German competition law came from Freiburg, where a group of professors of economics and law rebuilt liberalism during the inter-war period in a way that bridged public and private responsibilities. One of these professors was a veteran of the Ministry of Economy cartel office and thus brought a particularly relevant experience to the project. They held that a competitive economic system was necessary for prosperity and freedom, but that achieving these results required setting the market in a constitutional framework.

The Freiburg liberals believed that the Weimar republic had collapsed because its legal system could not constrain private economic power from undermining political and social institutions.* They faulted both classical economic theories and traditional legal positivism for excessive attention to matters of form. Economic formalism was oblivious to social impacts, while legal formalism had become a willing tool of entrenched interests. But they acknowledged that the "historical" approach to economics needed theory in order to be useful.

The "ordo-liberal" viewpoint accepted tenets of classical economic theory and some traditional liberal principles, notably the importance of competition to economic success and the link between economic freedom and political freedom. Seeing how private economic power had subverted government, the Freiburg school called for breaking up monopolies. They argued that the economy could integrate society on democratic principles, but only if it functioned fairly to provide equal opportunities for participation.

Their conception was "constitutional", in that it set out legal principles that would constrain the government. This economic Constitution would be constructed through legal and political decisions. Indeed, ordo-liberalism reversed the presumption of conventional liberalism: rather than divorce the economy from law and politics, it supposed that the economy's success depends on its organic relationship with law and politics.

Economics would set out the conditions for "complete" competition, in which no firm has the power to coerce others in the market. Those conditions would then become the standards for legal decisions. Officials could intervene only on those terms, and in doing so they could not exercise discretion. Administrative control was rejected, because it could be captured by the interests being regulated. Yet legislation about detail was disfavoured too, because the constitutional principle and general competition rules would provide a sufficient framework.

Enforcement would be entrusted to a strongly independent and autonomous body, outside and above politics just like a court. Like a court, it was imagined as applying objective law-based standards, without discretion to favour parties or outcomes. It should eliminate monopolies where possible and force firms to act as though they faced effective competition. Firms would be encouraged to compete in performance, but not in measures to hinder their rivals.

Box 3.1. **Competition policy as the economic Constitution: the ordo-liberal foundation of the social market economy** *(cont.)*

The ordo-liberal viewpoint became the basis for Germany's post-war economic reconstruction, in which some of its proponents played key roles. A professor associated with the Freiburg school's ideas, Ludwig Erhard, headed the self-government (under occupation) that eliminated rationing and price controls in 1948, then served as minister of economy until 1963 and as chancellor until 1966. The social market economy, built on ordo-liberal principles, was part of his party's platform from 1949. In that conception, competition policy assumed a leading, constitutional status and role, promoting basic values, protecting fundamental rights, and operating on juridical principles.

* Their early criticism of corporatist arrangements under the Weimar Constitution, and advocacy of a strong State that would be independent of economic interest groups, may also have prepared the ground for the authoritarian alternative that appeared after 1933.

Source: Gerber, 1998.

The 1958 competition law has shown enduring strength and adaptability so far: its distinctive features pose a growing challenge in relation to EU developments

The long gestation of the law, combined with its deep roots in Germany's political experience and academic tradition, produced a system that has shown enduring strength. The law set out specific rules to address the competitive effects of market actions. At least as important, it set up the *Bundeskartellamt* (BKartA), as a strongly independent, court-like expert body for enforcement. The political and economic climate of the 1960s reemphasised the importance of competition policy for economic success on the one hand, and for consumer and worker protection on the other. The ARC was amended in 1973 to add merger control, sharpen the provisions for controlling abuse, prohibit resale price maintenance, and permit more co-operation among smaller firms. Merger control soon became the BKartA's most important function. A new institution, the *Monopoly Commission*, was introduced to report on competitive conditions (and on the clearance decisions of the BKartA, which were not published at that time).

The most recent amendments to the ARC in 1999 bring the law more in line with EU competition law. They incorporate principles about restrictive agreements and dominance, a revision of the merger review process, and new responsibilities for the BKartA over competitive tendering in public procurement. Importantly for regulatory reform, changes were made that will allow the ARC to be more easily applied to infrastructure monopolies. Further amendments are underway, reflecting the growing importance of the EU dimension. Germany faces important challenges in adjusting to EU competition principles and to the EU reforms which are underway. Several features of its law make it distinctive and some of these run counter to the EU way (Box 3.2 gives an overview of the EU law). These include an approach to horizontal agreements which provides for classes of agreements that are subject to less stringent rules in the primary legislation (so as to reduce administrative discretion), and the use of specific rules to manage conduct by dominant firms in addition to a general prohibition against abuse. Reforms in EU competition law enforcement which will shift responsibilities to member States challenge Germany's institutions. Germany has been concerned that reducing the role of notification and clearance will reduce the legal certainty and transparency which it considers to be one of its strengths.

Box 3.2. **The EU competition law toolkit**

The law of Germany retains many distinctive features, but it also now includes some of the elements of competition law that have developed under the Treaty of Rome (now the Treaty of Amsterdam):

- **Agreements:** Article 81 (formerly Article 85) prohibits agreements that have the effect or intent of preventing, restricting, or distorting competition. The term "agreement" is understood broadly, so that the prohibition extends to concerted actions and other arrangements that fall short of formal contracts enforceable at civil law. Some prohibited agreements are identified explicitly: direct or indirect fixing of prices or trading conditions, limitation or control of production, markets, investment, or technical development; sharing of markets or suppliers, discrimination that places trading parties at a competitive disadvantage, and tying or imposing non-germane conditions under contracts. And decisions have further clarified the scope of Article 81's coverage. Joint purchasing has been permitted (in some market conditions) because of resulting efficiencies, but joint selling usually has been forbidden. All forms of agreements to divide markets and control prices, including profit pooling and mark-up agreements and private "fair trade practice" rules, are rejected. Exchange of price information is permitted only after time has passed, and only if the exchange does not permit identification of particular enterprises. Exclusionary devices like aggregate rebate cartels are disallowed, even if they make some allowance for dealings with third parties.
- **Exemptions:** An agreement that would otherwise be prohibited may nonetheless be permitted, if it improves production or distribution or promotes technical or economic progress and allows consumers a fair share of the benefit, imposes only such restrictions as are indispensable to attaining the beneficial objectives, and does not permit the elimination of competition for a substantial part of the products in question. Exemptions may be granted in response to particular case-by-case applications. In addition, there are generally applicable "block" exemption regulations, which specify conditions or criteria for permitted agreements, including clauses that either may or may not appear in agreements (the "white lists" and "black lists"). Any agreement that meets those conditions is exempt, without need for particular application.
- **Abuse of dominance:** Article 82 (formerly Article 86) prohibits the abuse of a dominant position, and lists some acts that would be considered abuse of dominance: imposing unfair purchase or selling prices or trading conditions (either directly or indirectly), limiting production, markets, or technological development in ways that harm consumers, discrimination that places trading parties at a competitive disadvantage, and imposing non-germane contract conditions. In the presence of dominance, many types of conduct that disadvantage other parties in the market might be considered abuse. Dominance is often presumed at market shares over 50%, and may be found at lower levels depending on other factors. The prohibition can extend to abuse by several firms acting together, even if no single firm had such a high market share itself.
- **Reforms in administration:** Recent reforms of EU competition policy reduce the scope of the prohibition against vertical agreements and will eliminate the process of applying for exemptions for particular agreements. Instead, exemption criteria will apply directly in decisions applying the law, and these decisions will increasingly become the responsibility of national competition authorities.

Competition law aims to promote effective competition and the market structures which help this: the network industries raise new issues

Germany's competition system relies on the analysis and application of rules rather than an appeal to expressions of legislative purpose which would need interpretation and reduce legal transparency. The ARC does not therefore contain a formal Statement of purpose. However the policy motivation of the law is clear. The ARC was in the first place intended to guarantee freedom of competition, and to prevent the emergence of economic power where it might impair the effectiveness of competition. Effective competition was expected to increase economic efficiency, via the classic virtues of competitive markets in allocating resources, responding to consumer demand, promoting productive efficiency and disciplining management. But effective competition was also considered important for sustaining a large number of competitors, so as to prevent companies from becoming too influential in society and politics. The law is therefore an instrument for political as well as economic ends.

The focus is on protecting the structures within which firms compete, rather than assessing the economic effect of particular conduct. The law thus aims to protect relationships which may be expected to yield desirable economic outcomes. One clear example is the use of the law to protect SMEs against the aggressive conduct of larger firms (amendments to the law since 1973 underline this). Retail regulations and the master-crafts qualification system are also consistent with this approach. The liberalised infrastructure industries pose a new type of structural challenge. Their network monopoly core means that competitive structures are hard to develop and to maintain. The deep-rooted faith in competition law led Germany to rely on it initially for promoting effective competition in these sectors, but this approach is now being adapted with the creation of regulators working hand-in-hand with the BKartA.

Competition policy is institutionally separated from the enforcement of competition law, which has implications for effective regulatory reform

There is a separation between the enforcement of competition law – the job of the BKartA – and competition policy, for which the responsibility is primarily with the Ministry of Economics and Labour. This can weaken the link between competition law and competition policy in regulatory reform. The relative weight of competition policy as a principle in regulated industries may be questioned in the light of a recent ministry decision to override the BKartA and allow a major gas-electricity merger.

The substance of the competition law

Cartels are handled according to sound assumptions about likely effects, and the system of sanctions works well

The first and most fundamental provision of the ARC prohibits horizontal agreements in general terms. There are two classes of exceptions: the "unopposed" cartels and the "authorised" cartels. Both classes must be notified to the BKartA. The former are permitted unless the BKartA objects, and the latter require prior BKartA approval. Unopposed cartels are categorised into three types: agreements about terms of business, specialisation cartels (so long as they do not lead to a dominant position), and agreements among SMEs. Likely efficiencies are presumed in these cases, for example that standard terms can facilitate transactions. About half of the 300 currently effective cartels are "unopposed" cartels involving SMEs.

Prior BKartA autorisation is required for rationalisation cartels and structural crisis cartels, and the law sets out the criteria for qualification. The benefits of rationalisation cartels must be significant: they must not create or strengthen a dominant position, and there must be no other means of achieving the rationalisation if price, purchasing or selling agreements are involved. Structural crisis cartel requirements are less stringent. The 1999 amendments to the ARC also provide for the authorisation of agreements that meet criteria for exemption similar to those of EU competition law: however, the ARC sets tighter competition-related criteria than EU law.

A cartel may be authorised – by the minister not the BKartA – for policy reasons that do not appear in the ARC criteria for exception. The minister may not reject the BKartA's decision under the ARC, but may exempt a cartel that fails to meet any of the criteria for exemption if the restraint is "necessary for prevailing reasons concerning the economy as a whole and the public interest". Ministerial authorisation is also possible in "especially serious individual cases" where there is an "immediate danger to the existence" of most of the firms in a sector, and other measures cannot be taken in time. The power to intervene has rarely been used.

Self-regulation by professional and trade associations is subject to special oversight, where it is not exempted from the ARC entirely.

Though the cartel rules have been mainly applied via the notification process, enforcement against unauthorised cartels has stepped up. The highest fines ever, 660 m euros, were imposed in early 2003 against a cement cartel, following an earlier set of cases. A criminal law against bid-rigging now backs up the ARC, resulting in a number of cases and some jail sentences. This should improve the effectiveness of the BKartA's well-conceived leniency programme which offers participants a strong incentive to provide evidence, and may well discourage the formation of prohibited cartels in the first place.

Vertical agreements are, with one major exception, allowed unless they substantially impair competition

With one exception vertical agreements are not prohibited, unless they involve a dominant firm and are thus covered by the ARC's prohibition against abuse of dominance. Instead they are subject to *ex post* control for abuse. A "competitive effects" test is applied: agreements may be prohibited only if they substantially impair competition. This sounds tolerant but may be demanding, as the test does not depend on market power or market share. The one prohibition is resale price maintenance. This is subject to a major exemption for newspapers, magazines, books, sheet music, and maps.

Abuse of dominance is subject to strong rules, with special regard for SMEs, though the enforcement record is mixed

German law traditionally controlled single-firm misconduct through specific rules. A general prohibition is also now in place to reflect EU law. This can be applied to practices that are not clearly covered by the specific rules. The specific rules apply to firms with a dominant or paramount position, and cover the following misconduct: impairing the ability of others to compete without objective justification (through predatory pricing for example), exploitation aimed at consumers (prices may be compared with those in a comparable competitive market, which can be difficult), discrimination that harms customers, and (a recent addition) denying access to a network or infrastructure facility. Some other conduct (such as boycotts) is also prohibited by the ARC, even in the absence of dominance. There is no provision for ministerial intervention.

Dominance is defined in several ways. A firm that has no competitors or that is not exposed to substantial competition is considered dominant. A firm that faces some competition would nonetheless be treated as dominant if it has a "paramount market position", which is assessed on a wide range of factors (market share, financial power, access to suppliers and markets and others). Several firms together could be considered dominant to the extent there is no substantial competition between them. Market share thresholds for presuming dominance are low, though this test is not conclusive.

Special attention is paid to protecting smaller firms against dominance in a bargaining relationship. Economic dependence issues are specifically covered by the ARC, which controls discrimination and "unfair hindrance" by dominant firms, associations and cartels. A recent addition defines sales below the seller's cost price as an abuse of market power relative to SMEs. As in other countries, the food retailing sector, and its use of "loss leaders", is a main target. The BKartA's first enforcement action was against three supermarket groups, and was largely upheld on appeal.

However the enforcement record against abuse of dominance has been limited and mixed so far. Most of the BKartA's formal challenges in the 1990s were rejected by the courts or overruled by the legislature, though some recent actions have been more successful.

The ARC's abuse of dominance provisions are increasingly being applied to the network industries, albeit with considerable difficulty (Box 3.3).

Box 3.3. **ARC abuse of dominance provisions and the network industries**

The ARC is increasingly involved in cases arising in the network industries. This was facilitated with the elimination of exemptions for most of these industries, and the new misconduct rule on denial of access to essential network facilities. Numerous cases have arisen both in telecommunications, and in the power sector concerning network access terms and charges. But enforcement has proved difficult. The normal *ex post* process for tackling misconduct is not adapted to sectors where the primary requirement is to encourage the emergence of competition across a whole industry where none existed before. The usual methods for analysis and proof are hard to apply in this context: notably, there are no comparable markets with which to compare prices. The substitute is detailed cost analysis, and a 2002 court decision supported this alternative, but determining the relevant costs to establish the existence of abusive pricing is also difficult. Also, delays in the courts hamper enforcement against denial of network access. An *ex post* approach could work, but speed is vital in these cases, and the process of investigation and proof takes time. Even after a decision is reached, the usual practice has been to suspend the decision pending appeal, though access orders for the energy sector may now remain in place pending appeal.

Merger control also has a strong legal framework but ministerial intervention is possible

For many years Germany had the most active programme of merger control in Europe. The standard is whether the transaction is expected to create or strengthen a dominant position (using the ARC definition that is also applied to abuse of dominance). The concept

that is most often relevant in merger cases is "paramount position". The BKartA will be concerned if an already paramount position is likely to become stronger. Assessment focuses on the position of the parties and market structure, and on the development of competition in the future. Economic analysis is used for market definition and identifying market-dominant positions. Defined markets reportedly tend to be narrow, making it more likely that the BKartA will find dominant positions. Issues of market structure and legal analysis appear to dominate the review process. The BKartA is dubious about efficiency as a defence, as consumers may be expected to suffer from the lack of discipline on the conduct of a dominant firm.

Whether a merger is subject to control is determined mainly by the size of the parties. A merger must be notified and approved if the parties' aggregate annual worldwide turnover exceeds 500 m euros and the domestic turnover of at least one party exceeds 25 m euros. Special rules for calculating turnover have the effect of contracting or expanding coverage in particular sectors. The legal characterisation of a concentration that is subject to merger control is such as to ensure broad coverage. Covered mergers must be notified and approved in advance. The examination period is four months (if the BKartA has taken no action the merger is cleared after this time). The BKartA must inform the companies within a month if it has initiated a "main examination", which happens for 10% of cases. Otherwise it issues an informal notice of clearance. For main examinations the BKartA publishes a formal decision with its reasoning, and the decision may impose conditions on clearance. Mergers implemented without authorisation are legally void, and those that are implemented despite the BKartA's prohibition may be dissolved, and penalties (fines) could be imposed.

The Minister of Economy and Labour may authorise a concentration that the BKartA has rejected, if the restraint on competition is outweighed by advantages to the economy as a whole or if the concentration is "justified by an overriding public interest". International competitiveness of the parties may be taken into account. Such interventions are infrequent, but important. The minister must first obtain a report from the Monopoly Commission and solicit comments from the *Länder* governments where the firms are registered, and must act with some speed and transparency. The Monopoly Commission assesses the non-competition policy interests against the BKartA's findings. The minister had not disagreed with it since 1989, until the *Ruhrgas* case in 2002.

The BKartA has tried to use merger control to support the development of competition in the network industries. For example in gas, it has examined a combination of neighbouring regional companies. However the *Ruhrgas* case may have set a political limit to this approach. The BKartA rejected the combination of the largest pipeline operator (Ruhrgas) and a combined gas-electric firm (E.ON). But it was approved by the ministry, which concluded that creating a national champion could improve supply security, a conclusion that undercuts the logic of restructuring to promote competition, even if the security argument is a strong one. As many other OECD countries have also found, competition and security of supply may raise difficult trade-offs.

The approach to related issues – procurement, State aid, unfair competition and consumer protection – is uneven

Oversight of competition in *public procurement* was added to the ARC in the 1999 amendments. The principles and jurisdictional thresholds are based on EU procurement rules. This addition is consistent with the conception of the BKartA as a law enforcer and

of the goal of the ARC to preserve competitive structures and relationships. In contrast, *State aids and subsidies* are not covered by the ARC (though they come under EU competition law), because these are considered to be policy matters for the ministry, despite the potential distortions to competition.

Germany's laws about *unfair competition* have probably tended to impair competition more than they have promoted it. Some protectionist rules (for example on discounting) are now being eliminated or corrected, encouraged by EU legislation. Two laws that made rebates more difficult were repealed in 2001. Some important protectionist legislation remains, not least the Unfair Competition Act (UCA) which can be used to prevent price competition, and which is still applied in ways that underestimate the extent to which consumers may be able to look out for themselves. A revision of the UCA is underway to reflect EU developments, and to give more weight to the interests of consumers, though Germany is seeking to preserve the rule against sales below cost.

Competition policy recognises how consumers benefit from it, but *consumer policy* is not closely linked and there is no strong national consumer protection authority. Enforcement of the rules on unfair practices or misleading advertising is left to private litigation by competitors or consumers. In the context of the EU Green Paper on consumer protection, Germany has argued against new and stronger consumer protection structures, a position that implies faith in the power of the informed consumer and the competitive market. Germany also does not support mutual recognition of rules in the EU because it would threaten what it believes to be its higher-level protections.

Competition policy institutions and enforcement

Germany's strongly independent institutional culture for competition issues is embodied in the BKartA

Germany's federal structure and separation of roles produce a complex set of institutions. Perhaps the most defining feature of German competition policy is the independent institutional culture of the BKartA, which is the main enforcement body. It is a federal agency, responsible to the Federal Ministry of Economics and Labour, but based in Bonn and hence geographically separate from it. Its independence results from political choice and support, not statutory guarantees. The BKartA president does not serve a fixed term, but it is politically inconceivable that he would be removed over a difference in policy. The enforcement staff are divided into 11 sections each covering particular sectors. There are also two divisions acting as procurement tribunals and a special unit for combating cartels. BKartA independence is embodied in its decision-making structure, under which actions in cases are determined by panels of staff (all career civil servants with lifetime tenure) organised like a court of law. There is no appeal to the BKartA president, only to the courts (unless the parties go the Minister on other policy grounds).

This all makes for a stable and efficient system. The BKartA is also reasonably transparent: the ARC requires public notice for many actions, and decisions are published in the Federal Gazette (albeit often in condensed form). Other information such as applications for recognition of associations' competition rules must be published. The main decisions and notices are posted on the BKartA's Web site and the BKartA must publish a formal report every two years.

The BKartA makes efficient use of its relatively modest resources for a large country and in a context of increased responsibilities

The BKartA's resources have been stable or even declining, against a backdrop of increased responsibilities (for procurement and utility industry problems) and a wider jurisdictional reach following re-unification. Total person-years were 267 in 2002, 300 with the addition of the *Länder* enforcement resources. The BKartA seems surprisingly small for such a large economy, but its distinctive and highly professional institutional culture may make it unusually efficient. Staff stability has been stirred up by the move from Berlin to Bonn, with shifts from the ministry to the BKartA and *vice versa*. This is healthy but the learning process could stretch resources in the short run. Budget support appears stable and adequate.

Until recently the BKartA concentrated almost completely on horizontal agreements and mergers. Activity increased across the board in 1999 with the new responsibilities, and there is increased attention to vertical agreements and abuse of dominance (Table 3.1).

Table 3.1. **Trends in competition policy actions**

	Horizontal agreements	Vertical agreements	Abuse of dominance	Mergers	Unfair competition[1]
2000: matters opened	55	18	79	1 735[2]	n.a.
Sanctions or orders sought	n.a.[7]	n.a.[7]	n.a.[7]	n.a.[7]	n.a.
Orders or sanctions actually imposed	3	–	5	6[3]	n.a.
Total sanctions imposed	DM 40 539 340	–	–	n.a.	n.a.
1999: matters opened	67	18	101	1 687	n.a.
Sanctions or orders sought	n.a.[7]	n.a.[7]	n.a.[7]	n.a.[7]	n.a.
Orders or sanctions actually imposed	4	1	–	7[4]	n.a.
Total sanctions imposed	DM 287 325 100	–	–	n.a.	n.a.
1998: matters opened	36	4	49	2 024[5]	n.a.
Sanctions or orders sought	n.a.[7]	n.a.[7]	n.a.[7]	n.a.[7]	n.a.
Orders or sanctions actually imposed	3	–	–	4[6]	n.a.
Total sanctions imposed	DM 21 741 350	–	–	n.a.	n.a.
1997: matters opened	26	3	19	1 736[4]	n.a.
Sanctions or orders sought	n.a.[7]	n.a.[7]	n.a.[7]	n.a.[7]	n.a.
Orders or sanctions actually imposed	2	–	1	6[5]	n.a.
Total sanctions imposed	DM 281 817 600	–	–	n.a.	n.a.
1996: matters opened	23	2	22	1 516[4]	n.a.
Sanctions or orders sought	n.a.[7]	n.a.[7]	n.a.[7]	n.a.[7]	n.a.
Orders or sanctions actually imposed	4	–	1	3[5]	n.a.
Total sanctions imposed	DM 19 394 950	–	–	n.a.	n.a.

1. In Germany, "unfair competition" falls under the Act against Unfair Competition. The *Bundeskartellamt* is not responsible for applying this Act.
2. Merger notifications per year.
3. 2 prohibitions, 4 clearances subject to conditions obligations.
4. 2 prohibitions, 5 clearances subject to obligations.
5. Merger control proceedings under the previous law which are subject to preventive and subsequent control (the most recent amendment of the ARC came into force in 1999).
6. Only prohibitions; the previous law did not provide for clearances subject to obligations.
7. In Germany, the competition authorities are the competent administrative authorities to issue orders and determine administrative fines. Therefore, sanctions or orders do not require to be requested.

Source: BKartA 2002, item 17.

The Länder have an important enforcement role too

Germany being a federal State, another set of enforcement bodies exist at the *regional level* (Box 3.4).

Box 3.4. **Federal structure and competition enforcement**

Because Germany is a federal State, there is another set of enforcement bodies at the regional level. For conduct (other than mergers) whose effect is limited to a single *Land*, the competent enforcement body is not the BKartA, but the authority designated by the local law. (Sec. 48) Each of the *Länder* has a competition office. All of these offices together comprise about 80 staff, of which about 30-35 are lawyers. The competition office in Bavaria is the largest, with a total staff of about 10, about half of whom are lawyers. The head of that office is a graduate in economics and law, and the office works with experts, including economists, from the Bavarian Ministry for Economic Affairs. Some of the offices also do procurement matters, as the BKartA does. Only the BKartA decides about mergers, but the governments of the *Länder* must be consulted in a merger matter, if the FCO proposes to prohibit it or if the parties apply for intervention by the Minister.

The BKartA and the offices in the *Länder* all apply the same federal law, because there are no *Land*-level competition statutes. But the *Länder* offices are not responsible to the BKartA. Their decisions applying the ARC are independent and final. They often work together with the BKartA, and by law the BKartA is always a party to their enforcement matters. But they may respond to local policy priorities. Bavaria, for example, has traditionally supported small business. Bavaria has issued its own guidelines about ARC compliance for small businesses, and some features of the ARC that protect small business interests represent Bavarian initiatives.

Typical objects of local responsibility are retail trade, construction and construction materials, and services. In the last few years, several have concentrated on the electric power sector. In Bavaria alone, there are 270 grid operators, and the Bavarian competition office has already handled about 25 cases about the cost of access to distribution. Taxicab service is another common source of problems, ranging from boycotts of taxi stands and dispatch services to claims of exclusion and evasion of local price regulation.

The Ministry looks after competition policy

The *Ministry of Economics and Labour* is responsible for competition policy. The BKartA does not have a regular, formal role in the policy process, though it is consulted about legislation that would directly affect the ARC. The ministry's responsibility includes monitoring the competitive effects of other regulations and legislative proposals, and responsibility for the EU dimension. But it also has a role affecting enforcement through its power (see merger section above) to authorise a cartel or merger for reasons other than competition policy. Typical justifications for going to the Minister are industry rationalisation, job preservation, or supply security.

The *Monopoly Commission* is the other independent federal body, set up in 1973 to be a politically neutral source of analysis and guidance. Its five members are appointed by the Federal President and may not be government officials or connected to industry or labour organisations. It chooses its own chairman. Its biennial report, which is presented by the

Federal government to parliament, assesses conditions and likely trends in industry concentration, appraises the application of merger control, and offers analysis on other economic issues. It can also issue special reports.

Enforcement rules and processes are well designed, and include an effective sanctions regime

The BKartA and the Land competition offices apply the ARC both through administrative work (such as reviewing notifications) and investigation and enforcement against conduct that violates the prohibitions. Proceedings can be initiated *ex officio*. A complaint is not necessary. Information is usually obtained through informal requests, backed up by formal authority that is subject to stringent due process protections. In practice, a formal request for information requires a concrete initial suspicion of a violation. Enforcing compliance with investigative requests can require going to court. A court order is needed for a search.

Enforcement action can lead to orders and substantial financial sanctions. Orders are typically prohibitory, to prevent repetition of the violation in future. Structural relief such as divestiture is not allowed, except in merger cases. Administrative fines are generally up to three times the additional proceeds obtained as a result of the violation or EUR 500 000. The fixed sum is not a minimum or mandatory fine, but it is intended to ensure that a significant fine could be imposed even if the gain from the violation is not great. This approach is consistent with economic theories of deterrence. Fines can be levied against natural persons as well as legal persons and associations. The BKartA's discretion in setting fines is broad enough to support a leniency programme, to encourage members of a cartel to come forward with evidence.

Appeals from BKartA decisions may be taken to the Court of Appeal at Dusseldorf (a new location with the BKartA's move to Bonn, so this court must now develop expertise in competition matters). Appeals from decisions of the Minister also go to the Dusseldorf court. Appeals from *Land*-level decisions go to the local Court of Appeal. A further appeal on points of law is possible to the Federal Supreme Court. Special chambers in these courts enable competition cases to be handled by a small group of judges who develop expertise in the subject. Appeals normally suspend the order being appealed. This makes it difficult to use competition law effectively where the problem is access or refusal to deal. The upcoming energy law reform would make network access orders effective immediately (though this will need to be put to practical test).

Private law suits are a significant, but difficult, enforcement alternative

The main alternative to public enforcement is private law suits. These are significant, although there are obstacles to success. Most of the Supreme Court's rulings about the ARC have been in civil law suits. Claims for private relief are based on violations of "protective" provisions of the ARC (prohibitions against horizontal cartels and abusive practices). The protected parties are typically competitors who are excluded from the market (consumer complaints about horizontal cartels have not been welcomed by the courts). It has been generally difficult to claim damages from a horizontal cartel because of the German civil code's historically stringent requirements to prove causation and the amount of damage, though the approach seems to be opening up. Civil actions for injunctions are also unattractive: the usual rule is that costs (including legal costs) are paid by the losers (the BKartA is not excluded from this).

The option of challenging BKartA inaction is circumscribed, and so far the courts have denied that parties have any right to compel the BKartA to exercise its powers to control abuse or challenge a merger.

Competition policy in the EU and international context

Changes in EU competition law raise important challenges for the German approach to competition policy

The upcoming modernisation of EU competition law procedures will increase the responsibilities of member State authorities for applying the competition provisions of the EU treaty, so this part of the BKartA's activity is likely to become more important. The changes present a particular challenge, because the German conception of competition law and its approach to enforcement differ from the new EU model (Box 3.5). A complicating

Box 3.5. **The challenges of EU competition law for the German approach**

The Monopoly Commission heavily criticised the draft proposed regulation that led to Reg. 2003/1. A fundamental complaint was that asserting the primacy of EU rules would disable national agencies from resisting the politicisation of EU competition policy and would undermine the clear separation of roles between the BKartA and the Minister in the German system. Its concerns illuminate the distinctive aspects of German competition law and tradition.

The Monopoly Commission called attention to variations in substantive law and to the tools in German law that are absent from EU law. For example:

- The classification of cartels is more systematic in German law than in Article 81, leaving little room for enforcement discretion.
- Abuse control is more clearly differentiated in the ARC's Secs. 19(2) and (3) than in Article 82.
- Relative market power, an important issue in German law, is absent from Article 82.
- A dominant firm has a greater obligation to provide access to its essential facility under German law, because it has the burden of showing that access is impracticable [Sec. 19(4)].

Even where texts appear similar, variations in doctrine matter. For example, the Monopoly Commission pointed out that the EU treats price recommendations as a species of agreement, considering the 2 parties as equivalent. By contrast, Germany regards these recommendations as one-sided, to be supervised as a species of abuse. The Monopoly Commission feared that the EC's proposed assertion of jurisdiction, which would not depend on an international competitive effect, might promote the tendency of EU law to deny the anticompetitive significance of most vertical restraints, a result that the Monopoly Commission did not support. The German approach based on control of abuse, though seemingly more lenient that the EU approach based on prohibition, might actually produce stricter control of vertical agreements, depending on how it is applied and on the breadth of the exemption from the EU prohibition.

Pointing to decisions under German law that could not have been reached under EU law, the Monopoly Commission claimed that the new regulation would be "moving away from well-proven national law and so tolerating a reduction in the protection of competition".

Source: Monopoly Commission, 2001.

factor is that the BKartA can apply both German law and EU law, but the *Länder* offices can only apply the ARC.

Co-ordination with other enforcement bodies is extensive and mostly informal

The ARC contains a broad "effects" test, and thus it applies to conduct anywhere that affects competition in Germany. But the converse is not true (for example export cartels are not covered if their only effect is outside Germany). Co-ordination with other enforcement bodies is extensive and mostly informal. It includes a couple of bilateral treaties on judicial assistance (one is currently under negotiation with the US). The mutual, shared, interests of national competition enforcers are increasingly recognised. The BKartA has worked informally with most competition authorities on merger cases. In a cartel investigation that also involved the US, the BKartA co-ordinated its own search action to coincide with the US action.

The limits of competition policy: exemptions and special regulation

SMEs are a favoured class for protective treatment

The quasi-constitutional heritage of the ARC might imply an unusually broad application of competition principles. But the scope and nature of exceptions are similar to those in most other OECD countries. A few are evidence that enforcement has been serious, as the prospect of BKartA action led the legislature to enact protection against it. Competition law defers to the demands of other laws in the event they conflict (as may happen, for example, with the health and social welfare system, and professional services). Publicly-owned enterprises must comply with the ARC with a few exceptions. Many, notably the postal services and municipal utilities, have been targets. SMEs are not technically exempted, but are a favoured class. The ARC gives SMEs tools to shield themselves against aggressive competition and hard bargaining from larger firms, and permits them to combine and co-operate, under certain conditions. For example SME purchasing co-operatives may be exempted from the cartel prohibition. The ARC's solicitude for SMEs is consistent with other policies to support the *Mittelstand* (Box 3.6), reflecting its importance and influence in Germany.

The network industries raise challenges for effective use of the ARC

The broad conception of the ARC and BKartA emphasises the unity of competition policy, and this disfavours special rules and regulators for competition in individual sectors. Also, there is a preference for local authority and private initiative. So Germany has traditionally favoured self-regulation subject to oversight by the competition enforcement bodies. The sectoral exclusions from the competition law that do exist are often aimed at avoiding the application of ARC prohibitions to conduct that is probably not anti-competitive. However the attitude to sectoral arrangements is changing, partly encouraged by EU legislation. Notably, Germany now has a regulator for telecommunications and postal services, and a decision has been announced to establish a regulatory authority to oversee the energy networks. The Monopoly Commission, for one, has come round to the view that natural monopolies need to be controlled through a regulatory process.

Arrangements for the *energy sector* (Chapter 5 gives more detail) are in a state of flux with this announcement. With liberalisation, exemptions from ARC prohibitions were repealed. The main basis for the control of market power is the ARC, via the BKartA and the *Länder* competition offices. The BKartA set up a separate unit in summer 2001 to deal with

Box 3.6. **Crafts and professions**

The ARC's solicitude for small and medium sized enterprises is consistent with other policies to support and protect the *Mittelstand*. Some systems of regulation that shelter smaller scale operations have been criticised for raising the costs of entry, preventing efficient business structures, and limiting consumer choices.

Master-crafts qualifications: For 94 defined services and crafts, a master's certificate is required in order to operate independently and own a company in the field. The system is the linear descendant of the medieval guilds. It has survived several rounds of efforts at reform since the beginning of the industrial era. Like the old guilds, the chambers of these crafts and services have some self-regulatory powers. The holders of the master's certificates are active on the boards that set the rules and standards for their trade. Obtaining a master's certificate requires 1 000-1 600 hours of formal training, in both technical subjects and business administration. Fees for training may range from EUR 3 000 to EUR 7 500 depending on the trade. Preparation for the master's certificate examination takes about a year if pursued full-time; in this case candidates must forgo a year's income in addition to bearing the expense of training fees. Candidates preparing for the master's certificate examination part-time usually do so in addition to their regular occupation. Depending on the trade, such preparation may take between two and two and a half years until the master's certificate examination. The costs imposed by this system discourage entry. Certification of high qualifications may provide customers with useful information and assurances, at least in some of the service areas. For many, though, restricting entry only to the most highly qualified probably leads to "gold-plating" and inhibits provision of acceptable, lower-quality, lower-priced services. The apprenticeships associated with the system are credited by some with performing a vital role in training workers for industry as well as for the crafts trades themselves. Apprentices who do not pursue the master's qualification, perhaps because they cannot afford it, often go to work in the same trade in industry. The training aspects of the system were recognised as a "best practice" in a 1998 EU study.

The master-craftsman system of training, certification, and entry control has come in for criticism. The Deregulation Commission report in 1991 explored the anomalies and recommended reforms, principally to open up new opportunities for providers who are technically capable but who cannot afford the time or expense of obtaining master's certification. The Deregulation Commission suggested this could be done by focusing on the apprenticeship system. Holders of master's certificates would continue to be the only ones who could take on and train apprentices. Removing the master-crafts qualification for doing the work would permit more providers to go into business for themselves, improve management opportunities, and increase competition.

Since then, the Monopoly Commission has repeatedly called for reform, in its regular report for 1996-97 and in a May 2001 special report. The latest report noted a decision by the European Court of Justice which in effect magnified the discrimination between master-craftsmen in Germany and competitors from other EU member States. The EU Commission argued that this awkward result should support a long-overdue thorough reform in Germany. Otherwise German firms would lose business to other providers, at least for one-time, unusual, or near-the-border work. Meanwhile qualified providers in Germany, frustrated at their inability to establish a German company because they lack the master's certificate, are setting up companies in other EU member States for that purpose, even to provide services in Germany in some cases.

Box 3.6. **Crafts and professions** *(cont.)*

Germany's Constitutional Court has ruled that preventing anyone without a master's certificate from establishing a company restrains a constitutional freedom, the right to enter a business. That ruling still left it up to Parliament to regulate access, though.

Professional services have also been regulated to prevent competition and preserve small-scale, local operations. Rules of professional associations that limit the competitive freedom of their members are exempted from the ARC because they are authorised by other federal laws. Examples include schedules of maximum and minimum fees for lawyers, architects, engineers, and doctors. These rules may be contained in bylaws pursuant to legislative authority. Even if they are exempt from the ARC, the rules may not be entirely beyond the reach of competition policy, because they might still be subject to European cartel law if they affect trade between EU member States. Restrictive rules may also be subject to constitutional scrutiny. Germany's courts have relied on the guarantee of the free choice of profession, in Article 12 of Germany's Basic Law, to limit constraints on providing professional services. Legislation that prevented truthful, informative advertising is being relaxed in some areas, such as accounting, engineering, and architecture, although not for doctors. Since 1994, a form of professional incorporation has enabled inter-professional co-operation that previously had been prevented, and lawyers gained the right to form limited liability companies in 1998.

electricity network problems, and numerous cases have been taken forward, mainly over excessive fees for network access. The terms for network access have been set by industry negotiation (the "Associations Agreements") rather than regulation (negotiated access rather than regulated access). The BKartA has expressed concern that these Agreements could facilitate agreement on prices. The industry was tasked with developing a better set of Agreements by the end of 2003, and the ministry reported on the performance of the negotiated access system in September 2003.

Using the ARC to promote competition in network industries is, in short, proving difficult. None of the ARC's actions has yet reached a final decision. The Monopoly Commission concludes that the negotiated access system is not leading to much interconnection. Market structure is part of the problem. A series of mergers in the last few years (nearly all approved by the BKartA) has reduced the number of independent power producers and extended vertical integration. Competition in the gas sector – which is also subject to negotiated access – is developing even more slowly.

Arrangements for the *telecommunications sector* (Chapter 6 gives more detail) have been handled differently. A regulator (the Regulatory Authority for Telecommunications and Post – RegTP) was set up by the Telecommunications Act (TKG) of 1996. Its main task is to regulate *Deutsche Telekom* AG (DTAG), the successor to the State-run monopoly, where it is dominant. To some extent the TKG displaces the ARC. The BKartA has merger control authority, although RegTP also has powers that affect mergers. There are both substantive and procedural links between the sectoral regulation and the ARC. For example, the TKG's requirements for financial transparency, rate approval, interconnection control and access depend on a finding of dominance through the ARC. The Monopoly Commission must make a status report on developments in both the telecommunications and postal sectors every two years.

Despite the specific arrangements for regulated access (intended to be expeditious), there are problems. Delays have arisen from numerous challenges to RegTP decisions, despite "fast track" procedures and a principle that RegTP decisions are to be immediately effective. DTAG has gone to court to resist RegTP's oversight efforts with some success, and has resisted disclosing its costs.

Postal services are subject to a monopoly authorised by the Postal Act which leaves little room for application of the ARC. The exclusive right of Deutsche Post AG (DP) was recently extended to 2007, though its scope is shrinking. The Postal Act regulation – which includes licensing and price control – has an important effect on competitive conditions. DP has certain financial advantages over competitors, and the EU Commission has found fault with the use of federal transfers to support DP's activities in competitive markets.

Competition law has some limits in *passenger transport*. The sectoral legislation exempts agreements among associations of regional and local passenger service (bus and train) providers (to allow connecting services and combined tickets). Mainly, competition is constrained by public sector regulation of rates and conditions of service, which take precedence over the ARC, and by slow and cautious restructuring. Deutsche Bahn AG (DB) has been restructured to separate the track from train services but accounting separation is as yet incomplete and DB remains sole owner, which undermines the effort to determine appropriate terms for track access. The Federal Railways Authority oversees access and timetables to prevent discrimination, and the BKartA also has the power to deal with abuse. Other providers now account for just 7% of passenger service, mostly at local level, though this is expected to increase. Non-DB providers are a more significant factor for freight service, though track access is a problem. The BKartA has found that DB's pricing system was discriminatory and non-transparent, and DB has made changes, but access issues in particular remain.

Access issues need to be tackled through strict managerial and accounting separation at the minimum. However the German Act on Corporations renders strict managerial separation impossible as managers of subsidiary companies have to act in the interest of the whole concern. Ownership separation may therefore be the only legally sound way of solving this problem. The Monopoly Commission has recommended stronger measures than exist today.

Public supply of *water,* which is mainly provided by municipally-owned utilities, remains exempt from the ARC, for reasons of public health and pollution control. Rates are high compared with others in the EU though quality is high too. Improvements could be promoted through greater use of benchmarking, expanding the geographical coverage of individual waterworks, and competitive tendering of water contracts.

Other sectors benefit from exemptions and special treatment, which is not always fully justified

A number of other sectors come under special arrangements and exemptions. Agreements involving the *agricultural sector* are excluded from the ARC prohibitions, as long as they do not fix prices or exclude competition. This is to allow for special conditions that limit market responsiveness, such as the weather. One exemption remains for agreements among *credit and insurance firms* concerning risk and loan syndication. *Statutory health insurance funds* are now in effect exempted from the ARC, because they are not considered undertakings (which would be subject to the ARC). Aspects of EU law may still apply.

Copyright societies are exempt from the basic prohibitions against horizontal and vertical agreements (though they would be subject to control for abuse) to help ensure the effectiveness of individual rights. *Sports broadcasting* is subject to certain exemptions, to help ensure that non-competition objectives such as youth training and sports can be promoted. Another media-related exemption applies to areas regulated by treaties, including the "treaties" among the *Länder* about the scope of *commercial television* and the distribution of fees among TV stations.

As regards the *media* the Lander are generally responsible for licensing private radio and TV operators and assigning broadcast frequencies, a role that is explained by their legislative competence concerning cultural matters. Media concentration and viewpoint diversity in national private broadcasting are overseen by the Commission for Investigating Concentration in the Media Sector (KEK).

An important sector with special treatment, which predates the competition law, is *publications*. The ARC continues to reflect this with an exemption for the imposition of resale prices by publishers, though it appears to authorise "rule of reason" treatment (the practice may be voided under certain conditions). The BKartA examined the market effects of the exemption in the 1970s when it found that prices in Germany were 2 to 3 times higher than in France for a category that was subject to different treatment in the two countries. The arguments advanced for resale price maintenance include promotion of cultural values, cross-subsidisation of low-demand products to encourage innovation and viewpoint diversity, and preserving an industry structure of SMEs throughout the country. A new law in 2002 – to counter an EU finding that the provision violates EU law – makes the protection even stronger, by requiring resale price maintenance for books, sheet music and maps.

Competition advocacy for reform

The BKartA has a limited policy and advocacy role: could it do more?

The Monopoly Commission has become the main source of analysis and advocacy about regulation and competition, through its biennial reports which examine topical issues as well as business concentration and merger control. It also now reports regularly on the state of competition in telecommunications and postal services. It also produces occasional special opinions, at its own initiative or at the request of the Federal government. Its work has, notably, drawn attention to problems with the master-crafts system and with network access.

The BKartA's role in policy and advocacy is limited. In the past, its policy comments ranged more widely. In the early 1990s (in the context of legislative proposals) it commented on a range of important issues such as the media laws, telecommunications policy and private competition with public service providers. Today it concentrates on infrastructure issues and its enforcement role. The BKartA's isolation from general debate about competition policy at first appears surprising, given the traditionally paramount importance attached to the competitive process in the social market economy. But the same tradition also emphasises independence in the application of the competition law. A strong ethos of impartiality can give the comments of an independent body considerable weight and authority. But that capital is a valuable resource, and there may be a concern that spending it too freely in contentious policy debates could undermine enforcement credibility.

Conclusion

Germany's competition law is an important heritage. The ARC was enacted to be a foundation of the post-war political economy, and must therefore take at least some of the credit for the success that followed. The institutional structure has been notably successful, within the law's defined sphere. The BKartA is widely respected and from the beginning has had a strong sense of mission, motivated by belief that the law it applies is "synonymous with the very principle of Germany's economic order". The institutional disruption attending the recent move to Bonn may challenge its confidence and capacities: its future efficiency depends on maintaining the traditional *esprit*. Methods tend toward legal formalism (as might be expected in the German context) but the implied presumptions behind the rules promote efficiency and are consistent with economic policy goals. The core of the law is well-balanced, and can now draw on nearly 50 years of precedent and experience. The rules about horizontal cartels send a clear message about the importance of competition while permitting efficient co-operation.

The law's motivating ideas have, however, become diffuse and in some respects have weakened over time through legislative fine-tuning of the rules and the special-interest character of some of these changes. Another issue concerns the key goal of the law to protect market relationships and structures. This needs to be tested against economic standards of market performance and encouragement of innovation, to be sure that the pursuit of this goal is not promoting the status quo and actually preventing competition. The risk is clearly present: for example (and notwithstanding the repeal of laws which made discounts difficult) the unfair competition rules which discourage discounts and give consumers too little credit for being able to look out for themselves.

The link between the law and competition policy is limited, because the law is institutionally separated. There are good reasons for this: it insulates the BKartA from political pressure and promotes its independence, which is a great asset. As the BKartA confines itself to applying the law, competition policy is with the Ministry. The reports of the Monopoly Commission inform policy debate too. But the latter cannot speak with the same authority as the BKartA, and the Ministry's capacity to advocate effective competition-based reform can be compromised by its role in promoting other policies, as shown in the recent action in the gas-electricity merger. Recourse to the minister has been rare, but two major mergers have been taken there within the past year. This process was not intended to be routine. If disappointed parties resort to it too often, it may be necessary to devise more stringent standards to discourage what may appear to be an effort to second-guess the BKartA's judgment.

The challenge of dealing with the changes in EU competition law and enforcement is a large one, and perhaps the most important issue facing Germany's competition law today. The BKartA rests on a distinctive system which could become an anomaly in Europe. An extended process of experiment and co-evolution is likely. Despite moves toward EU practices key underlying approaches remain fundamentally at odds, such as the EU system's reliance on administrative discretion and general criteria for exemption, rather than Germany's more systematic notification and clearance based on clear rules.

Regulatory reform has difficulty finding a place in the German system of competition law and policy. As an agent of effective change in liberalising sectors, the system falls short. Reform is not well served by the disconnection between competition law enforcement and policy. And the ARC is not well suited for implementing competition

policy principles in infrastructure sectors where competitive structures have not yet taken root. The usual methods of analysis and proof are hard to apply. The experiment of self-directed industry co-ordination subject only to antitrust oversight is now giving way to a regulatory solution. This incremental approach to reform does have the merit of clearing the way for other measures, where an experiment founders.

Policy options for consideration

1. Empower consumers by encouraging entry and competition in craft services and professions.

The high costs of qualification and the limitations on offering services increase the cost of entry and inhibit innovation. Moreover, they undermine the process goals of German competition policy, by reducing opportunities for producers and denying consumers the choice of different combinations of price and product quality. To be sure, in some of these fields – but not all of them by any means – there are information asymmetries that support maintaining standards, especially to protect uninformed or vulnerable consumers. But experience in other countries shows that less intrusive regulation can maintain sufficient protection while improving market outcomes. The pending ministry draft of a new Act Regulating the Craft Sector would respond to some of the criticisms of the current system, by limiting the master-craft qualification requirement to services that could endanger health and life, and by permitting others with sufficient experience to offer services in the field.

2. Reform protectionist marketing rules for the modern economy of informed consumers.

Regulations have protected incumbent producers and retailers against marketing innovations, while giving consumers too little credit for being able to protect themselves. Some of these constraints are already changing: the Discounts Act, which dated from 1933, and the Gifts Ordinance of 1932, were abolished in 2001. The trend is thus in the right direction, but the pace of change is slow. Changing shop hours did not revolutionise the schedule of daily family life; people continue to shop mostly during the times that they have been used to. Thus fears that change would rip apart the fabric of society were unfounded. A similar muted response is likely to follow relaxing the constraints on discounts and sales, which is promised in the upcoming reform of the unfair competition law. That reform should go further, and eliminate the formalistic prohibition of sales below "cost price" in the absence of any risk of predation or monopoly. That prohibition, which probably tends to sustain higher price levels along the distribution chain, ignores the reality of modern merchandising by requiring that market offerings be decomposed into individual "things." Consumers who respond to discount offerings and patronise mass merchandisers may find they prefer the corner store. Or they may not – and if they do not, it is because they have concluded that the alternative makes them better off.

3. End the anomalous special treatment for the publishing industry.

Mandating conduct that would be prohibited per se in every other sector of the economy is difficult to justify. To be sure, the sector has unusual characteristics, including very low marginal costs and highly variable prospects for success. Most items are losers, a few are big winners, and it is hard to tell in advance which will be which. Some means of spreading risk and sharing the windfall is inevitable. But doing so through an explicit

exemption undermines the consistency of competition law. More importantly, the goals, including supporting experimentation and viewpoint diversity, can be achieved by less disruptive means. In older distribution systems, these might take the form of sales through consignment or generous return policies, putting the risk on the publisher. In modern distribution environments, they might be sophisticated inventory control, overnight delivery, and distributed, just-in-time manufacturing of slower-selling items. In each setting, a recommended retail price, which could be permitted under the ARC, probably would achieve all of the legitimate purposes of the complete exemption. Even in small language markets, such as Sweden, experience has shown that allowing competition about retail prices need not reduce consumer choices, although it could lead to different systems of distribution.

4. Reassign disputes over the terms of network industry access to a single regulator.

Recognising the difficulties that have already been experienced in trying to promote reform through antitrust enforcement, the government has announced its intention to shift this function to a regulator in 2004. Details remain to be worked out. One important one is the institutional form and location, whether it will be connected to the BKartA or built on the existing network regulator for telecoms.

5. Raise the profile of competition advocacy and policy analysis.

This function has been left to the Monopoly Commission, except for matters that directly concern competition law enforcement. That body has the necessary technical expertise, professional stature, and political independence. But it does not have many resources. It is wasting some of the resources it has in obeying the statutory command to generate meaningless reports about industry concentration. The results are not useful for enforcement and not relevant to policy. The function is a relic of the political temper of the era when merger control was added to the law in order to challenge monopoly capital. Eliminating this reporting obligation would make time and resources available to deal with modern problems. In addition, the BKartA should reconsider its currently limited level of engagement in policy analysis and advocacy, other than concerning the content and application of the ARC itself. Although the Monopoly Commission is now a well-established institution, its purely advisory role might make its advice easier to ignore. To be sure, involvement in policy controversies can use up political capital and expose the enforcement body to some risks. Those potential costs counsel a judicious choice of opportunities for BKartA advocacy, perhaps concentrating on matters that implicate conduct which, but for the regulatory scheme or proposal at issue, would be covered by the ARC. Clearer formal authorisation should be considered, if that would facilitate the BKartA's performance of a wider advocacy role.

6. Consider enlarging the BKartA's staff resources.

The staff of the BKartA is about the same size it was a decade ago, with recent additions attributable only to its new responsibilities for procurement disputes. Differences in jurisdiction, powers, and processes make exact comparisons with other competition agencies imperfect. Even so, the BKartA looks surprisingly small compared to the agencies in many other countries – no larger than the competition policy staff of the UK's OFT, and well below France, Canada, and the Netherlands – and the addition of the *Länder* offices would not make up all of the difference. Professionalism and experience may

mean BKartA can do more with less. Some pressure will be relieved when electric power matters are transferred to a network regulator. But the likely increase in activity as EU modernisation is implemented will likely demand a larger staff.

7. Improve tools for dealing with network industry relationships and decisions.

Efforts to apply the ARC to network industry access situations have exposed some potential problems, in information gathering methods and in rules for addressing vertical relationships. The urgency of resolving these problems depends upon how quickly these cases are transferred to a network regulator. Pending that transfer, they may require some attention. Problems of getting information stemmed principally from controversies about what kind of information would be relevant. Now that the Court of Appeal has decided that enforcement of the ARC can be based upon costs as well as comparative prices, the purported irrelevance of cost information is not likely to be raised again as grounds for resistance to requests for that information, at least not so broadly. Controversies about details will probably recur. Increasing the sanctions for non-compliance with information requests or changing the procedure for obtaining information are not likely to be either necessary or feasible. The level of sanction is not relevant, because the courts do not in fact impose it. A process that exposes a party to sanctions without a hearing in court would not be acceptable. Obtaining information appears to be an increasing problem for German agencies. RegTP has had difficulty getting basic cost data from DT. The BKartA has not complained that its investigative tools are inadequate, As its practice extends to more foreign firms that do not have a history of co-operation with the BKartA, it may find more coercive methods to be necessary, though.

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APPENDIX

Appendix Tables

Table A.1. **Sectoral regulatory reform in Germany**

Industry	Key legislation/regulatory framework	Regulation on prices	Regulation of entry and exit	Other regulations	Remaining regulations on prices, entry, exit	Other remaining regulations
Telecommunications	Fully open to competition since 1.1.1998. Competition-oriented regulation in principle covers all telecommunications markets.	Sector regulator (RegTP) controls the market on *ex ante* and *ex post* basis.	Free entry and exit. (Proof of reliability and professional qualification); access regulation (interconnection, essential services).	Carrier-selection and pre-selection for local calls introduced by law since 1.12.2002, implementation of CbC 1.5.2003, pre-selection in summer.		Universal service obligation exists but without practical impact.
Electric power	Market liberalised in 1998. All customers free to choose supplier. Conditions for network access determined by Associations Agreements. *Ex post* control through BKartA/courts. Introduction of regulatory authority planned.	No *ex ante* regulation. Abuse control by BKartA/courts on the basis of competition law and/or the Act Against Unfair Competition. Tariff approval (small consumers via low voltage electricity networks) by State agencies (relevant for retailers, who are also entitled to special contracts).	Supply of electricity does require specific approval (however, specific activities are not included); reasons for non-approval are legally fixed. No specific regulations for exit.	Minimum quotas for "green" electricity purchased at regulated prices, compensated by fee on some consumers.		Universal service obligation exists but without practical impact.
Natural gas	Market liberalised in 1998. All customers free to choose supplier. Conditions for network access determined by Associations Agreements with quasi legal status. *Ex post* control through BKartA/courts. Introduction of regulatory authority planned.	No *ex ante* regulation. Abuse control by BKartA/courts on the basis of competition law and/or of the Act Against Unfair Competition.	Supply of natural gas does require particular approval (however, specific activities are not included); causes of decline for approval are legally fixed. No specific regulations for exit.	Notification of long-term natural gas supply contracts (longer than 2 years).		Universal service obligation exists but without practical impact.
Insurance and banking	Liberalisation of insurance market in 1994. Abolishment of insurance monopolies and *ex ante* control of insurance products. Phasing out of State guarantees for State-owned banks by 2005.	None.	Comprehensive licensing requirements and on-going financial supervision in compliance with globally accepted core principles including minimum capital requirements and professional qualifications. Supervisory powers include withdraw of licence.	On-going financial supervision in compliance with globally accepted core principles. New Federal Financial Supervisory Authority effective 1 May 2002 for banking, insurance, securities/asset management supervision with involvement of the Central Bank in the on-going supervision of banks.		Some agreements among health insurance funds are not covered by the competition law.

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Table A.1. **Sectoral regulatory reform in Germany** *(cont.)*

Industry	Key legislation/regulatory framework	Regulation on prices	Regulation of entry and exit	Other regulations	Remaining regulations on prices, entry, exit	Other remaining regulations
Railways	State monopoly transformed into joint stock company in 1994. Partial unbundling of infrastructure and train services in 1999. Currently guidelines of EU (first railway package) and results of task force of government "Future of railways" are put into practice.	Supervision by Federal Railway Office (mainly technical issues and track access and abuse control by BKartA *ex post i.e.*, prices for track access).	Proof of professional qualification. Free entry and exit.			
Air transport	National carrier privatised in 1997.	Unregulated pricing subject to abuse control by BKartA *ex post*.	Free entry and exit within EU.	Bilateral treaties on air traffic.		
Road transport	Partly liberalised market for occasional bus services; abolition of contingents for freight transport in 1998.	Prices fixed by the operator of regular bus services (approved by competent authority) and occasional bus services; prices for taxi services fixed by competent local authority. Liberalisation of freight rates in 1994 for road haulage.	Proof of professional qualification, financial and personal liability for carriage of passengers and road haulage. Restricted entry for taxi services.			
Postal services	In 1989 the integrated post and telecom operator was transformed into three enterprises (telecom, post, and bank); transformation into joint stock companies in 1995 with partial privatisation afterwards. Partial monopoly rights (to date for letters up to 100 g) were granted in return for universal service obligations; market opening for letter above 100 g and outgoing letters to foreign destinations.	RegTP is regulator and supervises price setting of dominant carrier(s) (letters *ex ante* regulation; other postal services *ex post* regulation).	Entry for the delivery of letter post items up to 1 kg is subject to a licence (licences are not restricted, except for the exclusive right area, now set at below 100 g). Some competition for Deutsche Post AG for letter services with added value. Free entry and exit for parcel and courier services where many companies entered the market long ago.			

Table A.1. **Sectoral regulatory reform in Germany** *(cont.)*

Industry	Key legislation/regulatory framework	Regulation on prices	Regulation of entry and exit	Other regulations	Remaining regulations on prices, entry, exit	Other remaining regulations
Pharmacy	Regulated sector.	Uniform prices for drugs that may only be sold by pharmacies (including prescription-only drugs).	Proof of professional qualification and citizen of a European Union State. Free exit and limited entry as neither pharmacy chains nor non-pharmacist owners are permitted.	Pharmacies restricted in products that may be carried; some restrictions on advertising. Subject to retail restrictions on opening hours, with modifications.		
Retail sector	The Gifts Ordinance and the Discounts Act were lifted on 31 July 2001. Opening hours recently further liberalised (takes effect from 1 June 2003). Act against Unfair Competition to be revised: regulation of special sales to be abolished.	Ordinance on proper price quotation. Act against Restraints on Competition forbids sales below purchase costs.	Free entry and exit; notification in register of companies and register of commerce. Construction license demanded outside town centers, even if change of use of an existing building for retail is intended.	Some locations are exempted from opening hours limit (gas station, railway stations). Ordinance on Packaging requires outlets to charge deposit for certain types of packaging and to recollect used packaging.		

Source: OECD.

Table A.2. **Potential impacts of regulatory reform in Germany**

Industry	Industry structure and competition	Impact on output, price, and relative prices	Impact on service quality, reliability and universal service	Impact on sectoral wages and employment	Efficiency: productivity and costs
Telecommunications	State monopoly in long distance and international services replaced by competition, mostly local monopolies in local connections, but some competition is developing.	Significant decline of prices for long distance and international calls, some decline for local calls.	More freedom of choice for customer.	Positive employment effects (since 1998).	Acceleration of productivity and declining unit costs.
Electric power	Regional legal monopolies replaced by oligopoly. Entry mostly on retail level and for renewables.	Prices have decreased, in particular for industrial customers.	More freedom of choice for customers, but relatively low rate of switching in reality. However, many customers have renegotiated prices.		Higher level of productivity.
Natural gas	Regional legal monopolies replaced by oligopoly at retail level, duopoly remains at import level and generally monopoly in transport.	Prices have developed in line with prices in other European countries. No relative decline.	More freedom of choice for customer; customers have renegotiated prices. However very low rate of switching in reality.	Wages still above average; employment decreased.	Increase in productivity.
Insurance and banking	Competitive market, with trend towards consolidation and mergers.		Improvement of service level due to ICT applications.	Negative employment effects.	Increase in productivity.
Railways	Increasing intramodal competition in the freight market; increasing competition for the provision of (subsidised) local passenger services; beginning intramodal competition for long distance passenger services.	Output by and large constant in the freight market with probably declining prices and declining market share of rail transport; output increase for local services even prior to public tenders, with partially shrinking subsidies per train kilometre; output by and large constant in the market for long distance passenger services. Successful entry of one competitor.	Improvement of service level due to ICT applications. Service level is generally good, so is reliability. Significant improvements of service level for local services.	Negative employment effects.	Increase of productivity.
Air transport	Competitive market.	Decreasing prices and new entry of several carriers.	Service level is good, as well as reliability.		
Road transport	Many small suppliers. Competitive market for road haulage.	Decreasing prices.			
Postal services	Partial monopoly.	Prices slightly falling in real terms.	Limited choice for customer, apart from courier services.	Decreasing employment.	Productivity increase.
Pharmacy	Potentially competitive.				
Retail sector	Competitive market.		Increased service level due to liberalised opening hours.		

Source: OECD.

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Table of Contents

List of Boxes

List of Tables

List of Figures