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Germany

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This chapter presents an overview of the most important areas of German competition policy, with special emphasis on its international aspects. From the German point of view, the most important international aspect concerns the development of competition policy in the European Union (EU). German policy goals for the institutional framework of EU competition policy and Germany's attempts to influence that policy are based on a strong conviction that German competition policy has a successful history. To understand the potential conflicts arising from a globalization of competition policy, it is therefore most important to clearly understand the philosophy of German competition policy and how it is translated into practice. As a result, this chapter is in large measure an exposition of German competition policy. Policy decisions are explained on the basis of the underlying philosophy and evaluated from a welfare economics perspective. Differences between German and other competition policies are pointed out where appropriate.

I begin by giving a brief background on the history of German competition policy, the philosophy underlying the policy's past 30 years, and an exposition of the main aims of competition policy today. I also discuss the important subject of the governance of competition policy. The next section discusses the main pillars of the original 1958 Law

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against Restraints of Competition: cartel prohibition, industry exemptions, and the control of abuses of "dominant position." The chapter then turns to merger policy—the currently most important policy area—to the policies toward vertical restraints of competition, and to a review of the policies toward research and development cooperation. Finally, I place German competition policies in the international context, in particular discussing issues that arise from European integration and EU competition policy. Furthermore, the relationship between German competition policy, industrial policy, and Germany's attitude to strategic trade policy are discussed.

Development and Philosophy of German Competition Policy

Cartelization and Competition Policy before World War II

Before the nineteenth century, there was no modern market economy in Germany. Most professions, including trading and retail, were closely regulated by the guild system, which also controlled entry. This changed in 1810-11, when Prussia became the first German state to introduce legislation that based the economic system on the freedom to do business and the freedom to contract. This legislation was extended to the rest of Germany in 1869, shortly before the German unification in 1871. Liberalization of the economy coincided with rapid industrialization.

Already in the 1870s, cartel agreements were recognized as a policy problem. However, since the freedom of contracting was a basic feature of the laws governing competition (*Gewerbeordnung*), preventing such contracting practices seemed difficult. In 1897 the Reichsgericht (highest court of the empire) ruled that cartels did not violate the right of other parties to do business. It interpreted the freedom to do business as the right of business to be free from interference by the state in a classical, liberal sense.

This judgment opened the way for rapid cartelization of German industry. By 1905 an official inquiry conducted by the Department for the Interior (Reichsamt des Innern) found 385 cartels with about 12,000 members. Later estimates put the number of cartels in Germany in 1911 at between 550 and 600 and at 1,500 in 1923. The large number of cartels in 1923 also reflects the fact that the state used cartels to run the war economy of World War I.

In 1923 the government tried to combat the growing economic power of cartels with a regulation barring the "abuse of economic power." This earliest attempt to limit the general freedom of contracting in order to achieve competition policy goals has been widely considered ineffective. In particular, scholars point to the further growth in the number of cartels to 3,000 or 4,000 by the end of the Weimar Republic in 1933. It should be noted, however, that the measure was never intended to stop the formation of cartels but only to limit their power vis-à-vis business partners or consumers. The move also has to be seen in the context of the 1923 inflation. The government intended to have powers of price control over cartels so that the monetary reform of 1923 would not lose credibility as a result of drastic price rises by cartels. With the takeover of the Nazis in 1933, the government promoted cartelization as a means of control over national industry, presaging the planned economy of the later war years.

Overall, the pre-World War II experience of Germany was characterized by a rapid process of concentration, which accelerated during the war years. Essentially, the philosophy until 1933 was to give priority to the freedom of contracting unless market power tended to excessively restrict the interest of other market participants. Thus, a strong priority was given to keeping the government from intervening in the structure of the economy except to correct abuses of private power.

Philosophy Underlying German Antitrust Law

Two major influences have shaped current German competition policy. First, after World War II, the Allies imposed a decartelization policy, which substantially reduced the concentration of German industry. This intervention was inspired by US antitrust law but also had a political dimension. The Allies wanted to curtail the political power of German industry, which was seen as detrimental to the development of a democratic political system.

Second, German economic policy in general became strongly influenced by the German neoliberal school of economics and its idea of *Ordnungspolitik*. This school supported a free-market economy but recognized the role of the state in guaranteeing the institutional framework (or *Ordnung*) necessary for market exchange. The exclusive purpose of economic policy, according to this view, is to guarantee such a framework. The whole approach can be seen as one of setting a constitutional structure for economic exchange with the aim of guaranteeing "liberty" not only in the political but also in the economic sphere.[1]

In contrast to the nineteenth century view of economic "liberty," these policies do not aim merely at keeping the state from interfering with the market; they aim more generally at preventing anyone with economic power from limiting the freedom of others to act. While economists of

1. Economic policies aimed at guaranteeing economic structures that are conducive to competition and voluntary exchange are usually referred to as *Ordnungspolitik* in the German economic policy debate.

the neoliberal school were quite certain that such a constitutional framework would be economically beneficial, the primary motivation underlying German competition policy rules was a constitutionalist one, not one driven by economic concerns about an optimal allocation of resources (Herdzina 1987, 123).

The two roots of German competition policy manifest themselves quite clearly in the 1958 Law Against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen*, or GWB). The two main principles were that (with some exceptions) cartels were prohibited and that firms with market power were subject to control for potential "abuse of dominant position." Since then, reforms of cartel legislation have successively tightened the means of control for the antitrust authorities. In particular, the 1973 reform of antitrust law prohibited implicit collusion and introduced merger control into German law for the first time. It also prohibited retail price maintenance.[2] Later changes in the law were mainly concerned with closing loopholes in merger control and controlling of dominant position. In particular, the concept of "financial strength"[3] is now clearly established as an important factor for determining a dominant position. Other changes have mainly concerned strengthening the powers of the German cartel office in response to restrictive interpretations of the law by the courts and adapting German legislation to EU law.

Current German Competition Policy

The central concept in German competition policy today is "dominant position." Dominance is established not just by the possession of a large market share but also by a high degree of forward and backward integration. Another important factor is the financial strength of a firm. The state is supposed to prevent the establishment of dominant positions and control firms holding such positions because they reduce the freedom of other actors in the economy. In this sense, competition policy intervenes in the economy to check the growth of firms.

Competition policy essentially has two parts. Merger policy is aimed at limiting the external growth of firms. Firms that achieve dominant positions through internal growth are subject to control for abuse of dominant position. Most German competition policy falls in one of these categories. Because the courts have made it difficult to prove abuse of dominant position, actual practice seems to be rapidly converging on an

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2. It should be noted that all of these regulations had been demanded when the GWB was first put through Parliament in 1957, but successful lobbying by industry somewhat undermined the initial goal of a tight competition policy. This explains many of the exceptions, based on efficiency defenses, to the prohibition of cartels.

3. The term "financial strength" is used very loosely and often simply refers to "bigness."

almost exclusive focus on checking the external growth of firms—that is, on merger policy.

The Governance of German Competition Policy

One of the main distinguishing features of German competition policy is the institutional framework within which it is conducted. It is characterized by a very clear allocation of decision rights to specific institutions and a large degree of transparency in decision making. The main executive body of competition policy is the Bundeskartellamt, or Federal Cartel Office, which is responsible for both merger control and control of abuses of dominant position.

While institutionally subordinate to the Ministry of Economics, the Cartel Office independently decides how to treat individual cases. Further, it is restricted to competition policy and cannot consider industrial policy, public interest, or other economic policy concerns the Ministry of Economics might have. The Cartel Office is organized similarly to a court of justice, and its decisions can be appealed through general judicial procedures. In some cases, the minister of economics can overrule the decisions of the Cartel Office or courts on public interest grounds, a feature that will be discussed in the section on merger policy below. Suffice it to say here that this provision adds to the transparency of the process, because the minister of economics has to overrule competition policy concerns publicly and specify the overriding policy interests.

The Monopolkommission, or Monopolies Commission, is another important institution for German competition policy. It is a body of experts, including academic economists and lawyers, who are not directly involved in the policy process. The commission reports every two years on the state of concentration in the economy and critically reviews the Cartel Office's decisions. It can also initiate reports on areas of competition policy it deems particularly important and is usually asked to review firms' applications for ministerial exemptions. The commission's expert opinion is thus particularly important for initiating changes in competition policy practices. Finally, there is a strong federalist element in competition policy, in the sense that cartel offices of the *Länder* (i.e., the states) deal with cases of only regional importance.

Core Elements

In this section, we consider the main ingredients of the original 1958 Law Against Restraints of Competition, the GWB. The more recent rules concerning mergers are relegated to a separate section, as are the rules governing contractual vertical restraints. In this section, we discuss the three remaining elements of German competition policy rules: the prohibition of cartels, the system of exemptions from the cartel prohibition for some sectors in the economy, and the framework for controlling abuse of dominant position.

Prohibition of Cartels

The GWB prohibits cartel agreements between firms that reduce competition, particularly agreements on prices and production quotas. The general cartel prohibition is, however, significantly weakened by a series of exemptions. Efficiency defenses for cooperation and strategic trade policy concerns explicitly encroach on German competition policy via these exemptions.

Cartels on Contractual Conditions and Discounting Cartels

Exemptions for cartels on contractual conditions (*Konditionenkartelle*) and discounting cartels (*Rabattkartelle*) have probably been included in the GWB because they promise to increase market transparency for customers. This seems most credible in the case of cartels on contractual conditions, which cover the standardization in sales contracts of general business conditions, delivery conditions, and payment conditions. Agreements on prices (including discounts) may not be part of such cartels. Numbering about 50 as of 1986 (Audretsch 1989), conditions cartels are relatively important. Unfortunately, little is known about how these cartels operate and what distinguishes their practices from those of other industries in which industry organizations provide sample contracts that are nonbinding for firms (as is the case in the rental housing market). It appears, however, that this form of cartel should raise relatively little competition policy concern.

More dubious is the role of discounting cartels (or rebating cartels), which determine the discounts from a given base price cooperatively, though the base price itself cannot be subject to cooperative agreement. Such discounts would include quantity discounts or discounts for cash payments. While it is again intuitive that such agreements might facilitate the comparison of two offers for a customer, such market transparency always has a downside as well. In particular, the fixing of discounts makes it harder to grant secret price cuts to customers, which would facilitate implicit collusion. More importantly, it appears possible that, by setting discounting schemes in a coordinated manner, firms may be able to also reduce the incentives for competition on the base price.[4]

4. I have some doubts that this argument would actually be valid for the discounting strategies observed in practice. It seems that, in order to commit to high prices, firms would want to establish very drastic quantity discounts. This would reduce the incen-

Discounting cartels were initially quite important but have dwindled to an insignificant number. Part of the reason for this has been the hostile position of the Bundeskartellamt toward such agreements.

As with all legal cartels (except for export cartels), the participants in the contract have to notify the Cartel Office that they are forming a cartel. Conditions cartels and discounting cartels are legal as long as the Cartel Office does not object to them within three months after notification.

The cartel authorities have been increasingly restrictive about discounting cartels. In particular, cartels that agreed on rebates based on total turnover were initially allowed but are now prohibited. Such discounts are today interpreted as loyalty rebates, which are seen as detrimental to competition. With this change, the German cartel authorities have adapted their practice to that of the European Union.[5]

Cost-Reducing Cartels

As discussed above, allocative efficiency is not the driving principle behind German competition policy. For example, potential efficiency gains and synergies play an almost negligible role in the Cartel Office's decisions on mergers. Curiously enough, efficiency gains are the most important reason for permitting cartelization in German law. The arguments for allowing some cartels are very similar to those economists would be willing to accept as efficiency defenses for mergers (Kühn, Seabright, and Smith 1992, section 5): synergy effects and capacity reduction in declining industries. Regarding such cartels, competition policy has to consider the potential trade-off between allocative losses and gains in productive efficiency.

A classic efficiency defense is captured in the concept of a "rationalization cartel." To gain the Cartel Office's permission to form such a cartel, firms have to show they will achieve significant cost reductions through the cooperative agreement. Furthermore, these reductions have to outweigh the resulting decrease in competition between the firms. The courts have interpreted the requirement that the member firms of the cartel "improve the satisfaction of demand" by achieving efficiency gains in production to imply that such cartels cannot be formed to coordinate price rises.[6] Nonetheless, Audretsch (1989) finds some evidence

tives to lower the base price. In general, firms are much more concerned about limiting the amount of discounts.

5. Note, however, that EU law does not explicitly permit any cartels. Nevertheless, discounts based on total turnover are seen as anticompetitive in and of themselves in EU competition policy.

6. There is a consistent practice in German competition policy where cost reductions are only considered to be beneficial if they are passed on to the consumer in form of price reductions. In this sense, German competition policy is concerned only with consumer surplus.

that such cartels tend to raise prices faster than other firms in the industry. The Cartel Office can also permit the coordination of prices or the formation of joint purchasing or sales organizations "if rationalization cannot be achieved without them."

There seems to be little doubt that rationalization cartels allow firms to raise prices significantly. In this sense, we have a pure efficiency defense for cartel formation. However, it is handled quite restrictively. The main difference between the rationalization cartel and an efficiency defense for mergers is that cartels may not persist. Indeed, because profits are not consolidated within the organization,[7] competitive pressures may (and do) lead to a cartel's eventual dissolution. German cartel law thus raises the question of whether an efficiency defense for cartel formation is preferable to an efficiency defense for mergers.[8]

The grounds for allowing "specialization cartels," which typically limit participants' production to specified product lines, is harder to see. Yet in such cases, no efficiency defense is needed for the cartel to become legalized; the cartel becomes legal unless the Cartel Office objects within three months. Given that specialization cartels are numerically almost as important (20 to 30 at any given time) and given the potential constraints on competition in quality and variety, it seems rather puzzling that this form of cartel is permitted. It is somewhat comforting that the permissive way in which these collusive agreements are handled is fairly unusual in the otherwise tight framework of the law.

The most important type of cartel permitted in Germany in terms of numbers (152 in 1992) is the cooperative agreement between small and medium-size companies aimed at rationalization "as long as competition on the market is not considerably affected" (GWB). The government has in fact promoted cooperation between small companies and even issued a booklet advising small and medium-size companies how to structure such cooperation so that the Cartel Office will not object. While one might see the advantage of strengthening smaller companies in their competition with firms that hold a larger market share, this is almost certainly not the motivation behind allowing and even promoting such cartels. Making cooperation easy for small firms is rather an expression of a conscious policy of favoring small firms, derived from the idea that small and medium-size companies are of themselves desirable for society. It also reflects the considerable lobby-

7. This is also one reason efficiency gains from cartelization will tend to be smaller than those from mergers.

8. I do not want to imply that any conscious decision on the part of German policymakers has led to the differences in treatment of cartels and mergers. However, the actual practice seems to make some sense economically. The issue of whether efficiency defenses are more appropriate for cartels or mergers apparently has not been discussed in the economics literature to any extent.

ing power of the organizations representing small and medium-size industries.[9]

In the group of potentially cost-reducing cartel agreements, "crisis cartels" are also permitted. These are meant to lead to an efficient reduction in capacities by participating firms in declining industries. Although there is not much theoretical research on this subject, there may be inefficiencies in the exit pattern in declining industries (Ghemawhat and Nalebuff 1984) that could be avoided by allowing cooperation. Only one such cartel has ever been permitted in Germany.

A similarly negligible role has been played by "emergency cartels," which are cartels authorized by the minister of economics for political reasons. These cartels have been created to give the government the means to let public-interest concerns overrule competition policy considerations in particular cases. As with ministerial intervention in merger policy, this instrument has been used very cautiously. Another fairly innocuous and unimportant form of cartel is the "standardization cartel," which consists simply of contracts between firms that aim at using the same technical standards and norms.

Cartels Affecting Foreign Trade

The principal way in which trade policy has been allowed to affect German competition policy has been through rules permitting the establishment of export and import cartels. The arguments in support of them are classical trade policy arguments: such cartels could not be abolished as long as other countries allowed them and as long as German firms faced trade barriers abroad. Indeed, the United States and the United Kingdom, along with most other countries, permit export cartels. Probably because of the strong concerns of the cartel authorities about competition within Germany, import cartels have never played any role in trade policy and have not existed for 20 years. However, next to cartels established by small and medium-size firms, export cartels are the most important form of legal cartels. They are a classic, pure restraint of competition. While export cartels are illegal under EU law, there were still 53 export cartels in Germany in 1986, down from 66 in 1974.[10]

9. This can be seen, for example, in the federal government's comments on the latest report of the Cartel Office. Repeatedly, it is emphasized that the competition policies of the government will be beneficial for small and medium-size businesses, or *Mittelstand* (Deutscher Bundestag, Drucksache 12/5200).

10. Later figures apparently are not available because export cartels only concern extraterritorial markets and, as a result, do not have to be notified to the Cartel Office. German courts have also severely restricted the ability of the Cartel Office to control these cartels, as their effect is purely extraterritorial.

Implicit Collusion

The primary goal of forbidding cartels is to make the cartel contract legally unenforceable. However, cartel agreements may alternatively be enforced through punishments for deviation from cartel behavior such as price wars (as, for example, in the case of the American railroad cartel; see Porter 1985). For this reason, the GWB cartel prohibition extends beyond making cartel contracts unenforceable and threatens to fine firms that practice cartel behavior. This implies that cartel authorities are required to detect and punish implicit collusion.

The ability to act against implicit collusion had been severely curbed before 1973 by the federal courts' insistence that there had to be proof of a cartel contract between the colluding parties, in the sense of German contract law, in order for implicit collusion to be illegal. This led to an explicit prohibition of implicit collusion (*Abgestimmtes Verhalten*) in the cartel law reform of 1973. The new rule (section 25, GWB) now relates to the behavior of firms, not to their contracts.

The fact that most competition policy actions against price collusion are still conducted under the rules of formal cartel contracts and not under rules forbidding implicit collusion is probably due to the general difficulties encountered with proving collusive behavior. The legal doctrine that has developed in this context has further weakened the position of the cartel authorities in tackling implicitly collusive behavior by requiring cartel authorities to prove intent. This seems practically impossible in the absence of a written agreement. Consequently, the main role of a policy prohibiting cartels has to be seen as rendering cartel contracts unenforceable.

An Evaluation of German Cartel Policy

The large number of exemptions gives German competition authorities much scope for permitting cartels. There are more than 300 legal cartels in Germany, most of which were formed on the basis of an efficiency defense. Much of the current practice could probably be defended on economic grounds, in particular when viewed in conjunction with a merger policy that almost completely disregards efficiency defenses. For example, it would seem somewhat contradictory not to intervene in mergers between small firms but to disallow cooperation that allows residual competition to remain. In this sense, the relatively large number of cartels in Germany (compared with those in the United States) may not reflect the whole picture because there is not enough information about the relative frequency of mergers among small and medium-size firms.

The main problem in this area of cartel policy is that the policy goals are unclear. The exceptions to the cartel prohibition as they stand are problematic mainly because they represent a collection of rules adopted to serve special interests. Relating the permission of legalized cartels more closely to merger policy might help focus policymaking in this area and clear up the role of efficiency defenses in German competition policy.

Cartels that affect international trade should definitely be taken out of the catalog of cartel exemptions. Given the typical arguments against their abolishment, it would probably be best to prohibit trade cartels at an international level, preferably in the context of the General Agreement on Tariffs and Trade (GATT).

Industry Exemptions

The law against restraints of competition explicitly exempts several industries from specific competition policy rules, including the cartel prohibition. However, the law explicitly covers government-owned businesses; unless they operate in an exempted industry, the same rules for cartel behavior, merger policy, and other restraints of competition apply. For example, the Cartel Office prohibited the Federal Republic of Germany from acquiring majority ownership in an oil company because it would have strengthened a dominant position in the market for gasoline (*Wirtschaft und Wettbewerb/E* Bundeskartellamt 1457, *VEBA/Gevelsberg*). This provision significantly constrains government intervention in industries with public ownership. But this constraint is not all that critical because government ownership outside the sector of exempted industries takes the legal form of standard private companies in which the state has the role of the owner of shares, which already provides a certain arm's-length relationship from the business's daily operations. Because government-owned companies are subject to the same competition policy rules and therefore to the same competitive pressures as private companies, from a competition policy point of view privatization should not be a major issue in these industries.[11]

More important both for competition policy within the European Union and for Germany's internal privatization debate should be the sectors of the German economy that have been exempted. These include postal services and telecommunications, the transport sector, the

11. Official government opinion in Germany certainly contradicts this view. However, from an economic point of view, privatization in most countries, especially the United Kingdom, was important mainly to establish an arm's-length relationship between the government bureaucracy and management, as well as to introduce competition in those sectors. In industries in which such problems do not exist (as, for example, in the German automobile industry, in which the public sector owns a majority of the shares in Volkswagen), one should not expect large gains in competitiveness from privatization.

banking and insurance industries, and public utilities. In addition to these industries, exemptions are granted to agriculture, the Bundesbank, and the government-owned credit institute, Kreditanstalt für Wiederaufbau.

All the exempted industries are subject to extensive regulation. While the general cartel prohibition and restrictions such as retail price maintenance do not apply, the Cartel Office is responsible in varying degrees for control of potential abuses. Independent regulatory bodies govern such sectors as insurance and banking, but in matters regarding competition policy, the Cartel Office shares control. The Cartel Office alone, however, is responsible for mergers affecting these industries. Pressure to change the system of exemptions from cartel law has come mainly from the European Union, which has attempted to bring these sectors under the general control of European competition policy rules.

Abuse of Dominant Position

Definition

The central concept in German competition policy is dominant position (*marktbeherrschend*). A firm is deemed to have a dominant position if it possesses (or nearly possesses) a monopoly, or if it enjoys a much better competitive position than other firms (*überragend*) in a particular product market. To judge the latter, not only market share but also financial strength, access to input and output markets, interlocking shareholdings with other firms, and barriers to entry are considered (GWB, section 22).

The central variables of interest are market share and financial strength. As I will argue later in the analysis of merger policy, financial strength is of much greater importance in German policy than in that of other countries. The law further sets benchmarks for establishing dominant position, including specific levels of both market share and turnover (as a measure of financial strength). A firm is considered to have a dominant position if it has more than one-third of the market share and has turnover of at least DM250 million. This is not a binding benchmark, however. Other factors, such as significant threats of entry, may prevent firms from being judged dominant.

The definition of dominant position extends also to joint dominance by several firms. In particular, three or fewer firms with a market share of more than 50 percent and five or fewer firms with a market share of more than two-thirds are considered to have a dominant position if their turnover does not fall below DM100 million a year. These rules are complemented in practice by an interpretation of the law that considers firms more likely to be dominant if their market share is much larger than that of the next largest competitor. German competition law has therefore established quite exact criteria for what kind of market structures it considers worrisome. Contrary to US practice, the Herfindahl-Hirschman index is not used to measure industry concentration. German authorities do not consider just absolute market shares but the complete distribution of market shares across the relevant industry. In principle, this is preferable to an aggregate measure such as Herfindahl-Hirschman. Yet in so far as both a large concentration and a large dispersion of market shares are considered problematic in German competition policy, the two approaches are in practice very similar.[12]

Following the Monopolies Commission's suggestions, the market dominance criteria established in the law have been applied somewhat more flexibly since the mid-1980s (Monopolkommission 1990). The Cartel Office has made more of an effort to evaluate the threat of entry, in particular from producers outside Germany. This is of particular importance because of the high integration of the German economy into the world economy and the relative ease of entry for foreign competitors. At the same time, the critical market-share criteria have to be seen as the main guideposts for policy. And so they will remain, given the widespread belief in Germany that in tight oligopolies, firms will inevitably achieve implicitly collusive agreements (Höfer 1978). Given the lack of success in controlling implicit collusion, there seems to be some tendency to err on the restrictive side rather than to allow market conditions conducive to collusion.

Since merger control is framed in terms of preventing the establishment of new or strengthening the existing dominant positions in the market, it is in principle based on the definitions of dominant position just discussed. However, for the purposes of merger policy, the criteria for dominant position have been recently extended to allow the cartel authorities to put greater weight on the financial strength of firms.[13] This additional criterion underlines two important aspects of competition policy in Germany. First, the establishment of large firms—and with it, economic power—is seen as a threat to the economic order per se. Second, the financial strength criterion reflects the high credibility that German competition policy implicitly gives to the possibility of predatory pricing, in particular the "deep pocket" variety.

Controlling Abuses of Dominant Position

German cartel law is aimed mainly at controlling dominant positions. The only way to control dominant positions that have not been estab-

12. This type of evaluation is not carried through consistently. Sometimes the Cartel Office or the courts argue that very evenly distributed market shares facilitate implicit collusion between firms.

13. These criteria are discussed in section 4 below.

lished by external growth is through controls of the "abuse of dominant position." Although the possibility of giving the cartel authority the right to break up dominant firms has been repeatedly suggested, it has generally been rejected as too interventionist (Höfer 1978; Möschel 1980; Schlecht 1992). What remains are interventions against practices by dominant firms that are considered abusive. "Abuses" are generally placed into two categories: "abuse by exploitation" and "abuse by hindering competitors." The latter generally concerns vertical restraints but would also be applicable to predatory pricing. The former essentially concerns high prices charged by dominant firms. While I will relegate the vertical issues to a later section, I will briefly describe the practices concerning "excessively high" and "excessively low" prices in this section.

Controlling Excessively High Prices

Rules allowing the cartel authority to intervene against excessively high prices[14] are effectively a form of price cap regulation. However, the cartel authority cannot simply set a price cap if it considers a price excessively high. It must prove in court that the price was excessive according to some benchmark. Evidence of exceptional profitability has not been enough to convince the courts. The acceptable method of proof has been to compare the price that is considered excessive to the price in a "comparable market" with significant competition.[15] This rule has made it practically impossible to prove that a price is excessive because the courts generally find the market comparison invalid. This has been shown most dramatically in cases against the oil industry in 1974 and against the pharmaceutical industry in 1980 (Valium).

The case concerning oil prices is closely linked to the first oil price shock in 1973. The six leading oil producers in Germany—Texaco, BP, Shell, Esso, Gevelsberg, and VEBA (ARAL)—had drastically increased their prices between the fall of 1973 and spring of 1974, arguing that increased costs in the international markets had made price increases necessary. After profit increases of 300 percent became public knowledge and published figures showed that oil prices had risen by about 30 percent more than input prices, the Cartel Office intervened, claiming that the five largest firms in the industry were abusing a joint dominant position. After a hearing, which is required in such cases, the Cartel Office ordered firms to take back the price increases as far as they had been instituted. Despite the enormous increases in profitability, the courts lifted the order because they did not see sufficient proof of excessively

14. The rules apply equally against oligopsonists that use their market power to gain excessively low prices from suppliers.

15. This rule has been explicitly stated in the GWB since 1980.

high prices. This case demonstrated clearly that profitability criteria could not be used in such cases as evidence.

In the Valium case, the cartel authority attempted to control prices by resorting to competition policy measures. This case was first taken up in 1974, when the Cartel Office ordered Hoffmann-La Roche to reduce its price for Valium by 40 percent and its price for Librium by 35 percent. In the market for tranquilizers, which was considered to be the relevant market, Hoffmann-La Roche had market shares of more than 50 percent in sales through pharmacies and about 85 percent in sales to hospitals. Dominant-firm criteria clearly were satisfied, and the Cartel Office supported the claim of an abuse of dominant position by supplying evidence that German Valium prices were 50 percent higher than in the Netherlands and 300 percent higher than in the United Kingdom.[16]

The case finally failed in 1980 because all possible comparable markets abroad were themselves subject to regulation, and it became impossible for the Cartel Office to convince the court that foreign markets were comparable. Three years before, the court had rejected the claim that prices on foreign markets could be taken directly as a benchmark and had developed a complicated scheme for calculating how a price on a foreign (comparable) market could be translated into a "quasi-competitive price" for the domestic market. Consequently, the Cartel Office has virtually given up its attempt to control excessive pricing. The only recent cases of importance have come with the unification of Germany and the scrutiny of pricing practices by companies in the former East Germany.

Predatory Pricing

Action against the "abuse" of setting too low a price—that is, predatory pricing—has not played a prominent role in German competition policy, but the Cartel Office did attempt to intervene against predatory behavior in 1981 (*Wirtschaft und Wettbewerb/E* Bundeskartellamt 2029, *Coop Bremen*). The case was brought against the retail chain Coop, which was considered a large, integrated retailing company facing mostly small retailers in the region of Bremen. Coop offered about 50 branded products of everyday use at a retail price below the average price it paid for these products, and it did so over a prolonged period. These retail prices were heavily advertised in the local media.

The Cartel Office argued that this strategy threatened the viability of smaller retail outlets. Smaller retailers had smaller product lines and a lower ability to finance advertising. Matching Coop's prices would have implied significant losses that could not be matched by profits in other

16. This refers to UK prices before UK government intervention forced the price for Valium down.

areas, as was possible for Coop. Essentially, the situation was seen as a classic, deep-pocket predatory strategy, with the additional advantages to Coop of a product-line effect and advertising advantages. The Cartel Office prohibited the use of prices below average purchase prices (*Einstandspreis*). Coop appealed in the courts, where the case has been stuck since.

This case was probably as strong a case as the Cartel Office could make to show predatory pricing. There was both pricing below average cost and a high potential of exit by competitors. The failure to win this case in court makes it unlikely that further cases will be brought forth. As a response to this situation, there was an attempt to forbid systematic pricing below cost during the last reform of the GWB in 1989. However, the government succeeded in keeping such a rule out of the law (Schlecht 1992). It seems fairly clear that attempts to prove predatory pricing in German courts would essentially be impossible. However, this does not mean that the competition authorities consider predatory practices unimportant. On the contrary, as I argue below, the possibility that such practices are prevalent affects the competition authority's evaluation of mergers that generate cost advantages.

Merger Policy

Horizontal Mergers

The cornerstone of German competition policy since 1973 has been merger control, partly because experience has shown that the behavior of dominant firms cannot effectively be controlled when abuse of dominance has to be proved in court. Price controls through competition policy instruments appear likely to fail in the absence of an explicit regulatory regime. While this leaves no effective means to control firms that become large through internal growth, it apparently underscores the importance of controlling external growth of firms in the eyes of policymakers (Schmidt 1990; Monopolkommission 1980).

When Are Mergers Subject to Control?

The majority of mergers in Germany have to be reported to the Cartel Office as soon as the merger has taken place. The merging firms must have a combined market share of at least 20 percent in some German market. The market can also be a substantial submarket.[17] Second, there

17. An exact translation of the wording of the law is: "In the area of applicability of this law or in a substantial part thereof, the merger creates or increases a market share of at least 20 percent, or one of the participating companies has on a different market a market share of at least 20 percent."

is a criterion for firm size, which requires the merging firms to notify the cartel authority if the participating companies jointly exceed an employment level of 10,000 employees or jointly exceed a turnover of DM500 million in the business year prior to the merger. The law is quite meticulous in identifying the merging companies for these purposes with the actual companies controlling ownership.

The number of merger notifications increased from 773 in 1973-75 to 3,750 in 1991-92. The Cartel Office had received a total of 16,147 merger notifications by the end of 1992. The number of mergers significantly increased in the 1980s, with a particularly sharp boost in 1990-91 as a result of German unification, and has stabilized at about 1,500 a year since then.

It has also become more evident over time that consulting the Cartel Office prior to a merger eased procedures considerably. As a result, the facilities for "preventive merger control" have recently been augmented. In particular, mergers that involve one firm with a turnover exceeding DM2 billion or two firms with a turnover of at least DM1 billion each will have to be announced to the Cartel Office in advance so the Cartel Office can delay the merger to investigate its impact on competition and possibly prohibit it. By 1989 two-thirds of all mergers subject to the general notification requirement already fell into this category. Thus, German mergers have become largely subject to prior approval from the Cartel Office.

What Constitutes a Merger?

German law attempts to include in its definition of a merger every agreement that gives one firm a significant influence on a company's policy, not just the complete takeover of a company. This is closely related to the laws on publicly held firms (in particular, the *Aktiengesetz*), in which special rights are given to minority shareholders of substantial size. Under the law, a share acquisition is considered a merger if, as a result of the share acquisition, shareholdings reach 25 percent, 50 percent, or a majority of the shares with voting rights. For example, an increase of shareholdings from 20 to 25 percent would be considered a merger. If the same shareholder were to subsequently increase the shareholding from 25 percent to 50 percent, this would be considered a second merger. Even if smaller minority shareholdings are involved, a share acquisition may be considered a merger under the law if, either directly or indirectly, the minority shareholder gains a significant degree of control in the firm. One case of this, which the law mentions explicitly, would occur if more than half the members of the supervisory committees of two firms involved in the transaction were identical.

German law correctly aims at the control rights that are gained through a formal connection between two firms. It recognizes that, for competition policy purposes, a merger should be defined only on the basis of whether control rights are distributed in such a way that the merging firms will be able to act in concert. This makes the law very satisfactory from an economic point of view.[18]

When Are Mergers Prohibited?

Mergers are prohibited if they are expected to create or expand a dominant position in some market unless the participating companies can prove that the merger will also generate "improvements in competitive conditions and that these improvements outweigh the disadvantages of a dominant position" (GWB, section 24[1]). The formulation "improvements in competitive conditions" does not allow for an efficiency defense for mergers. The clause only applies to market structure criteria.

Essentially, under the practice established by the Cartel Office, an improvement in competitive conditions comes about if the merger allows firms that do not have the largest market share to catch up to the one that does (see *Gemeinschaftskommentar* for examples). The idea is that such a merger reduces the dominant position of the largest firm in the market.

Considerations of public interest, international trade, industrial policy, and, in particular, efficiency gains cannot be used as merger defenses. In fact, claimed efficiency gains often seem to harm the prospects for the merger. A recent case involving the proposed merger between two meat processing cooperatives in Northern Germany is a relatively typical example (*Wirtschaft und Wettbewerb/E* Bundeskartellamt 2428). The two firms had, among other things, claimed that the merger would allow them to realize substantial efficiency gains by rationalizing capacity utilization in an environment of significant excess capacities.

The Cartel Office explicitly agreed that there would be efficiency gains for the participating firms in the merger. However, it argued that these gains would put other firms in the industry at a competitive disadvantage. In particular, the merging firms might push competitors out of the market because the combined firm was financially strong enough to sustain such a strategy.

German merger policy does not take synergy effects into account; instead it sometimes bases its decisions against mergers on the fact that the merged firm would achieve cost advantages. Implicit in this position is the importance attributed to predatory pricing arguments, especially if they are based on deep-pocket arguments.

As we have seen, there is a merger defense for dominant firms if market structure improvements in some markets may outweigh the rein-

18. It should be noted, however, that through these procedures the possibilities for a market in corporate control are limited. It is implicit in much of what has been written in Germany about competition policy that the authors consider product market competition, not the financial markets, as the main source of discipline for managers.

forcement of dominant positions in another. Given this policy, it would be logical for cartel authorities to make their agreements to mergers conditional on specific requirements—for example, divestiture in markets for which increases in market dominance are a particular concern. However, they are not allowed to do so. The Cartel Office tries to circumvent these constraints by eliciting "assurances" from firms to divest certain divisions before agreeing to the merger.

Overall the number of mergers prohibited appears remarkably small. From 1988 to 1989 the Cartel Office was notified of 2,574 concluded mergers, only 16 of which were prohibited. These numbers do, however, strongly underestimate the role of the Cartel Office in screening mergers. During the whole period of merger control, 101 mergers were prohibited, but 224 merger proposals were dropped or much altered after consultation with the Cartel Office before formal proceedings were initiated. Clearly, merger control in the preapplication phase was of primary importance. Furthermore, there is a high degree of predictability of Cartel Office decisions because of the clarity of the rules. This predictability can be expected to keep the proportion of mergers proposed and rejected relatively small.

Ministerial Exemptions and Industrial Policy Concerns

If the Cartel Office prohibits a merger, there are two courses of action open to the firms concerned. First, they can appeal to the courts to get the decision overturned. To do so, they must show either that the Cartel Office's assertion of a dominant position was false or that the office had not properly weighed the competitive advantages and disadvantages of the merger. Second, the firms can request special permission from the minister of economics. Unlike the Cartel Office, the minister may let public-interest arguments outweigh competition policy considerations.[19] Through this instrument, synergy advantages of mergers, industrial policy concerns, and strategic trade considerations may enter merger control decisions.

The system is therefore highly formalized and transparent. In order to grant an exemption, the minister has to publicly overrule the Cartel Office. Consequently, the minister of economics has been very reluctant to use the instrument actively. Substantial efficiencies must redound to the whole economy in order to make the minister accept an efficiency defense. Thus synergies that are claimed must be at a very high level. In practice, such synergies have only been recognized in R&D (*Wirtschaft*

19. However, the minister of economics' decisions have often stated that ministers cannot question the Cartel Office's assessments on dominant position and the effects on the competitiveness of markets. They may only allow the merger if they decide that public-interest concerns outweigh the negative effects underlying the decision of the Cartel Office.

und Wettbewerb/E Bundeswirtschaftminister 159, *Thyssen-Huller*) or in otherwise technologically important areas (*Wirtschaft und Wettbewerb/E* Bundeswirtschaftminister 213, *BayWA AG/WLZ Raiffaisen*). Otherwise, like the Cartel Office, the minister is likely to conclude, from the cost advantages of a merger, that firms will be able to push competitors out of the market.

The office of the minister of economics has also repeatedly rejected demands to let industrial policy concerns influence merger decisions. German policymakers largely agree that industrial policy, if conducted at all, should not seek specific market configurations.

Regarding the international aspects of German competition policy, it is remarkable that the minister of economics has been able to insulate himself from industry's demands to allow mergers that strengthen German companies' ability to compete in foreign markets. Ministerial decisions have repeatedly stressed that such mergers could be allowed if they were necessary for market access abroad. However, strengthening of German firms' competitiveness abroad is not seen as sufficient justification for a merger. Furthermore, the minister has emphasized that "considering improvements in international competitiveness at the same time requires an evaluation of the economic disadvantages from restrictions of international competition" (*Wirtschaft und Wettbewerb/E* Bundeswirtschaftminister 177, *IBH/Wibau*). This narrow interpretation of German public interest has led to a situation in which only four mergers have ever been permitted through a ministerial decision, despite the fact that the minister, unlike the Cartel Office, may tie its permissions to merge to conditions.[20] Most of these cases have involved securing energy supplies (*VEBA/BP,* 1979).

Nevertheless, the 1989 case of Daimler/MBB[21] sticks out as a policy inconsistency. The federal government had initially suggested the merger, and thus it appears to be a classic example of industrial policy. The government was interested in transferring German Airbus participation (in particular the financial risk) to the private sector.[22] The German partner of the European Airbus consortium, Deutsche Airbus AG, was nominally owned by MBB, but the government had significant control rights because of the subsidies involved. In Daimler, MBB was to gain a financially strong partner to shoulder the significant risks of the Airbus project in the long run. The competition policy problems arose because in many

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20. These may not, however, imply a permanent supervision of the firms' policies after the merger.

21. The company MBB (Messerschmidt-Bölkow-Blohm) is one of the largest firms in the German armaments industry.

22. The case has another specific feature: the states of Bayern, Bremen, and Hamburg—major production sites for MBB—jointly had a majority share in MBB. The three have been investing in the company to secure jobs. (Indeed, MBB and Daimler together account for a large share of employment in the state of Bremen).

areas of the defense, space, and aircraft industries the merged firm was to become by far the dominant supplier.

The government essentially supported the claims of the companies that the merger had significant positive effects for the national economy because it improved the abilities for the two companies to win "project leadership" in international high-technology cooperation. Given the relatively small number of such projects and the rather questionable significance of actual technological spinoffs, this move can better be seen as an attempt to increase German bargaining power in partly government-sponsored, international high-technology projects. Despite the Cartel Office's refusal to permit it, the minister of economics finally approved the merger, along with some restrictions that enforced the sale of some divisions of the merged company.

The case also showed the great importance the Monopolies Commission has as an advisory body. The commission supported the merger, conditional on some restrictions. Its report was, however, highly critical. The commission was split in its recommendations, adding to a general uneasiness about the whole case. One reason for finally approving the merger was that the government would otherwise have lost face after having initiated the process in the first place. This atypical case has therefore served to caution the government against using merger policy for industrial policy reasons. The case has also, through the initiative of the Monopolies Commission, once more raised the issue of bank involvement in German industry. Because Deutsche Bank is the largest shareholder in Daimler Benz and because it was influential in initial negotiations with the government, many policymakers felt that the leading banks were getting an excessive amount of bargaining power vis-à-vis the government.

Vertical and Conglomerate Mergers

The treatment of vertical and conglomerate mergers in Germany is very different from the US practice after 1980. While vertical mergers are not considered as dangerous as horizontal mergers, such mergers can be forbidden. For example, if a firm has a dominant position in a market and vertically integrates into the downstream market, it would be considered as having increased its dominant position—partly based on conjectured foreclosure effects, but also on the argument that if a firm can complete more stages of production internally than others can, it is likely to have a wider range of options. This is interpreted as an increase in "market power."[23]

23. Recent research on the welfare effects of vertical mergers in concentrated markets seem to make such restrictive policies toward vertical mergers rather questionable (Mathewson and Winter 1984; Kühn and Vives 1994).

With the fourth reform of the GWB in 1980, legislators particularly wanted to strengthen the instruments of the Cartel Office against conglomerate mergers. This reform led to additional turnover-based indicators for market dominance for the purposes of merger control.

There are essentially three cases that are regarded as market dominance. The first is the case in which the market is fragmented (i.e., it consists of mainly small and medium-size firms, or *mittelständischer Markt*) and a large firm of more than DM2 billion in turnover merges with a firm in that market, yielding a market share of at least 5 percent. Here it is assumed that, with its financial power, the large company will quickly dominate the market. The second case is a merger of a financially powerful company with a company that has a dominant position in a market (and the market turnover is at least DM150 million). Finally, pure financial size is also a criterion. If two firms with at least DM1 billion in turnover each and a combined turnover of at least DM12 billion merge, this is also regarded as increasing a dominant position.[24] These rules cover at least the 100 largest companies in Germany in terms of turnover. As such, the introduction of rules against conglomerate mergers can also be seen as an attempt to stop the overall trend toward concentration in the German economy.

Unfortunately, the role of financial strength, and in particular the role of conglomerate mergers, has not been analyzed to a great extent in the economic literature. It seems sensible to have some means of assessing relative financial power to determine the long-term prospect for concentration in an industry where a merger is proposed. It is somewhat worrisome, however, that financial strength is invariably measured by turnover. Use of this indicator has produced a number of cases in which loss-making firms that were proposing a merger were considered to have a dominant position partly because of their "financial strength." This is not necessarily incorrect because medium- and long-run profitability—and not the immediate financial situation—of the firms should determine a firm's financial strength. Nonetheless, the sole focus on turnover as a predictor of future profits appears rather dubious. Combined with the absence of both an efficiency and a failing-firm defense for mergers, this may very well lead to undesirable outcomes.

Vertical Restraints of Competition

Vertical restraints of competition are regulated in detail in the GWB. Except for the illegality of retail price maintenance (GWB, section 15),

24. Again, these rules are complemented by rules for dominant positions of oligopolies. They can be circumvented if the oligopolists can prove that there is significant competition among them.

vertical restraints fall under the prohibition of abuse of dominant position through hindrance of competitors, and therefore are regulated following a rule-of-reason approach. In practice, this rule overlaps the prohibition of discriminatory practices by dominant firms (GWB, section 26). The discussion below is organized according to economic practices.

Prohibition of Resale Price Maintenance

Until 1973 retail price maintenance was permitted under German law for all branded products. With the reform of the GWB in 1973, resale price maintenance (i.e., any contract that limits a contracting party's ability to set prices or conditions in contracts with third parties) was made per se illegal.[25] It was viewed as keeping retailer margins artificially high to the detriment of consumers.

Case studies concerning retail price maintenance show that this rule essentially ensures intrabrand competition while systematically ignoring its presence. An example of this arose from a case concerning a Japanese electronics firm (*Wirtschaft und Wettbewerb/E* Oberlandesgericht 5053), that had trouble persuading retailers to stock its brand because competitive price cuts by other retailers that were carrying the product reduced retail margins too much.

While it was a large firm on world markets, the company held only 0.8 percent market share in the German market, its turnover was falling, and it was starting to incur losses in its German operations. The firm concluded it could secure its presence in the market only by guaranteeing a retail margin, so it imposed retail price maintenance through indirect means. This was deemed illegal. At no point in the procedure did authorities consider the degree of competition with other manufacturers or market-entry conditions.

Given cases of this type and empirical research on retail price maintenance in the United States (Ippolito 1991), it is time to reconsider the strict abolition of retail price maintenance in German law. Fortunately, the per se illegality of retail price maintenance is the only per se rule on vertical restraints that is not tied to the existence of a dominant position.

One of the reasons a change in this rule will probably not come about lies in the basic philosophy of German competition policy. Retail price maintenance is considered as infringing on the freedom of contracting of other parties. This can be seen nicely from a case against a German ski maker (*Wirtschaft und Wettbewerb/E* Bundeskartellamt 2479, *Völkl*), that though it did not produce bindings, imposed a clause on its retailers stating that they could not bundle their skis with another producer's

25. The only exception is the publishing industry.

bindings and sell the package at a single price. This stipulation violated the rule against measures that affect retailers' pricing decisions and is a particularly blatant example of the rule to guarantee "freedom of contracting" leading to results that cannot be economically justified.

Refusal to Supply and Exclusive Dealing

"Refusal to supply" can usefully be divided into three categories. First, there is the classic exclusive dealing aimed at restricting distribution channels. Second, refusal to supply may be used to force potential contractual partners to comply with business conditions that cannot be made part of an enforceable contract. Finally, there is the possibility of inducing others to boycott a particular firm. The law prohibits the latter practice by outlawing any attempts at influencing others to terminate or refuse business relationships with third parties. Similarly, the threat of refusal to sell to enforce the pricing policies of another firm is forbidden. This follows from the fact that section 25 of the GWB prohibits the use of threats to induce a particular behavior, and also from the fact that the prohibition of retail price maintenance extends to implicit agreements[26] (*Wirtschaft und Wettbewerb/E* Oberlandesgericht 2822, *Uhren-Kramer/Seiko*; *Wirtschaft und Wettbewerb/E* Oberlandesgericht 5053).

The problematic case from a policy perspective is that of refusal to supply to ensure exclusive dealing arrangements. This is a common practice, especially in the sale of consumer durables. This is dealt with under the "abuse of dominant position" category. Firms with a dominant position in the market are not allowed to discriminate against firms if this unreasonably hinders the other firm and the discrimination cannot be justified.

The same rule applies if suppliers or downstream firms are "dependent" on a business partner in the sense that they cannot easily shift their business relationships to others. In fact, much of the discussion of competition policy in this area has focused on the question of when firms are considered "dependent." The courts have interpreted dependence quite broadly and have in some areas established a requirement to supply. Surprisingly, this includes forcing firms to supply (*Wirtschaft und Wettbewerb/E* Oberlandesgericht 2390, *Allkauf Nordmende*; *Wirtschaft und Wettbewerb/E* Bundesgericht 1885, *Adidas*). In the Adidas case (similar to the Raleigh bicycle case in Britain), the court put such weight on this principle that it forbade Adidas from continuing to distribute only through specialized sporting goods stores. Although there are many cases in which the right of firms to choose their distribution channels has

26. This is the same rule as that covering implicit collusion.

been upheld, the legal practice in the past seems to have excessively restricted firms in their distribution channel management.

Interestingly enough, the Cartel Office has dealt with exclusive dealing mostly under the rules against discrimination, despite the fact that section 18 of the GWB explicitly permits the Cartel Office to prohibit exclusive dealing arrangements. However, the preconditions are somewhat different from those under the discrimination rule. Under section 18, exclusive dealing (including restrictions on trading with third parties) can only be prohibited if many firms are treated in this way, other firms are prevented from entry, and competition is significantly reduced through the exclusive dealing contract. Thus, the rule focuses on foreclosure effects. It is revealing that this economically sensible rule is almost never the basis on which the Cartel Office intervenes.

Price Discrimination and Discounting Practices

Price discrimination and discounting practices essentially fall under the same rules as exclusive dealing. Again, the law addresses only dominant firms, cartels, and dependency relationships. The main issue in discounting practices has been the treatment of total turnover rebates. Similarly to EU policy, the German Cartel Office today considers these practices detrimental to competition and an unwarranted hindrance to competitors (*Wirtschaft und Wettbewerb/E* Oberlandesgericht 1983, Rama-Mädchen; *Wirtschaft und Wettbewerb/E* Bundeskartellamt 1817, *Effem-Tierfertignahrung*). Their arguments are not based on the idea that such schemes relax price competition[27] or prevent entry. Instead, the Cartel Office argues that discounts on total turnover "limit competitors and entrants in their economic freedom and in particular in their freedom of setting prices since they have to grant their customers larger rebates in order to compensate them for not concentrating their purchases on the supplier that provides the turnover discount" (Schmidt 1990, 237).

Price discrimination has mostly been handled under the guise of protecting "dependent" firms. Price discrimination by sellers between buyers has traditionally been treated quite leniently. Usually, the Cartel Office accepted producers' claims that price discrimination was based on economic grounds and therefore justifiable. A case originating in 1976 is a rather worrisome indication that this might have changed. A well-known German producer of brandy, Asbach Uralt, was granting additional discounts to wholesalers specialized in dealing with restaurants and bars if they agreed to a dealership contract with Asbach.

The Cartel Office considered the additional discounts as unreasonable

27. See the literature on switching costs, in particular Klemperer (1992), for an overview of the effects of loyalty bonuses.

discrimination between the Asbach dealers and other wholesalers, while the court argued that Asbach dealers were providing special services that justified the discrimination—the traditional argument used to permit discriminatory practices. However, the federal court complained that the lower-court decision had not sufficiently considered the goal of the law—protecting the freedom of competition. As in the earlier refusal-to-supply cases, the court argued that, to be competitive, the wholesalers had to have Asbach Uralt in their product line. Therefore, the restriction of the additional rebate to only Asbach dealers hindered other wholesalers.

Based on this argument, the Cartel Office's position was confirmed. The decision did not take into account whether the rebate had foreclosure effects but was aimed only at protecting the profits of the independent wholesalers—a highly questionable practice that cannot be justified on economic grounds.[28]

The treatment of price discrimination by firms with market power on the demand side has been more controversial. It has been argued in these cases that discounts were simply an expression of effective competition. The Cartel Office nonetheless pursued a case in this area despite rather weak economic grounds for doing so. Metro, a large firm in the food sector, is a large customer of many companies in food supplies. Metro asked supplying companies to pay a fee if they wanted an additional product to be included in Metro's product line.

The Cartel Office interpreted this practice as discrimination between customers who already supplied the product and those who did not. The office argued that this practice made entry more difficult for new suppliers and prohibited the further use of such fees. The case was abandoned when, in a merger case involving Metro, a court decided that Metro did not have a dominant position. Nevertheless, the case raises the issue of whether two-part pricing by an oligopsonist should be prohibited by cartel authorities as anticompetitive. Both cases demonstrate that competition policy authorities seem to have too little economic guidance on how to evaluate vertical contractual relationships.

Tie-In Sales

While tying (or bundling) products was once always considered an abuse of dominant position, the legal assessment became somewhat more lenient in the 1980s. Early cases did, however, smack strongly of attempts to exclude competitors from the market. For example, in the case of *meto-Handauszeichner* (*Wirtschaft und Wettbewerb/E* Oberlandesgericht 995), a firm forced customers to use only their stickers with their sticker-marking device, thereby tying the sale of a durable good in which it

28. The extensive reliance on product-line effects to show "dependence" is worrying in itself. It can only be justified economically if foreclosure effects can be demonstrated.

had a monopoly to the sale of stickers in which it would have had to contend with competitors. This practice was rightly prohibited.

Recently, courts have been willing to accept efficiency defenses for tying. In a case involving two newspapers in Stuttgart that were forcing customers to advertise in both newspapers at the same time, the court found that rationalization justified the practice (*Wirtschaft und Wettbewerb/E* Oberlandesgericht 2126). The Monopolies Commission in its most recent report has advocated following a cautious route in dealing with tying arrangements: "The tying arrangements of a supplier with a powerful market position are only then inadmissible if they threaten to cause substantial deterioration of the market structure on the market for the tied commodity" (Monopolkommission 1992, 525). The commission essentially suggests treating tie-in sales like mergers. If their recommendations are followed, the market structure for the tied commodity would have to be analyzed. If the tying arrangement leads to substantial increases in market share in the market for the tied product (beyond the intervention levels of merger control), tying would be considered illegal. This suggestion is very sensible because it focuses on the horizontal effects of tying and emphasizes the close relationship to merger control.

Research and Development

In all policy concerning research and development, the basic idea that R&D is good for economic development dominates general thinking. Anything that helps intensify R&D efforts is therefore welcomed. This is particularly true of interfirm cooperative R&D and strongly influences competition policy in this area.[29] Firms can choose to do cooperative R&D simply by contractual agreements, or they can form joint ventures. Contractual cooperation could potentially violate the prohibition of cartels. R&D joint ventures will be subject to merger control. If they contain agreements about downstream production, R&D joint ventures may also fall under the cartel prohibition. In this section, I discuss both forms of cooperation.

Contractual Cooperation

For a long time, German competition policy has treated R&D as a precompetitive activity that was an internal organizational matter of the individual firm. Agreements between firms to mount exclusively R&D efforts were thus of no concern to competition policy. This approach is

29. EU competition policy related to R&D cooperation is particularly important in practice. For the purpose of exposition, I will concentrate purely on the German side of policy for the moment.

in strange contrast to the often-repeated statement that competition policy is guided by a view of "competition as a dynamic process." It has, however, strongly shaped policy toward R&D cooperation. The Cartel Office regards any cooperation that only involves R&D as unproblematic, but it is concerned with cooperation that extends to production and marketing using R&D results.

As a consequence of this general approach, pure cooperation on R&D is considered as falling outside the GWB's cartel prohibition because it does not "restrict competition." Neither is the Cartel Office troubled by some further degree of cooperation on the use of R&D results nor on licensing (Monopolkommission 1990). The only objections the Cartel Office is likely to raise is that a cooperative effort eliminates competition in "research and development markets." This is generally seen to be the case only if firms cede their right to do independent research.

In contrast, agreements on R&D that also lead to a coordination of production activities should be considered as violations of the cartel prohibition. But in practice, R&D cooperation is almost always regarded as contributing substantially to "rationalization" effects and thus would be permitted as a rationalization cartel. Yet few R&D cooperative agreements have been turned into rationalization cartels, because firms believe R&D cooperation is generally exempt. They thus notify the Cartel Office of few R&D cooperative agreements. Nonetheless, empirical research has found these agreements quite important (Monopolkommission 1990).

R&D Joint Ventures

The formation of R&D joint ventures falls under the usual regulation of merger control. The majority pass by the Cartel Office without objection. When the Cartel Office did prohibit R&D joint ventures or made firms change the scope of the venture, the venture usually concerned cooperation at the production and marketing stage.

Markets in which the Cartel Office prevented R&D-related mergers have characteristically been emerging markets with significant growth prospects, because these mergers were viewed as establishing or strengthening dominant positions. This raises the issue of the extent to which mergers in emerging markets actually prevent the early entry of competitors. Unfortunately for the cartel authority, little is known about the evolution of markets.

One instrument to control R&D cooperation is the imposition of a 10-year limit on the joint venture (Deutscher Bundestag: Drucksuche 8/1925, *Bosch/Deutsche Vergaser Gesellschaft*). This is a sensible way of dealing with the problem and is analogous to the limited duration of a patent grant. Unfortunately, the Monopolies Commission has criticized this practice on legal grounds, so it likely will be discontinued.

One of the big problems in merger control involving R&D ventures is determining the relevant market. In some cases, the Cartel Office considers market share in the "market for R&D" a concept difficult to assess.

Even more problematic is the evaluation of the effects of R&D cooperation on future market conditions. R&D efforts create new markets, and technological developments integrate formerly separate markets. The application of market-dominance concepts would require some information about the market's future, which is not available. The best that authorities can do is to evaluate the likelihood of later potential competition based on other producers' current ability to perform the R&D necessary to compete in new markets.

Reasoning about the role of R&D competition is less developed than in other areas of competition policy. For example, large-firm R&D cooperation is often justified with the argument that today's R&D projects are so big that even large companies cannot undertake them alone. This raises several questions: Are financial constraints the chief impediment to large-scale R&D, and, if so, why is it so difficult for large companies to obtain support in the financial markets? Why do firms need to cooperate on some projects while they are able to continue substantial R&D efforts on other projects on their own? Is human capital a limiting factor for R&D activities?

There are no clear answers to such questions. Essentially, cartel authorities are at a loss when it comes to evaluating the main motivations for R&D joint ventures. There seems to be a growing suspicion, however, that R&D joint ventures are often motivated mainly by the prospect of gaining market power (Monopolkommission 1990, 365).

International Aspects

So far, I have discussed German competition policy in isolation. Although useful for expositional purposes, it does not, of course, capture the international reality. While the GWB is only concerned with the Federal Republic of Germany or parts of it as relevant markets, German competition law is still extensively applied to restraints of competition agreed to outside Germany that affect the German market.

This is clearest in merger policy. Even in 1992, when many mergers involved the Treuhand's sales of companies in East Germany, more than 40 percent of all mergers had some degree of foreign participation (Bundeskartellamt 1993), reflecting the high degree of German integration into the international economy. As a consequence, questions of extraterritoriality frequently arise in merger control. For example, a merger with a firm abroad can be stopped even if the foreign firm neither produces nor sells its product in Germany.

In the case Daimler Benz/MAN-ENASA (*Wirtschaft und Wettbewerb/E* Bundeskartellamt 2445), a merger was prohibited in which Daimler Benz and MAN were to jointly take over the truck production of ENASA, a Spanish company, splitting ENASA facilities between them. Daimler and MAN are virtually the only competitors in the German market for trucks. The Cartel Office ruled the merger would not only allow the two firms to coordinate indirectly through their control in a foreign firm but would also eliminate potential competition. The GWB generally governs foreign mergers that, like this one, affect home markets (see Königs in Gemeinschaftskommentar).

Naturally, the extraterritorial application of German law leads to some competition between legal spheres. The introduction of EU merger control has created a single institution responsible for merger proceedings for large mergers in Europe. Still, there are a significant number of cases in which several authorities deal with control of European mergers. In the recent case of Gillette/Wilkinson, both the German and the British cartel authority prohibited the merger. The Cartel Office tries on a limited scale to coordinate policies through consultations with foreign cartel authorities. There is, for example, a formal information exchange agreement with the United States.

Potential Conflicts between German and EU Competition Policy

In principle, there should not be much conflict between EU and German competition law because EU law, wherever it applies, traditionally has superseded national law. In this sense, national laws would have to converge on EU norms. The federal government expects efforts to harmonize German law with EU rules to dominate the next reform of the law against restraints of competition.

Some rules have already been established. For example, a merger or anticompetitive practice that the European Union has prohibited cannot be permitted at the national level. Similarly, it has been agreed that national law cannot overturn block exemptions the European Union has granted. What this rule means in practice is slightly less clear. For example, if the block exemption is granted for reasons unrelated to trade between member nations, national legal rules should apply. In practice, unresolved questions of this nature will remain a source of conflict for some time.

From the German point of view, conflicts arise mainly over the governance of European competition policy. The German government in particular worries that the European Commission cannot handle the rising case load. Germany has thus been demanding the establishment of an independent European Cartel Office and some more extensive delegation of cases falling under EU law to national cartel authorities. The

German Cartel Office is already conducting some inquiries into cases concerning Article 85 of the Treaty of Rome. So far, the German cartel authorities can only prohibit practices; declaring exemptions remains firmly in the hands of the European Commission. The institutional structure Germany prefers apparently closely resembles Germany's own: a strong, independent cartel authority, which is nonetheless confined to interpreting the rules exclusively on the basis of competition policy aims. On the other hand, a federalist structure in which national cartel offices handle cases with relevance mainly in national markets while the European Cartel Office restricts itself to mergers where international aspects dominate. This would closely resemble the division of authority between the federal and state cartel offices in the Federal Republic.

There is also a reluctance on the part of both the German government and the Cartel Office to reduce the threshold levels on size that determine whether a merger falls under EU jurisdiction. This partly reflects the institutional concerns and partly a concern about implicitly loosening the vigilance of German competition policy.

According to the German Cartel Office, industry largely perceives that EU merger policy is more permissive. The Cartel Office points to the fact that it has observed large companies choosing to arrange mergers in such a way that they fall under the EU merger directive although the purposes of the merger could have been achieved otherwise.

A further area of concern is the transparency of European-level decisions. The Cartel Office in its latest report criticized the Commission for failing to make public its reasoning in the decision against the Aérospatiale/Alenia/de Havilland merger.

Institutional structure explains much of the problem: EU competition policy decisions fall directly under the political influence of the EU Commission. Competition policy and industrial policy concerns are not clearly separated. Indeed, the merger directive does address industrial policy concerns. The German competition policy community, in contrast, presses for a separation of the two policy areas, secured by the institutional structure of an independent cartel authority that must report decisions it takes. Germany will likely link any extension of competition policy powers for the Union to concessions in the institutional sphere and to its general philosophy of competition policy. From a political economy point of view, the German focus on governance may be rather fortunate because it can help the Union avoid regulatory capture problems.

Areas of Exemption

The EU Commission has actively sought to bring the areas exempted from competition policy under regular competition rules. This has put pressure for reform on the German government. Some reforms have already begun in the transport sector through the application of European competition policy rules. In all sectors exempted from competition policy in Germany, regulatory regimes date back to the 1930s. The rationale for some of the rules is hard to understand today, although reasons for ongoing regulatory intervention clearly exist.

The German government has committed itself to "deregulation" in these areas. The German Cartel Office recently tried to force the pace of deregulation in the public utilities sector by challenging exclusive-supply arrangements between an electricity company and a municipality under Article 85(1) of the Treaty of Rome. The Cartel Office is trying to clarify to what extent the rules apply in the electricity industry in an attempt to gain an instrument against exclusive-supply contracts and contracts between suppliers granting each other exclusive rights in certain territories. The government also seems determined to press local governments to withdraw from their ownership of local utilities as part of a general privatization drive.

The main problem in these areas is that elements of natural monopoly remain in these industries, and the introduction of competition can only be seen, as in the United Kingdom, as part of an overall change in the regulatory regime. Unfortunately, the discussion is being conducted as if natural-monopoly problems would never exist. Consequently, policy completely ignores the remaining regulatory problems and the question of what level these should be addressed.

Germany's Specific Entry Barriers

Besides the areas traditionally exempted from competition policy, there are several features of the German economy that may lead to conflicts between EU member countries in evaluations of competition policy. While entry into retailing is free in Germany, there are many professions for which entry into the market requires evidence of relevant qualifications. As with other areas of regulation, this is bound to become a source of conflict should European competition policy concentrate more on government-induced barriers to entry. The difficult decision that has to be made is to what extent member states have autonomy in regulatory decisions and when regulatory regimes become unacceptable barriers to entry.

A particularly important recent example is the introduction of comprehensive regulations on recycling that have been introduced in Germany. French companies complained that the recycling policy puts them at a disadvantage vis-à-vis German companies because very often their products will not qualify for the "green dot," a label that signifies high recycling standards. Given the strong preference of German consumers for "green" products, the green dot gives firms a pricing advantage.

The conflict arises because different governments prefer different solutions to mounting waste problems, and firms want to design their technology according to the requirements in those areas where their sales are highest. The best solution to such conflicts probably lies in requiring that regulations apply equally to all competitors. Anything else would imply a great deal of centralization in political decision making in Europe and a severe reduction in the ability to develop competing ideas for the solution of political problems. Furthermore, if a country decides to incur higher costs for the goods it consumes, supranational competition policy should not prevent it from doing so. A line demarcating where legitimate competition policy intervention ends will have to be drawn.

Industrial Policy and Strategic Trade Policy

In the classic sense of government supporting specific industries, possibly through approving mergers and intervening in industry structure, industrial policy is highly unpopular among German policymakers. "Picking winners" is something everyone rejects. This explains the vigorous opposition of the government, the Cartel Office, and in particular the Monopolies Commission to the intrusion of industrial policy on European merger rules. This does not mean that there is no industrial policy in Germany. There is indeed both on the federal and the state level a very active research and technology policy (Forschungsbericht der Bundesregierung 1993) that consists of a whole range of incentives and subsidies to R&D activities, both for basic and applied research. Based on very activist policies in the 1980s, "technology parks" near universities and state government funding have proliferated. As mentioned earlier, the government in many cases encourages firms to cooperate on their R&D activities (or even requires it as a precondition for funding). There is therefore a strong industrial policy in Germany that basically reflects the conviction that anything that furthers technological progress is good. However, industrial policy geared at sector-specific or project-related promotion of research is seen as inferior to "a technology policy which employs indirect means of promotion and decentralist decision-making structures" (Monopolkommission 1992).

Strategic trade policy raises even greater skepticism. EU member states have delegated trade policy to the Community level. However, unlike some other members, Germany wants to limit trade policy instruments. German policymakers generally agree that "aggressive" strategic trade policy—that is, trade policy aimed at shifting economic rents between countries—should not be used. They even doubt the usefulness of "defensive" strategic trade policy. The Monopolies Commission in its last report severely criticized the use of unilateral countermeasures used by the EU in its trade policy: ". . . the antidumping and antisubsidization regulations and the so-called New Commercial Policy Instrument are in urgent need of reform. They do not move in the right direction and in practice have a protectionist and anticompetitive effect." In particular, the commission would like to see a competition policy regime substitute for defensive trade measures wherever possible but sees difficulties achieving this in the GATT. The commission suggests a larger free trade area, including the European Union, North America, and Japan, within which trade could be regulated by competition policy instead of trade policy.[30] In particular, it envisages substituting antidumping rules with established competition policy on predatory practices and discriminatory behavior.

Naturally, the Monopolies Commission, as a statutory, institutional watchdog over competition policy, will fight for much purer competition-enhancing policies than other institutions. It is therefore remarkable how much official government statements support this thinking. In its comments on the last Cartel Office report, the government suggested increasing the control over export cartels in the international competitive order (Deutscher Bundestag, Drucksache 12/5200).

As demonstrated in the practice of ministerial exemptions to merger control, strategic trade concerns have been expressly limited. One of the largest strategic trade projects, the Airbus consortium, shows, however, that the German government does support some degree of strategic trade policy. It has often stressed that the aircraft industry has very high entry barriers, mostly due to the long lags in development and testing. German authorities see Airbus mostly as a means of opening up a market, making a competitor viable, and thus reducing the complete dependence of the European airline industries on American production. It should thus be seen as the exception that proves the rule in German attitudes toward competition policy. This is, indeed, acknowledged by the Monopolies Commission, despite its opinion that Airbus cannot be termed a success (Monopolkommission 1992). Overall, German policymakers seem to support relatively strongly the notion that trade policy should be treated as international competition policy.

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30. This corresponds to the position of Canada that within NAFTA, trade disputes should be resolved through standard competition policy measures and not by the rights of any parties to use trade sanctions.

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