

Michael Böheim

The Role of Competition Policy in the Fight against Inflation

An Overview of Possible Short-term Measures to Intensify Competition

The accelerating price inflation since the autumn of 2007 has triggered a growing interest in competition policy. A positive impact of competition policy on inflation, innovation, growth and employment will only be felt in the medium to long term. The economic consequences of its neglect in the past cannot be overcome in the short term. Intensifying competition in a sustainable manner requires a broad political consensus and the readiness to embark on profound reforms of competition policy and antitrust law. A short-term anti-inflationary effect may be achieved through intensified competition in the markets for network-bound energy and for over-the-counter drugs.

Michael Böheim is an economist at WIFO. The author is thankful to Gunther Tichy for useful and constructive comments. The data were processed and analysed with the assistance of Sonja Patsios • Cut-off date: 1 December 2008. • E-mail-address: Michael.Boeheim@wifo.ac.at, Sonja.Patsios@wifo.ac.at

Until very recently, competition policy in Austria suffered from a distinct "lack of political interest" (Böheim, 2004). Triggered by the steep rise in inflation since the autumn of 2007, political and public interest in functioning competition within a market-economy framework as an anti-inflationary instrument has increased considerably.

In the political debate, intensified competition is presented in simplified terms as a fast-acting "panacea" against home-made inflation (Baumgartner, 2008C, in this issue). Given the fact that competition policy is unable to fulfil this function, at least not in the short term, the Austrian population is bound to be disappointed by its failure to produce immediate effects. Thus, confidence in the positive effects of functioning competition and a committed competition policy, already at a fairly low level, would be further weakened in the long run. Correcting the past failures and misguided developments of competition policy will only be feasible on a medium to long-term basis; due to very lenient merger control rules, breaking up the market concentration in some sectors of the economy will not be possible at all (Böheim, 2002).

The short-term revival of interest in competition policy should not blur our view of the fact that the fundamental political and public attitude towards market-economy competition in Austria remains largely unchanged.

Despite numerous measures to stimulate competition in individual areas, taken rarely upon the initiative of economic operators but rather under external pressure from the European Union, Austria is still far from competition-minded. Contrary to economic theory and empirical evidence (Monopolkommission, 2004), the prevailing attitude is to rely on the advantages of size (increasing economies of scale) and to believe in the possibility of achieving international competitiveness through mergers (instead of innovations). This holds for government authorities at the federal and provincial levels, which tend to opt for the "national champion" or for a solution that allows them to exercise their own power to the greatest possible extent, as well as for professional and representative bodies, which intervene for the benefit of their own stakeholders. Competition authorities and regulatory bodies are weak (and

Competition policy can only develop its positive impact on innovation, growth and employment in the medium to long term. In the short term, its effectiveness in the fight against inflation is quite limited.

tend to defy any attempts at strong leadership) and antitrust courts, contrary to empirical evidence¹ (Tichy, 2001, 2000, Gugler et al., 2003), have so far decided against competition in the majority of merger cases, as they overestimate the advantages (e.g., efficiency increase through economies of scale) and underestimate the disadvantages (e.g., increase of market power and risk of collusion) of mergers.

After a first wave of liberalisation, characterised by the reform of the Trade Code and (genuine) privatisation measures, the move towards deregulation is now stagnating; the fundamental decision to halt further privatisation also runs counter to the goal of intensifying competition. At the same time, international studies quantify the growth potential of deregulation at about 0.5 percent of GDP per year (Böheim – Friesenbichler – Sieber, 2006).

A long-term competition-policy strategy is not yet in sight in Austria. Economic policy-makers do not seem to take much interest in the development of sustainable strategies for competition policy, the Federal Competition Authority is too busy working on individual cases and has no time left for strategic considerations, while the Competition Commission, which could fill this strategic vacuum with its expertise, falls far short of its potential due to a lack of resources and powers. However, if competition policy fails to look beyond individual cases and short-term issues, it runs the risk of overlooking essential macro-economic relationships. Hence, urgent calls for the development of a comprehensive competition-policy strategy in Austria ("competition policy in small open economies") have been voiced for quite some time (Böheim, 2008, Böheim – Friesenbichler – Sieber, 2006).

Against the background of this "strategic vacuum" in Austrian competition policy, a number of useful measures can be identified as strong strategic elements in the optimisation of competition. Basically, "competition reform" could be aimed at three objectives: optimising the enforcement of existing competition law, further developing the legal framework and the organisational structure, and redefining the orientation of competition policy. In the following, the short-term options for competition-policy measures as well as their medium to long-term effects will be discussed in the context of subject-oriented reform packages. Moreover, short-term approaches to the intensification of competition in selected areas will be presented.

Without changing the legal framework, positive effects could be achieved by improving the enforcement of Austrian competition law through stricter merger control and through a tougher stance taken by the Federal Competition Authority against firms that refuse to open up to competition.

Austrian competition authorities systematically underestimate the importance of merger control for the maintenance of fair competition (Tichy, 2000, 2001). Mergers of companies are hardly ever prohibited in Austria. In the past, the conditions imposed upon companies intending to merge have only rarely been strict; in the majority of cases, they have been so lax that in retrospect they have often proved to have been mere formalities that were totally ineffective (Böheim, 2003).

Neglecting merger control by allowing highly concentrated market structures to develop and assuming that such market structures can be controlled simply by watching out for any abuse of market power is a serious error of competition policy.

Though rather weak in their abuse-of-power monitoring function, competition authorities are in a very strong position when it comes to merger control: the merging companies have to provide evidence of the fact that the merger will not result in or strengthen a dominant market position. In a merger case, substantial measures of ownership disintegration can be imposed to maintain competition in the relevant market. However, once the merger has been approved, the competition authorities are reduced to the role of an abuse-of-power watchdog. The problems of a highly concentrated market (market power, risk of collusion) not eliminated through

Competition policy goes beyond a mere focus on specific anti-trust cases. Modern, growth-oriented competition policy needs to take a long-term approach and pursue an overall strategy coordinated with other policy areas (industrial policy, energy policy, environment policy, etc.).

Reform Package Number 1: Optimising the enforcement of competition law

Stricter merger control

¹ According to Gugler et al. (2003), only about 30 percent of all successful mergers (resulting in a higher enterprise value) are motivated by the synergy effects to be achieved. In another 30 percent, the increase in enterprise value is exclusively due to the exercise of market power.

merger control are bound to re-emerge in the abuse-of-power context, though with the competition authority now being in a significantly weaker position vis-à-vis the company.

Given the fact that a case of market abuse is extremely difficult to detect and even more difficult to prove before a court – a possible easing of the rules of evidence (see below) will not result in any fundamental changes – competition authorities are well advised not to give up the powerful instrument of merger control by targeting their efforts primarily at combating the abuse of market power and, on top of that, signalling their intentions in advance to the firms concerned (*Böheim, 2003*).

Sectors that refuse to open up to competition need to be dealt with firmly and consistently. However, the Federal Competition Authority prefers to opt for consensus-based negotiated solutions instead of taking a firm stance on this issue (*Böheim, 2003*).

As the example of the initiatives taken in the electricity and gas sectors shows, this approach does not produce the desired success. Although the sectoral studies carried out by the Federal Competition Authority and by E-Control (*Bundeswettbewerbsbehörde, 2006A, 2006B*) provided evidence of a serious lack of competition in the energy markets, almost two years later many of the obstacles to competition are still in place (*E-Control, 2008*; see also Reform Package Number 4 below).

Regardless of warnings expressed by the Competition Commission, the Federal Competition Authority (together with E-Control) at the end of 2006 agreed with the electricity industry on a basic set of measures to "stimulate competition", including a counter-productive internal system of self-evaluation for the sector (*Wettbewerbskommission, 2008A*) – the result being that to this very day even violations of legal obligations go unpunished. As regards the "Gas Competition Initiative", a rough outline has only just been produced – almost two years after publication of the empirical findings on obstacles to competition: it mentions three priorities in rather vague terms (improved access to different gas suppliers, improved access to flexibility services, such as storage facilities, as well as wider choice and more information for gas customers). Again, measures to stimulate competition are being elaborated in cooperation with the sector concerned, a procedure which already proved to be of little use in the past².

As a location for business and industry, Austria has suffered greatly from its lack of commitment and the delayed implementation of competition-enhancing measures, as the potential for competition-induced price cuts was not utilised. In the future, competition and regulatory authorities should take more stringent measures against firms that consistently refuse to open up to competition – and not only in the energy sector.

In an antitrust case it is up to the competition authorities to prove that a company in a dominant market position is actually abusing its market power. However, given the fact that the abuse of market power is difficult to detect and even more difficult to substantiate in a court-proof manner, a further "sharpening" of the instruments of investigation is to be taken into consideration.

The Competition Commission recommended that the rules of evidence should be eased with regard to both market domination (e.g., through legal but refutable presumption rules) and the abuse of market power (e.g., facilitation of evidence through prima facie evidence; use of plausible information by plaintiffs as "best available information"). At the same time, the Competition Commission recommended that measures taken by the authorities should be subject to judicial control to compensate for the more extensive powers granted to the authorities (*Wettbewerbskommission, 2008B*).

Going beyond the proposals made by the Competition Commission, *Böheim (2008)* pleads in favour of a *reversal of the burden of proof in cases of abuse of market*

**Taking a firm stance
against "competition-
resistant firms"**

Reform Package Number 2: Further development of the legal and institutional framework

**Stronger controls in
cases of abuse of
market power**

² See <http://www.bwb.gv.at/BWB/Aktuell/wiq.htm>.

power under antitrust law according to the German model (Sect. 29 of the Restrictive Practices Act): market-dominating firms ought to have to prove that they have not abused their market power. This would greatly strengthen the position of the competition authorities in cases of abuse of market power and increase their supervisory powers under antitrust law.

However, ex-post controls of the resulting market situation through a reversal of the burden of proof will be no substitute for stricter merger control (see above) or an efficient self-control of competition. By no means can it be deemed to be as effective as eliminating the economic causes of the absence of competition in the markets concerned (*Monopolkommission*, 2007). In the long run, competition policy should be aimed at intensifying competition by removing barriers to market access. To make markets contestable, the market access of potential competitors ought to be promoted (*Baumol – Panzar – Willig*, 1982). A geographical expansion of markets would be another way to increase the number of market actors and, consequently, the intensity of competition³.

Lowering the barriers to market access does not immediately result in intensified competition. Nevertheless, compared with abuse-of-power monitoring, this approach offers the advantage of tackling the real causes of the problem and producing a long-term effect; moreover, it actually stimulates competition (*Monopolkommission*, 2007). However, ensuring stricter monitoring for any abuse of market power through a reversal of the burden of proof may be a useful addition to the array of competition policy instruments, producing a short-term effect as long as functioning competitive markets are not yet fully developed.

In practice, the current antitrust law regime (Antitrust Act 2005, Competition Act 2002) has proven to be seriously deficient in terms of enforcement efficiency. In particular, the Federal Competition Authority has very limited investigative powers. The Competition Act reflects the legislator's commitment to the widest possible range of investigative powers, especially in respect of "demands for information". However, if firms refuse to provide the relevant information, the Federal Competition Authority is referred to "legal recourse". As the example of the "food retail trade" investigation (*Bundeswettbewerbbehörde*, 2007) has shown, referring a case to the antitrust court may trigger an "endless loop of legal remedies", which seriously delays the proceedings.

The draft bill of the 2005 amendment to the Competition Act had included a provision empowering the Federal Competition Authority to demand the obligatory submission of information by firms by administrative decision. Thus, firms unwilling to provide information would no longer be able to evade their legal obligations (under the Competition Act) by exploiting the current system of legal remedies.

The current draft of the 2008 Competition Authority Reorganisation Act, introduced by the Federal Ministry of Economic Affairs, takes up this useful idea of broader investigative powers⁴. If the Federal Competition Authority were in a position to impose monetary fines and penalty payments to obtain an appropriate response to its demands for information, investigations would be rendered much more efficient.

This extension of its investigative powers would strengthen the position of the Federal Competition Authority as an investigating body and should therefore be further pursued by the legislator.

Through the 2002 amendment to the Antitrust and Competition Act, the Austrian antitrust authorities were transformed into a hybrid system consisting of a civil court and an administrative authority, with two new investigating and prosecuting authorities (Federal Competition Authority and Federal Cartel Attorney) being "crafted" onto the existing system (antitrust court).

To optimise the system, the structure of antitrust institutions should be further developed by *combining the Federal Competition Authority and the Federal Cartel At-*

³ In the energy market this could be achieved through the extension of cross-border interconnectors and the elimination of bottlenecks (*Bundeswettbewerbbehörde*, 2006A, 2006B).

⁴ Draft bill and legal texts: <http://www.bmwa.gv.at/BMWA/Rechtsvorschriften/Entwuerfe/e2008500.htm>.

Strengthening the investigative powers of the Federal Competition Authority

Creation of a comprehensive competition authority

torney into a single competition authority with comprehensive powers – in line with European standards and based on the model which has been practiced successfully in Germany for over fifty years. This institutional reorganisation, recommended repeatedly in the past (Böheim, 2008, 2003, Böheim – Friesenbichler – Sieber, 2006), was included in the government programme for the 23rd legislature (Bundeskanzleramt, 2007) and incorporated into a draft for a 2008 Competition Authority Reorganisation Act introduced by the Federal Ministry of Economic Affairs and Labour; it could be implemented expeditiously by the next federal government.

The 2002 reform of the Antitrust Act upheld the position of the antitrust court as a decision-making body of first instance. In this respect, Austria – together with Ireland – is in a special position within the European Union, as in all other EU countries first-instance decisions are taken by the national competition authority.

Once the "dual structure" of the Federal Competition Authority and the Federal Cartel Attorney has been replaced by a single competition authority with comprehensive powers, a *transfer of the first-instance decision-making power in antitrust cases to the Federal Competition Authority* ought to be taken into consideration (Böheim, 2008, 2003, Böheim – Friesenbichler – Sieber, 2006). This would make the Federal Competition Authority a modern, "fully-fledged" competition authority modelled on the European Commission or the German Federal Cartel Office⁵.

The Competition Commission was originally designed as an advisory body of experts supporting the Federal Minister of Economic Affairs and Labour and the Federal Competition Authority. However, in terms of practical competition policy, it has never played more than a minor role, for lack of resources and powers. If it were *repositioned as an independent body of experts, modelled on the German Monopolies Commission* (Böheim, 2008, 2003, Böheim – Friesenbichler – Sieber, 2006, Wejwoda, 2008), it could direct its attention to issues of principle in competition law without being involved in the day-to-day operations of the Federal Competition Authority. While retaining its right to be informed on merger control investigations, it should no longer have the right to address recommendations to the Federal Competition Authority. At the same time, its main focus should be on drafting expert opinions on general competition-policy issues, comparable to the general and special opinions issued by the German Monopolies Commission, in order to fill the strategic vacuum in Austrian competition policy at least to some extent. Upgrading the Competition Commission along these lines would, however, imply that it has to be granted the appropriate powers (e.g., drafting of regular competition reports) and allowed a relatively small but independently managed budget. Although the "Inflation study" drafted by the Competition Commission (Wettbewerbskommission, 2008B) was well received and the value of the Commission's activities was explicitly acknowledged in political circles, the possibility of upgrading the Commission and focusing its attention on matters of principle in competition policy has not been considered in a favourable light to date. Therefore, an addition to the draft of the 2008 Competition Authorities Reorganisation Act introduced by the Ministry of Economic Affairs is recommended.

Modern competition policy must be based on an overall strategy coordinated with other policy areas (industrial policy, energy policy, environment policy, etc.). *Implementing a forward-looking competition policy based on transparent, quantitative competition monitoring* is therefore an urgent requirement for Austria. Denmark's proactive and investigative competition policy, which provides for all sectors of the economy to be subjected to quantitative competition monitoring on the basis of

Repositioning of the Competition Commission

Reform Package Number 3: Proactive and investigative competition policy

⁵ This measure was also part of the last government programme and has been incorporated into the Ministry's draft for the 2008 Competition Authorities Reorganisation Act. As it implies a substantial departure from the constitutional principle of the separation of administrative and judicial powers – the reform provides for cases to be referred direct from the Federal Competition Authority (administrative authority) to the antitrust court (civil court) – this "system change" requires a comprehensive discussion and a broad political consensus. Basically, it would transpose the proven German model, in which the Federal Cartel Office takes first-instance decisions and the Upper Regional Court of Düsseldorf acts as court of appeal, to Austria.

clear political guidelines, might be a good example to follow (*Böheim, 2008, Böheim – Friesenbichler – Sieber, 2006, Janger, 2008, 2006*).

The establishment of a central information platform, including a database comprising the complete product offer of all food retail chains, would be conceivable as an integral part of the proposed competition monitoring system. Such a "virtual price labelling obligation" may be expected to have a significant stimulating effect on competition in the highly concentrated food retail trade (*Schulmeister, 2008*).

In order to place its competition and regulatory policies on a clear, quantitative basis, Austria should also participate in the "OECD Reviews of Regulatory Reform"; at the same time, the compilation of competition-related data should be improved, for instance through national concentration statistics to be compiled by Statistics Austria. On that basis, regular reports on competition in the Austrian economy should be published. To ensure the highest possible degree of independence, objectivity and transparency, this annual competition report could be drafted by the newly positioned Competition Commission. Together with obligatory comments by the firms concerned and by the competition and regulatory authorities, the report should be debated in Parliament. The competition and regulatory authorities would have to submit a set of specific measures aimed at eliminating the competition problems identified in the report (*Böheim, 2008, Böheim – Friesenbichler – Sieber, 2006*).

Besides the medium and long-term measures described above, efforts to intensify competition in the markets for energy and over-the-counter drugs can produce a short-term anti-inflationary effect.

Like Great Britain, Italy, Spain, the Netherlands and Germany, Austria is among those EU countries that completely liberalised their markets for electricity (since 1 October 2001 in Austria) and gas (since 1 October 2002 in Austria; *E-Control, 2003*) – long before the deadline set by the European Commission (1 July 2007).

Up to 2006, the liberalisation of the energy market turned out to be very positive for energy consumers. Industry was the main beneficiary of liberalisation, but private households and small businesses also derived an advantage from the "liberalisation dividend" (*Kratena, 2004*). However, for Austrian energy consumers the initial price reductions in the wake of energy market liberalisation were soon offset by increasing public charges (price surcharges to promote small-scale hydro power plants, co-generation and green electricity as well as a higher energy tax on electrical energy) claimed to be justified for reasons of energy policy. Repeated cuts of network user charges by E-Control and the implementation of an incentive-oriented regulatory regime as of 1 January 2006 had at least some effect in counteracting a price structure⁶ that practically closed the Austrian electrical energy market to foreign competitors (*Böheim – Friesenbichler – Sieber, 2006, Böheim, 2004*). Since 2007, Austria's position in the European Union with respect to electricity and gas prices has been deteriorating substantially. The price level, which had approached the lower end among all European countries after liberalisation, has returned to the European average. Industrial consumers are even back to paying the prices charged prior to liberalisation (*E-Control, 2008*).

Austria's efforts to liberalise electricity and gas prices have not yet resulted in the development of a well functioning market (*Wettbewerbskommission, 2008A*). The strong market position of the provincial energy utilities and the major public utilities in Austrian cities, held by public majority shareholders – as provided for by a constitutional act – and hardly willing to compete with each other (across provincial borders), have remained unaffected by liberalisation. Based on low-cost energy gen-

Electricity, gas and over-the-counter drugs are among the groups of goods which account for a substantial part of home-made inflation. Intensified competition in these markets is likely to have a short-term anti-inflationary effect.

Reform Package Number 4: Short-term anti-inflationary measures

**Energy Markets:
absence of competition
despite liberalisation**

⁶ For a long time, the Austrian price for the pure energy component, e.g., for residential customers, was the lowest in Europe, but network user charges were extremely high (*Bundeswettbewerbsbehörde, 2006A*). Long after liberalisation, this price structure still constituted an essential barrier to market access for alternative, non-local suppliers, as the pure energy component – the only one subject to competition in liberalised markets – only accounted for a small part of the price for the final consumer, while network user charges, subject to regulation, as well as taxes and charges, made up the major part of the price paid. Thus, local energy utilities (network operators) were able to cross-subsidise their energy supplies via network user charges, which in turn enabled them to keep out non-local competitors.

eration from fully amortised hydro power plants and a natural gas price coupled to the steeply rising oil price, the net income of energy utilities and, consequently, the dividends paid to the public sector have been going up considerably, while energy costs for consumers have kept rising steeply.

What has been done so far – opening the market without breaking up regional monopoly structures and, at the same time, pursuing a course of politically supported, horizontal and vertical market integration without opposition from the competition and regulatory authorities – is not suited to stimulate sustainable competition in the Austrian energy markets. As the integrated European internal market for energy will not materialise in the foreseeable future (European Commission, 2006 SEC (2006) 1724 of 10 January 2007), national initiatives to stimulate competition are urgently required – all the more since no such input is to be expected from foreign suppliers in the absence of cross-border competition.

As a complementary long-term measure of strategic importance, the creation of a competitive single European energy market is to be vigorously pursued at the EU level. "Opening the borders" to international suppliers is of primary importance, as competition in Austria will not intensify "on its own" as long as the existing oligopolistic market structure remains unchanged. The transit of electricity and natural gas across Europe requires appropriate infrastructure investments and must be ensured through guaranteed non-discriminatory network access.

However, regardless of what the European Commission is doing, the Austrian competition and regulatory authorities need to effectively monitor the dominant energy utilities for a possible abuse of market power. The steps taken to date, including a set of measures to stimulate competition in the electricity sector, have been insufficient to ensure well-functioning competition, as they were inadequately designed and implemented and did not provide for effective market monitoring.

Energy utilities quote international price developments to justify higher price increases, although they are not even exposed to competition in their home markets. Greater stringency in dealing with "competition-resistant" energy suppliers, based on full use of all the instruments of antitrust law, is essential. In practice, barriers to market access are due to the non-effective separation between network operation and the competitive part of the business, especially in distribution networks. Moreover, the markets lack transparency, which in turn results in substantial restraints on competition, above all through supplier-change and settlement processes⁷.

In the long run, competition in the energy markets will only work if all suppliers are subject to the same procedures. Therefore, the automation, standardisation and centralisation of supplier-change and settlement processes are of fundamental importance and should be tackled immediately by the energy sector. This standardisation process needs to be accompanied, controlled and strictly supervised by the competition and regulatory authorities, if a pro-competitive and non-discriminatory system is to be put in place.

In this context, the Competition Commission (*Wettbewerbskommission*, 2008B) recommends the following "instant measures" for the sector:

- adjustment of the Austrian supplier-change process to the non-bureaucratic process used in Germany, which does not require written authorisations,
- implementation of a database of single meter numbers,
- a consumer-friendly legal regulation providing for uniform (short) periods of notice.

An essential conflict of interest results from the multiple role of the federal and provincial governments: they own the public utilities, they create the framework for market liberalisation in their capacity as legislators, and they function as supervisory bodies responsible for licensing and the monitoring of unbundling. On the one hand, the federal government and the provinces are obliged to implement and supervise

⁷ A detailed list of restrictive practices is contained in the "Inflation Opinion" of the *Competition Commission* (2008B).

the legal framework for market liberalisation, i.e., to establish functioning competition that reduces the margins earned by the utilities. On the other hand, these very same entities, as the owners of the utilities, have a profound interest in keeping their revenues from the (former) regional electricity monopolies high, i.e., in sheltering them from free competition in order to maximise the dividend income for the public households.

It was mainly due to this conflict of interest that "unbundling", i.e., the separation of network operation and electricity distribution, took such a long time in Austria. Moreover, in practice the vertically integrated energy utilities tend to opt for "minimum versions" of unbundling, which, strictly speaking, meet the requirements of the Directives, but are far from sufficient to stimulate competition to any noticeable extent (*E-Control*, 2006).

One way out of this problem might be to privatise the energy generation and distribution components of the public utilities, while upholding the public ownership of the network infrastructure. However, this would require an amendment to the Austrian constitution, as the existing ownership structure (public territorial authorities as majority shareholders) is based on a constitutional provision. Another possibility would be unbundling in terms of ownership, if the practical implementation of legal unbundling remains unsatisfactory. In any case, the powers of the energy regulator regarding supervision of the implementation of unbundling in the electricity sector would have to be broadened, with the provincial governments transferring some of their rights to E-Control. If such supervisory rights, effective in the gas industry since 2002, were implemented in the electricity sector, the above-mentioned conflicts of interest would at least be partially mitigated. Moreover, in order to increase the efficiency and credibility of law enforcement, E-Control would have to be granted the right to impose stricter sanctions on energy utilities in cases of abuse of market power or infringement of antitrust law. E-Control must be in a position to impose monetary fines that should be comparable to those provided for by the Antitrust Act⁸ as far as the amount of the fine and its deterrent effect are concerned (*Böheim – Friesenbichler – Sieber*, 2006, *E-Control*, 2008).

The Austrian market for pharmacy-only OTC drugs has a volume of approximately € 350 million (including 20 percent value-added tax) and is growing at an above-average rate (*Wettbewerbskommission*, 2008B).

As in France, a low-price country for pharmaceuticals, prices for OTC drugs have been going up considerably in Austria in recent years (*Baumgartner*, 2008A). The steep price increases in Austria are due to the national regulatory framework, which permits hardly any influence of market forces on price formation (*Wettbewerbskommission*, 2008B).

Price regulation comprises the entire value added chain: based on applications submitted by the pharmaceutical companies, ex-works prices are fixed by the price commission of the Federal Ministry of Health, Youth and Family. The commission merely checks whether the prices are above the European average (arithmetic mean of the net prices in the countries in which the pharmaceutical has been approved). If manufacturing costs go up, higher prices can be applied for. Naturally, nobody ever applies for a price reduction. This system, which offers no incentive whatsoever to cut prices, would have to be adjusted to provide for automatic price reductions.

Besides ex-works prices, wholesale and pharmacy margins for OTC drugs are also regulated by the state, which excludes price competition between pharmacies. In this protected sector, pharmacies earn a margin which is up to 12 percent higher (51 percent on average), while their stock-keeping costs and the related entrepreneurial risks are reduced to a minimum due to frequent deliveries by wholesalers (*Wettbewerbskommission*, 2008B).

⁸ The Antitrust Act provides for monetary fines of up to 10 percent of a firm's revenues. By comparison, the district administrative authority (acting upon the request of E-Control) can sanction infringements with an administrative fine in the "symbolic" amount of € 50,000. An administrative fine of this magnitude is unlikely to have a preventive effect in either specific or general terms.

To intensify competition in the energy markets on a sustainable basis, it will take a broad-based political consensus and the willingness to implement profound reforms aimed at resolving anti-competitive conflicts of interest.

Over-the-counter drugs: price control restricts competition

Consumers require far less advice and information for these products than for prescription drugs. The pharmacy-only rule for self-medication drugs should be critically reconsidered. A sustainable stimulation of competition in this market will only be achieved through consistent deregulation of margins and by abandoning the pharmacy-only rule for the majority of OTC drugs. The price reductions to be expected from deregulation could be in the order of the reduction of the VAT rate currently under discussion (up to € 60 million for OTC drugs only⁹), while costs for the public sector would only amount to a fraction thereof.

The revival of competition policy in an environment of accelerating inflation has the potential to encourage a more stringent enforcement of competition law as well as the implementation of previously neglected competition-policy and antitrust reforms, which will ultimately have a positive impact on the competitiveness and attractiveness of Austria as a location for business and industry. Measures suited for short-term implementation can be grouped in *four subject-oriented reform packages*.

In the past, the Austrian competition authorities have neglected their merger control function and allowed the creation of highly concentrated market structures. Assuming that ex-post controls of such market structures can be ensured simply by monitoring the market for a possible abuse of power is a serious error of competition policy.

The approach taken by the Federal Competition Authority, which tends to opt for consensus-based negotiated solutions when dealing with competition-resistant firms, also fails to produce the desired result, as shown by the delayed and insufficient implementation of initiatives aimed at stimulating competition in the energy market.

Without changing the legal framework, the enforcement of Austrian competition law could be improved in the short run through *stricter merger control and a tougher stance taken by the Federal Competition Authority against firms that refuse to open up to competition (Reform Package Number 1)*.

In practice, the current antitrust law regime (Antitrust Act 2005, Competition Act 2002) has proven to be seriously deficient in terms of enforcement efficiency. Besides optimised antitrust law enforcement, four interesting perspectives for the *further development of the legal and institutional framework* can be identified (*Reform Package Number 2*): first, there is a need for more effective monitoring of firms for any abuse of market power; second, the investigative powers of the Federal Competition Authority should be strengthened; third, this should lead to the creation of a comprehensive competition authority and, fourth, the upgrading of the Competition Commission.

In an antitrust case it is incumbent upon the competition authorities to prove that a company in a dominant market position is actually abusing its market power. However, given the fact that the abuse of market power is difficult to detect and even more difficult to substantiate in a court-proof manner, a further "sharpening" of the instruments of investigation is to be taken into consideration.

Therefore, a *reversal of the burden of proof in cases of abuse of market power under antitrust law* according to the German model (Sect. 29 of the Restrictive Practices Act) is recommended: market-dominating firms ought to have to prove that they have not abused their market power. This would greatly strengthen the position of the competition authorities in cases of abuse of market power and increase their supervisory authority under antitrust law.

However, ex-post controls of the resulting market situation are no substitute for efficient self-regulation through competition. Hence, eliminating the economic causes for the absence of competition in the markets concerned is all the more important in the long run. Ensuring stricter monitoring for abuse of market power through a reversal of the burden of proof is therefore a useful addition to the array of competi-

⁹ This amount would apply if OTC drugs were completely exempted from VAT. A mere reduction of the current VAT rate of 20 percent to 10 percent would reduce public-sector revenue losses correspondingly less: halving the VAT rate to 10 percent would thus cost the public sector about € 30 million.

tion policy instruments, as it produces a short-term effect as long as functioning competitive markets are not fully developed.

Moreover, the Federal Competition Authority should be granted greater investigative powers, as it would otherwise be at a disadvantage vis-à-vis firms that avoid having to provide the required information through an excessive use of legal remedies. The Federal Competition Authority should have the power to *enforce an appropriate response to its demands for information by imposing monetary fines and penalty payments*.

Through the 2002 amendment to the Antitrust and Competition Act, the Austrian antitrust authorities were transformed into a hybrid system consisting of a civil court and an administrative authority, with two new investigating and prosecuting authorities (Federal Competition Authority and Federal Cartel Attorney) being "crafted" onto the existing system (antitrust court).

To optimise the system, the structure of antitrust institutions should be further developed by *combining the Federal Competition Authority and the Federal Cartel Attorney into a single competition authority with comprehensive powers*, in line with European standards. Subsequently, *a transfer of the first-instance decision-making power in antitrust cases to the Federal Competition Authority* ought to be taken into consideration. As this measure implies a substantial departure from the constitutional principle of the separation of administrative and judicial powers – cases would be referred directly from the Federal Competition Authority (administrative authority) to the antitrust court (civil court) – this "system change" requires a comprehensive discussion and a broad political consensus.

The Competition Commission was originally designed as an advisory body of experts supporting the Federal Minister of Economic Affairs and Labour and the Federal Competition Authority. If it were *repositioned as an independent body of experts modelled on the German Monopolies Commission*, the Competition Commission could focus on issues of principle in competition law – an area that has been badly neglected in Austria and needs urgent attention – without being involved in the day-to-day operations of the Federal Competition Authority.

Competition policy goes beyond a mere focus on specific antitrust cases; modern competition policy needs to be based on an overall strategy coordinated with other policy areas (industrial policy, energy policy, environment policy, etc.). *The implementation of a forward-looking competition policy on the basis of transparent, quantitative competition monitoring (Reform Package Number 3)* is an urgent requirement for Austria.

Denmark's proactive and investigative competition policy, which provides for all sectors of the economy to be subjected to quantitative competition monitoring on the basis of clear political guidelines, might be a good example to follow. The establishment of a central information platform, including a database comprising the complete product offer of all food retail chains, would be conceivable as an integral part of competition monitoring. Such a "virtual price labelling obligation" may be expected to have a significant stimulating effect on competition in the highly concentrated food retail trade.

In order to place its competition and regulatory policies on a transparent, quantitative basis, Austria should participate in the "OECD Reviews of Regulatory Reform"; at the same time, the gathering of competition-related data should be improved, for instance through national concentration statistics to be compiled by Statistics Austria. On that basis, annual reports on competition in the Austrian economy should be published. To ensure the highest possible degree of independence, objectivity and transparency, this annual competition report could be drafted by the newly positioned Competition Commission. Together with obligatory comments by the firms concerned and by the competition and regulatory authorities, the report should be debated in Parliament. The competition and regulatory authorities would have to propose a set of specific measures aimed at eliminating the competition problems identified in the report.

Besides the medium and long-term measures described above, competition policy has the potential to produce *short-term anti-inflationary effects in the markets for energy and over-the-counter drugs (Reform Package Number 4)*.

In the absence of stringent competition and regulatory policies, Austria's efforts to liberalise the electricity and gas sector have not yet resulted in the development of a well-functioning market. The strong market position of the provincial energy utilities and the major municipal utilities, which are held by public majority shareholders – as provided for by a constitutional act – and only willing to compete with each other (across provincial borders) to a minimal extent, has remained unaffected by liberalisation.

The Austrian competition and regulatory authorities need to effectively monitor the dominant energy utilities for a possible abuse of market power. The steps taken to date, including a set of measures to stimulate competition in the electricity sector, have been insufficient to ensure well-functioning competition, as they were inadequately designed and implemented and did not provide for effective market monitoring.

In practice, the main barriers to market access are due to the non-effective separation between network operation and the competitive part of the business, especially in distribution networks. Moreover, the markets lack transparency, which in turn results in substantial restraints on competition, above all in supplier-change and settlement processes. Therefore, the automation, standardisation and centralisation of supplier-change and settlement processes are of fundamental importance for the stimulation of competition. This standardisation process needs to be accompanied, controlled and strictly supervised by the competition and regulatory authorities, if a pro-competitive and non-discriminatory system is to be put in place.

Furthermore, the multiple roles of the federal and provincial governments – as owners of the public utilities, as legislators responsible for the framework for market liberalisation and as supervisory bodies in charge of licensing and the monitoring of unbundling – should be separated. These conflicts of interest have an anti-competitive effect and should therefore be resolved through a determined political effort. E-Control should be equipped with a broader range of sanctions to impose on energy utilities acting in restraint of competition and/or unlawfully.

Over-the-counter drugs, all of them subject to the pharmacy-only rule in Austria, are another market in which deregulation would lead to substantial price cuts without jeopardising quality. The high price level is due to the national regulatory conditions: owing to the fact that price regulation comprises the entire value added chain (from ex works prices to wholesale prices to pharmacy selling prices), market forces have no influence whatsoever on price formation.

Given the fact that consumers require far less advice and information for these products than for prescription drugs, the distribution of preparations for self-medication could be largely deregulated. Price competition would be stimulated considerably, if margins were rigorously deregulated and the pharmacy-only rule were abandoned for the majority of OTC drugs. Substantial price reductions would result from such a move.

Baumgartner, J. (2008A), Statistische Zerlegung produktspezifischer Inflationsraten in Österreich und in der Eurozone, WIFO, Vienna, 2008, http://www.wifo.ac.at/wwwa/jsp/index.jsp?fid=23923&id=33140&typeid=8&display_mode=2.

Baumgartner, J. (2008B), Die Preistransmission entlang der Wertschöpfungskette in Österreich für ausgewählte Produktgruppen, WIFO, Vienna, 2008.

Baumgartner, J. (2008C), "Statistical Decomposition of Product-Specific Inflation Rates in Austria", Austrian Economic Quarterly, 2008, 13(4), pp. 156-170, http://www.wifo.ac.at/wwwa/jsp/index.jsp?fid=23923&id=34560&typeid=8&display_mode=2.

Baumol, W.J., Panzar, J.C., Willig, R.D., Contestable Markets and the Theory of Industry Structure, New York, 1982.

Böheim, M., "Ökonomische Analyse der Wettbewerbssituation im österreichischen Lebensmitteleinzelhandel", WIFO-Monatsberichte, 2002, 75(5), pp. 325-338, http://www.wifo.ac.at/wwwa/jsp/index.jsp?fid=23923&id=21983&typeid=8&display_mode=2.

References

- Böheim, M., "Wettbewerbspolitik unter neuen Rahmenbedingungen. Zwischenbilanz und Ausblick", WIFO-Monatsberichte, 2003, 76(7), pp. 515-528, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=24415&typeid=8&display_mode=2.
- Böheim, M., "Wettbewerb, Wettbewerbspolitik und Wirtschaftswachstum. Theoretische Grundlagen und empirische Evidenz für Österreich", WIFO-Monatsberichte, 2004, 77(10), pp. 751-768, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=25297&typeid=8&display_mode=2.
- Böheim, M., "Reform Options for Competition Policy in Austria", Austrian Economic Quarterly, 2008, 13(3), pp. 106-116, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=33339&typeid=8&display_mode=2.
- Böheim, M., Friesenbichler, K.S., Sieber, S., WIFO-Weißbuch: Mehr Beschäftigung durch Wachstum auf der Basis von Innovation und Qualifikation. Teilstudie 19: Wettbewerb und Regulierung, WIFO, Vienna, 2006, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=27458&typeid=8&display_mode=2.
- Bundeskanzleramt, Government Programme 2007-2010. Government Programme for the 23rd Legislature, Vienna, 2007, <http://www.austria.gv.at/DocView.axd?CobId=19542>.
- Bundeswettbewerbsbehörde (2006A), Allgemeine Untersuchung der österreichischen Elektrizitätswirtschaft. Endbericht, Vienna, 2006, <http://www.bwb.gv.at/NR/rdonlyres/3236A7BD-7697-4594-BDD4-15F6B8EB8E24/26974/EndberichtStromfinal1106.pdf>.

The Role of Competition Policy in the Fight against Inflation

An Overview of Possible Short-term Measures to Intensify Competition – Summary

Competition policy has a positive medium to long-term effect on innovation, growth and employment. In the short term, however, its effectiveness in the fight against inflation is quite limited. Four sets of subject-specific reform measures elaborated by WIFO illustrate the range of effects to be achieved through a growth-oriented competition policy.

1. Reforms to optimise the enforcement of existing competition law

Without changing the legal framework, it would be possible to improve the enforcement of Austrian competition law substantially through *stricter merger control - a matter neglected in the past - and a tougher stance taken by competition and regulatory authorities against enterprises continuing to act in restraint of competition.*

2. Reforms aimed at the further development of competition law and the institutional landscape

In practice, evidence of abuse of market power needs to be "court-proof". A reversal of the burden of proof in cases of abuse according to the German model (Sect. 29 of the Restrictive Practices Act) is therefore recommended. This would strengthen the position of competition authorities in cases of abuse of market power and substantially increase their ability to identify violations of anti-trust provisions.

Moreover, the investigative powers of the Federal Competition Authority need to be greatly strengthened. The Federal Competition Authority should have the right to demand that companies respond to its requests for information in due course and to impose administrative fines and penalties in the event of non-compliance.

The institutional structure in the field of competition law needs to be further developed through the creation of a comprehensive competition authority combining the functions of the Federal Competition Authority and the Federal Cartel Attorney. Ultimately, such a competition authority, equipped with the full range of powers, should also have the right to take first-instance decisions in accordance with European standards.

Modelled on the German Monopolies Commission, the Competition Commission should be repositioned as an independent body of experts focusing on the fundamental issues of competition law.

3. Reforms to implement a future-oriented competition policy based on transparent quantitative competition monitoring

Implementation of a proactive and investigative competition policy, based on the Danish model, under which all sectors of the economy are subject to objective and transparent, quantitative competition monitoring, is to be recommended for Austria.

4. Reforms aimed at intensified competition in the energy sector and the deregulation of over-the-counter drugs to achieve a short-term anti-inflationary effect

To *intensify competition in the energy markets* on a sustainable basis, it takes not only greater stringency on the part of competition and regulatory authorities in dealing with energy utilities that refuse to open their markets to competition, but also a broad political consensus aimed at resolving anti-competitive conflicts of interest resulting from the multiple roles of the Federal Government and the Provinces.

The high price level of over-the-counter drugs in Austria is largely due to the fact that the entire value added chain is subject to regulation. Without compromising on quality, competition on prices could be promoted through a consistent deregulation of margins and by abolishing the pharmacy-only rule for the majority of OTC drugs.

- Bundeswettbewerbsbehörde (2006B), Allgemeine Untersuchung der österreichischen Gaswirtschaft. Endbericht, Vienna, 2006, <http://www.bwb.gv.at/NR/rdonlyres/3236A7BD-7697-4594-BDD4-15F6B8EB8E24/26975/EndberichtFinal112006.pdf>.
- Bundeswettbewerbsbehörde, Allgemeine Untersuchung des österreichischen Lebensmittelhandels unter besonderer Berücksichtigung des Aspekts der Nachfragemacht, Vienna, 2007, <http://www.bwb.gv.at/NR/rdonlyres/606ACEA5-7710-4811-8F50-26852FB5A331/29052/Berichtfinal.pdf>.
- E-Control (Ed.), Liberalisierungsbericht 2003, Vienna, 2003.
- E-Control (Ed.), Bericht über den Stand der Umsetzung des Unbundling der österreichischen Elektrizitätsnetzbetreiber, Vienna, 2006.
- E-Control, Wettbewerb – Quo vadis? Zur Lage des Strom und Gasmarktes in Österreich 2007/2008, Vienna, 2008.
- Gugler, K., Mueller, D.C., Yurtoglu, B.B., Zulehner, Ch., "The Effects of Mergers: An International Comparison", *International Journal of Industrial Organization*, 2003, 21(5), pp. 625-653.
- Janger, J., "Nationale Lissabon-Reformprogramme: Ideen für die österreichische Wirtschaftspolitik", *OeNB, Geldpolitik & Wirtschaft*, 2006, (Q2/06), pp. 49-71.
- Janger, J., "Angebotsseitige Erklärungsfaktoren der Inflationsentwicklung in Österreich", *OeNB, Geldpolitik & Wirtschaft*, 2008, (Q2/08), pp. 35-73.
- Kratena, K., Makroökonomische Evaluierung der Liberalisierung im österreichischen Energiemarkt, WIFO, Vienna, 2004, http://www.wifo.ac.at/www/jsp/index.jsp?fid=23923&id=25238&typeid=8&display_mode=2.
- Monopolkommission, "Wettbewerbspolitik im Schatten "nationaler Champions"", 15. Hauptgutachten, Bonn, 2004. http://www.monopolkommission.de/haupt_15/sum_h15_de.pdf.
- Monopolkommission, Preiskontrollen in Energiewirtschaft und Handel? Zur Novellierung des GWB, 47. Sondergutachten, Bonn, 2007, http://www.monopolkommission.de/sg_47/text_s47.pdf.
- Schulmeister, St., "Wie sich Preise per Mausklick senken lassen", *Der Standard*, 25 July 2008, p. 31.
- Tichy, G., *Fusionen und Übernahmen: Erfolgsaussichten von Fusionen*, Vienna, 2000.
- Tichy, G., "What Do We Know About the Success and Failure of Mergers", *Journal of Industry, Competition & Trade*, 2001, 1(4), p. 347-394.
- Wejwoda, K., "Die Stellung der Wettbewerbskommission im österreichischen Kartellrechtsvollzug – Gedanken zu einer Weiterentwicklung", in Thanner, Th., Matousek, P., Müller, E. (Eds.) *Österreichisches Kartellrechts-jahrbuch 2008*, Vienna, 2008 (to be published soon).
- Wettbewerbskommission (2008A), Opinion of the Competition Commission on the final reports drafted by the Federal Competition Authority on the general studies regarding the Austrian electricity industry and the Austrian gas industry, Vienna, 2008, <http://www.bwb.gv.at/NR/rdonlyres/319BA8E4-0E7B-4C60-9702-49770639F4BA/31957/StelnderWK200607.pdf>.
- Wettbewerbskommission (2008B), Opinion of the Competition Commission of 14 July 2008 pursuant to Sect. 16, sub-sect. 1, of the Competition Act submitted to the Federal Minister of Economic Affairs and Labour, Vienna, 2008, <http://www.bwb.gv.at/BWB/Aktuell/inflga08.htm>.