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Competition and Inflation – Note by Germany

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More documents related to this discussion can be found at
www.oecd.org/competition/competition-and-inflation.htm

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1. Introduction: Demands placed on policymakers and enforcers in an inflationary environment

1. The Call for Contributions of 2 August (COMP/2022.114) for this roundtable stresses the point that the national competition authorities are coming under increasing pressure due to the current inflationary environment. This can also be seen in Germany. For example, appeals can be heard from politicians, media and consumers to the Bundeskartellamt to take action in response to the sharp rise in fuel prices in Germany and in particular to ensure that a cut in the energy tax (adopted as part of a relief package) is passed on to consumers. Even if many of the demands made by the public to the national competition authorities exceed their mandate, the current price rises do place a certain amount of pressure on the enforcers of competition law, and this mainly feeds into greater efforts to communicate to the outside world what action they are taking.

2. Regarding the price rises on the fuel markets in Germany, the Bundeskartellamt acted in April 2022 and launched an investigation of the oil sector, focusing on the refinery and wholesale level. The sector inquiry includes an analysis of the market and price developments and the interlinkages within the oil sector. An interim report will appear soon. The key factor behind the decision to launch a sector inquiry was an observed decoupling of the prices of products leaving the refineries from the development in the crude oil price. However, there are no specific indications of conduct on the fuel markets that violates cartel law. Also, no collective dominant position of the oil companies active in Germany at wholesale or refinery level has been identified, preventing any potential measures against (possible) abusive pricing.

3. Despite the pressure on the national competition authorities described above, the main focus of the inflation debate is on the policymakers. The current price rises are creating substantial pressure to act at policy level in a large number of policy fields, such as tax, energy and welfare policy – and also competition policy. The following article considers the relationship between competition and inflation, the contribution that competition policy can make to fighting inflation, and in particular the conclusions drawn for competition policy by the Federal Ministry for Economic Affairs and Climate Action, which has the lead responsibility for this portfolio in Germany.

2. Relationship between competition and inflation, and role of competition policy in the fight against inflation

4. The European Central Bank (ECB) defines price stability (as an absence of inflation or deflation) as an annual rise in the harmonised consumer price index for the eurozone of 2% in the medium term. Inflation in the eurozone stood at 9.9% in September 2022; the figure for Germany was 10.9%. The range within the eurozone stretches from 6.3% in France to 24.1% in Estonia. At 4.8%, core inflation is also well above the ECB's goal. The ECB's current forecast[1] anticipates inflation of 5.5% for 2023.

[1] As of 8 September 2022

5. In order to counter the inflationary development, it is necessary to start by gaining an overview of the impact vectors that can contribute to inflation.[2] Whilst there are a variety of potential causes of inflation, it should be uncontentious that the main causes are not to be found in the field of competition policy. For example, the money supply has expanded much more strongly than the economy in the eurozone in recent years, and this is frequently cited as a key factor. On 27 October 2022, the ECB (again) raised key interest rates by 75 basis points to 1.50% (deposit facility), 2.00% (main refinancing operations) and 2.25% (marginal lending facility). Beyond monetary policy, it is also necessary to discuss demand-side and supply-side causes of inflation.[3]

6. Demand-side causes very probably do play a role, albeit not a prominent one. Following a considerable slump due to the COVID-19 pandemic, a pick-up in national and (to some extent) international demand was observed, and this has also pushed up prices. However, the supply-side causes are likely to be of greater significance; they can be subdivided into cost inflation and profit inflation. In the current situation, the rising cost pressure is a central factor. Fossil fuels are the strongest drivers of inflation here.[4] In fact, not only the energy prices have risen massively in Germany and the EU: the increase in prices of other input factors and raw materials (e.g. grain, nickel) is also resulting in a substantial increase in production costs in many companies. In view of the current inflationary environment and the skills shortage in many sectors, rising wage costs are also possible, which in turn impact on production costs. There are however no indications of a wage-price spiral at present.

7. Competition policy cannot have a direct impact on any of these factors. Profit-driven inflation is the only area in which discussions focus on the extent to which it can be reduced by stricter competition law and more rigorous enforcement. Here, it is often argued that excessively lax competition policy has led to growing market power on numerous markets, and that this market power is now resulting in high profit mark-ups. In principle, however, dominant companies are always in a position to enjoy high profit mark-ups. In a market economy, the incentive to earn profits is inherent, so that companies do not need a crisis situation before they exercise market power to maximise profits. Nevertheless, to the extent that inflation, the COVID-19 pandemic or Russia's war of aggression against Ukraine result in a reduction in competitive pressures, a market-power-induced (further) increase in the profit mark-up does seem plausible. Assuming constant demand, such a reduction in competitive pressures can result for example from a decline in the useful manufacturing capacities available on the market – due to a loss of labour in the pandemic and a shortage of inputs – and via the market exits of companies – e.g. due to rising refinancing costs or direct effects of the war (cf. figure 10 about this as well).

8. There have been wide-ranging empirical studies of the development of concentration in many sectors. Whilst the strength of the effects varies from one OECD country to another, the trend does show an increase in concentration over time.[5] For

[2] In this article, which focuses on the interplay with competition policy, this can only be sketched out in a simplified way.

[3] There are of course other potential causes as well, but they are not considered in depth here. For instance, a minor role is probably played by the current account in the eurozone or Germany (since these are registering a significant surplus), and this is not addressed further here.

[4] Energy prices in the eurozone have risen by 40.7%.

[5] Cf. e.g.: Bajgar, M., Berlingieri, G., Calligaris, S., Criscuolo, C. and Timmis, J. (2019): Industry Concentration in Europe and North America, OECD Productivity Working Papers, 2019-18, OECD Publishing, Paris.

Germany, in macroeconomic terms, however, no rise in corporate concentration was identified as of 2020.[6] Since individual studies have found a positive correlation between corporate concentration and price rises,[7] this is sometimes used as evidence of the positive effect of intensive competition on the price level. The extent to which this correlation actually justifies the presumed causality is contentious, since market concentration is not a perfect proxy variable for the intensity of competition.[8] This suggests that greater insights might be gained from studies which work from the mark-ups to define the market development, and which identify not only an increase in the mark-ups, but also their (macro-)economic implications.[9]

9. It is easy to show in theory that rising intensity of competition has an (at least one-off or short-term) inflation-reducing effect in many cases and results in lower prices. Ultimately, however, the question arises as to whether these effects have a longer-term impact or whether competition only has a price-reducing effect for a limited period. Even if there are some indications in economic literature of long-term inflation-reducing effects (particularly on product markets),[10] we do not believe that this question can yet be answered with sufficient certainty.

10. In Germany, the debate also focused particularly on the question of the extent to which companies with market power pass on cost increases or reductions to the buyers and whether the current price increases are serving as a pretext to restrain competition. On the one hand, disrupted supply chains and markets fragmented by bottlenecks offer suppliers the possibility to use the resulting reduction in the number of competitors in specific market segments to arrive at implicit coordination more easily, or to make more stable explicit agreements. On the other hand, it could also be argued that a rising and thus more dynamic price development (especially when many input factors are affected) makes implicit coordination and prohibited agreements much more difficult, since it will be necessary to keep renegotiating or adapting them.[11] In terms of economic theory, the full passing on of cost increases and reductions to buyers is something that would tend to be expected where competition is functioning. A monopolist (as the maximum possible form of market power) determines the profit-maximising price taking account of the marginal revenue, and this

[6] Cf. Monopoly Commission (2022) Hauptgutachten XXIV, Wettbewerb 2022, p. 6. [Only available in German; Summary in English: https://www.monopolkommission.de/images/HG24/HGXXIV_Summary.pdf]

[7] Re price rises after cost shocks cf. Bräuning, F., Fillat, J. and Joaquim, G. (2022): Cost-Price Relationships in a Concentrated Economy, Current Policy Perspectives 94265, Federal Reserve Bank of Boston.

[8] Cf. e.g.: Albrecht, B (2022): Is Concentration Driving Inflation? [https://pricetheory.substack.com/p/is-concentration-driving-inflation#:~:text=So%20even%20if%20concentration%20caused,explain%20an%20increase%20in%20inflation.]

[9] Cf. e.g. De Loecker, J., Eeckhout, J. and Unger, G. (2020): The Rise of Market Power and the Macroeconomic Implications, Quarterly Journal of Economics, 135 (2), pp. 561-644.

[10] Cf. Cavelaars, P. (2003): Does Competition Enhancement Have Permanent Inflation Effects? In: Kyklos 56(1), 69–94; and Przybyla, M. and Roma, M. (2005): Does Product Market Competition Reduce Inflation? Evidence from EU countries and Sectors, European Central Bank Working Paper Series No. 453.

[11] Cf. Dürsch, P. and Eife, T. (2014): Price Competition in an Inflationary Environment, German Economic Association (Verein für Socialpolitik) Annual Conference 2014.

(depending on demand or on elasticity of demand[12]) generally results in smaller price reactions. This implies that high price increases can also be indicative of functioning competition and need to be the subject of in-depth analyses – e.g. in the context of market investigations.

11. Ultimately, it is highly probable that more intensive competition impacts the price level. However, it must be borne in mind that competition policy primarily intervenes in product and services markets. The effect on the labour market, which is also an important market, is very weak. The majority of the other interrelationships between competition and inflation discussed above remain unclear, so further research in this field would appear useful. This is unsatisfactory for competition policy-makers, since the expected impacts of more stringent competition policy remain difficult to estimate. Nevertheless, there is still an incentive in an inflationary situation for policy-makers to enforce the principle of competition more strictly and thus to boost the intensity of competition on many markets, in full awareness that this can only contribute towards the solving of the problem.

12. Correspondingly, the Federal Ministry for Economic Affairs and Climate Action has brought forward a planned revision of national competition law (cf. III.). The current inflationary environment has chiefly triggered an earlier revision of the law. In addition to the effects on the macroeconomic price level, a role was played in particular by indications of inadequate competition policy instruments for oligopolistic markets with little dynamism.

3. Conclusions for competition policy in Germany

13. On 20 September 2022, the Federal Ministry for Economic Affairs and Climate Action, which is responsible for competition law in Germany, presented the draft of a "Competition Enforcement Act".[13] This represents the eleventh revision of national competition law. The draft centres around a reform and extension of the existing sector inquiry instrument.

14. Following a sector inquiry, the Bundeskartellamt is in future to have the power to impose measures to remedy a substantial and lasting "malfunctioning of competition". These remedies can target both the market structure and the conduct of companies. Amongst other measures, there can be actions to reduce market entry barriers, to oblige companies to notify mergers in certain markets (even if the transactions are below the current turnover thresholds), and as a last resort in extreme cases to order a divestment. It can be seen that the range of possible remedies is wide, that their intensity of intervention varies, and that they are guided by the severity and persistence of the malfunctioning of competition.

15. Since a malfunctioning of competition does not necessarily have to be grounded in a prohibited agreement, market power or related abusive conduct, there is no need for a violation of the law or evidence of a dominant position to exist for the measures to be taken. The primary criterion is the malfunctioning of competition in a specific instance, and this can for example result from the (structural) circumstances on a market.

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[12] Demand can also change in the current situation e.g. due to temporary psychological effects or the disappearance of substitutes.

[13] Cf. https://www.bmwk.de/Redaktion/DE/Downloads/Wettbewerbspolitik/wettbewerbsdurchsetzungsgesetz-referentenentwurf-bmwk.pdf?__blob=publicationFile&v=4 (only available in German).

16. This instrument is new to Germany, but it is similar (to differing degrees) to existing instruments in other countries.[14] For example, there are strong parallels to the market investigation by the Competition and Markets Authority (CMA). Also, the instrument is similar to the New Competition Tool (NCT) that has been considered by the European Commission.

17. The draft law is driven by a more proactive competition policy in Germany and can thus make a contribution to reducing the price level. The aim is the comprehensive enforcement of the principle of competition – particularly in markets with structural competition problems.[15] For example, companies have built up strong market positions on some markets through internal growth, market exits or acquisitions not subject to merger control, and these are often underpinned by barriers to market entry. It can also be seen empirically that not all companies were able to increase their mark-ups to the same extent, but that the increase is particularly great at the upper end of the distribution.[16] This means that an instrument that can be deployed in a targeted way will be advantageous.

18. However, the instrument will not be focused entirely on sectors with high price increases, but will be oriented to a wide range of criteria which can be causes of a malfunctioning of competition and which can be theoretically derived.[17] Substantial price increases which are not rooted in cost increases of input factors can trigger a sector inquiry. Similarly, however, special features in the development of prices between the suppliers on a market (e.g. rigid prices or striking price patterns) can result in deeper investigations. And, further to this, other market outcomes, e.g. in terms of the quantities or quality on offer – can provide important input for sector inquiries. This means that the envisaged instrument is not oriented primarily to price increases, but rather to circumstances which pose problems for competition, so that the fight against inflation is one of many aspects of the instrument.

19. As mentioned in figure 3 above, the current inflationary environment is creating substantial pressure to act, particularly at the level of policy-makers. This is true not only of competition policy, but also of, for example, tax, energy and welfare policy. In order to bring short-term relief in the current crisis situation, legislative measures are to intervene in prices on various markets in order to keep down the extent of economic disruption. Even if, in terms of competition policy and ordo-liberal policy, this can be viewed critically in principle, and price caps generally tend to exacerbate demand surpluses and impact negatively on propensity to invest, the alternatives to such measures are likely to be limited. This results not least from the coming together of several crisis situations (war in Ukraine, COVID-19, etc.) and the political goal of improving the situation for certain market participants (consumers, companies in certain sectors) which are confronted with massive economic hardships or are even facing bankruptcy. It is therefore part of the political reality that intervention on prices in sectors will happen. When these interventions are designed, the organisational units responsible at ministerial level for competition policy are included in the work. The national competition authority also has the possibility to make comments. This expertise feeds into the various legislative projects.

[14] For the OECD e.g. United Kingdom, Greece, Mexico or Iceland.

[15] In the policy debate about this draft law so far, a central role has been played by oligopolistic markets which tend toward collusion.

[16] Cf. De Loecker, J., Eeckhout, J. and Unger, G. (2020): The Rise of Market Power and the Macroeconomic Implications, Quarterly Journal of Economics, 135 (2), pp. 561-644.

[17] These can be found in section 32f (5) of the draft law.