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Publisher: Routledge

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UK



## German Politics

Publication details, including instructions for authors and subscription information:

<http://www.tandfonline.com/loi/fgpr20>

### Reform in the shadow of community law: Highly regulated economic sectors

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Published online: 05 Aug 2006.

To cite this article: Susanne K. Schmidt (2005) Reform in the shadow of community law: Highly regulated economic sectors , German Politics, 14:2, 157-173, DOI: [10.1080/09644000500154102](http://dx.doi.org/10.1080/09644000500154102)

To link to this article: <http://dx.doi.org/10.1080/09644000500154102>

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**MPiFG Journal Article**

Susanne K. Schmidt: Reform in the Shadow of Community Law: Highly Regulated Economic Sectors. In: Politics of Economic Reform in Germany 14(2), 157 - 173 (2005). Routledge

The original publication is available at the publisher's web site: <http://dx.doi.org/10.1080/09644000500154102>

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# Reform in the Shadow of Community Law: Highly Regulated Economic Sectors

SUSANNE K. SCHMIDT

*Characteristics of the German model of managed capitalism were particularly pronounced in highly regulated sectors and the utilities. Nevertheless, far-reaching reforms were enacted. Taking the examples of telecommunications, electricity, insurance and road haulage regulation, this study examines the locked-in nature of domestic sector regulations. Demonstrating the importance of the impact of European policies for domestic reforms, it shows how this 'top down' pressure was combined with attempts of national actors to use the European context as an opportunity structure to push their interests. Consequently, domestic reforms often went beyond European requirements. More recently, the German crafts law has been reformed, which showed again the many institutional avenues to veto reforms in the German system. A new initiative by the European Commission to foster service liberalisation might thus become an opportunity to push for policy change once again.*

During the 1990s, *Modell Deutschland* has given way to the picture of *Reformstau*, suggesting that the 'institutional pluralism' of the German political system stands in the way of economic reforms needed to confront the double challenge of Europeanisation and globalisation. Yet *Reformstau* is not ubiquitous. As in other EU states, highly regulated monopoly utilities sectors have been liberalised. Despite the many veto points in the German political system, contentious reforms were concluded relatively swiftly. Reforms were an integral part of the EU single market, and it was therefore possible to circumvent national veto players in the multi-level European polity.

This study reviews the impact of European policies on domestic reforms, showing the domestic effects of the EU's approach to market integration. The EU does not distinguish between trans-border and domestic economic exchanges. Instead, it has created a unified regulatory regime, with far-reaching implications for domestic regulation. Although domestic reforms took place in the shadow of community law, however, they cannot simply be seen as top-down enforced adaptation. Rather, top-down pressure combined with attempts of national actors to use the European context as an opportunity structure to pursue their interests.

Beginning with a review of the traditional German approach to sectoral regulation, arguing that actors' interests and institutional veto points represented formidable obstacles to reform at the domestic level, the reform requirements emanating from the European level are then outlined. The ensuing account of domestic reform shows both the scale of adaptation required by the EU legislation, and the importance of European law as an opportunity structure for the domestic advocates of reform.

## THE STABILITY OF ECONOMIC SECTOR REGULATION

Governing is difficult in Germany. Policy making is characterised by joint decision making with the attendant danger of joint-decision traps and immobilism.<sup>1</sup> A strong second chamber means that governments have to negotiate with different veto players. Agreement is frequently prohibited by party competition,<sup>2</sup> accentuated by a crowded schedule of 16 Länder elections which puts Germany in a state of permanent electoral competition. In addition, associations play an important role in a pattern of neo-corporatist decision making that operates at sector-specific rather than macro level.<sup>3</sup> Even if bargains can be struck, the powerful constitutional court with its extensive powers for judicial review means that the losers can always try to reverse the deal. Accordingly, the likely position of the constitutional court plays an important role in the deliberations of the Bundestag.<sup>4</sup> It is therefore not surprising that sectoral regulation has been marked by the utmost stability.

*Utilities*

A characteristic of *telecommunications* until the end of the 1980s was the comprehensive monopoly that the PTTs enjoyed. Provision for telecommunications and postal services were fused under the direct responsibility of a Ministry. The PTT model combined operative, regulative and public power responsibilities. In Germany, the model was particularly protected as Article 87 of the Basic Law gave the exclusive responsibility for posts and telecommunications to the federal administration.<sup>5</sup>

Monopolisation was justified by technical and political arguments relating to the natural monopoly status of network-bound sectors, and to concerns about universal service across the country, including rural areas. Monopoly led also to a very limited range of policy actors beyond the Deutsche Bundespost and the Postal Ministry. A small number of 'court suppliers' cooperated closely with the Bundespost in the development of technologies geared to national technical specifications.<sup>6</sup> The high membership density of the German Postal Union (Deutsche Postgewerkschaft, DPG) gave it an important role in the defence of the status quo.<sup>7</sup> In the face of this broad political consensus-supporting monopoly, far-reaching reforms would have been difficult to enact on a purely national level.<sup>8</sup>

*In electricity* the absence of competition was justified by very similar natural monopoly arguments. Unlike in telecommunications, and in contrast to the electricity sector in countries like France, the German state did not play a large role as a direct provider of electricity. The sector was extremely fragmented. The market was dominated by eight trans-regional interconnected utilities responsible for over 80 per cent of production. Eighty regional and 800 communal providers concentrated on distribution.<sup>9</sup> Competition was suppressed by a system of contracts between the municipalities and the utilities, and between the utilities themselves. Electricity was exempted from national competition law, and the mandate of the Federal Cartel Office was restricted to preventing abuse of dominant position. The Federal Ministry of Economics was responsible for regulation.<sup>10</sup> Electricity suppliers were organised in the Vereinigung Deutscher Elektrizitätswerke (VDEW). The municipal companies were organised separately in the Verband Kommunaler Unternehmen (VKU). Also

important was the Verband Industrielle Kraftwirtschaft (VIK), organising the large electricity users.<sup>11</sup>

### *Regulated Sectors*

Insurance and road haulage both fall in the area of legislation requiring the consent of the Bundesrat. The sectors originally displayed quite similar patterns of meso-corporatist regulation, with close coordination between the regulatory authority and business associations. Regulation concerned market access, tariffs, supervision over operational matters, and (in the insurance sector) products. Markets were characterised by very little competition. There was a congruence of interests between regulated firms and the regulators, with evidence of regulatory capture.<sup>12</sup>

The regulation of *insurance* was marked by a considerable continuity.<sup>13</sup> The insurance oversight act dates back to 1901. In 1951 the Bundesaufsichtsamt für das Versicherungswesen (BAV) was established as regulatory authority, largely modelled on the previous Reichsaufsichtsamt. Originally, competence was located in the Federal Economics Ministry, but the responsibility was moved to the Finance Ministry in 1972. In exercising its regulatory function, the BAV cooperated closely with the different branches of the insurance association (Gesamtverband der Deutschen Versicherungswirtschaft, GDV). The centrality of the association in regulation was reflected in a high degree of cooperation between companies, facilitated by exemption from competition law and the restriction of the Federal Cartel Office to controlling abuse of dominant position.

This pattern of regulation resulted in a market with largely uniform products. It was successful in that no insurance firms went bankrupt. Tariffs, however, were high in international comparison, at least for private contracts which were widely used to subsidise industrial insurance. There were few product innovations, and it was difficult for consumers to terminate contracts in the short or medium term, even if companies raised their tariffs. Consequently, consumer and business associations were critical of the system, advocating reform to make insurance cover more flexible. Different reforms of the cartel law tried to induce more competition but failed due to the powerful opposition of the insurance industry. In the 1980s, the Monopoly Commission and the Deregulation Commission joined in calls for liberalisation. However, the Finance Ministry was deterred from reform initiatives by adamant opposition from the insurance associations and the regulatory authority. Opposition also included the Länder, particularly those that contained important insurance companies.<sup>14</sup>

The regulation of *road haulage* showed similar features of continuity.<sup>15</sup> Founded in 1952 by the Güterkraftverkehrsgesetz (GüKG), the Bundesanstalt für Güterfernverkehr (BAG) regulated the sector in close cooperation with the different business associations. Market access was licensed, with uniform tariffs set by tariff commissions composed jointly of private actors and the Federal Ministry of Transport which had clientelistic links to the sector.<sup>16</sup> This situation of regulatory capture resembled that in insurance. It came at great cost for freight forwarders which stood little chance of avoiding tariffs calculated to be 20 per cent above market prices.<sup>17</sup> Their interest in reform was backed by the Federal Ministry of Economics, but the latter was powerless

against the regulatory authority, the Transport Ministry, and the associations which all had stakes in the status quo.

#### EUROPEAN PRESSURES FOR REFORM

With the move towards the single market, member states lost their ability to regulate their economic sectors at will. Monopoly rights, or cartel-like structures in regulated sectors limited the economic activity of potential competitors in other member states, thereby infringing against the single market. Under the new legislation, such infractions of market competition could only be justified by one of the few exemptions of European competition law.

Compared to other policy fields, *European competition law* is highly supranational in character with few formal opportunities for member state governments to influence the way the Commission handles its powers.<sup>18</sup> Articles 81 and 82 are directed at private actors, prohibiting cartels and the abuse of dominant positions. Governments are involved in decision making through advisory committees, giving the Commission the final power of decision. Articles 86 to 89 restrict the potential of member states to grant special rights or state aid to enterprises. These articles thus target utilities in particular. Although member states lack formal means of influence, in cases of high political salience governments have multiple means to put significant pressure on 'their' commissioners and the Commission as a whole when controversial measures arise, so that they may successfully prevent negative decisions.<sup>19</sup>

In addition to competition rules safeguarding the competitive order of markets, the Single European Act of 1987 upholds the different market freedoms (the mobility of goods, services, capital, and persons) which may be restricted only in exceptional cases. While constraints necessary to realise important national goals are generally recognised, this is granted under the caveat that the internal market is not adversely affected.<sup>20</sup> Accordingly, the Commission has the potential to seriously interfere with the parts of the national economies that are *not* predominantly structured by market principles. Similar to the market freedoms, European competition law knows hardly any restrictions. This is very different from national competition law which normally exempts certain areas, such as the classic utilities, and where it is taken for granted that parliament remains free to regulate certain areas of the economy.<sup>21</sup> On the European level, member states are denied this freedom, which would amount to a breach of the single market. Whereas national competition rules are a kind of secondary law, European ones have the status of primary law.<sup>22</sup>

It is important to note how far Treaty rules reach into the national realm. Though the rules only aim to eliminate hindrances to the single market and do not engage with purely national concerns, the likelihood of such disturbances has been interpreted very broadly. Since national restrictions almost always hamper the potential economic activities of other European nationals, there may in fact be few inherently national affairs.<sup>23</sup> *In sum*, while both sets of rules are complementary, referring either to competition or to inter-community trade, they may partly serve as substitutes. Whenever national markets are not fully competitive, they can be liberalised either by applying competition law, or by allowing foreigners to offer their services in this domestically protected market.

Primary law – Treaty rules – is supplemented by secondary law in the form of directives or regulations targeted at specific sectors or issues. Primary law has undergone a history of interpretation since its inception in 1957, often setting it quite apart from the original will of the ‘masters of the Treaty’. By contrast, secondary law is now often passed by qualified-majority vote in the Council and co-decision in the European Parliament. The application of secondary law to the single market is a comprehensive one. Although the objective is to facilitate the single market, all economic matters, whether trans-border or simply domestic, are treated in the same way. The single market thereby follows a different regulatory philosophy than the US with the inter-state commerce clause. The idea is that companies should not have to fulfil a different set of regulatory requirements if they want to offer products or services on the single market, as this would amount to an additional burden.<sup>24</sup> This however means that the single market enjoys a considerable privilege – in order not to burden trans-border economic activity, all domestic economic activities are regulated in conformity to the single market.

*Former Monopoly Sectors: Telecommunications and Electricity*

The realisation of the single market for telecommunications and electricity is heavily influenced by the fact that these are sectors very close to the state. In *telecommunications*, the European Commission used its competition law powers (Art. 86) to a previously unknown extent by issuing Commission directives, thereby taking all liberalisation decisions seemingly single-handedly from the late 1980s to the mid-1990s. From 1998 onwards, telecommunications was fully liberalised. In parallel, the Council enacted harmonisation directives.<sup>25</sup> The harmonised legal framework and European competition law contains a catalogue of different rights which can be enforced in national courts or by addressing complaints to the Commission. Within this common framework, national regulatory authorities and parliaments still have competences for shaping the domestic regulatory regime.

A new package of directives being currently enforced aims, *inter alia*, to realise EU licences, allowing companies to offer community-wide services under a single licence (Directive 97/13/EC, 10 April 1997). Previously, companies needed to be licensed in each member state where they aimed to provide services.

In *electricity*, the Commission originally considered following its successful path from telecommunications, but refrained from Commission directives in view of significant opposition from member state governments. Consequently, electricity was liberalised by a Council and Parliament directive, taking the normal course of European legislation. The experience with electricity politics showed with hindsight the extraordinary situation that had facilitated the Commission’s telecoms policy. Only the broad support of member states for liberalisation had allowed the European Commission to use its competition law powers to this extent.<sup>26</sup>

It took the Council the determined attempts of four presidencies (German, French, Spanish and Italian) to finally reach a compromise in June 1996. Directive 96/92/EC opened the market incrementally. Starting in 1999 the market share equivalent of users with more than 40 GWh<sup>27</sup>/year consumption was opened, equalling 22 per cent of market share. This level was lowered later to 20 GWh/year, and in 2003 to 9 GWh/year, thus liberalising 33 per cent of the market.<sup>28</sup>

A new directive was agreed in 2003 (2003/53/EC), in order to accelerate market liberalisation. It requires the liberalisation for all business customers from mid-2004, and for all customers from mid-2007 onwards. By mid-2004, member states were obliged to have established an independent regulatory authority. Electricity companies have to organise the distribution of electricity separately, in order to guarantee non-discriminatory network access to competitors. A separate regulation (1228/2003) deals with the trans-border trade of electricity.

### *Insurance*

The single market for insurance services was established mainly through three generations of directives. The freedom of establishment was realised first, followed by the freedom of services for large risks, and later for mass risks from 1994.<sup>29</sup> As with banking services, there is a single European passport: The supervisory authority of the home country regulates all activities of the company in the EU, thus realising the freedom of services. It is sufficient to simply inform the home supervisory authority of plans to enter other member states.

Based on partly harmonised rules, the home member state is responsible for authorisation, legal oversight and financial control. But insurance companies also have to obey several rules of the host country where they offer their services. Examples are general legal rules, consumer protection and insurance contract laws.<sup>30</sup> As insurance services are legally defined products, but insurance contract law is not harmonised, it is impossible to offer unified insurance services on a community-wide scale.<sup>31</sup>

### *Road Haulage*

Member states were much divided about the single market for road haulage. However, pressure from the Commission and member states like the Netherlands that were interested in liberalisation, as well as rulings of the European Court of Justice made it clear that the single market could not be prevented forever.<sup>32</sup> Since 1992, access to trans-border transports is subject to EU licences that are allocated according to qualitative criteria (namely training, reputation and financial assets).<sup>33</sup> Within this harmonised framework, member states regulate market access. Cross-border transport can be offered at freely negotiated tariffs. In addition, partly harmonised social, technical and tax rules apply.<sup>34</sup>

Cabotage services, i.e. the delivery of domestic transport services through EU foreigners, have to be distinguished from cross-border transports. Their liberalisation was particularly contentious in high-cost countries such as the FRG. However, while cabotage was fully liberalised from 1998 onwards, companies have to obey the legal and administrative rules of the host country, relating for instance to tariffs, transport conditions, weights and sizes, and driving and resting times. This means that cabotage and cross-border services are not regulated in parallel. For cabotage, a member state may require stricter driving and resting times than those harmonised in the cross-border context.<sup>35</sup> Differences in competitiveness result mainly from a lack of tax harmonisation (vehicle and fuel), a different intensity of controls of driving and resting times or stricter national rules as well as differences in wages.

## NATIONAL RESPONSES TO EUROPEAN PRESSURES

As described above, the traditional regulation of these sectors in Germany was very stable, characterised by congruence of interests between regulators and regulatees that made it difficult for critics to pursue a successful national reform agenda. In contrast to the welfare state,<sup>36</sup> where the pressure of the European Union is limited, the application of single-market rules to these economic sectors led to far-reaching measures for national reform. However, these national reforms were not only a response to top-down pressures. For once, German political actors took part in formulating European sectoral requirements. In addition, the single market programme was an opportunity structure for those reform advocates who lacked the institutional resources to realise their preferences in the domestic context.

*Liberalisation of the Utilities*

The stepwise liberalisation of *telecommunications* provides the best testimony to the sharp contention that liberalisation could generate. The threat to employee interests provoked large-scale protests by the union. Possible disparities in service levels between cities and the countryside aroused opposition from some Länder.

The liberalisation of telecommunications proceeded in three steps, and is already well documented. The *Postreform I* in 1989/90 liberalised terminal equipment and services but left telephone service and the telecommunications network under monopoly. Regulatory responsibilities were split from operative functions, and the latter were divided in three branches – telecommunications, postal and banking services. The Basic Law did not need changing, since the organisational form of federal administration was retained.<sup>37</sup>

Whilst leaving the extent of liberalisation unchanged, *Postreform II* (1994) took the preliminary organisational steps towards privatisation. All three companies were converted into independent joint-stock companies. This entailed a change of the Basic Law, which in turn required a very broad consensus. Meanwhile, the huge investment burden of German unity had changed the preferences of many actors regarding liberalisation. Deutsche Telekom ran into serious capital scarcity, hampering its potential for becoming a global player. Also the court suppliers came to realise that the possibility of competitors to invest in networks would be good for them. Moreover, a shares issue offered a much-needed injection of capital into the company. The reform obliged the federal state not to sell any of its shares until the year 2000.<sup>38</sup>

*Postreform III* followed shortly after in 1996 and prepared to meet the EU requirement for full liberalisation by 1998. At the same time, the Postal Ministry was abolished and the Regulierungsbehörde für Telekommunikation und Post (RegTP) took over as the independent regulatory authority. The political responsibility for telecommunications shifted to the Federal Economics Ministry, by now the Bundesministerium für Wirtschaft und Arbeit, BMWA.

It would, however, be wrong to assume that during these reforms the German administration simply reacted to European demands. In the Postal Ministry there was an attempt to speed up liberalisation by cooperating with the European Commission to put additional pressure on German politicians.<sup>39</sup> This may appear paradoxical given that the ministry was to be dissolved in the process? Normally we assume that

corporate actors seek to defend, or even expand their responsibilities.<sup>40</sup> However, liberalisation also held considerable potential for Postal Ministry administrators – new responsibilities in the independent regulatory authority, or in Deutsche Telekom and its competitors – offering much more independence, freedom of action and most likely better pay.

Telecommunications liberalisation has rendered the corporatist and clientelistic network of actors much more pluralistic. A range of new associations represent the interests of new actors in the field. The association of the providers of telecommunications and value-added services VATM (Verband der Anbieter von Telekommunikations- und Mehrwertdiensten), represents about 50 of the larger competitors of Deutsche Telekom, whilst Breko (Bundesverband der regionalen und lokalen Telekommunikationsgesellschaften) represents regional and local carriers.

Finally, the new telecommunications directives required further reforms (Germany was a year behind the implementation date of mid-2003). Activities requiring a licence no longer need to have prior permission. Regulation now covers all dominant providers, with no bias against Deutsche Telekom. With the exception of those (parts of) markets where competition is not yet functioning, regulation has given way to general competition law under the jurisdiction of the Federal Cartel Office. With the latter assuming a more prominent role, the two regulatory bodies will therefore have to cooperate closely in the future.

In contrast to the incremental liberalisation in telecommunications, the 1998 reform of the Energiewirtschaftsgesetz (EnWG) implemented the European *electricity* directive in one single radical step, liberalising the whole electricity market, including simple household customers. Electricity reform is therefore a very clear example of using the European reforms to realise more far-reaching domestic liberalisation. Alongside the European policy process, the FDP-run Ministry of Economic fostered its own reform ideas. The Monopoly Commission took up the issue in its X. Main Report in 1994, following discussions in the Deregulation Commission and BMWi.<sup>41</sup> Thus, opinion shifted towards treating electricity as a normal economic sector in a competitive market economy. Immediate, full liberalisation could also be justified by the important role in the German economy of small and medium enterprises, which would otherwise have had to wait for the benefits of liberalisation.<sup>42</sup>

Germany faced a problem, however, relating to network access for alternative electricity suppliers. Given the starting point of a very fragmented ownership structure, it was not possible to make a clean break and to establish an independent network holder that would grant non-discriminatory network access to established companies and newcomers alike. This was the solution the UK had been able to take a decade earlier, when it was breaking up its integrated monopoly. In view of the dispersed ownership structure, Germany opted for network access via negotiation between the parties, under the *ex post* control of the Cartel Offices at federal and Länder level. No sector-specific regulatory authority was established, and *ex ante* regulation was kept at a minimum.

Rather than opting for state regulation, the electricity reform relied on corporatist self-governance. Principles of network access and tariffs were negotiated in an associations' agreement (*Verbändevereinbarung*) between the VDEW, VKU on the supplier side and the VIK and the German Association for Industry (BDI) for the

users. Germany was alone in the EU in opting for this model of corporatist self-governance. Responding to criticism that it had not taken sufficient care of the interests of new market actors, the first agreement of May 1998 was replaced by a second in early 2000. The associations' agreement was reached 'in the shadow of hierarchy' as the law foresaw regulation by the Federal Economics Ministry should the associations fail to provide for an effective market opening.

Eberlein argues that the electricity reform – despite its radical approach to liberalisation – stood very much in continuity to the existing traditions of the sector.<sup>43</sup> Rather than being seen as the result of regulatory capture, he contends that the resort to a form of self-governance should be understood to mirror several institutional constraints and path dependencies. Thus, the fragmented federal political organisation made it difficult to establish a new regulatory authority at the federal level, where – in contrast to telecommunications – the tradition of a separate ministry was missing. Voluntary self-regulation on the basis of an associations' agreement conformed to the traditional corporatist model of state–society relations under organised capitalism. In this context, it was also possible to cater for environmental issues, employment security, as well as municipal and East German interests, all backed by the idea of a social market economy. Thus, legislators reverted to established routines to cope with the changes entailed by liberalisation.

Meanwhile, a more significant break from sectoral traditions is underway. Heavily criticised by market newcomers and by larger incumbents eager to expand their market shares,<sup>44</sup> the new associations' agreement also came under fire from the European Commission. The voluntary nature of the agreement meant that it was not justiciable and did not fulfil the requirements of the electricity directive. Moreover, since the decisions of the Federal Cartel Office were not legally binding, its interventions led to protracted court proceedings that disrupted efficient sectoral regulation.<sup>45</sup> Consequently, the Commission pushed increasingly for the establishment of an independent regulatory authority (Germany was the only member state which had not taken this step).

The acceleration directive required the establishment of an independent authority by mid-2004. At the time of writing, the German government had agreed on the basic principles of legislation, but it had not yet passed into law. The draft legislation gives responsibility for regulating electricity and gas to the existing regulatory authority for telecoms and post (Bundesregulierungsbehörde für Elektrizität, Gas, Telekommunikation und Post, ReGTP). Meanwhile, it was agreed with the European Commission that the ReGTP would exercise its new responsibilities on an interim basis. Interestingly, the expedient of using ReGTP as the independent regulator for electricity may entail a more radical rupture with past practice than would otherwise have been the case, since the advanced institutional development of telecommunications regulation will now set the pace for electricity.

Beyond the independent regulator, however, the reform has been difficult to agree. The draft law requires electricity companies to operate their transmission networks separately from their supply operations. The *conditions* for network access and tariffs, however, remain undecided, and will appear subsequently as separate regulations to be passed by the BMWA. The form of network access regulation is particularly contentious. The draft law makes provision for Germany to retain a system of *ex post*

control of network access. The opposition CDU, however, favours *ex ante* regulation, and its majority in the Bundesrat gives it a potential veto. The government view is that *ex ante* authorisation of network tariffs for 900 or so different operators is unfeasible.<sup>46</sup> With such a large number of network operators, European Commission requirements that tariff approval should be subject to a review of pricing principles would appear to prohibit *ex ante* authorisation.

The draft law was rejected by the Bundesrat in September 2004. Thereafter, agreement became even more difficult to achieve, as the Greens took up the demand for *ex ante* regulation. Coalition disagreement also arose over the extent of subsidies for alternative energies. The future of the law is thus unclear, and the Commission has already initiated infringement proceedings against Germany for its failure to implement the acceleration directive.<sup>47</sup> Despite European pressures for reform, then, the multiple veto points in the domestic political process can entail persistent disagreement and delay, although ultimately the binding nature of European requirements make reform inevitable.

#### *Liberalisation of the Regulated Sectors*<sup>48</sup>

European insurance liberalisation required very far-reaching changes from Germany. Parallel to liberalisation, the directive prohibited the *ex ante* control of insurance conditions and services which had been at the core of the German regulatory model. Regulatory oversight switched from the control of products to the solvency of companies. In addition, the monopoly insurers that existed in some of the Länder had to be abolished.

As mentioned above, the dominant sectoral actors – the associations, companies and the regulatory authority – were all opposed to these changes in the regulatory structure. The Federal Ministry of Finance, however, backed by the cabinet, did not oppose European liberalisation, since it offered opportunities for *Finanzplatz Deutschland*. Furthermore, in the aftermath of unification, Germany wanted to dissipate the concerns of its European partners – particularly France – that the new East German market would be closed to outsiders.

Thus, insurance liberalisation exemplifies Moravcsik's argument that European integration strengthens member state governments by offering a negotiating arena that bypasses national veto players.<sup>49</sup> This is particularly true in the case of monopoly building and fire insurance, where some of the Länder originally considered appealing to the ECJ.<sup>50</sup> The reduced influence of the associations also stands out, since as insurance products ceased to be regulated, their cooperation with the regulatory authority was no longer needed. Their resistance was undermined by an increasing diversity of interests amongst insurance companies, as the larger ones began to see liberalisation as an opportunity to expand market share against smaller competitors.

Unlike insurance, the Federal Ministry of Transport opposed the liberalisation of *road haulage* until the end. Nevertheless, some domestic reforms were enacted in the early 1990s to prepare the domestic sector for a liberalisation which was seen as inevitable given European pressures. The inevitability of liberalisation in cabotage services led Germany to begin lifting some of its road haulage regulations, fearing that otherwise a reverse discrimination of nationals (*Inländerdiskriminierung*) would take place. Restrictions on market access could result in barriers to *Germans* doing business

in *German* transport markets in which *EU foreigners* could be active. Consequently, lorries under 3.5t (previously 0.75t) were freed from licensing requirements, and the number of licences was considerably increased. The licence system was retained, however, despite a coalition agreement in 1990 to liberalise all licence requirements and tariffs.

The case was different for tariffs, providing a very interesting example of the way domestic reforms can take place. Parliament abolished the system of regulated tariffs from January 1994, under the impression that the ECJ would rule the existing system to be in violation of European competition law. The question was raised by the *Landgericht Koblenz* in a preliminary proceeding (C-185/91) of a case concerning a company that had transported goods below the official tariffs and at the same time declined the penalty payments that the BAG had foreseen for such cases – if detected. Instead, the freight forwarder started the court case, supported by the relevant association, with the explicit aim of overturning valid national rules with the help of European competition law.<sup>51</sup> In the legal literature, the assumption had been common that the fact that the associations took part in the tariff commissions meant that tariff decisions could be seen as an illegal cartel under European competition law.<sup>52</sup> Legal uncertainty over regulated tariff systems under European law was aptly exploited by liberalisation advocates like the FDP, which argued in parliament in favour of altering the domestic system immediately rather than waiting for a ruling from the ECJ that was expected to be negative. In anticipation of the Court ruling, tariff liberalisation was carried out. Given the imminent liberalisation of cabotage, it was seen to be necessary to prepare the road haulage industry for competition. Paradoxically, the anticipation was incorrect – the Court ultimately ruled that the tariff commissions could be kept, since it was the formal responsibility of the Minister of Transport to set the tariffs.

### *Reform of the German Crafts Law*

In contrast to the other liberalisation processes, the reform of the German crafts law was only indirectly connected to European politics. Some domestic adaptation was necessary, since the single market entailed Community-wide freedom of establishment for EU foreigners who had been active in a craft for six years in a member state. The German crafts law of 1953, however, restricted this privilege of establishment (and of training apprentices) to individuals having a *Meisterbrief* (master craftsman's diploma) involving expensive long-term training additional to the basic craftsmanship training as *Geselle*. Both the red–green coalition and the opposition agreed that EU foreigners would have to be granted this opportunity, and that potential reverse discrimination against nationals (*Inländerdiskriminierung*) must be kept to a minimum.<sup>53</sup>

There were significant cross-party differences, however, over the extent of liberalisation to a crafts law that was – by international standards – extremely regulated. The Greens had already argued for an end to the *Meisterzwang* at the time of the previous reform under a conservative government in early 1998. Despite two years of discussion, this reform made only minor changes to the definition of crafts, the resistance of the craft associations preventing any noticeable liberalisation.<sup>54</sup>

Part of *Agenda 2010*, the 2004 reform of the crafts law was much more far-reaching. A minor amendment, not requiring the consent of the Bundesrat, allowed

persons established as *Ich-AG*<sup>55</sup> being able to offer simple craftsmanship services requiring no more than two to three months of training. This was accompanied by a major amendment with a more explicit liberalisation goal. In order to cut red tape and to provide new impetus for growth, Economics Minister Wolfgang Clement proposed to abolish the *Meisterzwang* for all those crafts where more advanced training could not be justified by safety concerns. In addition, *Gesellen* working in a craft still falling under the *Meisterzwang* should be able to establish themselves after a certain period of employment in a responsible position. Along with the requirements of European law, this proposal reflected concerns over relatively slow growth in the crafts sectors, and a belief that over-regulation had fuelled the ‘black economy’ and curtailed employment.<sup>56</sup>

The debate among the parties centred on two questions – how many of the 97 crafts on the list would be excluded from the *Meisterzwang*, and how many years of employment as a *Geselle* would be accepted as an equivalent? Acting as guardians of craft interests, the CDU/CSU and FDP tried to keep as many crafts as possible within the *Meisterzwang*, and to restrict the possibility of equivalence. The opposition parties argued that alongside safety concerns, environment, consumer protection and the extent of apprenticeship training should be taken into account.<sup>57</sup>

The government conceded to the opposition that both reforms would be negotiated together – despite the fact that only the major one required the consent of the Bundesrat.<sup>58</sup> At the same time, however, the government emphasised its determination to reconfigure the major reform so that many of its parts could be passed without Bundesrat consent, should the opposition not refrain from obstruction.<sup>59</sup> Thus, while Clement originally planned to restrict the *Meisterzwang* to 29 crafts, the CDU wanted to allow 53 and the FDP 47, the final reform adopted in 2003 settled on 41 crafts. Alongside safety criteria, the crafts remaining under the *Meisterzwang* are those with a training rate of 50 per cent or more above the average. Despite the reform, 90 per cent of the craft sector is still covered. Without *Meister*, a *Geselle* must have worked for two years, with an additional four in a management position, to be able to establish their own enterprise.<sup>60</sup>

At the time of writing the reform is still too recent to determine its impact. In the first six months since liberalisation in January 2004, 16,000 new establishments were counted, 11,700 of which were in crafts liberalised from the *Meisterzwang*.<sup>61</sup> It should be emphasised that quite far-reaching changes were achieved relatively quickly – the first reading in the Bundestag was in late June 2003 – despite fierce resistance from craft associations and reservations about the extent of liberalisation on the part of opposition and some SPD-governed Länder. Nevertheless, the apprenticeship criterion means that only a small percentage of crafts have profited from liberalisation. Most widely-practised crafts like baker, hair-dresser, butcher or painter remain highly regulated.

### *The Services Directive*

Reform of the crafts law has thus shown once again just how difficult reforms are in the Federal Republic. Although much was achieved, it was still too little to make a significant impact on the crafts which matter quantitatively. This explains the turmoil that the European Commission’s proposal for a services directive has generated

in Germany, especially since services make up about 50 per cent of all economic activity across the member states. Launched in early 2004, the directive is meant to realise the single market freedoms of services and of establishment in all those service sectors where specific measures have not yet been taken. Very few exceptions are envisaged. The principle of home-country control means that member states must mutually recognise services regulated in other member states as equivalent to their domestically regulated services. The directive proscribes excessive regulatory requirements for establishment. Given that most service sectors are very highly regulated, the directive has a significant deregulatory potential. As former Commissioner Bolkestein has put it:

We cannot expect European businesses to set the global competitiveness standard or to give their customers the quality and choice they deserve while they still have their hands tied behind their backs by national red tape, eleven years after the 1993 deadline for creating a real Internal Market. Some of the national restrictions are archaic, overly burdensome and break EU law. Those have simply got to go. A much longer list of differing national rules needs sweeping regulatory reform.<sup>62</sup>

In view of the many problems he experienced in the crafts law reform, Economics Minister Clement originally welcomed the directive as an opportunity to overcome the obstacles. More recently, however, Germany has been very vocal in its opposition to the directive, with Chancellor Schröder demanding exemptions for services that are close to the state, such as health or education, and insisting on special provisions to protect environmental and work-place safety. The *Deutsche Gewerkschaftsbund* opposed the directive from the start. Since the EU's eastern enlargement, the freedom of services has proven problematic for Germany. Thus, in German slaughterhouses, Germans have been laid off in large numbers to be replaced by East European service providers with personnel on low pay working under deplorable conditions. While Germany opted to delay freedom of movement for East Europeans for some time, service providers have immediate entry into the country.<sup>63</sup>

It remains to be seen in what form this directive – part of the Lisbon strategy for EU competitiveness – will emerge from the EU policy process, if indeed it does so at all. It seems clear, however, that it would have noticeable impact on the German government's *Agenda 2010* programme. The bargains the government had to face when reforming the crafts law would probably pale into insignificance compared to the likely deregulatory potential of this directive.

## CONCLUSION

In the highly regulated economic sectors, many reforms in Germany have taken place – and are still in process – in the shadow of Community law. Of course, it is always difficult to prove the counterfactual point that reforms would not have happened had it not been for the requirements of the EU. However, the high level of ministerial autonomy in German government,<sup>64</sup> close meso-corporatist cooperation with the relevant associations in sectoral regulation, and the scope for Länder veto through

the Bundesrat all made reforms highly unlikely. Moreover, domestic criticism of the extent of regulation has largely been absent, with the most relevant regulatory actors preferring the status quo. Liberalisation advocates – users, the FDP and the Economics Ministry – were generally too marginal in the policy process to force measures through. Thus, it has been argued that the liberalisation of road haulage would not have occurred without the pressure of the EU. In the case of Germany, European transport liberalisation was in fact vital for overcoming the stability of sectoral corporatism and for the switch to a liberal transport policy approach to be achieved.<sup>65</sup>

The requirement to conform to European law has brought about far-reaching changes in highly regulated economic sectors. This is due in large part to a comprehensive approach to the single European market that regulates domestic and trans-border activities alike according to the same set of rules. Thus, in insurance, Germany could not restrict product authorisation to companies active only on the domestic market. This approach privileges the single market, even where cross-border trade of services is relatively insignificant. Thus, cabotage services in road haulage made up only 0.76 per cent of total road transport in 2001. In France and Germany, where most of road haulage takes place, it made up 1.6 per cent and 1.1 per cent of domestic road transport respectively.<sup>66</sup> In the German insurance market in 2000, 3.2 per cent of market share was made up by cross-border service providers or secondary establishments of EU foreigners. In contrast, foreign-controlled companies (at least 50 per cent) had a market share of 13 per cent in 2000.<sup>67</sup> As these are establishments in Germany, they fall under any additional national regulation and would not have needed the complicated European rules to realise the freedom of services in the single market.

It would be wrong, however, to perceive Germany as responding only passively to the demands of European liberalisation. In several regulated economic sectors – telecoms, electricity, insurance, road haulage, and the crafts – domestic reforms have gone beyond European requirements. The fact that once reforms became necessary these went beyond requirements shows how locked in previous sectoral regulation had been. With its multiple veto points, the German polity privileges a blocking minority over the majority, facilitating the defence of regulation against reform even where it is supported only by a minority of actors. Once the veto position of the minority was circumvented through the need to implement European requirements, however, it became apparent how far away from the balance of actor preferences the previous regulatory regime had been.<sup>68</sup> Furthermore, the case studies presented here show the way in which liberalisation can change actor preferences. For actors that had previously been united in support of highly regulated regimes – large insurance and electricity companies – the advent of liberalisation led to a reconsideration of preferences as the market opportunities became apparent. Thus, those actors set to profit from liberalisation came to support it.

Finally, it is interesting to note that the same forces of lock-in and stability typical of the German polity have set in again after the reforms. This becomes apparent when comparing the German to the French case. Details are beyond the scope of this study, but comparison shows that French political actors have been much more able than their German counterparts to grasp the autonomy that remains under European law to realise domestic regulatory objectives.<sup>69</sup>

## NOTES

This essay draws on the results of my habilitation project (S.K. Schmidt, 'Rechtsunsicherheit statt Regulierungswettbewerb: Die nationalen Folgen des europäischen Binnenmarkts für Dienstleistungen', Habilitationsschrift, Hagen, 2004). I would like to thank Fritz Scharpf for his comments to this project. Additionally, I am indebted to the editors, Kenneth Dyson and Stephen Padgett, and to Ines Läufer for research assistance.

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