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The Regulatory State: Britain and Germany Compared

Ian Bartle, Markus M. Müller, Roland Sturm and Stephen Wilks

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Ian Bartle, Department of Politics, University of Exeter
**Markus M. Müller, Institut für Politische Wissenschaft,
Friedrich-Alexander-Universität Erlangen-Nürnberg**
**Roland Sturm, Institut für Politische Wissenschaft,
Friedrich-Alexander-Universität Erlangen-Nürnberg**
Stephen Wilks, Department of Politics, University of Exeter

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THE REGULATORY STATE IN GERMANY AND BRITAIN

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Deutsch-Britische Stiftung für das Studium der Industriegesellschaft
34 Belgrave Square, London SW1X 8DZ
Tel: +44 (0)20 7823 1123 Fax: + 44 (0)20 7823 2324
Website: www.agf.org.uk**

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Executive summary

Over the past two decades the industrial societies of Britain and Germany have undergone dramatic transformation. In Britain the transformation in the governance of the economy has been breathtaking and Germany seems to be adopting many Anglo-Saxon methods of economic governance. One of the most notable features is the prominence given to regulation as a technique of governance and the rise of a ‘new regulatory state’ in Europe. There are many detailed analyses of regulation in the two countries, principally by economists and lawyers. There are, however, fewer studies by political scientists, and particularly few taking a broad perspective on change from cross-national and cross-sectoral perspectives.

This comparison of Britain and Germany has a number of aims:

- To provide a perspective on British developments
- To assess the extent to which British reforms are influencing those in Germany
- To provide a comparison between the two capitalist ‘models’ – the Anglo-Saxon and the continental ‘Rhineland’ model
- To assess the extent of convergence and the persistence of divergence.

For illustration, we draw on case studies from the telecommunications, electricity and financial services sectors.

Since we were seeking to take stock of changes over the last two decades, our main approach has been the synthesis of existing work, although we have undertaken some new empirical research. To assist in this task we deployed an experimental research methodology based on a ‘virtual focus group’ of experts in both countries set up to discuss regulatory transformation and to assess our interpretations. The focus group consisted of about 40 experts (academics and practitioners) from Britain and Germany. Our interpretations were discussed with most focus group members through the circulation of working papers and in interviews conducted by the research team.

In this report we question the intuitive and apparently plausible argument that Germany has approached the British economic model. Central to the new economic order are new forms of regulation and a distinctive British model of regulation has arisen. The British experience of the 1980s and 1990s, although drawing in some ways from the US, is seen to be instructive for the rest of Europe. It is true that developments in Germany, such as the liberalisation of markets, particularly in the utilities, appear to indicate convergence towards Britain. Nevertheless, the question arises as to whether there has been a unidirectional convergence of Germany towards Britain. Central to this discussion therefore is the apparent importance of the ‘British model’ for state–market relations in Germany. We consider some of the central features of the British regulatory model in order to assess whether and to what extent Germany is converging on Britain.

In analysing convergence and divergence, several criteria of regulation are examined. Regulatory institutions and instruments are considered in detail in each sector. Other criteria considered are legalisation and juridification, consumer protection, decision-

making procedures and the process of reform. We deploy the policy learning approach in order to assess how convergence occurs. There is abundant evidence of policy learning on regulation from the US to Britain and it needs to be considered whether and in what way it has occurred from Britain to Germany. The causes of convergence and the persistence of divergence are analysed on the one hand in the context of sectoral structures and economic forces (which can lead to cross-national convergence), and on the other hand in the context of national regulatory and administrative traditions which often militate towards diversity.

Although there has undoubtedly been a general unidirectional shift in Germany towards a British-style market orientation, the evidence of a concomitant unidirectional shift of German regulatory regimes towards British regimes is limited. Most of the evidence of convergence of Germany towards Britain is in telecommunications, with Germany now having a sector-specific regulator and utilising an *ex ante* regulatory approach. The establishment of a single financial services regulator in Germany is also an indication of convergence on Britain (although this is also a recent initiative for Britain).

There is, however, not only persisting divergence but also evidence of some convergence of Britain to Germany and of both countries converging to a third form. The electricity sector displays the most distinctive divergence, with Germany adopting an *ex post* approach without a single national regulator. Even in telecommunications there is evidence of divergence: the form of regulatory independence, the internal organisation of the regulators and decision-making procedures all differ. Other areas of divergence include the extent of legalisation and juridification (with a little evidence of Britain moving towards Germany) and systems of consumer protection. Finally, in the supervision of banking we see evidence of both countries moving towards a third, internationalised model based on the Basel process.

We conclude that there has not been a convergence towards one form of regulation, neither the post-privatisation British model, nor some new model. This report supports previous work which suggests that in Europe many of the key aspects of regulation are still achieved in very specific national contexts. It cannot therefore be assumed that the new neo-liberalism in Europe is necessarily reproducing the regulatory institutions, approaches and styles of Britain, nor a newly emerging ideal type.

1 Introduction

The privatisations and liberalisation undertaken in Britain during the 1980s and 1990s have been described not only as a great success but also as an example for other countries:

'Indeed, this is an area in which Britain can reasonably claim to have set an example to the rest of the world. Other European nations, notably France and Germany, have followed Britain along the same path, as have a growing number of developing countries.' (Owen 2000: 5)

Owen's position corresponds to an orthodox view of the transformation of the economic order in Britain. This has not only achieved efficiency gains but has also shown the world how the change should be undertaken. In this report we question the intuitive and apparently plausible argument that Germany has approached the British economic model. A critical examination of the argument must consider two problems:

1. Is there a distinctive 'British model' and what distinguishing features does it have? In Britain there is a discussion in political science literature of a 'new regulatory state' which conceptualises the re-ordering of state-market relations after the transformation of the political economy in the 1980s and 1990s (Moran 2001). For pragmatic reasons in this report we follow this British conception of the regulatory state though we recognise the analytical qualities of a broader conceptualisation (Müller and Sturm 1998).
2. Is it justified to consider the transformations of the German economic order, which occurred after Britain, as a transformation towards the 'British model'? Where such a convergence can be established the mechanisms and causes must also be considered. The 'policy learning' approach, which will be outlined later in this introduction, is invoked as a way of assessing the mechanisms of convergence. Sectoral contexts and national traditions are then considered as means of assessing the causes of convergence and divergence. We focus on cases of both convergence and divergence as our conviction is that negative cases can be as revealing as positive cases.

This report focuses mainly on three economic sectors: telecommunications, electricity and banking. It is shown that that these are three different cases in the divergence-convergence debate and are very useful for analysing the causes of cross-sectoral and cross-national learning in both the positive case of convergence and the negative case of divergence.

1.1 National traditions in political economy and regulation

The transformation of the economic order as implied in the new regulatory state can involve a confrontation with deeply embedded national traditions in state-economy

relations, administration and regulation. New economic ideas and imperatives arising from international forces may or may not be compatible with national traditions. Where there is no easy 'fit' between new ideas and imperatives and national traditions, historical institutionalist analyses suggest that national economic orders and administrative traditions will remain relatively impervious to outside forces.

1.1.1 Economic orders as expressions of state traditions: models of capitalism

It is generally accepted that Britain and Germany have very different economic orders and these reflect different state traditions in Europe (Dyson 1980). On the one hand Britain, as the forerunner of the industrial revolution, experienced the development of competition as a quasi-natural process. The state, especially in its modern sense, played little role in the creation and preservation of competition (Sturm 1996: 59). On the other hand the ordoliberal ideas of the Freiburg school, which have had a significant influence on Germany, see the state as having an important role in organising an enduring and stable competitive market economy and being the judge of good and bad effects of the market economy. The post-war west German 'social market economy' can be seen as a continuation of this understanding of the role of the state in the economy. This also corresponds to the 19th-century understanding of the role of the state in Germany.

This typological distinction between economic orders is at the heart of a growing literature on capitalist diversity (Coates 2000). Albert (1993) is a popular example of this literature, which focuses particularly on the difference between Anglo-Saxon and Rhineland capitalism (Hodges and Woolcock 1993; Crouch and Streeck 1997; Rhodes and van Apeldoorn 1997). In Germany (and in France) Albert identifies a certain scepticism towards the free market. The state plays a role in bringing together economic groups in society to a position of social responsibility. This 'integrative' concept stands in stark contrast to the Anglo-Saxon model with its emphasis on the interest of capital in the economic order. Firms measure their success almost exclusively in terms of 'shareholder value' while objectives beyond profit maximisation are secondary. The state also accepts this understanding of the players in the market. If one accepts Derlien (1996), the chances of significant re-orientation towards the market in Germany are slim. Legal guarantees of monopoly in public services reflect a deeply embedded hierarchism which is alien to market logic.

The British model of capitalism seems to be much more compatible with the new regulatory state. In particular, its market-oriented nature appears to be highly compatible with the central role accorded to the market in the regulatory state. British capitalism also sits much more easily with the converging forces of globalisation, with the City's powerful political position in Britain, with its strong support for neo-liberal policies, and what it sees as the beneficial forces of globalisation (Rhodes and van Apeldoorn 1997: 183). In Germany, by contrast, the scepticism towards a high degree of market orientation, particularly in public services, indicates a certain incompatibility with the regulatory state. Moreover, although Germany has responded to the Anglo-Saxon-inspired neo-liberalism, its capitalism seems much less suited to internationalisation (Streeck 1997).

1.1.2 Administrative traditions and regulatory styles

National systems of administration can have an impact on regulatory transformation and many key aspects of the 'politico-administrative systems' of Britain and Germany have

very different structures and cultures (Pollitt and Bouckaert 2000: 40; Wollman 2000). The most obvious difference lies in the basic structure of the state: the British unitary state in contrast to the German federal state. Moreover, although both countries have parliamentary systems, they are of very different forms. The British Westminster system is the classic parliamentary system: parliamentary sovereignty and ministerial responsibility are paramount, state power is formally unlimited and there is little real separation of the three main branches of the state. In Germany, by contrast, the main powers of the state are more clearly separated and the power of parliament is constitutionally limited. These trends are manifested most notably by the constitutional and administrative courts, which have no equivalents in Britain.

A second broad aspect of systems of public administration is cultural, and again the two countries represent two very different approaches: 'public interest' and *Rechtsstaat* (Pollitt and Bouckaert 2000: 52–4). These cultures can have a strong impact on the habits and norms of administrative and regulatory practice. The key differences between the systems are the attitude towards the idea of the state and law. In the 'public interest' model, prevalent in Britain, there is a suspicion about the dominance of the state, and the process of administration is geared towards seeking the public's consent for measures in their interest. Decision-makers strive for fairness in the face of competing societal interests and in this way decisions tend to be made in a flexible, *ad hoc* and pragmatic fashion. In British administrative practice the role of the law is very much in the background and there is no clearly distinctive administrative or public law separate from private law (Ridley 2000). Administrative law in Britain, so far as it exists, deals mainly with the 'judicial review' of decisions, and although the number of cases has increased in recent years, it remains very small compared to the cases German administrative courts have to deal with. British courts consider it outside their realm of responsibility and competence to make substantive judgements on the decisions of administrative authorities, more so if it implies a deviation from the substance of administrative decisions. However, the Human Rights Act may lead to a new and more political direction for the British courts, and some commentators note the increasing influence of law on British politics (Foster 2000; Woodhouse 2001).

In the *Rechtsstaat* model prevalent in Germany the state is much more of an integrating force and a self-standing concept in its own right (Wollman 2000). It is primarily through law that this concept of the state is manifested and a clearly separate body of administrative law with an associated court system has developed. In this context the habitual approach of civil servants is highly rule-bound and the actions and decisions of civil servants are subject to strong legal control. Decision-making is therefore much more formalised with little scope for discretion or flexibility in specific cases.

These administrative traditions are also reflected in contrasting approaches to regulation, often referred to as 'regulatory styles', in Britain and Germany. Regulators in Britain have traditionally eschewed legalistic instruments of enforcement and pursued strategies of conciliation and accommodation (Vogel 1986). In the emerging regimes of utility regulation which have developed since the 1980s, the emphasis has been on negotiation between regulator and regulated without formalised procedures and with a marked reluctance to involve the courts and impose sanctions. By contrast regulators in Germany have been subject to the omnipresent legalistic culture of both administration and political decision-making. This means that the internal procedures of the regulators are substantially shaped, if not determined, by the *Rechtsstaat* principle and a legalistic approach to matters and tasks assigned to them. It extends also to the significance of the

judiciary as an effective counterpart to regulatory agencies. Formalisation and a tendency to avoid discretionary room for manoeuvre has therefore traditionally been a distinctive feature of regulation in the German political economy.

1.1.3 Limits of national traditions

Stark contrasting typologies of national traditions are, however, abstractions which can oversimplify reality. At the very least national traditions are subject to similar international challenges and technical and economic changes. Firms and markets constantly change, so it is logical to suppose that their relationship to the state is constantly changing, irrespective of the role the state claims. Also, despite the apparent enduring administrative traditions and models of capitalism, fundamental economic ideas can come and go. The Keynesian welfare state, for example, was seen to be victorious in both countries as in most western countries (Hall 1989), indicating the limits of the impact of national traditions on economic orders. Therefore it seems that, rather than being fixed and static entities, economic orders and 'models of capitalism' constantly change, adapt and develop in the context of new economic ideas, and of technical and economic change.

Irrespective of economic and technical change there are also limits on the extent to which Britain and Germany are diametrically opposed ideal types. A contrast between a British 'stateless tradition' and a continental 'state tradition' is too simplistic (Laborde 2000; Gamble, 1994). Britain, for example, cannot be depicted simply as a society in which there is a strong distrust of the state. After World War II Britain experienced a period of extensive nationalisation of industry and in the following period of privatisation the state has played a role in the promotion of the public interest through regulation. Moreover, it has been argued that privatisation and new forms of regulation involve not a disengagement of the state but a re-empowering of the state (Wolfe 1999). Similarly, the market is a central feature of the German ideas of ordoliberalism and the social market economy, so the state cannot be depicted simply as a dictator of the economic order. The free market has also been constrained by the subsidies given to some German industries in the post-war period. In short, generalised and fundamental typological differences between the two countries fail to capture many of the dynamics of economic change and state-market relations. Typological generalisations can help us to understand key aspects of different systems of capitalism by reducing their complexity but can often overlook empirical reality. The latest developments in the 1980s and 1990s both in Britain and in Germany are testimony that the state and its role in the economy have undergone significant transformation. Hence the identification of long-term constants requires empirical observation and cannot be taken as deterministic.

1.2 The 'new regulatory state' in Britain

Britain is the homeland of the 'new regulatory state', despite the fact that some of the features of the regulatory state have a longer history in Germany. Prior to the 1980s post-war Germany, with less state ownership and some independent state agencies (the central bank, the Cartel Office and financial services supervision), appears to have been closer to what is now conceived as the 'regulatory state'. Yet there are few studies of regulation in Germany beyond technical, legal and economic analyses of specific cases or political

science analyses of the process of policy change in particular sectors. The most notable studies are written by British academics (Dyson 1992), draw on Anglo-Saxon ideas of regulation (Müller and Sturm 1998) or consider broader trends in the EU and Europe as a whole (Majone 1994, 1996). For these reasons in this section we focus on the British 'model' of the regulatory state in order to set up a definition to consider the extent of convergence and divergence.

The revolutionary change in the relationship between the state and the market in Britain in the 1980s and 1990s is well known and does not need to be depicted in detail here. Its radical extent can in part be attributed to the size of the public sector in Britain in the late 1970s: one of the largest among the western industrial states. By extensive privatisation and market liberalisation (the latter often later than privatisation) Conservative governments achieved not only marked economic efficiencies but also redefined the nature of statehood and the meaning of the state's role in the provision of important goods and services, in particular in the utility industries. The British model of the 'new regulatory state' synthesises the new state characteristics that have developed.

Two questions arise: what are the characteristics of this model? And why is the 'regulatory state' new? Regulation itself is not new: in one way or another states have regulated the market order for centuries (Polanyi 1957). As long as there have been free markets and private actors making their own decisions, with the use of various instruments in the name of the 'public interest', the state has either minimised the negative effects of free market forces or encouraged market participants to achieve state objectives. Completely free markets in which the state, outside of the realm of civil law, has no influence have become exceptions in modern economies. There are, however, varying levels and frequencies of intervention so that it can sometimes appear that a market is not regulated, when in fact it is merely burdened by fewer regulations.

What are the main characteristics of the British model of the 'new regulatory state'? In this study we employ the concept in a pragmatic and descriptive manner. An extensive description of the 'new' economic order and the 'new' understanding of the role of the state in the economy – as represented by Britain – provides a basis for this study. It will serve as a measure of convergence when Britain and Germany are compared.

1.2.1 The relationship between the state and the market

A fundamental aspect of the new regulatory state concerns the confidence in the market to solve economic and socio-economic problems and involves a sustained critique of the Keynesian welfare state (Majone 1997). In essence the regulatory state involves a semi-detachment of the state and the economy and a separation of policy-making from service supply (Loughlin and Scott 1997). The state no longer starts from the assumption that certain economic areas are so sensitive that private providers should be excluded from them. The belief is that private firms can provide reliable and affordable products and services. In particular the natural monopoly argument that private companies cannot supply utility services such as telecommunications, energy and public transport is no longer appropriate.

Semi-detachment implies that markets have a central role but not the complete detachment of the state from the economy (Gamble 2000). The form of state influence on non-state actors is best characterised as a process of regulation and has several basic objectives:

1. Market failure, caused particularly by natural monopoly of networks in some industries, requires regulatory intervention to overcome its negative effects. In a sense regulation performs a substitution function – where there are non-competitive processes it is a substitute for competition. In the British utilities one of the most notable instruments is price regulation. Prices are controlled not to prescribe a ‘market price’ but to create incentives for efficient and innovative behaviour.
2. Regulation goes beyond the substitution function to the creation of a competitive market which can be self-functioning in the future. This approach can be termed proactive regulation and it is hoped that when competition has been fully created regulation can be dispensed with. With this understanding regulation has a transformative character and is a time-limited process.
3. Regulation involves the achievement of public service objectives such as environmental standards, supply security and value for money. Although market-oriented interventionary instruments are adopted where possible, at the core is the belief that certain public service objectives cannot be achieved by market mechanisms and thus regulation is required.

1.2.2 The internal reconstruction of the state: independent regulatory authorities

The new confidence in the market, the extensive retreat of the state from ownership and the establishment of a state activity as promoting and protecting competition has been accompanied in Britain by the establishment of new institutions. These are regulatory authorities, which have a certain legal and political independence. One of the main arguments for independence is ‘credible commitment’. Market actors require confidence that regulatory policies will be technically efficient and politicians and government ministers are not tempted to intervene to achieve short-term political objectives (Wilks with Bartle 2002).

There are several characteristics of the British independent regulatory authorities which display a high level of consistency and coherence in intersectoral comparison. The utility regulators themselves – OFTEL, OFWAT, OFFER, and OFGAS (the latter two now combined in OFGEM, Office for Gas and Electricity Markets) – and the similarities of their internal structures and ways of working are evidence of a cross-sectoral regulatory model. There were certainly similar institutions before the liberalisation and privatisation of the 1980s and 1990s, such as the competition agencies, the Office of Fair Trading (OFT) and the Monopolies and Mergers Commission (MMC, now the Competition Commission). However, the utility regulators show sufficient common characteristics that it is justified to speak of a single regulatory model (Mitchell 1990; Foster 1992; and for a critique, Hood 1996):

1. One person heads up the institution – the director general. This individual, not the authority itself, is the regulator and this is reflected in the external relations of the authority. Decisions or announcements are not by the authority but by the ‘regulator’, i.e. the director general. In public appearances and in annual reports the first person singular ‘I’ has become the established mode of speech. From a German perspective the high level of personalisation is one of the most visible characteristics of British regulatory authorities, though this is beginning to change as we will see.

2. The regulator needs to develop a close and long-term working relationship with the regulated, in contrast to other important administrative officials. Assurance of market confidence is clearly focused: the regulator as a person should look after the long-term interest of the (new) market and the continuity in the arrangements and working conditions in the particular sector. This approach contrasts, for example, to the approach of the Austrian school, in which the confidence of market participants is achieved by general rules rather than discretionary and problem-oriented interventions. In the British model the confidence of the market is influenced by the reliability and the personal integrity of the regulator, though each regulator works within a clearly established framework of rules, agreements and precedents.
3. The regulator has considerable decision-making discretion, with a status more like that of a minister than the head of an inferior authority. The regulator also has an autonomy that is striking when compared to the German *Rechtsstaat* tradition and especially the legal control of administrative activity. Without the 'Damocles sword' of the judiciary, the administration has little incentive, formally and substantively, to be concerned with the transparency and coherence of its decisions.

These features were characteristic of all the above regulatory authorities up to the end of the 1990s. The extraordinary similarity and coherence in institutional design makes it worthwhile to question the causes. The very existence of independent centres of authority seems to contradict the basics of the British political system of parliamentary sovereignty. Traditionally Britain has a highly centralised political system in which independent decision-making bodies do not appear compatible with the imperatives of ministerial responsibility.

However, the extent of coherence in intersectoral comparison of British regulatory authorities is not so surprising when one considers the circumstances of economic reform in the 1980s. All the utilities (energy, telecommunications and the railways) were state-owned. Furthermore, many of these sectors have been the responsibility of one merged ministry: the Department of Trade and Industry (DTI), which adopted a model based on the OFT (Wilks 1999). Also, because of the greater importance of the head of government, the co-ordination between ministries and departments of high-profile political reform, such as privatisation, is better developed than at the federal level in Germany. This initial position makes it understandable that the choice of an institutional framework for the regulatory regime for one (privatised and now liberalised) sector is likely to be projected into the choice of regulatory regime in other sectors (in the same and in different government departments).

As privatisation and liberalisation of utilities was a politically motivated initiative by the Conservative governments of the 1980s and 1990s, the question remains why the Blair government since 1997 has not made any substantial changes to the regulatory model.

1.2.3 The consolidation of the new regulatory state under New Labour

In the early and mid-1990s the British model of utility regulation received strong and sustained criticism. Several studies were critical of aspects such as personalisation, discretion, accountability, and the roles of ministers, competition offices and consumer groups (Hansard 1996; National Audit Office (NAO) 1996; Corry *et al.* 1994; Graham 1998a; Wilks 1998). Against this background and in view of public controversies, particularly over directors' pay, there were signs that Labour would radically reappraise utility regulation. However, despite some reforms which attempted to introduce the

'third way' into utility regulation, notably strengthening the role of the consumer (Jones 2000), the defining feature since Labour took power in 1997 has been consolidation. The debate has focused around the Utilities Act 2000, which proved more incremental than revolutionary, and in broad terms Tony Blair's government has not departed from the established British model (Bartle and Wilks, 2002). Nevertheless there have been changes, some of which confirm the model while others have led to a new orientation in which the regulatory state can be seen in a new light.

In the first category of model-confirming reforms under the Labour government is the tendency for the integration of sector-specific regulators. Thus OFFER and OFGAS have been integrated into OFGEM (Graham 2000: 193) and the government has proposed to establish OFCOM from the telecommunications and broadcasting regulators. Outside the utilities, the Financial Services Authority (FSA) brings together the various elements of financial services regulation (banking, insurance, securities and other financial services) (MacNeil 1999).

In the second category of re-orientation there are tendencies such as the move away from the director general model and formalisation and legalisation, which do not seem to confirm the British model.

Although we consider these developments as setting a course for a new regulatory state, it is too early to speak of a new era. The extent to which the growing formalisation and legalisation of the work of OFGEM is an expression of a party-political programme, the maturing of regulation, or simply another expression of personalisation, must remain open. These developments are in any case a little paradoxical given the traditional lack of a distinctive public law system in Britain (Mitchell 1965). These latest developments will not feature as central aspects of this report; they merely modify the British model which serves as a measure for this analysis. They do not question the basic approach of a convergence–divergence comparison of the regulatory state in Britain and Germany.

1.3 Convergence, divergence and the regulatory state: what, how and why?

Analysis of convergence and divergence is well established in comparative political economy and public policy (Berger and Dore 1996; Unger and van Waarden 1995). There are essentially three questions in relation to the analysis of convergence (and divergence): what? how? and why? (Unger and van Waarden 1995: 4). First, we need to assess *what* is converging or remaining divergent. This is an empirical question which concerns observable phenomena. In relation to the regulatory state in Britain and Germany we need to know how convergence is recognisable and how we measure the supposed shift of Germany towards the British model. Second, we need to investigate *how* convergence takes place: what are the mechanisms by which the policies in different jurisdictions move together? Third, we need analyse *why* convergence takes place or divergence endures. The first question requires a selection of the empirical criteria to observe and compare. The second and third questions require substantial theoretical frameworks.

1.3.1 What is converging? Convergence criteria

Two of the main features of the regulatory state are the *institutional arrangements* and the *regulatory instruments* and these are the principal criteria that are assessed in the three sectors covered in this report. In relation to the institutional arrangements one of the most salient features of the British model of regulation is the sector-specific independent regulatory authority. At the institutional level we therefore can speak of convergence if Germany adopts this feature. Institutional arrangements also refer to the internal design of established institutions. A particularly striking sign of imitation of internal institutional design would, for example, be the adoption in Germany of the British director general model.

Assessing the regulatory instruments can tell us about the underlying regulatory approach. In the British model of regulation outlined above the instruments utilised indicate a predominantly proactive approach. We can therefore assume convergence if a proactive approach is adopted in Germany. Under proactive intervention regulatory instruments can be understood as *ex ante* measures to re-orientate market players (primarily the former state monopolies in the utilities) towards competitive behaviour (possibly by price incentives). In contrast to this an *ex post* reactive approach deploys instruments which sanction or correct competition-damaging behaviour. There is an understanding of regulation in Britain as transitional, effectively a 'midwife' for the new market (and British regulators, as we will see, have this understanding due to their retreat from certain parts of the market). We should therefore see signs of an end to proactive regulation when competition is established. Considering that full liberalisation in Germany was only introduced in the utility sectors in the late 1990s, we may not yet expect to see substantial evidence of regulation declining.

Four other convergence criteria are also considered in this report: decision-making procedures, processes of reform, legalisation and juridification, and consumer protection. Regarding *decision-making procedures* we could speak of convergence if substantial discretion has been introduced in Germany. However, caution is required here as decision-making freedom may imply institutional independence, a repeat of the first criterion. Decision-making processes could, however, be limited to general processes of formalisation which are qualitatively different from institutional independence. Evidence in Germany against a shift towards more discretion is not necessarily an argument against convergence. As noted above, recent developments point to a new direction for the British model. Regarding the *process of reform* we could speak of convergence if the process of development of the new order in Germany corresponds to that in Britain. In this context the mode of liberalisation, recognisable above all by the possibility of market entry and user choice, can be assessed. As noted above in relation to *legalisation and juridification*, the traditions in Britain and Germany are poles apart. We could therefore speak of convergence of Germany towards Britain if there is greater flexibility and discretion in German regulation and much less involvement of the courts. Finally, in the conclusion we consider the different systems of *consumer protection*. A highly institutionalised form of consumer representation has developed in Britain (consumer panels, committees and independent councils) and we could speak of convergence if similar institutions are being established in Germany.

We are aware that these criteria do not represent all aspects of convergence of the regulatory state; moreover, there is considerable room for uncertainty and judgement. Each of the cases in this study appears as a test for convergence but is limited, given the

relative flexibility of the above criteria and uncertainty about just what the British model is. They do, however, serve as a means of giving greater transparency and comprehension to our analysis and assessment.

1.3.2 How does convergence occur? The policy learning approach

Policy learning can enable us to answer the question how policy convergence occurs. Policy learning is an aspect of a wider process currently labelled 'policy transfer' but includes processes such as lesson-drawing, policy convergence, policy diffusion and policy transfer. The phenomenon can be succinctly described as 'a process in which knowledge about policies, administrative arrangements, institutions etc. in one time and/or place is used in the development of policies, administrative arrangements and institutions in another time and/or place' (Dolowitz and Marsh 1996: 344). Dolowitz and Marsh (2000: 13) identify various gradations of policy transfer:

'[There is] copying, which involves direct and complete transfer; emulation, which involves transfer of ideas behind the policy or program; combinations, which involve mixtures of several different policies; and inspiration, where policy in another jurisdiction may inspire a policy change, but where the outcome does not actually draw from the original.'

One can also identify selective, symbolic or negative learning. There may be policy adaptation, but without change in the fundamental attitudes learning is likely to be incomplete. Recent work suggests that the transformation of basic belief systems is at the heart of successful policy learning (Levy 1994; Sabatier, 1993: 122ff).

In relation to the regulatory regimes for the British privatised industries there is abundant evidence of policy learning and transfer from the US. Policy transfer, however, was far from a simple process of policy-copying. The idea of a regulatory agency appears to come from the US, but policy learning has involved a significant element of emulation and negative lesson-drawing. For example, personalised regulation (i.e. the director general model) and a discretion-based regulatory style was preferred in Britain to the more formalised US regulatory commission and the highly litigious US regulatory culture. Once the British regulatory regimes for the privatised industries had developed in the 1980s, bi-directional lesson-drawing became possible.

1.3.3 Why does convergence occur? Sectoral contexts versus national traditions

Understanding the causes of convergence, the persistence of divergence and the form and extent of policy learning can be encapsulated in two opposing perspectives (Hulsink 1999: 18):

1. *Cross-national convergence* ascribes primacy to the technical and economic problem context. Within this perspective within the same sector, where problem contexts are likely to be similar, cross-national convergence is expected and cross-national policy learning is more likely (Rose 1993). The most notable pressures for convergence are economic internationalisation and globalisation (Unger and van Waarden 1995), which are cited as reasons why policy learning occurs and has increased in recent years (Dolowitz and Marsh 1996). Economic globalisation is widely recognised and is conventionally seen as reducing the power of national policy-makers to shape their own policy agendas. Policy-makers are under increasing pressure to learn from

jurisdictions that have adopted policies which have successfully responded to globalisation. While globalisation is often perceived as exerting pressures on a wide range of areas of public policy, there is significant cross-sectoral variation in globalisation (Gummett 1996). In this perspective cross-sectoral variation would therefore be expected. The techno-economic problem context is not, of course, only connected to international pressures. Technological change and innovation in certain sectors (in this report most notably telecommunications and financial services) can impart a cross-national converging dynamic on policy. In this perspective policy-makers at national level are likely to be highly receptive to new policy ideas.

2. *National diversity* ascribes primacy to national politics and institutions. Within this perspective, irrespective of the forces of convergence, persistent cross-national diversity is expected and within nations similar approaches will be adopted in different sectors. Understanding the causes of policy change therefore requires analysis within the context of the specifics of domestic politics and national traditions in decision-making and administration. As noted above, Britain and Germany have very different traditions of administration and regulatory styles: the British informal and flexible 'public interest' tradition contrasts with the highly formalised and legalised *Rechtsstaat* tradition in Germany. These traditions appear to be highly pertinent to the shift towards the 'new regulatory state', and in this perspective it is expected that there would be persisting divergence. National traditions can also act as constraints on policy learning and can explain the variegation in patterns of policy learning and transfer. A historical institutional approach to public policy stresses the importance of endogenous characteristics of jurisdictions such as established rules and organisations, norms and values and established and accepted practices of cooperation. 'Path dependency', in which the historical direction of policy and traditional ideas shape policy, is a defining feature of policy change. The transplantation of policies, practices or organisations of one system to an alien body, which may be predisposed to reject them, may therefore be highly limited. Policy learning and transfer might be possible, but a process of adaptation occurs in which imported ideas are selected and adjusted to suit the new institutional environment. Beliefs, policy norms and ideologies can also shape policy learning and transfer. In evaluating systems of regulation, Vogel (1996: 263), for example, notes that judgements are highly dependent on the values which the proponents cherish the most. A more specific example is the recent transformation of the electricity sector, in which Sturm and Wilks (1997) point out the lack of an ideological propensity for the British to look to Germany for policy ideas.

In the literature neither perspective comes out consistently as a 'winner' and there is no easy way of reconciling the dilemma between the perspectives. We can suppose that policy outcomes will depend on the strength of converging forces and the extent of the resistance of national institutions.

1.4 Research methodology and work programme

This research project is primarily based on existing sector-specific and comparative research in the sectors. New empirical research was undertaken, but this was not

extensive and was undertaken primarily to confirm our interpretations of the existing secondary literature. Instead we set up an experimental research methodology centred on a 'virtual focus group'. The focus group consisted of about 40 experts (academics and practitioners) from Britain and Germany. Our interpretations were discussed with most focus group members through the circulation of working papers and in interviews conducted by the research team. During this process new ideas arose, initial interpretations were reconsidered and individual pieces of the jigsaw were collected to form a more complete picture. The different perspectives and elements of the whole enabled us to develop a distillation of a new quality. This is not only due to its relevance, topicality and 'inside' knowledge, but also the close cross-national collaboration of the research team and the dialogue with the focus group.

Four discussion papers written since the start of the research project in late 1999 served the purpose of synthesising and summarising the current state of the research and enabling our interpretations to be given critical attention:

- Theory, methodology and cross-national analysis of political economy and regulation (Bartle 2000)
- Regulatory institutions and arrangements (Bartle and Müller 2000)
- Regulation, competition and industrial policy arrangements (Müller and Bartle 2000)
- Regulatory enforcement and styles arrangements (Bartle and Müller 2001).

The discussion papers formed the basis of exchange of views with the members of the focus group. In addition they have been received as self-standing contributions and have been cited by some focus group members in their work.

The exchanges between the research team and members of the focus group took place between the beginning of 2000 and May 2001 and were undertaken both by virtual (Internet and email) and conventional means (post and personal interviews and discussions). The form and depth of the empirical investigations varied somewhat between the sectors.

2 Telecommunications: the case of convergence

The new regulatory order developing in German telecommunications displays distinct similarities to that which has developed in Britain since the early 1980s. This convergence suggests that significant cross-national learning has taken place between Germany and Britain. While limitations on convergence are evident, such as the decision-making procedures and the form of institutional independence, extensive convergence has occurred at both the institutional and instrumental levels. The high level of convergence can be attributed in particular to similar industry structures prior to liberalisation and to the dynamic nature of telecommunications markets.

2.1 The British 'regulatory experiment' and the German latecomer

Telecommunications was the first of the utilities in Britain to undergo radical reform and the first experiment in privatisation, liberalisation and re-regulation (Hall *et al.* 2000; Thatcher 1999; Hulsink 1999). The principal reforms in the sector in the early 1980s were the licensing of a second operator, Mercury, in 1981 and, more significantly, the privatisation of British Telecom (BT) which commenced in 1984. While the sale of BT was massively oversubscribed and a great success for the government, in terms of stimulating competition, the reforms were of much more limited success. After ten years of duopoly by the end of the 1980s Mercury had only gained about 10 per cent of the market (Armstrong *et al.* 1995). It was only after the Duopoly Review in 1991 (DTI 1991; Carsberg 1991) and the active promotion of competition in the 1990s by the regulator that the market became more dynamic and many players entered the market. A central aspect of the reform was the creation in 1984 of a new regulator for telecommunications, OFTEL. The idea of a sector-specific regulator became embedded in British utilities and, in a 'snowball effect' (Hood 1996: 62), OFTEL became the prototype for other new regulators in the utility industries such as electricity, gas and water (Baldwin and Cave 1999: 190–200). OFTEL, however, was not the original model of a regulatory authority in Britain: the structure and organisation of OFTEL was largely drawn from the Office of Fair Trading (OFT), which was created in 1973 (Wilks 1999: 253).

Was the regulatory experiment in telecommunications part of a grand vision of radical reform? Privatisation itself can be seen as an ideologically motivated programme, the first stage of which began in the first term of the Conservative government with companies such as British Steel and Cable and Wireless (Wright 1994; Heald 1989). While privatisation of companies in competitive sectors was undoubtedly a clear vision of the early Thatcher government, there was no 'blueprint' for the extensive privatisation, liberalisation and new regulatory regimes in utilities sectors, considered by many to be natural monopolies (Veljanovski with Bentley 1987: 7ff.). Privatisation of the utilities and the development of what in retrospect appears a distinctive model of utility regulation must be understood

as a process of discovery and learning and can be interpreted, as some of our focus group members argue, as a history of 'unintended consequences'. In 1984 the successful privatisation of BT was far from certain and privatisation of the other utilities was seen as even more improbable. However, the sale of BT was a success for the government, with about 2 million people buying shares, more than half of whom for the first time. This gave the government great encouragement to continue with the privatisation of the utility industries (Riddell 1989: 98). In addition the sector-specific model of regulation was stumbled on rather than a part of clear vision of regulation of the privatised industries. There were no clear ideas on the regulation of BT, which became a near-private monopoly, and after the Director General of the OFT, Gordon Borrie, refused to take it on, it was decided to set up a sectoral regulator (Wilks 1999: 253). One can only speculate what may have happened had Borrie accepted the regulation of telecommunications.

Why did the experiment in regulation begin with telecommunications? The risk and consequences of failure were smaller than with the other utilities: the disruption of the supply of energy and water would have had far worse consequences than the loss of telephone services. Also, the risk of failure was limited given that BT was not restructured and remained the dominant supplier of telecommunications services. It is true that the central thrust of the privatisation of BT came from the government and there was strong interest group opposition with little encouragement even from large users and the City (Moon *et al.* 1986; Thatcher 1999: 146), nevertheless there were some sectoral imperatives for major reform. The British telecommunications system in the 1970s was seen as antiquated and in need of substantial investment. Privatisation was seen as a way this could be achieved by a government averse to the policies of 'tax and spend'. Moreover, City interests and organised large and small business users were concerned about the quality of data transmission services and pressurised the government for the liberalisation of these services, though not for privatisation (Hills 1986: 90; Hulsink 1999: 127–32). The idea of a second network operator came from a group of financial and industrial interests (Barclays Bank, BP and Cable and Wireless), who were becoming more and more dependent on high-quality international telecommunications services (Thatcher 1999: 176; Hills 1986: 93).

The transformation of the telecommunications sector in Germany, as in Britain, did not occur overnight. The Telecommunications Act of 1996, which introduced full liberalisation of the sector in 1998, came at the end of a three-stage process of reform. The first reform of 1989 included the liberalisation of advanced telecommunications services and terminal equipment (in line with the EC directives) and the separation of the former Deutsche Bundespost into three businesses: telecommunications, postal services and a bank. Soon after, in the early 1990s, the pressures for further reform increased dramatically. The sudden and unexpected re-unification of Germany required a programme of massive investment in the east and this added to the increasingly dynamic and globalised sector which required operators to be responsive to the market and fit for international competition. As a result, in 1994, the second stage of reform involved the change of status of the three parts of the Deutsche Bundespost from a specially constituted federal organisation to three autonomous corporations (Jäger 1994; Schmidt 1996). The telecommunications corporation Deutsche Telekom AG was created and in 1996, with 40 per cent of the shares sold.

In Germany the liberalisation of the different parts of telecommunications – terminal equipment, data and voice services, networks and mobile systems – was, like in many countries, staggered. It commenced with terminal equipment and data services in 1989,

leading to the liberalisation of all infrastructure and services by 1998. In this period in Germany, as in Britain, the telecommunications sector became one of the most dynamic in the economy with massive investment in networks and services by new providers and incumbents alike. Technological developments and user demand had eroded the argument that telecommunications as a network-based industry was a natural monopoly.

2.2 The adoption of the British regulatory approach in Germany: the importance of the market context

In comparing regulatory approaches to telecommunications in Britain and Germany, the most obvious similarity is market structure. In both countries a former state monopoly operator dominated the market and the primary objectives of regulation were the control of the dominant operator and the promotion of competition and new entrants. Thus a similar problem context faced each country and there was a good chance of the adoption of similar approaches. Cross-national similarities are evident in the key aspects of both the institutional and instrumental levels of regulation.

At the *institutional level* both countries have adopted the independent regulatory authority model. In Germany the regulatory functions could have been undertaken by existing authorities such as the ministry or the competition authorities. There was a debate over whether a strengthened Cartel Office was an appropriate institutional solution. However, although the Cartel Office fought hard to enlarge its portfolio, the ministry, which preferred a sector-specific regulator, proved stronger. The British model therefore proved the most appropriate example for the institutional regulation of telecommunications. Moreover, in the naming of the new regulatory authority one can see the transfer of the concept of 'regulation' (*Regulierung*) from Britain to Germany. For the first time *Regulierung* was explicitly used in German law. There is, of course, a tradition of regulation and independent regulatory authorities in Germany, but they have normally been termed an *Aufsichtsbehörde* (supervisory authority) rather than a *Regulierungsbehörde*. Rather than being named the *Bundesaufsichtamt für Telekommunikation und Post*, the new authority is the *Regulierungsbehörde für Telekommunikation und Post* (RegTP).

Moving onto the *instruments of regulation* and their deployment, one of the most notable features of the British model is a proactive regulatory approach with asymmetrical intervention. Germany has adopted the British approach in which the introduction of competition is pursued through interventionary measures of the sector-specific regulatory authority.

Other important instruments of regulation adopted in Britain were price control and the licensing of operators. In particular, there was a distinctive approach towards price regulation known as 'price cap' or incentive regulation. This was advocated by Stephen Littlechild who was commissioned by the DTI to write what became a seminal report on telecommunications regulation (Littlechild 1983). Incentive regulation has become centred on the 'RPI-X' formula, in which a price cap is set at Retail Price Index minus an efficiency factor X, resulting in an incentive to cut costs. This formula has been adopted by all the utility regulators for price control and is usually contrasted with the American

'rate-of-return' regulation (Wilks 1999: 269). Incentive regulation appears to have been very successful in Britain and companies have become more efficient. Another regulatory instrument in Britain is the idea of the licence, whereby companies were authorised to undertake the regulated activities and the licences determined the rules under which they operated. The telecommunications licence gives requirements for universal service, for interconnection, for price levels and for tariff structures.

The liberalisation law of 1996 in Germany introduced a range of regulatory instruments whose Anglo-Saxon origin is easily recognisable. The concept of price cap regulation was introduced without translation into German. There was an assessment of the British model in the light of the similar market structural problem contexts in both countries. According to experts in our focus group, this assessment took place before the development of rules by the European Commission for the liberalisation of telecommunications. In the early 1990s in the development of the proposed regulatory regime the former telecommunications and post ministry assessed and internalised some aspects of the British model, most notably price regulation (Bundesministerium für Post und Telekommunikation (BMPT) 1993), and these were included almost completely in the 1996 law. The licensing procedures adopted in Germany are also similar, notably the use of the auction procedure for the issuing of third-generation licences. The 'essential facilities' doctrine – whereby regulation is justified to provide facilities that are essential for the operation of a sector – has also been adopted in Germany, though it is sourced more from the US than Britain.

The adoption in Germany of these regulatory concepts, procedures and instruments all indicate the support for a proactive regulatory philosophy. That is, the regulator seeks not only to sanction and prevent anti-competitive behaviour but also to create, *ex ante*, the conditions for competitive behaviour. The proactive style is appropriate for the special conditions of telecommunications: its asymmetrical market structure with a dominant former monopolist. In Germany, as in Britain, it is possible that as competition develops and the market structure becomes less asymmetrical, regulatory instruments and institutions could be reduced, for example by the abolition of decision-making chambers in the RegTP. In this sense it can be considered to be a transitional regime. However, the British experience indicates that, although there is a shift of emphasis from the control of a dominant incumbent towards the promotion of competition, the regulatory regime remains highly proactive.

Sector-specific regulatory regimes with distinctive similarities are therefore evident in the two countries. An important cause which has been put forward in this section is the similar problem context, i.e. the market structure. We conclude that similar market structures have played a significant role in the development of the regimes and encouraged a learning process between the two countries. Nevertheless, this conclusion cannot be adopted without some critical appraisal and some qualification. It was noted above, for example, that the sector-specific model was not adopted without a debate on the possibility of the Cartel Office taking on the regulatory duties, more in line with the German tradition. There are also some significant differences in the two regulatory regimes which lead us to qualify this conclusion. At the very least it is shown that market structures are not so dominant that they override national regulatory styles and administrative traditions.

2.3 **British–German contrasts: the persistence of administrative traditions and regulatory styles**

The first key aspect of regulation in which there is notable cross-national divergence is the way in which institutional *independence* is created. Independence is a relative concept: in no country have regulatory authorities full independence from governmental authorities. Often termed ‘independent’ agencies, there are in reality substantial *de facto* and *de jure* limitations on their independence. This applies in both countries, but there are distinct differences both in the nature of independence itself and in the way it is constrained. In Britain and Germany the parliamentary system and the emphasis on parliamentary sovereignty give rise to problems for the creation of independent agencies and the dispersal of power.

In Britain the limits of regulatory independence reflect the enduring importance of ministerial power and the reluctance to delegate fully. The limits of independence are evident in the organisation of the telecommunications regulatory regime. In addition to OFTEL the Secretary of State is one of the most important actors in the regime (Hansard 1996: 28). The Telecommunications Act itself also gives the Secretary of State a right to veto the decisions of the regulator ‘where it appears to the Secretary of State to be requisite or expedient to do so in the interests of national security or relations with the government of a country or territory outside the UK’ (cited in Littlechild 2000: 37). More specifically and usually, the Secretary of State has the power to issue licences, block licence modifications under certain circumstances, enforce competition law and appoint the regulator’s director general (Hansard 1996: 29–30). In practice the DTI has worked closely with OFTEL on regulatory matters and issued guidelines on certain aspects of regulation. The limitations in practice of the independence of OFTEL are such that it has been described as an ‘interdependent regulatory agency’; ‘far from being an all powerful regulator with uncontrolled discretion, OFTEL as a regulatory agency was highly constrained in each of its main spheres of activity by relations of interdependence with other actors’ (Hall *et al.* 2000: 83, 87).

Nevertheless there is one notable aspect of independence which arises from the British system of regulation. The tradition of informality and the suspicion of the legalisation of administration meant that the more formalised US regulatory commission model was rejected in favour of the personalised director general model. This has led to a particular form of independence: the directors general have become central figures with a high public profile which has in practice given them a certain discretion in decision-making. However, this model also enables easier political intervention. In comparison to a regulatory commission, it is politically easier for the Secretary of State to replace a director general with someone who is more likely to follow the government’s agenda.

In Germany, by contrast, the independence of the RegTP is created not primarily from the personal public profile of the president but through the structure of the authority. In particular the decision-making chambers, which follow the model of the Cartel Office set up in the 1950s, work in a similar way to courts, and are subject to the Administrative Procedures Act (the *Verwaltungsverfahrensgesetz*). The decision-making chambers in the RegTP are responsible for specific areas such as the granting of licences or price regulation. They make decisions on the collegiate principle and in individual cases are fully independent: neither the minister nor the president of the RegTP can give

instructions in single cases. The minister can only give general instructions to a chamber or abolish the chamber itself. The president of the RegTP can likewise not influence the chambers except for the so-called 'President's Chamber', which is, however, the most important chamber.

The president of the RegTP nevertheless has a public profile and this can give the institution strength. However, a strong president can be vulnerable to political attack if their position deviates significantly from that of the government. The departure of RegTP's first president, Klaus-Dieter Scheurle, represents such a case. After the successful auction of the third generation mobile licences in 2000, and its positive impact on the SPD-led government's finances, Scheurle attained too high a public profile. The particular problem was his close connection to the previous government: he was not only a member of the CSU but also a leading civil servant in the former Post Ministry and had a leading role in the drafting of the telecommunications law. He was told the government would not stand in the way of his departure (i.e. he was encouraged to leave) and a successor more favourable to the new government was appointed. While this is an indication of the limits of independence, its significance should not be overestimated. In particular, as noted above, regulatory decisions are taken by the decision-making chambers. It is this institutional structure, rather than the president, which is the main source of independence and in this way the independence and its limitations are formed in different ways in Britain compared to Germany. While Coen *et al.* (2002) are a little sceptical about the degree of independence, the constant legal battles between the regulator and Deutsche Telekom in the first few years of liberalisation indicate that the regulator has resisted a historical institutional bias towards Deutsche Telekom. The decision-making chambers therefore appear to be highly independent but they are constrained by an aspect of regulation endemic in Germany: a high level of legalisation.

The *extent of legalisation* is a second aspect of regulation of telecommunications in which there is significant divergence. The decision-making process of the RegTP is highly influenced by legal procedures and stands in the shadows of court judgements. In the first two years of operation the RegTP has been sued about 400 times, and to win the court judgements the RegTP must at the very least meet the requirements of the Administrative Procedures Act. Moreover, the courts in Germany are not reluctant to make judgements on substance as well as procedure. The regulator certainly has scope for discretion in decision-making but must be constantly aware of what will pass the judgement of the courts, both procedurally and substantively. Thus this increasing juridification clearly implies the legalisation of telecommunications regulatory practice.

This example of the legalisation of regulatory practice in Germany shows a significant difference in regulatory styles in Britain and Germany. There is, however, some evidence in Britain of increasing codification and legalisation of regulation and thus a move towards the German style, though this is not to imply it is the result of a bilateral learning process. Rather than learning from Germany, the codification and legalisation of regulation in Britain is developing as regulators move beyond early discretionism and experimentation and formalise what has been seen to work (Scott 1998a; Graham 1998b). A modest increase in the juridification of utility regulation is also evident (Scott 1998b) and may increase as a result of the Competition Act and the Human Rights Act (Graham 2001). The introduction of the Competition Act and the increasing formalisation of competition policy is more a reflection of increasing Europeanisation in Britain and the desire to move closer to European law. However, the evidence for a fundamental

reorientation towards a highly legalised British politics is limited (Sturm 1999: 215–16) and we wait to see the real significance of the recent signs of change.

The unbundling of the local loop is an example of the possibility of a reversed learning process, i.e. Britain learning from German practice. In Germany since 1997 the RegTP has supported and assisted the access of new market entrants to the local loop. Up to 2000 OFTEL attempted to promote access to the local loop by the so called 'co-regulation' approach, a light-touch approach which attempts to encourage BT and market entrants to reach voluntary agreements and the local loop access. It is widely recognised, however, that this approach failed, and in 2000 OFTEL introduced a stronger regulatory practice by a licence amendment which specified detailed rules for local loop unbundling (Hunt 2000).

Despite the evidence of some divergence of regulatory practice and reversed learning, our view is that telecommunications is a case of significant convergence. Both in the regulatory regimes, from an institutional and instrumental perspective, and in the development of competition there is much evidence of convergence. The notable differences can be understood in the context of the significant differences in the traditions of administrative practices in the two countries. The shift towards liberalisation and competition therefore does not necessarily involve complete adoption of the British model of regulation. The case of reform of the electricity sector in Britain and Germany covered in the next section shows that liberalisation can be introduced by diametrically opposed systems of regulation.

3 Electricity: the case of divergence

Despite the moves towards liberalisation and competition in both countries, the regulatory regimes in the electricity sector exemplify enduring divergence (Sturm and Wilks 1997). The regimes are distinctly different in all key features. The institutions, instruments and decision-making procedures of regulation as well the process of reform are very different.

3.1 Background and reform in Britain and Germany: structure matters

Up to 1990 the electricity supply industry in the UK was a state-owned monopoly though there was some horizontal (regional) and vertical separation (Roberts *et al.* 1991; McGowan 1996; International Energy Agency (IEA) 1994; Gilland 1996). In England and Wales the Central Electricity Generating Board (CEGB) was responsible for the generation of electricity and the bulk transmission to local electricity companies, the so-called 'area boards', which distributed electricity to the end user. In Scotland and Northern Ireland there were regionally separated but vertically integrated companies (two in Scotland, one in Northern Ireland) responsible for generation, transmission and distribution. While not exactly fitting the model of a single state-owned monolith (such as EdF in France), the companies were closely integrated and an umbrella organisation, the Electricity Council, worked closely with the industry and government to foster integration.

Despite the extensive reform of the British system in 1990 it cannot be argued that the pressures for reform were very strong nor was the organisation of the industry unsuitable. The new direction of the electricity industry in Britain from 1990 can rightly be termed an 'experiment' (Surrey 1996). The 1990 reforms not only replaced a working system with a new and untested model but also took risks with one of the most essential products of modern life.

The 1983 Energy Act was the first legislation for liberalisation and aimed to encourage private generation. The statutory monopoly of the generating boards was ended and private generators were to be allowed to use the transmission system to supply customers on a contract basis (Roberts *et al.* 1991: 51–2). However, there were still significant barriers, almost no new private generators entered the market and the Act was seen to have failed (Roberts *et al.* 1991: 52). In comparison to the reforms in telecommunications in the early 1980s, the Act was modest. One can point to a powerful community of interests – generators, distributors, the nuclear industry, the coal industry and power plant manufacturers – who were strongly opposed to any radical measures of reform such as privatisation and liberalisation (Roberts *et al.* 1991: 43–50). In the late 1980s, however, radical reform was a little easier due to the defeat of the miners in 1984/5; moreover, the failure of the 1983 Act had disappointed large users and independent generators, who increased pressures for more radical reform. With the big election victory of 1987 the Conservatives were in a much stronger position to enact more radical reform.

At the heart of the reform initiated in 1989 was the privatisation and radical restructuring of the industry in England and Wales. The CEGB was divided into four new companies (National Power, PowerGen, Nuclear Electric and National Grid) with the aim of creating competing generators and separating transmission (the natural monopoly element) from generation (the potentially competitive part). In the early 1990s all the new companies, except Nuclear Electric, and the area boards were privatised. The Scottish companies were also privatised but due to their smaller size, with the exception of the nuclear element, the companies remained in their previous vertically integrated structure. The development of competition in the early period of the reform focused mainly on competition between generators rather than consumer choice, with large consumers above 1MW able to choose their supplier. In order to create a market place for electricity the 'pool system' was developed which enabled generators to compete to supply into the transmission network (Weyman-Jones 1993; Surrey 1996; Hunt and Shuttleworth 1996; Pfaffenberger 1996). The essence of this idea was developed in the 1970s by the German Helmut Gröner (1975) and was known as the 'Gröner model' in the subsequent literature.

The German electricity industry was structured very differently to Britain and thus reformers were confronted with a different set of problems in relation to the introduction of competition. The structure of the German industry is a complex three-tiered system and the companies have been owned by a mixture of private, federal and *Land* and municipal governments (Ortwein 1996; Padgett 1990). The first tier consists of eight large companies (nine after re-unification) which control about 75 per cent of generation and the transmission system. The second tier consists of the regional companies, which consisted in West Germany of about 50 medium-sized firms of mixed ownership which provided generation and controlled distribution to the smaller utilities which supply most consumers. The third tier consists of several hundred small utilities owned and controlled by the municipal governments. Despite the mixed pattern of ownership the industry was structured in a non-competitive way around a set of long-term demarcation and concession contracts. Demarcation contracts were agreements between these companies on their supply areas, effectively agreeing to operate as regional monopolies. The concession contracts were contracts between the large companies and the smaller municipal-based distribution companies. In return for being paid concessions the small companies agreed not to receive supplies from another company. This complex and rather opaque structure arose from market developments in the early decades of the 20th century and was first established in an energy law in 1935 (Ortwein 1996). This structure resulted in a high level of security of supply, although it came at a high cost.

The high cost of electricity supply was one of the main pressures for reform since the 1970s. German electricity prices were very high in international comparison and were a constant source of complaint by large industrial users. In the 1970s and 1980s reform proposals focused mainly on easing the monopolies based on the concession and demarcation contracts. By the late 1980s large users were supporting the European Commission's initiative for a single market in electricity, particularly to increase cross-border supplies and gain access to cheaper power from France. The electricity industry, however, was strongly against liberalisation, saying that the technical characteristics of electricity meant that co-ordination rather than competition was necessary and the latter could threaten the security of supply. In the early 1990s, in the context of the European Commission striving for a single European market, industrial users stepped up their campaigns and were strengthened by the British experience which weakened the argument that competition could threaten supply security. In 1997 a limited EU directive

came in force, specifying a staged process of liberalisation over almost a decade and different options for the realisation of a liberal market. The options are:

- Mandatory Third Party Access (TPA) in which the terms of network access are set by the regulator
- Negotiated TPA in which the terms of access are negotiated, and
- The Single Buyer model which allows for choice but a central organisation administers all purchases.

In 1998 a new energy law was passed in Germany which, despite the limitations of the EU directive, specified 100 per cent market opening. After decades of stability, it seemed, a complete re-ordering of the industry was in prospect (Kumkar 2000).

The adoption of the British model, particularly the separation of transmission from generation and the way it was achieved, i.e. by Act of Parliament, was not possible in Germany. The fact that the transmission network was not state-owned would have meant that the state would have confronted constitutional and legal problems of property rights if it had attempted to impose a new structure on the industry. A voluntary creation of a German 'national grid company', if all the companies agreed to found such a company, was possible but did not occur. Instead a regulatory approach based on third-party access to the networks of the electricity companies was chosen. As will be seen, this was to be *ex post* regulation, i.e. based on industry agreements backed by reactive supervision of the relevant ministries and competition authorities. This is in distinct contrast to *ex ante* regulation adopted in the electricity industry in Britain (and in telecommunications in both Britain and Germany) – i.e. a proactive regulator setting the conditions and prices for access to the grid system.

3.2 Contrasting regulatory instruments in the new competitive order

In telecommunications in both Britain and Germany competition is created by asymmetrical measures directed against the former monopolist in order to promote new market entrants. By contrast, in electricity there are different national understandings of the necessary form of regulation to promote competition and the structure of the industry prior to liberalisation has had a significant impact on the appropriate form of regulation. Despite the same basic objectives these forms of regulation are highly divergent. Analysis of the regulatory instruments and procedures shows that both countries believe in very different ways of creating competition but also that the state has not given up responsibility for assuring the supply of low-cost energy to consumers.

The central aspect of competition in the earlier years of liberalisation in Britain was at the level of electricity production. Electricity generators compete to supply into the national grid system and competition was achieved by the pool system – a marketplace in which generators bid to supply electricity at a price which, ideally, is related to the prevailing conditions of supply and demand. This price has never been regulated except for a two-year period in the mid-1990s when the two dominant generators (National Power and PowerGen) agreed to bid prices which limited the price to the average set by the pool.

This was in response to strong criticism of the process of price determination. Intensive users, most notably, have argued that the large generators have too much power in setting the price (Thomas 1996; MacKerron and Watson 1996).

The effective duopoly of the generators gradually eroded over the 1990s but the pool system was still perceived as flawed. The market share of the two large generators fell from over 70 per cent in 1990 to about 40 per cent in 1999 (Littlechild 2000: 27). However, in essence the pool continued to be a sub-optimal solution as it was only 'half a market' with prices being artificially set rather than negotiated in a market process (Littlechild 2000: 39). The New Electricity Trading Arrangements (NETA) is an attempt to overcome the problems with a bilateral system which enables price negotiations to be conducted between producers and users (Littlechild 2001; House of Commons 2000).

The transition to competition on the side of the end consumer has involved several regulatory elements:

1. Users have been given the right, in a staged process depending on their size, to choose their supplier.
2. Price caps (using the RPI-X formula) on the price of supply to the final consumer, seen by Littlechild as a temporary measure, have been gradually relaxed. Price controls for large industrial users were removed at the start of liberalisation in 1990, for medium-sized users in 1994, for larger small business in 1998 and for all non-domestic customers in 2000. OFGEM has also stated its intention of removing all price caps for the electricity supply (i.e. excluding network charges).
3. As well as encouraging new market entrants in generation, the regulator has also striven to separate all monopoly network aspects from the competitive supply of electricity, and rules have been introduced to achieve that end. Thus in 2000 the regional electricity companies which were responsible for both the distribution network (monopoly) and the supply of electricity to consumers (competitive) were restructured and split into separate businesses.

One of the main regulatory tasks at present is to reduce the monopoly aspect of the business to its minimum. Thus the regulator has closely scrutinised the activity of the regional distribution companies and requested the separation of potentially competitive aspects, such as the supply of meters or cable connections, from the aspects which remain necessarily monopolistic. It is also envisaged that the regulator will continue indefinitely to regulate, *ex ante*, the price for the use of the transmission and distribution systems, the monopolistic aspects of the industry.

One of the most notable features in the liberalisation of the German electricity sector in comparison to Britain is that there has been little intervention which has impacted on the patterns of ownership nor any confrontation with the property rights of the companies. There has been, to be sure, some intervention in the vertically integrated companies to ensure the internal separation of generation, transmission and distribution in order to prevent anti-competitive cross-subsidisation. Overall, however, the new supervisory regime has been designed to fit the pre-existing sectoral structure rather than the reverse. The rationale for this is that, although previously organised into monopoly supply areas, the pre-existing structure of the sector was well suited to competition. The number of different suppliers, with different modes of ownership, and the highly interconnected grid system are seen as appropriate conditions for competitive behaviour to develop.

The German approach for the development of competition in generation and supply, in contrast to the British pool system, rests primarily on negotiated access to the network. The interlocking demarcation and concession contract system mentioned above, which prevented a company supplying an end user outside its own supply area, ended in the 1990s, though only after a court case. Also in contrast to the British system, the new 1998 German law allowed 100 per cent market opening immediately, i.e. there was no staged introduction of competition dependent on level of consumption. The actual development of competition and user choice depends, of course, not on the formal requirements of the law but on the actual realisation of competition. The realisation of competition by negotiated network access requires that the players in the market accept the new basic principle of the new framework. In opting for this system the state shows confidence that the companies and their associations will be able to deal with the many specific problems, most notably the network access fees but also a wide range of technical problems (Kumkar 2000). The state, in the guise of the federal and *Land* competition offices, would only intervene with the instruments of competition law if a satisfactory agreement between the companies could not be reached or the network access charges hindered or prevented competition.

The 1998 law does allow the Economics Minister to prescribe the arrangements for the rights of use of the network. However, the ministry has made it clear that it does not intend to make use of this. In what is a clear manifestation of industrial self-regulation the ministry has stated that industry association agreements (the so-called *Verbändevereinbarungen*) will be sufficient for the realisation of competition (Eberlein 2000). Only in specific cases of anti-competitive practice will competition law be invoked, *ex post*.

The German regulatory approach is closer to that of normal functioning market, though the German electricity sector is of course not yet a fully working market. It may be that proactive measures are necessary, at least in a transitional phase, in order for such a functioning market to develop. One aspect of the German regulatory approach is that, in a limited way, the state is concerned about the appropriate price for the end user and takes measures to ensure a reasonable price is available to consumers. Just as before liberalisation, the electricity supplier for a particular area is duty-bound to offer all tariff customers electricity at a price agreed by the *Land* authorities, the so called '*Pflichttarif*'. It is true that this form of price control has been predicted to be eliminated in the near future (Schulte Janson 1999: 74). However, it remains in place and in the light of the increases in electricity prices since mid-2000 seems likely to remain for foreseeable future.

Nevertheless there is a certain limitation of the argument of enduring divergence in electricity regulation. As in telecommunications, German law has imported the Anglo-Saxon 'essential facilities' doctrine. However, it is noticeable that this legal idea does not conform to the regulatory approach in energy, nor do the policy-makers appear to have fully understood the original idea of the doctrine (Börner 1998; Hohmann 2001). This appears to be a case of 'symbolic learning' from abroad which has little material impact on regulatory practice.

3.3 Contrasting regulatory institutions and decision-making procedures in the new competitive order

The most notable difference between the regulatory regimes in Britain and Germany is the institutional organisation of regulation. In Britain a single sector-specific regulator, OFFER, was set up in 1990. Following liberalisation in 1998 the German industry is supervised not by a single national sector-specific regulator but by the federal and *Land* cartel offices and economics ministries. This shows that although the electricity industry reforms in Germany, like telecommunications, followed the British reforms, there was little learning from Britain on the institutional arrangements for the regulation of the sector.

In Britain the design of OFFER, and its relations to other governmental institutions, matched OFTEL in all its significant points. The director general model was adopted and the competition offices and the DTI were also significant institutions of the regulatory process. The director General of OFFER, Stephen Littlechild, believes that regulation is necessary to create competition in all potentially competitive areas and accepts that in an industry such as electricity there is a natural monopoly component which makes some regulation necessary (Littlechild 2000, 2001). As an economist bringing strong beliefs to a high-profile public office he stood in stark contrast to the classic 'neutral' public administrator and manager. The personal characteristics of Littlechild were well known in the industry and created a certain predictability and reliability.

Callum McCarthy, who became the chairman of the new gas and electricity authority, OFGEM, has become known more as a managerialist than an economic theorist. With McCarthy, predictability and reliability are therefore achieved by a more bureaucratic and procedural decision-making approach and the increasing codification and legalisation of regulatory practice, a very different approach to Littlechild. It is questionable, of course, whether the regime is simply a reflection of its leading person. As members of our focus group have pointed out, the personalities may reflect the imperatives (political or economic) of the period in question. Regulation in the earlier years was experimental, then slowly but surely what was proved to work became codified.

The institutional organisation of regulation is very different in Germany. There is no federal regulatory authority and the industry is supervised by 34 authorities: the federal and *Land* cartel offices and economics ministries, the former being responsible for the implementation of competition law and the latter for the supervision of tariffs. Cross-regional working groups have been set up in order to overcome the possible problems of different practices in different *Länder*. In particularly difficult cases, which frequently end up in court, the other cartel offices wait for the court judgement until they pursue a course in their own jurisdictions. Analysis of the implementation of the 1998 energy law confirms the legalisation of regulatory practice in Germany.

The division of regulatory authority in Germany and the ministerial responsibility for the supervision of prices shows that there is considerable divergence between Germany and Britain. It is true that the Federal Cartel Office is an 'independent regulatory authority' and can be said to be a defence against direct political influence (Ortwein 1998). However, there are no parallels of the director general or regulatory board models in

Germany and of course political influence on decisions of officials in ministries cannot be avoided.

The institutional organisation of regulation in both countries is not, due to EU membership, under the full sovereignty of the respective governments. This is of particular significance for Germany. All member states in the electricity sector with the exception of Germany have now set up a sector-specific regulatory authority and the European Commission has demanded that Germany do likewise. It remains unclear what the outcome of this external pressure will be, but without an 'independent' regulatory authority in electricity Germany will continue to stand out as the exception.

Of course the electricity regulator in Britain cannot be said to be fully independent despite frequent depiction as such. The law, for instance, gives the Secretary of State stronger powers over the regulator than in telecommunications: 'in the energy sector the Secretary of State has an unconstrained power to veto agreed licence modifications proposed by the regulator' (Littlechild 2000: 37). Also in the late 1990s the Labour government decided to be stricter on granting consents for the construction of new power stations and in certain cases has refused consent, arguably for highly political reasons (Littlechild 2000: 36–7). Moreover, as some of our focus group members point out, the DTI appears to be playing a more proactive role in regulation, particularly in issuing specific guidelines on social and environmental matters. It is clear that political and social matters are embedded in regulation and the regulator is far from fully independent.

3.4 German exceptionalism: alternative explanations for the German approach

The above analysis implies that the German approach arises above all from the pre-liberalisation industry structure and the federal political structure. There were already a large number of companies in the industry, which more closely resembles a competitive market than a state-owned monopoly. In addition the pre-existing structure meant that it has been difficult to radically restructure the industry, not least because of legal and constitutional problems of property rights. Traditionally also the *Länder* have had a significant role in the supervision of the industry and removing this control would have been politically extremely difficult. The new German regulatory order can therefore be justified as being appropriate for a market and indeed closer to a true market order. However, an alternative and more critical interpretation can be put forward.

This interpretation is that the reform has been half-hearted: despite the *de jure* full liberalisation in the 1998 act, policy-makers did not intend to fully liberalise and the measures taken are insufficient for developing a fully competitive market in an industry previously organised as a monopoly. This interpretation can be justified on the basis of the following observations:

1. There is no single regulator pursuing a common regulatory practice for the whole country. This is particularly important for potential new entrants who require a clear regulatory framework in order to develop a successful strategy and a regulator that is actively striving to facilitate market entry.

2. The regulatory instruments specified in the 1998 law, in comparison to telecommunications, do not appear detailed and substantive enough for the creation of a functioning market. The Energy Act of 1998, for example, is approximately one fifth of the length of the Telecommunications Act of 1996, the latter including detailed and precisely defined ordinances which enable the regulator to create a functioning market. A number of observers have concluded that the lack of detailed specification in the law means there is uncertainty over how regulatory practice and the market will develop (Kumkar 2000, 412ff.; Franke 1999; Börner 1998). Court judgements were necessary to create legal clarity.

It can be supposed that policy-makers wanted liberalisation but were not willing to confront the strong interests in the electricity sector. A glance at the process of reform prior to the 1998 Act and the difficulty the German government had in the policy process seems to support this interpretation. In the early 1990s most of the sector was strongly opposed to liberalisation. The opposition of the large and regional generators fell somewhat in the mid-1990s as they saw that the new order might offer them some new market opportunities. Despite this there remained some concern about the loss of existing markets – reflected for instance in the insistence of the insertion of a reciprocity clause in the EU directive agreed in 1996. In Germany it was, however, the local distributors (the *Stadtwerke*), who seemed to have the most to lose and put up the strongest political resistance (notably in the *Bundesrat*) in the mid-1990s prior to the new law. As a result policy-makers were compelled to dilute the new law by avoiding the detailed specification of the instruments of liberalisation. Also the *Stadtwerke* successfully managed to have the so-called ‘single buyer’ model (introduced in the EU directive) incorporated into the law as an option.

The lack of a single regulator adopting clear and transparent rules to promote market entry gives rise to the suspicion that either there was no intention to create full competition or the government had to compromise too much to the industry. In a system of organised self-regulation the question arises whether a public interest (e.g. the creation of competition) broader than the industry interest can be served. German support in the Stockholm EU summit in 2001 for the French resistance to further liberalisation in the EU appears to reinforce this interpretation. While the German position appears mainly to be due to opposition to the Commission’s insistence on the establishment of a single national regulator, it can also be interpreted as a reflection of Germany’s reluctance to liberalise.

We therefore have two very different interpretations of the German approach. The positive interpretation suggests that the system is closer to a market and more appropriate for the sectoral structure as well as the federal system. A second view questions the intentions of the policy-makers and sees the new organisation as maintaining the control the former monopolists had over the market. Which interpretation is correct? We conclude that it is too early to say: there is evidence to support both interpretations and more experience of the system is required.

In support of the positive interpretation, it can be said, first, that up to now the fears of the *Stadtwerke* have proved unfounded. In fact they have proved to be among the winners of the reform. Not only have they benefited from being able to choose their suppliers but, especially if they keep their networks, they have also benefited from high network access charges. Second, many end users from large industrial users to private household have benefited from falling electricity prices. This process has benefited from

the many new electricity traders, which are often subsidiaries of established electricity suppliers, who have entered the market. Assessment of the generation side of the industry is, however, less positive. There have been no significant new entrants, reflecting the difficulty the regulatory regime presents for market entrants. Moreover, a small number of large generators dominate the market and there has been some consolidation (*Financial Times* 23/5/01). A more substantial judgement of the effectiveness of the German system requires more experience and analysis of its operation.

The explanation of German exceptionalism in electricity is in our opinion, therefore, less of a rejection of the British model after consideration and reflection (a process of negative learning) and more a reflection of the limitations of the political and sectoral circumstances. The fragmented industry and regional supervision together with strong sectoral interest, suspicion and resistance to liberalisation and centralised intervention have all constrained and ruled out the adoption of the British centralised and proactive regulatory approach and limited the possible solutions to something more in line with a traditional German regulatory approach.

4 Banking: the case of globalisation

The banking sector is an excellent example of the way in which, under the pressure of globalisation, regulation is moving to a new form which is being adopted in both countries and originated in neither.

4.1 Banking structures and regulatory traditions in Germany and Britain

In both Britain and Germany the private sector has accounted for a significant part of the financial services sector. However, the structure of the banking sector and indeed the whole financial services sector have been very different in the two countries. Moreover, although the sector has been regulated for many years, the regimes traditionally established in the two countries have been very different.

The structure of banking in Germany has been characterised as a universal system while in Britain (as in the US since the 1929 stock market crash) the system is separated. In essence German banks cover all financial services (Edwards and Fischer 1994: 96–123), whereas in Britain the activities have traditionally been separated, for example into commercial banking, investment and merchant banking, insurance, fund management, housing finance and securities trading (Heffernan 1996: 96). The different responsibilities of banks are reflected in the systems for the supply of investment capital to industry: Britain's system is capital market-based while Germany's is credit-based and dominated by the banks (Zysman 1983). German banks are well known for their ability to mobilise capital for industry and their close relations to industry (Tipton and Aldwich 1987: 20–1), and historically in comparison to the major industrial countries Germany has the strongest tradition of sustained industrial banking (Cox 1986: 27). The *Hausbank*, which evaluates projects and provides loan capital, is a particularly important institution as it represents the close relations between a bank and an industrial company. By contrast, British banks are much more distant from, and passive towards, industry. By far the largest capital markets in Britain are in London, which has been established for several centuries as the main centre of international finance. Germany and Britain are paradigm examples of two contrasting banking systems. Britain (with America) is an example of a 'laissez faire internationalist' style, while Germany (along with Japan and France) traditionally has a more nationally oriented system of 'industrial banking' (Cox 1986: 4). In Germany the idea of *Ordnungspolitik* means that a state-led industrial policy (like in France or in Britain up to the 1980s) has been rejected. The role of the banks in industry can be seen as a substitute for state functions vis-à-vis industry (Müller 2000).

Irrespective of the structure and status of banking in a particular country there is a requirement for a specific kind of regulatory framework for banks – to ensure the stability of the system (Heffernan 1996: 217–20). The purpose of regulation in banking differs fundamentally from the economic regulation of the utilities which focuses on the problem of natural monopoly and the creation of competition. In banking the problem is

the stability of the whole system, which can be threatened by the collapse of one bank. This can lead to a loss of confidence in the banking system and a 'run on the banks' and can have a significant impact on the performance of the whole economy. The regulatory function is therefore to supervise the operation of the banks, notably their reserve capital requirements, in order to ensure the stability of the whole system.

Banking supervision in Britain has been the responsibility of the Bank of England, the central bank, and up to the 1980s it was a classic example of the British regulatory style (Moran 1991). Trust, moral suasion and dependence on sectoral experts and not lawyers are distinctive features. Small, close-knit and socially exclusive British elites have been able to regulate important matters by informal communication (Baggott 1989: 443). There were few formal rules and the Bank of England strove for close, trust-based relations with the banks. In the 1980s and 1990s, however, this approach gradually became more formalised. As liberalisation and internationalisation increased, together with high-profile banking crises, moral suasion and informal relations were no longer appropriate (Vogel 1996: 99; Braithewaite and Drahos 2000: 141).

In Germany banking regulation was the responsibility of a specific regulatory office from 1962 to 2002, the *Bundesaufsichtsamt für das Kreditwesen* (BAKred) (Federal Supervisory Office of Banking). However, the existence of a federal supervisory office gives the false impression of centralisation. Since 1961 the supervisory office has had about 100 employees for the supervision of about 9,000 banks. Clearly this is only possible if many of the detailed supervisory tasks are delegated. This is achieved on the one hand by the Bundesbank and its branch network, which provides some of the necessary data and undertakes technical tasks as well as engaging with some of the basic questions of supervision. On the other hand, a large network of auditors and auditor associations of the savings and co-operative banks play a significant role in the technical tasks of supervision. This extensive delegation of supervisory tasks would not be possible if the relationship between the regulators and the banks were highly informal as it has been in Britain. A highly formalised and rule-based system was necessary and is characteristic of the German approach. The supervisory relationship with all supervised banks tended to be the same. Discretionary rules related to specific financial organisations, a traditional feature of the British system, were therefore alien to the German system, though not impossible.

However, within this formalised system BAKred relies on responsible behaviour by the banks which only requires limited checking by the auditors. BAKred does not impose specific technical requirements but specifies the basic approach. In contrast to the telecommunications regulator and the Cartel Office, there has only been a comparatively small number of court cases, indicating that working relations between banks, auditors and their associations, and BAKred have stabilised. Thus regulatory compliance is achieved by a trust-based, 'soft' approach which is not necessarily incompatible with the legalisation of administration and regulation; they are different aspects of the whole process of regulation.

4.2 External causes of convergence: globalisation and the Basel process

The last four decades of the 20th century witnessed an extraordinary increase in the globalisation of banking and finance. Since the 1960s there has been a rapid increase in the international operations of banks, particularly those from the US, Britain and Japan. In the US, for example, the number of banks with foreign operations grew from fewer than ten in 1960 to about 100 in 1977 (Braithewaite and Drahos 2000: 102). Another manifestation of the globalisation of finance is the rapid increase in capital mobility, particularly since the late 1970s.

Some of the main factors of financial globalisation can be identified (Braithewaite and Drahos 2000: 102) as follows. A significant impetus was the growth of international trade in the 1960s and particularly the rise of US-based multinational corporations requiring international financial services. The breakdown of the Bretton Woods system in the early 1970s led to the introduction of floating exchange rates, which provided many new opportunities for financial institutions in currency exchange. This gave banks and other financial institutions the opportunity to embark on a period of rapid innovation which was marked not only by new products but also by their global reach. The deregulation of financial markets in the late 1970s and 1980s, particularly in Britain, the US and Japan, also gave further impetus to the globalisation of finance in the 1980s and 1990s (Helleiner 1995).

The Bretton Woods system was the first multilateral system of global financial regulation; nevertheless the prudential regulation of banking remained nationally oriented and prior to the early 1970s there was no system of global banking regulation to match the increasing globalisation of banking (Braithewaite and Drahos 2000: 98–103). In the early 1970s cross-border banking activity became more and more complex and national authorities no longer had sufficient information for satisfactory supervision. The increasing integration of financial markets also meant that a problem in one country could much more easily be transmitted to other countries. Increasingly it became apparent that the maintenance of systemic stability could not be achieved only by national regulation but required a global regulatory framework. The failure of the Herstatt Bank in Germany in 1974 due to foreign exchange dealings, and the failure of the Franklin National Bank in the US, were dramatic signs that a new regulatory response was necessary.

In late 1974 the representatives of the central banks and supervisory authorities of the leading industrial nations began to meet in Basel to initiate a process towards global banking regulation (Heffernan 1996: 251–59; Coleman and Porter 1994). In 1975 the first agreement, the Basel Concordat, was reached which aimed to ensure that all parts of multinational banks would be adequately supervised. Although it has had a low profile and lacks the hierarchical governing mechanisms of other international organisations, it has developed a leading role in banking supervision and many of the most important rules applicable in countries such as Britain and Germany have been developed in Basel. Moreover, although the EU is much more institutionalised and has far greater formal powers than the Basel committee, EU agreements on banking regulation tend to follow Basel (McKenzie and Khalidi 1996).

The power and independence of the Basel committee can in a sense be seen as the depoliticisation of banking regulation. Officials of national central banks and the supervisory authorities have played a leading role in the rule formulation and implementation; finance ministries, though formally in authority, in practice play a less significant role.

4.3 Common regulatory instruments: towards 'second-order regulation'

As discussed above, the traditional approaches for the regulation of banking and financial services generally are excellent examples of contrasting styles. At one end of the spectrum is the British approach which has traditionally been highly informal, discretionary and predominantly self-regulatory, while Germany, with its strongly quantitative and rule-based approach is at the other end of the spectrum. Since the inception of the Basel process in the 1970s harmonisation of regulation in banking and financial services has been an important objective, but the decisive impulse towards harmonisation came at the end of the 1980s with the 'Basel I Accord' in which detailed rules were specified on capital reserve requirements of banks. In the 1990s there was a shift towards the adoption of more flexible rules, to be consolidated in the expected agreement of the Basel II Accord in 2002.

This is not some kind of compromise between the two systems but a shift to a qualitatively new form which we label 'second-order regulation'. It represents a shift from the external specification by the regulatory authority of regulatory rules (the most important being capital adequacy requirements which are based on risk assessment models) towards a more flexible approach of risk assessment in which the banks' own models are adopted (Jackson 2001). The regulatory approach therefore changes from one of specifying rules on capital adequacy to assessing the effectiveness and reliability of the banks' own internal models and the banks' management procedures.

While all banks have an interest in guarding against their own failure, they also have a special status in the economy and their ability to function effectively depends on consumer confidence in the reliability of the bank. The threshold at which a customer can lose confidence in a bank and thus threaten its stability is lower than for companies in other sectors of the economy. Nevertheless banks do not want to be overly cautious and are interested in economically practical and appropriate mechanisms for assuring stability. Therefore they have for many years developed their own models for the management of risk.

The Basel II Accord and the 'supervisory review process' is the way in which these internal risk management techniques will be implemented. There will be continuing negotiations between countries on the criteria for the acceptance of particular risk management models. The definition of, and the weighting given to, specific risks faced by banks can have different consequences for competitiveness in different countries. The kinds of banks, and the companies which they finance, may vary between countries, and thus different techniques for different banks and different forms of risk may result in competitive advantages and disadvantages for particular countries.

The leading role played by the Basel process mentioned above continues to be evident. At the EU level directives have greater legal force than Basel agreements and the relevant directives contain more specifics. Nevertheless, as experts from our focus group confirm, the European Commission has proposed directives which effectively represent the implementation of the Basel agreements.

The Basel process represents an extensive internationalisation of regulatory principles and instruments. 'Second-order regulation' does not involve an imposition of specific rules and techniques of risk management, but instead a supervision of risk management techniques so that specific rules (on transparency, for example) are introduced only to assist this process of supervision. Despite the potential difficulties of competitiveness, this approach has eased the development of common regulatory standards.

4.4 Common regulatory institutions: the consolidation of financial services institutions

The continually changing financial services sector also requires changes at the institutional level. The separation between the main areas of financial services – banking, insurance and securities – is no longer clearly defined. Product innovation and mergers have meant that in both countries the different parts of financial services are moving together and the traditionally separated regulatory structure no longer seems appropriate. In both countries changes have been initiated and are proposed to integrate the regulatory institutions in financial services.

In Britain in 1997 the Securities and Investments Board (SIB) was renamed the Financial Services Authority (FSA) with the stated intention that it would become the independent regulatory authority for all financial services (House of Commons 1999). After a transitional period the FSA will take on all regulatory tasks including all those undertaken by the self-regulatory organisations, though the Bank of England still retains a role in banking regulation alongside the FSA. The FSA and the requirements of the Financial Services and Markets Act 2000 represent a consolidation of the trend towards formalisation, less discretion and a move away from self-regulation which was initiated by the Financial Services Act 1986 (MacNeil 1999). The 1986 Act aimed to develop regulation that was 'practitioner based with a statutory framework' but the statutory element became more dominant. In comparison to the McCarthy-led OFGEM, the FSA represents a more distinctive shift from the traditional British model of regulation. These changes are more appropriate for the implementation of the Basel rules – the need for independent assessment of the banks' internal credit risk models and more rules to specify transparency. However, crises, scandals and controversies in various aspects of financial services have also been significant reasons for the increasing formalisation and the FSA is taking a more proactive approach in the early identification of risk (FSA 2000; House of Commons 1999).

This consolidation and increasing independence (from the sector) at the institutional level seems to be a confirmation of a trend in the new regulatory state in Britain. Several arguments for a single regulator for all financial services are not sector-specific but relate to the general arguments for independent regulatory authorities. The creation of a more

'rational and coherent' regulatory system for financial services, the benefits of economies of scale, the need only to deal with one organisation and one set of rules and procedures, the sharing of information and increased accountability are all arguments that have been applied to the creation for example of OFGEM or the proposed OFCOM (Lomnicka 1999; House of Commons 1999). Arguments against a single regulator – such as concerns about an overly powerful and overly bureaucratic regulator and one institutional structure and set of rules constraining regulatory innovation – are equally general in nature and equally have been discounted.

Nevertheless sectoral imperatives such as the blurring distinctions between different parts of financial services and crises and scandals are the primary stimulus for the institutional integration and consolidation. While regulatory reform in the utilities was primarily driven by the privatisation and regulatory reform policies of the Conservatives in the 1980s and 1990s, the stimulus for reform in financial services was of a much less direct and more exogenous nature, though the increasing internationalisation and product innovation can, in part, be traced to policy decisions to liberalise. Moreover, because financial services had a very different starting point compared to the utilities (privately owned and 'light touch' regulation), the regulatory functions to be undertaken by the FSA differ significantly from the utility regulators. Also the establishment of the FSA was not simply the merging of existing regulators (such as OFFER and OFGAS in the case of the energy sector) but the consolidation of a complex regulatory system much of which was carried out by agencies and self-regulatory organisations. Nonetheless there are similarities. In particular, Howard Davies, as the Chairman of the FSA, has taken on some of the characteristics of a personalised regulator and has become a prominent figure in the debates over regulatory reform.

The FSA has also had a certain impact on the debate over the establishment of a single regulator for financial services in Germany. As in Britain, the main pressures for the establishment of a single regulator are undoubtedly sectoral, including the blurring of the distinction between the three main parts of financial services (well exemplified by the proposed merger of Allianz, the insurance company, and Dresdner Bank). Nevertheless, according to experts in our focus group, international trends towards the creation of a single regulator (for example, in Britain and the Scandinavian countries) have had an impact. In the main the lessons learned are limited to the principle of a single financial services regulator and the time period in which it takes over the regulatory activities, rather than the institutional design of the authority. The British experience raised questions about whether a phased transition of the new responsibilities over several years was the best approach or whether it is better for this to be achieved in a single act.

A single regulator for all financial services in Germany has been established in 2002. The *Bundesaufsichtsämter* (federal supervisory offices) for *Kreditwesen* (banking), *Versicherungswesen* (insurance) and *Wertpapieraufsicht* (securities) have been combined to form a single organisation – the *Bundesanstalt für Finanzdienstleistungsaufsicht*. According to the plan of the Federal Finance Minister, Hans Eichel, the new authority will have more independence than the three separate offices vis-à-vis the Finance Ministry.

A notable feature of the new authority is that the Bundesbank will take on few of the responsibilities of financial services regulation. At the beginning of 2000 the President of the Bundesbank, Ernst Welteke, proposed a joint forum in which the three existing supervisory offices would work together under the leadership of the Bundesbank. This plan would have had little impact on the existing supervisory system. In contrast the

proposed reforms will have a significant impact and, although the Bundesbank has not been excluded, it has nevertheless been weakened. This can be seen as an institutional defeat for the Bundesbank. Its independence and public status were gained not least by taking some difficult and unpopular decisions in the preceding decades and its success in establishing a stable currency. With its loss of monetary policy decisions to the European Central Bank it lost this public status and along with the *Land* central banks strove unsuccessfully for a more substantial role in financial services supervision.

4.5 Convergence to a new regulatory model?

The changing nature of banking regulation in Britain and Germany is exemplary of a form of policy transfer which can be easily overlooked in two country comparisons. Rather than transfer from one country to another, as we have seen in varying ways in telecommunications, there has been a learning process in banking regulation in both countries. This is related to an international process of negotiation and has been given impetus from external stimuli, most notably the globalisation of banking. The impact of the globalisation of finance is often considered in terms of the pressures on Germany to converge to Anglo-Saxon forms of regulation and capitalism even though convergence is far from total (Lütz 2000; Story 1997). However, while changes in German finance have led to the suggestion that Germany is moving to a new 'hybrid' model of capitalism (Lütz 2000: 167), the changing regulation of banking discussed here suggests that both countries are moving to a third model. Despite the very different traditions and sectoral structures, the Basel process has had a similar effect and the developments in the near future are part of a move into a new era of regulation in both countries.

The new regulatory approach brings together some of the strengths of the existing approaches in both countries as well as some new aspects. This must not of course be exaggerated. Within the Basel process each country has some discretion and various options on the way in which the rules are to be implemented and the new form of regulation does not entail imposition of detailed prescriptions of rules. It involves a supervision of 'self-control' or, as we have labelled it, 'second-order regulation'. This new form of regulation should not be confused with deregulation: we are not seeing a regulatory 'race to the bottom' (Lütz 1999). The regulatory density has increased even if flexibility and individualisation are distinctive features of the new regulation.

5 Conclusion: continuing diversity

The regulation of the utilities is one of the best examples of the 'new regulatory state' in Britain which has characterised the re-ordering of relations between the state and the economy since the early 1980s. Although some features of the British model have been adopted in many advanced countries including Germany, we conclude that there has not been a general adoption of the model. Undoubtedly in terms of liberalisation, competition, privatisation and internationalisation, there has been a unidirectional convergence of Germany towards Britain in many economic sectors. There has not, however, been a similar process of convergence of the concomitant regulatory regimes in Germany towards the British model and, in cross-national and cross-sectoral comparison, a complex patchwork of convergence and divergence is evident. In Germany the characteristics of the British regulatory state are most evident in the telecommunications sector, though not all features have been adopted. Germany has, however, taken a very different road towards liberalisation in the late 1990s in the electricity sector. The banking sector, the third case analysed here, can be seen as a 'control case' that demonstrates the patchwork. Both countries are converging on a qualitatively new form of regulation. It is therefore not possible to speak of a general unidirectional learning process in Germany from Britain in relation to the liberalisation of the utilities and the increasing market orientation and internationalisation of the whole economy. Where cross-national commonalities are evident, such as in telecommunications, successful policy transfer may have occurred, providing the commonalities are not simply contingent.

5.1 What is converging and what is diverging?

5.1.1 Regulatory institutions

In Britain there are cross-sectoral commonalities in the regulatory institutions in all three sectors considered here: independence from politics and administration, centralisation at the national level and increasing consolidation. A cross-sectorally consistent model has arisen: the arguments for independence, centralisation and consolidation (of closely related sectors) have won over the arguments for institutional fragmentation, self-regulation or regulation by government ministry. Some institutional features of the British model are, however, on the retreat. The director general model which manifests a high degree of discretion in decision-making is on the wane and there is some evidence of depersonalisation and increasing formalisation.

In Germany there is much more of an institutional patchwork. The telecommunications sector displays the greatest degree of German convergence towards Britain. There is regulatory independence (although produced in a very different way) and centralisation at the national level. Also the agencies in both countries do not have full independence but share some competences with the responsible ministry. By contrast, there has been no convergence of the German electricity sector towards Britain. In Germany regulatory authority is decentralised and divided between the federal and *Land* levels. These authorities, with the exception of the competition authorities, are not independent as the

economics ministries at federal and *Land* levels play a decisive role. There is, however, pressure from the European Commission and other European countries for the adoption of the centralised model of regulation in electricity. If this does happen it would be more a result of the pressure for a greater European harmonisation rather than specifically the British model as the example from which learning has taken place (Coen *et al.* 2002).

In banking and financial services there appears to be an even greater level of institutional convergence, but the convergence is neither towards a British nor a German model. While there has been a relatively independent supervisory authority in banking in Germany since 1962, there was no similar arrangement in Britain up to 1997 when a single authority for financial services was proposed. The Bank of England was responsible for banking supervision while a range of self-regulatory organisations and the SIB were responsible for the remainder of the financial services sector. Since 1997 a single authority, the Financial Services Authority, has been taking over all the regulatory functions of financial services. An authority for all financial services in Germany was established in 2002. Some of the pressure for these reforms comes from outside the country. In Britain the increasing participation of foreign companies in banking and financial services has contributed to the breakdown of the self-regulatory approach and led to pressure for greater formalisation. Another feature in both countries have been the changing markets and innovative products which are bringing together the different parts of financial services. In addition the Basel agreements are requiring increasing specialisation of supervisory functions. These factors are leading to consolidated and stronger independent regulatory authorities.

5.1.2 Regulatory instruments

In Britain there has been a broad cross-sectoral similarity in the regulatory instruments and approach in the utilities. In essence a proactive, *ex ante* approach, with the necessary instruments, has been adopted in order to control the dominant companies and to promote competition. This approach has been adopted in telecommunications in Germany with a range of similar proactive regulatory instruments, most notably the licensing of competitors (for example by auction) and price control (by incentive-oriented price cap regulation) to incentivise competitive behaviour and create more competition for the future. In essence this approach is adopted as there is little confidence in the spontaneous development of competition and a belief that regulation is required in order to create it.

By contrast the regulatory regime in electricity in Germany more closely resembles that of a functioning market as the market conditions prior to liberalisation were more suited to competition. The regulatory approach is limited to the responsible cartel offices using anti-competitive instruments *ex post*, as opposed, for example, to *ex ante* price regulation. Nevertheless some more *ex ante* regulatory interventions remain from the old regulatory order in German electricity, such as tariff supervision in order to guarantee the supply of electricity to consumers at an affordable price. The *ex post* approach is perhaps overly optimistic: some policy-makers and observers, particularly from abroad, and some new entrants, suspect that full liberalisation was either not intended or the policy-makers were unable to confront strong German sectoral interests.

The comparison of the different situations in electricity and telecommunications illuminates the choices and the boundary problems between sectoral regulation and competition policy. An *ex post* competition approach requires certain market structures

which do not always exist. If one assumes that the former monopolists in telecommunications (British Telecom and Deutsche Telekom) continue to dominate the market because of their ownership and control of the essential network infrastructure, then it is clear that an *ex ante* regulatory approach is necessary to limit the market power of these companies. On the other hand if competitors in a market have their own networks, as in the German electricity sector, and there is an incentive for mutual use of each other's networks, fairer agreements on network access are more likely to arise. In this situation competition is more likely to develop spontaneously and an *ex post* approach possible. Viewed from this perspective, with the necessary restructuring, it is possible that a more market-oriented regulatory arrangement could have been developed in the British electricity industry. However, like the actual reform in Britain this would have been highly experimental. There is no established working example nor is there any consensus on how successfully competition will develop in Germany.

A stark contrasting depiction of competition policy and sectoral regulation – of *ex ante* and *ex post* approaches – can, however, obscure the reality of the increasing overlap of the two approaches. In Britain in recent years the concurrent powers held by the competition and sectoral agencies have become an increasingly important issue. For many years these agencies have held limited concurrent powers, such as the power to refer anti-competitive practices to the MMC. However, the sectoral regulators have rarely used these powers (Bloom 1999). With the stronger enforcement powers brought in by the 1998 Competition Act (Bloom 1999) and sectoral regulators increasingly focusing on competition (Graham 1998b) concurrency has become much more salient. The decision to provide concurrent powers has advantages, such as utilising the expertise of sectoral regulators and encouraging a move to competition (Bloom 1999), but there are problems of co-ordination and the possibility of conflicting decisions. Mechanisms have been put in place to promote co-ordination, such as the Concurrency Working Party (Riley 2000). In German telecommunications the question also arises whether there is a conflict of competencies between the sectoral regulator and the Cartel Office. While potentially their tasks overlap, the law governing telecommunications regulation clearly specifies the respective powers of the agencies. Most importantly, there is considerable interlocking in decision-making, such as in the cases of abuse of dominant position, but the respective roles are well-defined. However, the regulator for telecommunications remains in the leading position, facing varying degrees of intervention by the Cartel Office, extending as far as a *de facto* veto right (Geppert *et al.* 1998).

In banking regulation, proactivity is also a distinctive feature. However, the instruments adopted in the newly emerging regimes in both countries in the banking sector are very different from both telecommunications and electricity. The supervisory regimes in both countries come from very different traditions but, under the influence of the Basel process, are moving towards a common regulatory approach, which we have labelled 'second-order regulation'. While the approach in Britain was highly informal, discretionary and individualised, in Germany there are detailed and quantitative rules which are applicable to all banks, though there is significant decentralisation in the enforcement of these rules. The development of a new supervisory regime in the context of the Basel process and the Basel II Accord means above all more formalisation for Britain and more flexibility and specific case orientation for Germany. In the future bank regulators will look less at the risks of specific borrowers in order to take precautionary measures to assure the stability of the bank. Their role will be more of a proactive assessment and approval of the banks' own risk assessment models and specifying in more detail procedural and management aspects of banks. While this requires a re-orientation

and in a sense an increase of the work of regulators, it also represents a form of self-regulation.

5.1.3 Legalisation and juridification in regulation

As stated in the introduction, Britain and Germany have very different administrative traditions. A key difference was the role of law in administration. The British 'public interest' tradition has no concept of public law comparable to that of Germany. British courts lack special measures for judging administrative decisions and the administration also has a certain freedom of decision-making that is not subject to a substantive judgement by the courts. In Germany, by contrast, there are general principles and demands of the *Rechtsstaat* to fulfil. The possibility of court influence on administrative decisions has a significant disciplining influence on decision-makers. In each case the influence can be both procedural and substantive. There are significant cross-national differences in the level of legalisation and juridification, but there are also cross-sectoral differences which are dependent on specific sectoral cultures.

While in the German banking sector, which is highly dependent on consumer trust and confidence, there have been few legal challenges to regulatory decisions, a range of unresolved questions have had to be settled by the courts in the liberalised electricity market. The telecommunications sector, on the other hand, was faced with numerous challenges to its decisions as there was no established loyalty between the regulator and the regulated companies.

The British courts have played a very insignificant role in the regulation of all three sectors, shying away from involvement in substantive and material issues. Instead the peculiarly British administrative tribunal of the Competition Commission has been called upon to arbitrate and to provide technically based compromises. In recent years there are some signs that the courts may play a greater role in regulation, at least in procedural matters. However, the extent to which the increasing trend towards the codification and legalisation of regulation, particularly in finance and energy, will lead to an increasing juridification of regulation is uncertain at present.

5.1.4 Consumer protection

One aspect of the regulatory state to which we have not given attention in this report is legitimacy and accountability. The 'semi-detachment' of the state from the economy and the creation of semi-independent regulatory authorities at the heart of the regulatory state undermine the traditional means of legitimation in a parliamentary democracy, i.e. the accountability of the executive to parliament. In Britain in the mid-1990s a 'crisis of accountability' was perceived which set up pressures for new ways of achieving accountability and of legitimising the regulatory state (Graham 1998a; Scott 2000). One of the central means of achieving this in Britain has been to protect the interests and strengthen the role of the consumer. Consumer protection is also of concern in Germany, though the means by which this is achieved is very different. Cross-national comparison of consumer protection is therefore predominantly a story of divergence (Lodge 2000). In broad terms consumer protection in Britain has been and is becoming more institutionalised (e.g. in separate consumer councils or by a consumer panel within the regulator). In Germany the consumer is often represented by *Land* ministries and protected by legal processes.

The representation of the consumer interest has a long history in the British utilities and attempts have been made to strengthen it in recent years. From 1997 the Labour government has attempted to strengthen the role of the consumer and the reforms, first proposed in 1998, specified a standard model for all the utilities which involved the establishment of independent consumer councils and the upgrading of the statutory duty of the regulator to a primary role for consumer protection. However, the Utilities Act 2000 only covered the energy sector and a cross-sectoral patchwork of arrangements for consumer protection is emerging. While in telecommunications an ombudsman and a consumer panel with limited powers are proposed, in energy a separate publicly financed consumers' council has been set up (EnergyWatch). The latter can make cases of conflict public and has the resources to lead investigations and demand information from the regulator. In this way an opposing institution to the regulator has been created and more open political struggles between EnergyWatch, the regulator and the regulated companies seem possible. Despite a new primary duty to protect consumer interest, the energy regulator OFGEM will therefore be seen as a regulator of the electricity market, not for the consumer interest.

In financial services there have been ombudsman systems for dispute resolution for many years and these have recently been supplemented by a separate consumers' panel within the FSA. The strength of this arrangement is, however, under dispute, particularly in the context of the various crises in certain areas of financial services, for example, the inability of Equitable Life in 2001 to meet the expectations of holders of its 'with profits' pension and endowment policies.

In Germany consumer protection is generally less institutionalised than in Britain, with the exception of telecommunications, despite the lack of a separate organisation for consumer protection. The telecommunications regulator is legally required to give the consumer first priority. One way the regulator has realised this responsibility is by establishing a call centre for consumers. The regulator has a powerful incentive to respond positively to consumer matters as a failure in this area endangers not only its legitimacy for its independence but may also lead to more court judgements against its decisions. Consumers also have an interest in court success given that decisions of the telecommunications regulator are so often subject to court judgement. Consumer protection in energy and financial services in Germany is less institutionalised than in Britain. In banking BAKred was not created for consumer protection, though there may be some change in the future with the creation of a regulator for all financial services. The protection of the consumer interest in banking is primarily achieved by legal means and disputes are taken to the courts. In energy consumers are able to make complaints to the *Land* ministries or to local government.

These very variable ways of protecting the consumer show that the future of consumer representation and, more broadly, the way the regulatory state is legitimated, are open to question. The traditional relationship between the state and citizen in public administration was based on public service and trust and the idea that citizens have certain social and economic rights (Haque 1999). Contrasting administrative cultures in Britain and Germany mean these rights have been achieved in very different ways – the informal 'public interest' tradition in Britain as opposed to the formalised *Rechtsstaat* in Germany (Pollitt and Bouckaert 2000: 52–4). The emergence of the regulatory state appears to have shaken the foundations of these processes of legitimation. It remains to be seen whether a more direct and participatory form of legitimation (for example by further strengthening systems of consumer representation) will be necessary, or whether

a more transparent and formalised decision-making system (Majone 1999) in the German tradition will be sufficient.

Tables 5.1 and 5.2 give an overview of our conclusions regarding regulatory convergence and divergence in Germany and in Britain.

Table 5.1
Cross-sectoral summary of convergence and divergence

	Telecommunications	Electricity	Banking, finance
Institutions	<p><i>Convergence</i></p> <p>Single national independent regulator</p> <p><i>Some divergence</i></p> <p>Different forms of independence and decision procedures</p> <p>Different responsibilities: Germany: also post and many technical matters; Britain: telecoms and media soon to be together in OFCOM</p>	<p><i>Divergence</i></p> <p>Britain: one centralised independent regulator</p> <p>Germany: fragmented and decentralised: shared between economics ministries and cartel offices</p> <p><i>Future convergence?</i></p> <p>Some pressure for the adoption of single regulator model in Germany</p>	<p><i>Convergence</i></p> <p>From different traditions, move towards single national regulator for all financial services</p>
Instruments	<p><i>Convergence</i></p> <p><i>Ex ante</i> and asymmetrical, for the control of former monopolist and promotion of competition</p>	<p><i>Divergence</i></p> <p>Britain: <i>ex ante</i></p> <p>Germany: <i>ex post</i></p> <p><i>Future convergence?</i></p> <p>Not likely: if <i>ex post</i> in Germany fails, pressure may rise for <i>ex ante</i></p>	<p><i>Convergence</i></p> <p>From different traditions towards Basel II: 'second-order regulation'</p> <p>Assessment and approval of banks' own capital adequacy models; increased transparency of banks' procedures</p>
Legalisation	<p><i>Divergence</i></p> <p>Germany: highly legalised and juridified</p> <p><i>Future convergence?</i></p> <p>Britain: increasing formalisation and codification may continue</p> <p>Germany: juridification may reduce as regulatory relations are established</p>	<p><i>Divergence</i></p> <p>Germany: Legalised and juridified (though less than telecoms)</p> <p><i>Future convergence?</i></p> <p>As telecoms</p>	<p><i>Some convergence</i></p> <p>Britain: codification and legalisation becoming established</p> <p>Germany: legalisation long established, little juridification</p>
Consumer protection	<p><i>Divergence</i></p> <p>Britain: ombudsman and separate consumer panel to be set up</p> <p>Germany: regulator's primary duty to protect consumer</p> <p><i>Some convergence</i></p> <p>Both regulators have a role in consumer protection</p>	<p><i>Divergence</i></p> <p>Britain: independent consumer council (EnergyWatch)</p> <p>Germany: <i>Land</i> ministries</p>	<p><i>Divergence</i></p> <p>Britain: consumer panel in FSA</p> <p>Germany: law and courts</p> <p><i>Future convergence?</i></p> <p>Germany: new financial services regulator to take on consumer representation?</p>

Table 5.2
Summary of convergence/divergence: direction of convergence

	Policy area	Direction of convergence (this does not necessarily imply learning)
Clear convergence	Telecoms: national sector-specific regulator; <i>ex ante</i> regulatory instruments and approach	Germany to Britain
	Banking supervision: Basel instruments and approach	Germany and Britain to 'third' (internationalised) model
	Financial services: single national regulator for all financial services	Germany to Britain
Some convergence	Telecoms: consumer protection undertaken by regulator (but change likely in Britain)	Germany to Britain
	Financial services: increasing legalisation in Britain	Britain to Germany
Possible future convergence (this remains speculation)	Electricity and telecoms: nascent trends in legalisation in Britain become established?	Britain to Germany
	Juridification: fall in German telecoms? Increase in Britain (Competition Act, Human Rights Act)?	Germany and Britain to mid-point
	Electricity: single federal regulator?	Germany to Britain
Persisting divergence	Electricity regulatory instruments and institutions	Not applicable
	Telecoms: form of institutional independence, internal organisation and decision procedures	
	Systems of consumer protection	
	Legalisation and juridification	

5.2 How does convergence occur? Policy transfer by policy learning?

The extent of the convergence and divergence in the regulatory regimes in three sectors in Britain and Germany has now been described. The question now arises how the convergence or divergence has occurred, and particularly whether there has been cross-national policy learning in the cases of convergence.

In relation to the learning process in telecommunications and electricity one thing is certain: Germany has followed Britain on the road to liberalisation. Leaving aside recent indications of some learning in Britain from Germany (such as access to the dominant operator's local loop in telecommunications), where learning has occurred, the direction of the adoption of rules and institutions has been unidirectional, i.e. from Britain to Germany. In the banking sector, although there has not been a shift towards a traditional British model, British banking has been highly internationalised and dynamic for many years and adjustment to the new Basel rules has been taking place over a longer period than in Germany.

Where there has apparently been policy transfer from one jurisdiction to another, we have yet to assess the extent to which the process was one of imitation or learning. Learning is more than the pure copying of policies. Successful learning involves a change of norms and values, without which there can be conflict between the intended consequences and the adopted recipe for the problems. Where there is conflict, learning is more likely to be selective, negative or symbolic.

As expected, Germany has not simply copied the regulatory reforms in the British utilities, not even in telecommunications. What happened was more an assessment of the British model in the light of the similar market structures in both countries. Negative learning was also involved: for example, the director general model was not seen to correspond with the way in which independence is created in the German regulatory tradition. Although many details of the British system were rejected, the broad approach was seen in a very positive light, not least because the market structure meant that both countries were faced with the same problem: how to transform a sector dominated by one former monopolist into a competitive sector.

By contrast very little inspiration was gained from the British regulatory regime for electricity. The initial market structures were very different and a regulatory regime in Germany emulating Britain would have meant radical restructuring, would have impacted on property rights of existing companies and *Land* governments and overall was politically impracticable (Sturm and Wilks 1997: 34–41). Moreover, a view of the role of the state in a competitive sector based on *Ordnungspolitik* ruled out the highly regulated approach of the British example (i.e. a national regulatory authority utilising proactive interventionary instruments). A change of the *Ordnungspolitik* norms could have been possible if a process of learning took place. Our interviews at the *Land* level in Germany made clear that the introduction of a British-style regulatory approach was not seriously examined. Also at the federal level there was little interest in the Economics Ministry to consider the work of the former Post Ministry in relation to telecommunications regulation as a possible solution for the energy sector. Nevertheless, because of European guidelines, the so-called ‘essential facilities’ doctrine was adopted in the Germany energy law. This seems to be a case of symbolic learning as it is outside the regulatory approach for Germany electricity and does not seem to fulfil any specific role.

We have depicted the banking sector as a special case of convergence – in instrumental and institutional respects. There is an international forum in Basel in which the participating countries’ central banks and supervisory representatives discuss matters and reach agreements. What appears to be occurring is a transnationalised and institutionalised process of mutual learning, or ‘elite networking’. In this process states are learning from each other while at the same time attempting to protect their national interest. We do not make any further speculation here about the learning process in Basel.

The possibilities of a comprehensive explanation for the developments of convergence and divergence in this two-country comparison are limited. From the specific cases and with the complex policy contexts covered in this report it is very difficult to show a clear process of cross-national learning. How can statements of the changing norms and values of so many actors who regularly talk of new policies, as well as specifics of regulation, be verified as a process of cross-national learning? On the basis of our analysis one thing is certain: successful learning always involves a process of reconciliation with legal and administrative traditions. Advanced industrial states do not, as a rule, copy the policies of

others, and when they do, the adopted rules often have little influence or meaning. It is more a process of integration of new ideas, where they appear sensible, in the context of the existing circumstances, market structures and sector-specific ideas.

5.3 Explaining convergence and divergence: sectoral forces versus national traditions

As stated in the introduction, cross-national convergence and divergence can be understood in terms of two opposing perspectives: the sectoral problem context (usually convergence) and national administrative traditions and regulatory styles (divergence). Where sectoral forces confront the institutional core of administration, we can expect substantial national resistance to converging forces. The most notable areas of convergence as shown in Table 5.2 are telecommunications institutions and instruments, banking instruments and financial services institutions. In these sectors strong forces of convergence are evident, i.e. globalisation, technological change and innovation. Moreover, in telecommunications, in contrast to electricity, the sectoral problem context at national level (i.e. the industry structure) with one dominant former monopolist is the same in both Britain and Germany (and most other European countries). There certainly have been challenges to the 'institutional core' in both sectors and countries. In Germany an *ex post* approach without a sector-specific regulator would have corresponded more to the normal approach of economic regulation associated with the Economics Ministry and Cartel Office. In banking with the Basel II approach, regulation in Germany is becoming less formalised and more flexible, while the regulatory approach of all financial services in Britain since the 1980s has become increasingly formalised and legalised.

Nevertheless in these sectors there is evidence that the reforms have not seriously challenged the institutional core:

1. In telecommunications, despite the adoption of a sector-specific regulator, many of the organisational features of the RegTP are drawn from German rather than British approaches. The form of independence and the decision-making procedures are very different: the German approach is the decision chamber model, drawn from the Cartel Office, which contrasts with the British director general model.
2. Some of the key changes have not involved a radical re-ordering of the main institutions. With a federal Post and Telecommunications Ministry and the centralised supervisory offices in financial services some of the reforms, i.e. the creation of a single regulator in telecommunications out of the former ministry and the merger of the three financial services regulators, have drawn on past arrangements (as historical institutionalism would predict) rather than abolishing the old institutions and starting again. A possible German federal electricity regulator similar to the British model would have challenged the institutional core much more since it would have required the removal of responsibilities of the *Land* economics ministries and cartel offices and a creation of a new federal institution from nothing.

In two of the most notable areas of persisting divergence (in addition to electricity regulation) – legalisation and consumer protection – there have been some changes in the

context of similar forces (internationalisation and liberalisation), but the dynamics in the two countries are very different. In relation to legalisation, international and sectoral forces seem to tell us little about the process of reform. In Britain, as liberalisation and regulation have become established in the utilities, there are nascent trends of legalisation and formalisation. There are also some signs that the 1998 Competition Act and the Human Rights Act may lead to increasing juridification, though there is little substantial evidence of this to date. By contrast, although no one foresees a decline in legalisation in Germany, there may be a reduction in juridification in telecommunications when regulatory relations are more established. Economic forces may lead to convergence to a 'mid-point' (legalisation with a little juridification) suited to an era of liberalisation, but at present this is no more than speculation. The dynamics seem best explained by nationally divergent historical institutionalism and path dependence.

The development of consumer protection systems can be explained in a similar manner. While there is increasing emphasis on the consumer in an era of the market, beyond consumer choice and information, systems of consumer representation and protection are developing in different ways. An 'ideal' form appropriate for an era of the market may develop (possibly a more direct system of consumer representation), but this is simply speculation. Given that consumer protection is a way of establishing the legitimacy of liberalisation and the regulatory state, it is likely to draw from different political traditions and legitimation.

5.4 Concluding remarks: convergence, divergence and the future of the regulatory state

A key conclusion is that, despite some evidence of convergence, the extent of German borrowing from Britain and the British model of the 'new regulatory state' is very limited. There is undoubtedly unidirectional convergence to Anglo-Saxon market orientation, internationalisation and privatisation. However, the evidence of unidirectional convergence of the German regulatory regimes towards Britain is limited primarily to some institutional features and instruments in telecommunications. Even in telecommunications regulation there are some significant differences such as the internal organisation of the regulator and the proliferation of court judgements in Germany which play almost no role in Britain. There is more convergence in the other sectors covered in this report but of a different form. In banking we have seen convergence neither to a German nor to a British model but to a qualitatively new internationalised form. In Britain there are also some nascent trends in the legalisation of regulation which suggest a shift towards a German approach.

Despite the neo-liberal turn in Europe and the shift towards the Anglo-Saxon market-oriented form of capitalism, there has been no convergence towards one concomitant form of regulation (neither the post-privatisation British model, nor some new model). An 'ideal' type of economic regulation suited to an age of competition and privatisation can be conceived intellectually, for example in some studies by the Organisation for Economic Cooperation and Development (OECD). In this ideal type, regulatory variation due to sector-specific, techno-economic problems is expected, but in general a single regulatory approach is perceived in which regulation is firstly a substitute for competition (before

competition is established); it also promotes competition and should wane as competition becomes established (OECD 1997, 2000: 11, 25). It could be supposed that the approach in Britain, as the pioneer of late 20th-century neo-liberalism in Europe, would closely resemble this ideal and provide the example for other countries. Although some of these characteristics are evident in both Britain and Germany, we have not seen, nor do we foresee, a clear cross-national convergence to a single ideal type of regulation suited to an era of neo-liberalism. This report supports previous work which suggests that in Europe many of the key aspects of regulation are still achieved in very specific national contexts (Wilks 1996). It cannot therefore be assumed that the new neo-liberalism in Europe is necessarily reproducing the regulatory institutions, approaches and styles of Britain, nor a newly emerging ideal type.

The sector-specific analyses of the British model of the regulatory state presented here show that there is not only a re-ordering of the relationship between the state and the economy but also that there has been no political master plan. The British model of reform was more the result of a historical process of discovery. Because of this the question of the significance of this model and its endurance is highly relevant. Since 1945 Britain has experienced a phase of extensive nationalisation followed by a period of privatisation. When, for example, the latest debates regarding the organisation of the railways, which many expert observers see as requiring some form of reform, or the future ownership of the regional water companies are considered, then the possibility of some form of greater state control or even 'deprivatisation' is not unthinkable. Railtrack is being replaced by a non-profit-making company, Network Rail, and some water companies have moved towards the mutualisation model of ownership. It is true that a return to a full nationalisation programme is extremely unlikely, if only for fiscal reasons. Nevertheless new ideas on the organisation of public interest activities such as rail and water are openly being considered.

Speculation of the future of the economic order in Germany and Britain should not, however, be taken too far. The key question is not whether a change to a more state-led system, perhaps state ownership of the utilities, is likely. We merely want to draw attention to the fact that the 'end of (economic) history' has not been reached in either country. Despite the European Commission's priorities for market solutions the regulatory order of the utilities remains untidy in relation to ideal competition solutions. Regulation in various forms is only one of the methods by which the public interest can continue to be asserted in the political economies in the two countries.

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Appendix: List of focus group members and interviewees

Focus group members

*(Interviews and discussions were undertaken with those indicated *)*

Dr Bötsch*, Former Federal Minister of Post and Telecommunications, Germany
Michelle Childs*, Head of Policy Research, Consumers' Association, London
Dr David Coen*, London Business School
Professor Bruce Doern*, University of Exeter
Mr Dörr*, RegTP (Telecommunications and Post regulator), Bonn.
Dr Ellenrieder, DaimlerChrysler, Surrey, UK
Dr Sebastian Eyre*, EnergyWatch, London
Mr Farrel, British Consulate, Munich
Professor Fechner, Technical University Ilmenau
Professor Cosmo Graham*, University of Leicester
Mr Groß, Bundesverband deutscher Banken, Berlin
Dr Heid*, Bundesbank, Frankfurt
Dr Liebig*, Bundesbank, Frankfurt
Dr David Levi-Faur*, Visiting Fellow, Nuffield College, Oxford
Professor Stephen Littlechild*, Consultant, University of Birmingham
Dr Neumann*, BAKred (Banking Supervision Office), Berlin and Basel Committee
Professor Mick Moran*, University of Manchester
Dr Gill Owen*, Consultant, Member of Competition Commission, London
Professor Stephen Padgett*, University of Strathclyde
Professor Michael Power*, Director, CARR (Centre for the Analysis of Risk and Regulation),
LSE, London
Mr Schmitz-Lippert*, BAKred, Berlin then Bonn
Professor Rick Schultz, McGill University, Canada
Professor Starbatty*, University of Tübingen
Dr Mark Thatcher, Department of Government, LSE, London
Peter Vass*, Director, Centre for the Study of Regulated Industries, University of Bath
Bob Westlake*, Regulatory and Government Affairs Manager, Western Power
Distribution, Bristol
Professor Zöllner*, Berufsakademie Karlsruhe

Interviewees

(not in focus group)

Dr Susanne Lütz, Max Planck Institute for the Study of Society, Cologne.

Mr Menold, Economics Ministry, Baden Württemberg, Stuttgart

Natasha Richardson, Western Power Distribution, Bristol

Jonathan Ward, Financial Services Authority, London.

Mr Wennrich, Head of Section in Economics Ministry, Baden Württemberg, Stuttgart.

Mrs Westhoff, Bundesbank, Frankfurt