

# On the urge to regulate freedom

Digitization is transforming the economy, society, and every individual's life. With it, the need is growing for clear legal framework conditions. These should leave sufficient freedom for the data economy, while preventing too much market power from being concentrated in a single place. Our authors examine the ways in which politics have approached these challenges in the recent past. They also warn against protectionist regulation and rushed decisions – not only in the digital sphere.

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**T**he German Basic Law entered into force in the night of May 23<sup>rd</sup> to 24<sup>th</sup>, 1949. This freedom-based system was the foundation on which a democratic and constitutional society formed in Germany, while a level of prosperity that was barely conceivable at the time emerged. The drafters of the Basic

## The weathervane of economic policy is turning in the wind of national phantasms

Law deliberately avoided defining a particular economic system. Nevertheless, the cornerstones of a liberal economic order were already laid: the right to own property, free choice of profession, and general freedom of action.

Now, 70 years later, a market-based system seems like a matter of course, especially since this was agreed upon by the European Economic Community that was established in 1957. The development of a “common

market” is in turn based on the principles of freedom of movement for people, goods, services, and capital. What began with the Franco-German reconciliation has meanwhile culminated in the form of a single market that is available to half a billion people. This European market is driven by the principle of competition. Its functionality is guaranteed through protection against distortions of competition. It is through effective competition that market participants are constantly encouraged to create innovations, and which keeps providing new solutions to problems.

The specific design of a liberal economic system is, of course, a matter of controversy: what conditions are suitable for supporting innovative economic players? What degree of freedom do they need – and what role should the state play? Which aspects should a state focus on when designing market-relevant regulation? Questions like these are an ongoing theme of economic policy discussions. In the context of increasing digitization, however, they have become particularly acute issues. Why is it, for example, that Germany has recently dropped to rank 17 in the IMD World Competitiveness Ranking, and appears to be at risk of being left behind in the course of a global power shift? >



Protests against the proposed Article 13 of the EU copyright reform took place across Europe in spring 2019. Legal scholars share the concern that the new regulation may lead to a general use of upload filters. The EU Parliament adopted the Directive nevertheless.

In the midst of the current global political climate there is a virulent risk of legislators trying to trace any failings back to simple causalities, and to “fix” supposedly undesirable developments through specific regulation. A better approach would be to focus on improving general conditions and thus to create open-ended incentives for investment. Instead, the weathervane of economic policy is increasingly being tuned by national phantasms, which disregard basic economic principles. A symptomatic example of this development is the German-French “Manifesto for Industrial Policy” and the “Industry Strategy 2030” issued by the German Minister of Economics Peter Altmaier in spring 2019.

The strategy paper propagates a more active federal industrial policy, designed to help German enterprises to compete successfully on a global level. The paper sets a target of 25 percent of German gross value creation to be reached by the industrial sector by 2030. To be able to compete on the world market, the strategy provides that particular industries and

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### Structural change is being delayed to protect traditional business models

specifically also major German corporations should be strengthened. Furthermore, the paper recommends that a federal equity fund should be established in order to be able to prevent companies from being bought by non-European investors in certain important cases. These ideas were inspired by the proposed merger of rail assets of Siemens and Alstom that was prevented on grounds of competition law, and the successful takeover of the Augsburg-based robot manufacturer Kuka by the Chinese Midea group.

Unanimous criticism from the business world, which strongly opposed the suggestion, was not long in coming. Also, the Scientific Advisory Board of the Federal Ministry for Economic Affairs firmly rejected this approach. The ministerial perception that political decision-makers were more capable of predicting future developments than decentrally organized market actors was indeed disconcerting. Not only

does this approach reveal the policymakers’ lack of confidence in the fundamental principle that everybody will ultimately benefit from entrepreneurial freedom. It also questions a crucial determining factor for innovation: the decisive information required for mastering future challenges is provided by the market. This is why the active players on the market are much better equipped than the government to analyze the ongoing technological developments and to adequately address new demand.

By instead designating national champions and specifically directing the production of particular goods and services, the state encroaches on a sensitive core area of entrepreneurial decision-making. A similar route is taken when particular industries are promoted in order to supposedly catch up with the global market or to remove dependencies. The EU Commission and the Member States did just this in October 2017, by launching the so-called Battery Alliance, which plans to use considerable amounts of public funds to promote the development of a battery cell manufacturing industry for electric mobility. Industry consortia are to be subsidized with funds of the EU and the Member States. According to the French Minister for Economics, Le Maire, several billion euros are to be invested for this purpose over the next few years. Meanwhile, his counterpart from Berlin calls for one-third of the worldwide demand for batteries to be covered by European producers by 2030 (the current figure stands at around four percent).

However, the more long-term the strategic timeline for this type of development scenarios, the greater the risk of their failure. It is therefore quite justified that the EU Court of Auditors criticized the focus of the EU funding of the Battery Alliance mostly on existing (in particular lithium-ion batteries) rather than on innovative and pioneering technologies. Even at an early stage, according to the Court of Auditors, there are signs that the wrong route is being taken: the competitive disadvantage is not being reduced – quite the contrary, it is even being reinforced, as state intervention removes the pressure to provide real innovations. This gives rise to industries that are unable to survive upon expiration of the subsidies.

Naturally, this caution regarding state intervention does not mean that the state should not play a role at all. On the contrary, if business practices might cause harm to the society, there is a reason to draw





clear legal lines. It is among the state's core duties to decisively promote the public interest in such cases. Intervention designed to protect individual market actors against those trying to stimulate competition with innovative products, services, sales channels, and business models, on the other hand, is not part of the state's role. This necessary delineation is often overlooked, and as a result, innovative players are frequently presented with obstacles in the form of specific market regulations. This applies equally to pharmacies as to book retailing or the taxi business.

There are, of course, cases in which public welfare considerations justify specific regulation; for example, with respect to health protection, a diversity of opinions, or the establishment of ethical principles. It is alarming, however, if such reasons are merely a pretext for measures intended to safeguard traditional business models. In a global competitive environment, this approach will cause the affected industries to fall behind even more quickly. It would merely delay the structural change that is inevitably brought about by technological progress. This is why farsighted policies tend to focus on the exact opposite: on identifying necessary structural changes in good time and on creating the kind of room for maneuver that facilitates the steps that must be taken. At the same time, it is a central task of the state to provide a socially acceptable design for significant changes and to determine framework conditions that allow for the stakeholders' activities to also be beneficial to the general public in the long run.

A particularly complex task in this context is to draw up a "regulatory framework for the digital sphere". Policymakers must beware of hastily introduced and dysfunctional rules. The political approach to the data economy that has been pursued to date can on the whole be considered a positive example. Its origin was the idea that a kind of "data property right" had to be established. This discourse was initiated by legal scholars from Germany. The EU Commissioner Günther Oettinger promptly added the issue of data property to the Commission's agenda. The situation seems perfectly clear at first glance: companies should exchange and trade more data. This applies in particular to machine-generated data such as soil measurements taken by tractors while working the fields, information about traffic density gathered by moving vehicles, or real-time

sensor data from industrial manufacturing. From an innovation policy point of view, it appears sensible to share data, as it can be used and recombined in many different ways. Modern methods for data analysis provide for new findings and are therefore beneficial to the most diverse areas of society.

It seems obvious to grant a data property right to whoever "produces" the data. However, such considerations do not withstand closer inspection. Rather

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### Google has enough market power to enforce licenses being granted for free

than promoting exchange, property in data would make transactions more complicated. Third parties might be excluded from access, and dominant market positions might be reinforced; new legal uncertainties would occur. The EU Commission has carefully pieced together these interrelations. Based on a successful combination of analyses of real-life circumstances and theory, it was found that there is simply no need to establish a new exclusive right. The introduction of data property would therefore have become a battle with a hydra: rather than solving one supposed problem, it would have given rise to a multitude of new ones.

To abandon the issue of data property was a daring step from a political point of view; however, it was a step that is likely to be forgotten much sooner than would a new regulation. Meanwhile, the path was paved for another, much more important debate: at its core is the availability of data as a decisive innovation factor. The central issue in this context, which needs to be addressed in view of macrosocial benefits, is who should be granted access to particular sets of data, for which purposes, and under which conditions. It should be considered a success that industry stakeholders, the academia and politics are cooperating in this matter in order to determine regulatory requirements and to avoid any rash legislative activism.

A very different approach was used in the most recent EU copyright reform. Across the European Union, people took to the streets to protest against



the notorious “Article 13”. These protests were based on the justified concern that the reform might give rise to a general use of upload filters on online platforms. Nevertheless, the EU has now formalized the rule as Article 17 of the new “Digital Single Market Directive”. Another provision with far-reaching consequences was determined at the same time: ancillary copyright for press publishers is now to be established across Europe, aiming primarily at enabling publishers to participate in the profits generated by “news aggregators”. Such services are designed to take users who are searching the Internet directly to the publishing websites via links. Along with these links,

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## The issue of the press publishing law was taken to EU level despite its obvious deficits

they post small extracts (snippets) of the articles in question, which are not protected by copyright. This is where the new ancillary copyright comes in, as it provides for this use of snippets to be subject to the respective press publisher’s approval. From a superficial perspective, this arrangement may make sense. What is overlooked, however, is the central function of such aggregators: all in all, they direct far more users to the publishers’ pages than could possibly be achieved by the publishers themselves.

Nevertheless, German press publishers initially campaigned for this type of ancillary copyright on a national level. The legislature was promptly willing to support their case. As a result, ever since 2013, aggregators in Germany have needed a license to use snippets. Unfortunately, the biggest player was not taken into account. Google, the very stakeholder that the regulation was intended to hit the hardest, has sufficient market power to enforce that licenses are granted for free. Smaller – i.e. specialized national – aggregators find it almost impossible to follow suit. If they are unable or unwilling to pay, certain content may no longer be linked at all. This is detrimental not only to the affected publishers, but especially to users, as access to information is made significantly more complicated.

Despite its obvious deficits, the German press publishing law was never evaluated, contrary to the agreement included in the coalition contract that was in place at the time. Instead, the issue was addressed at the EU level. There is a particular reason why this approach is so alarming. Influential media companies have significant potential to exert pressure on political decision-makers. If politicians give in to such pressure, they do a disservice to the free democratic society. This causes a threat not only to entrepreneurial freedom, but in fact also to freedom of opinion.

This example ultimately illustrates that there are two sides to the issue of digital transformation: while digitization initially promotes the distribution of and access to information and thus also promotes free opinion forming, the essence of a liberal system is at risk of being undermined if market power, opinion-making power and political power coincide. Particular caution is necessary, especially with regard to the information markets, to ensure that a suitable economic regulatory framework is established with the help of competition law. It is for good reason that the EU Commission’s Directorate-General for Competition is endowed with broad enforcement powers.

The responsible Commissioner, Margarethe Vestager, recently raised awareness of the important role of competition law, as record-level fines were imposed on Google: anybody who has enough market power to influence the rules of the market in their favor holds special responsibility to not abuse this power. This is particularly true for data-driven business models and value chains, as network effects and the de facto concentration of data held by individual players give rise to an increase in the risk of economic influence being exerted in the private sphere to an extent that is almost inconceivable at this point. What is currently primarily a cause of concern in relation to search engines, social networks, and trading platforms is increasingly expanding. In view of the great importance of the availability of data, there is an imminent threat of new concentrations of power and predominance forming in the field of technology, especially in the area of machine learning. The fact that the EU Commission and the German government are paying particular attention to such developments should be welcomed.

Even beyond this particular problem, it is within the state's responsibility to provide for framework conditions that promote innovation. This includes – as pointed out by the Scientific Advisory Board of the Federal Ministry for Economic Affairs – an internationally competitive tax system, for example, but also sufficient availability of energy, venture capital, and most of all, human resources. The latter aspect is of greatest relevance to the education and research system. There is no easy solution to this issue. If the federal government announces, for example, that as part of the artificial intelligence (AI) strategy, 100 additional professorships will be awarded to allow for a broader-based anchoring of AI in the university landscape, this is going to raise fundamental questions about the attractiveness of Germany as a research location. Even filling the currently vacant positions is a challenge, as public institutions are facing fierce global competition from the private sector. Such planned economy targets attract attention, especially in a country in which just a few years ago, a wake-up call from the Federal Constitutional Court was required in order to increase basic W2 salaries that were so low that they violated the Basic Law. Would prospects of freedom not be a better way to attract the brightest minds to Germany, rather than setting target values?

The Basic Law, with its freedom-oriented emphasis, points the way in this respect, as does an integration of the EU Single Market based on fundamental freedoms. Compared to the conditions in 1949, it is a groundbreaking development that it now appears perfectly natural for France and Germany to join forces to think about such matters. It would not be expedient, however, if attempts to master digital challenges led to a foot race, or even to the coordination of short-sighted state interventions. Legislators should instead focus on establishing freedom-based framework conditions from which private-sector stakeholders will benefit. It goes without saying that there are limits, especially where central societal goals and moral concepts do not develop naturally on the breeding ground of freedom, but must be realized by the state as part of its fundamental duties. It would also be disadvantageous for politics to squander people's trust in the great benefits of individual freedom. Personal freedom is the best way to facilitate innovation and progress. After all, freedom ultimately serves the wellbeing of all people. ◀

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