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BACKGROUND PAPER TO THE FORUM ON NEW TRENDS IN COMPETITION LAW AND THEIR IMPLICATIONS FOR BUSINESS IN CENTRAL AND EASTERN EUROPE AND THE CIS

Note by the secretariat:

This paper was prepared by the secretariat. It is based on interviews with competition experts and replies to a questionnaire survey of competition authorities and businesses which the secretariat undertook in preparation for the Forum. The topics examined in the paper been chosen in consultation with the Czech Office for the Protection of Competition. The Working Party is requested to comment on the paper and to make recommendations, taking into account the proceedings and recommendations of the Forum.

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Introduction

1. Effective competition law is a key component of a properly functioning market economy and is an essential prerequisite for a healthy private sector. This fact is becoming more recognized in the transition economies of central and eastern Europe and the Commonwealth of Independent States, virtually all of which have either established competition enforcement regimes or are currently doing so. There is a renewed recognition of the role that competition policy plays and the benefits which greater competition can bring to business and consumers alike. The benefits from competition are already apparent in transition economies. In many countries, the implementation of competition policy within the overall framework of policies to support structural change, sectoral restructuring, privatization and de-monopolization has encouraged the creation of a large number of small- and medium-sized enterprises, and generally improved efficiency in many sectors (such as the trade, services and consumer goods sectors).

2. However, the implementation of competition law and practice has not promoted the development of private enterprise to the extent required. Private companies still encounter many barriers to entry in specific industries, non-transparent relationships between the State and State-owned companies, and restrictions upon initiative and private sector development. Competition authorities can do much to remove these barriers. In addition, the private sector is still very weak in most transition economies and needs support if it is to compete successfully in increasingly open markets. Competition authorities will have to examine the nature of this support to the private sector taking into account the welfare of the consumer.

3. The primary focus of the report is the measures and mechanisms for improving the national enforcement of competition law. However, there is also an important international dimension to competition enforcement. As a result of globalization more competition cases have international components. To develop effective national enforcement regimes, the competition authorities of advanced western economies are increasingly cooperating. They are sensitive to the need to reduce business costs and uncertainty especially in the case of transnational mergers. Above all, competition officials have been keen to coordinate their efforts to detect and prosecute international cartels. Various international organizations including the Organisation for Economic Co-operation and Development, have been active in promoting cooperation among national competition authorities.[1] In addition, cooperation between the competition authorities from European Union States and those from accession countries is growing. Various Europe agreements concluded between the European Union and countries of central and eastern Europe who have applied for membership of the European Union, require the acceding States to harmonize their competition laws with those prevailing in the European Union.

4. The overall objective of this report is to examine the best ways the competition authorities and other bodies can effectively stimulate competition and promote the development of the private sector in transition economies.

5. It is organized into three sections:

(I) Main challenges facing the competition authorities in the transition economies;
(II) Methods and mechanisms required for improving competition law and practices in the transition economies in specific areas.

[1] See OECD Council recommendations of 1995 and 1998 on competition at: http://www.oecd.org/daf/clp

(III) Recommendations for strengthening the private sector through more effective implementation of competition laws

Section I
Main challenges facing the competition authorities in central and eastern Europe and the CIS

6. The transition economies have made rapid strides in enacting new commercial legislation. However, one of the problems has been that the supporting institutions have been too weak and inexperienced in implementing the new laws. The countries, which began their transition first or had some experience with market institutions prior to the transition, have made the most progress in building the required institutions but even in these most advanced countries there are still gaps. Without such supporting institutions, the laws will remain unenforced and the confidence of investors and consumers will be undermined.

7. In the case of competition, the challenge of building appropriate institutions in the transition economies is greater for a number of reasons. First, competition policy has tended to be given less priority than other objectives. In the early period of transition, competition policy tended to be superseded by other activities and policies, such as privatization and foreign direct investment (FDI) promotion. Indeed, in privatization and the promotion of FDI, Governments, ignoring the competition implications, often adopted highly anti-competitive policies. In privatization, the Government tended to disregard the dominant position of companies because it realized that investors were willing to pay more for assets that enjoyed a position of dominance. Even today these pressures are still apparent: the State's needs for revenues from the sale of enterprises often imposes on the competition authorities an obligation to preserve the monopoly in order to increase the price at which the purchaser will buy the entity.

8. Second, there is generally a poor understanding of the role of the anti-monopoly office among the wider population including the other arms of Government. For many people, the anti-monopoly office is a technical arm of the State, even an optional extra rather than a body, that contributes to the economic health of the country. Third, there is no straightforward blueprint that can be followed in establishing a competition authority. In western European countries, most competition authorities have only relatively recently become fully active bodies and still are in the process of defining their role and strategy. The ways these bodies have implemented competition laws has varied considerably. Great differences exist, for example, between the United States and countries belonging to the EUROPEAN UNION in the degree of stringency to which they implement competition law.

(i) Developing a strategy

9. A competition authority is established by national law, which sets down its powers and responsibilities. However, its strategy is an important supplement to its legal mandate as it provides a vision and purpose that unifies those who work for the body and attracts support from those, such as the public and the business
community, whom it is trying to serve. To be successful and relevant, competition authorities must adopt a strategy that addresses the country's specific economic challenges rather than trying to emulate something elsewhere. These challenges differ markedly within transition economies.

10. In the countries of central and eastern Europe, the competition authorities' missions are primarily related to post-privatization issues: the need to establish a competitive environment that has been dominated

for so long by State monopolies. Privatization has not removed the monopolies in many cases. This is particularly true in the natural monopolies and public utilities. It also refers to many industries that still are

dominated by the former State-owned monopoly even though the company has been privatized. In many cases a foreign investor has acquired the State monopoly. There is a risk that without strong action by competition authorities these monopolies and their practices will raise barriers to the entry of new private companies in the region.

11. Within certain CIS countries, these issues are also apparent, but privatization has often advanced far less. Private monopolies have replaced public monopolies and market structures are still concentrated and vertically integrated. Subsidies are used to keep bankrupt companies alive. There is an absence of a level playing field. Competition is stifled and so is the growth of new companies.

12. The strategy of competition authorities should be to accelerate the development of the private sector in the transition economies. The more a healthy private sector is developed, the more the demand for the services of the competition authority will be required. Indeed, if the competition authorities are to be successful they must arise from societal demand rather than being imposed from above by Government decree. A weak, State-owned sector dependent on subsidies will exert weaker demand for proper implementation of laws by competition authorities. Hence the interest of the competition authorities in building up a healthy private sector in their countries.

13. Competition enforcement should, therefore, be targeted toward removing the myriad of barriers to the private sector, namely: continuing subsidies (including trade protection and monopoly privileges) that support enterprises which are not commercially viable; barriers to entry or exit from a field of production; excessive costs from prices charged by regulated businesses; complex procedures for doing business; and rules which effectively restrict competition and initiative, continuing to act as a constraint to private sector development.

(ii) Defining a role

14. The main *role* of the competition authority is law enforcement: As law enforcers, competition agencies investigate and prosecute or prohibit agreements, which either exclude competitors or substitute collusion for competition. They also prohibit monopolization or abuses of dominant position whereby enterprises unilaterally restrict national or potential competitors. Finally, most competition authorities review mergers to ensure that these are not used as a means to eliminate or restrict competition. To fulfil their role they need access to highly specific, often confidential information, concerning the workings of markets and individual firms. It also requires sensitive judgements and trade-offs to be made concerning the economic effects of various types of conduct and mergers.

15. In building the competition institutions, there is, however, much to be decided upon with respect to how it undertakes these roles. For example, the United Kingdom's Office of Fair-Trading (OFT) operates differently from that of its counterpart in the United States of America. The main roles of the United Kingdom Office are to: identify and put right trading practices which are against the consumer's interests; regulate the provision of consumer credit; act directly on the activities of industry and commerce by investigating and remedying anti-competitive practices and abuses of market power, and bringing about market structures which encourage competitive behaviour. In contrast, the United States of America's Department of Justice Antitrust Division promotes and protects the competitive process – and the American economy – through the enforcement of the antitrust laws. The British approach tends thus to be more oriented towards *consumer*-led issues, while the US agency concentrates on the *enforcement* of

competition legislation. [2] In addition, with regard to judicial decisions, the United Kingdom along with other countries such as Sweden and Spain, employs an administrative system of decision taking. In the United States of America, as well as in many countries belonging to the EU, an alternative tradition is employed whereby judicial decisions play a central role. A decision on whether to adopt a judicial approach or an administrative approach has important implications for the costs and working style of the competition authorities. The administrative approach promotes more informal, less costly and quicker procedures; the judicial approach more stringent, legalistic (and expensive) processes.

16. These models may apply better to some transition economies than to others. For example, the market structure of many transition economies remains highly concentrated and vertically integrated, especially in the CIS, and a strong anti-monopoly policy is required. While in Russia, a legal basis for anti-monopoly policy has almost been installed, there have not been many cases in which the vertically and horizontally integrated operations of large-scale enterprises have been broken up and their restrictive practices stopped. Authorities should consider more actions where privatization has failed to remove such structures. In Russia, for example, as a result of post-privatization mergers and restructuring activities, a number of huge financial industrial groups have been created, with a unique relationship to Governments, banks and various industrial activities. Accordingly, the judicial model which is more stringent in tackling anti-monopoly practice may be more suitable in the case of the Russian Federation than the other transition economies where monopolies have less of a stranglehold on the economy.[3]

(iii) Improving their powers

17. Another central challenge is for competition authorities to obtain the necessary powers to undertake their work and the ability to fully exercise those powers. The needs in this area are numerous but the following are most required in light of the strategies and roles defined above:

Independence of the competition authority

18. Of principal concern for competition authorities is the power to exercise their authority independently from the Governments and corporate lobbies. The private sector, if it considers it is being discriminated against by the State, must have an arbitrator who is both independent and can have undesirable anti-competitive practices and discriminatory policies stopped. There is very little experience of such an independent body in the transition economies and the challenge of developing such an institution in economies with scare resources will be considerable.

Competition advocacy

19. The competition authority will have to become a bastion of advocacy for the benefits of competition, through the undertaking of studies, research and public programmes to raise awareness. Often the value of competition is not well perceived even amongst the civil servants charged with undertaking the work. The costs of maintaining regulations are not well understood, while the more temporary negative effects of

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[2] These different missions were recently summarised by a British newspaper as follows: "The United States sends price fixing bosses to jail and fines their firms. Britain asks them not to do it again" The Observer, 18 July 1999).

[3] "Russia: Financial Industrial Groups", by Djordjija Petkoski, from EDI Forum, vol. II, No. 4, 1998

removing restrictions and introducing competition on previously protected sectors are common knowledge. It

will be necessary to improve this power if the competition authorities are to be able to challenge Government policy where it conflicts with competition practice. This is a role, which already is becoming more widespread and effective. In Hungary, for example, the competition authorities have used their powers to advocate for better regulation of natural monopolies. While this new public advocacy role is still very new in most of the transition economies, the competition authorities are increasingly adopting this power to
demonstrate the case for deregulation and competition. The competition authorities are, for example, undertaking studies on markets in particular industries to develop a knowledge base on which to exercise powers as well as to demonstrate the comparative costs and benefits of competition.

Regulation of public utilities

20. In the process of privatising their utilities, Governments have now to deal with their regulation. However, to date, Governments have encountered problems in developing a comprehensive policy of regulatory reform; rather they have, if at all, devised policies for individual sectors. One of the difficulties is to identify the responsibility of the regulatory authority. In some countries there is a risk of overlap between the competition authorities on the one hand and the ministry of energy, telecommunications etc. which has overall responsibility for the sector. In addition, the powers are often not clearly identified between the local levels and the national regulatory bodies. The divisions of responsibilities between these different bodies and levels has, in most cases, still to be determined.

Investigating anti-competitive practices

21. Taking action requires a thorough and detailed analysis of market structures by industry and sector by the competition authorities. So far the competition authorities in the transition economies have undertaken some work in this area. However, this power will have to be expanded, particularly if State aids problems are to be tackled effectively.

Exemptions

22. Discretionary powers are needed to permit exemptions to prohibitions regarding anti-competitive practices. These practices may be perceived acceptable if they contribute to increasing or improving the production of goods and the provisions of services, to promoting technical and economic progress or of increasing the competitiveness of domestic firms abroad. Many laws already grant exemptions to small and medium-sized enterprises when the actions lead to enhancing their competitiveness. This exemption should, however, be granted after investigations and be subject to time limits. The authority should also have the power to revoke or amend its authorization if the enterprises breach any of the obligations contained in the agreement granting exemption.

Resources

23. There is a great need for a well-resourced and proactive competition authority, committed to using its new powers. In most cases, this will require extra staff and more training. The training of staff, however, is often not up to standard mainly because of the novelty of the competition issue. The resource problem is compounded by the low salaries offered by the competition authority which makes it very difficult to retain well qualified people and prevent them from leaving for better paid employment in the private sector.

Section II
Methods and mechanisms required for improving competition law and practices in the transition economies in specific areas

(i) State aids

24. State aids refer to a wide range of grants which industries receive from Government. They include outright grants, interest-free loans, protection from imports, fiscal and non-fiscal incentives, etc. Their effects can be benign but they can also have a strong and undesirable anti-competitive impact. Discussion thus takes place on the degree to which they can harm the competitive environment. In the transition economies, the scope and amount of State aid varies considerably and there is a clear distinction between the EU accession countries and those like the Russian Federation where required disciplines are less apparent.

Central and eastern European countries

25. Overall, for the majority of central and eastern European countries, the social orientation of the State and the deficit of the State budget and the other sources of public funds determine the scope of State aids. The size of the budget in most countries in the region does not allow for the granting of any aids beyond those considered to be of vital necessity. The main objective of State aid is to help in the restructuring process as well as to subsidise the production costs for goods and services of social importance. The prices of these services are maintained below the level of their production cost in order to make them affordable for the consumer. These services chiefly concern the prices of the public utilities – central heating, railway transport, postal services, accommodation for students, etc. Without subsidising these industries the strains on the population would prove to be socially unacceptable. However, it is important that these subsidies are gradually lifted as their continuation acts as a barrier to private investment and the overall improvement of the service. The main form of aids in the above context is direct grants from the State budget, State guarantees and soft loans.

26. Apart from a few cases, State aids, unlike in the advanced western economies, have rarely been used for a clearly defined industrial policy. Very few of the transition economies have tried systematically to promote specific industries and enterprises by the use of protection and State aids.[4] This is also due in part to their socialist past and the general reluctance of Governments in the region to pursue an interventionist State policy.

[4] Some countries have adopted industrial strategies but with limited success. In Poland, for example, in the telecommunications equipment industry, the authorities gave exclusive supplier rights to the monopoly telecom operator TPSA, to three foreign companies, AT&T, Alcatel and Siemens, which had purchased three Polish equipment manufacturers,. This was the only way at the time the Government could preserve its domestic industry in a strategically important industry. However, TPSA was obliged to purchase its equipment from these companies at rather high prices and higher than it could obtain from Asian sources. These anti-competitive linkages in addition, put another impediment in the way of the Government privatizing TPSA, as privatization would have undermined its supplier relationships with these three foreign companies.

27. However, the use of State aids can be controversial. For example, various incentives by Governments to attract foreign direct investment have been challenged for its anti-competitive effects. Recently, the European Union has asked Poland to withdraw the tax breaks it has given to almost 200 investors, some of which include tax holidays for 20 years.[5] Generally, foreign companies invest for other considerations than public grants and Governments are thus better advised to use scarce resources on improvements to the environment and infrastructure. However, even where they are used by some States in central Europe, their size is very small and certainly far smaller than those used by Governments in the west to attract FDI.[6] In addition, the effect on trade has been a matter of concern.

28. As a result of the Europe agreements, goods from accession countries enjoy tariff-free access to EU markets and State subsidies in so-called sensitive sectors such as steel and heavy industries are perceived as giving enterprises from the transition economies unfair advantages vis-à-vis enterprises in EU countries where such subsidies are either prohibited or better controlled.

29. Thus, despite their limited scope, there is still a need for establishing a fully transparent system of State aid. One method for developing more transparent mechanisms has been to establish an inventory of all the State aids, which have been granted. The transparency of State aids has been affected by their complexity and by the numerous sources from which they are provided: State, local and city budgets, and special public funds under specific laws. Such an inventory would allow State aids to be broken down according to volume, type and objective and would provide a better basis for reassessing their use and for improving the State's control of its aid policy.

30. Under the Europe Agreements, the Ministry of Finance of the country concerned is obliged to prepare and submit to the European Commission annual reports on State aids and subsidies under article 93(I) of the ECE Treaty and Article 25 of the World Trade Organization Agreement on subsidies and countervailing measures, elaborated under the format required by the European Commission. In many countries now there are special departments formed within the ministries of finance to report regularly to the European Commission on State aids. The responsibility of the competition authority with regard to State aids varies. In some countries such as Bulgaria it is intended to play a monitoring and investigative role. The Bulgarian Commission for the Protection of Competition can investigate and where it finds that a State aid is incompatible with the law and cannot be exempted, it can propose to the competent authority that it withdraws the aid and reimburses the State. It can also demand changes to the project so that it can legitimately receive aid thus obviating the need to repeal the whole aid. In other countries, such as Hungary, the terms of the new competition law do not foresee any role to be played by the competition authority.

CIS countries

31. In the case of CIS countries, the use of State aids is qualitatively and quantitatively different, as the disciplines for their use are less apparent. Many companies are kept alive by direct and indirect subsidies: In many industries various measures are used which impede fair competition: different tax rates for different enterprises; preferential access to land and Government procurement; different energy prices; variable degrees of red tape; differential law enforcement; differential access to Governmental controlled export infrastructure. These supports favour the less productive enterprises and discriminate against more efficient

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[5] Business Central Europe, "Danger Zone" p.31 July/August 1999.

[6] EBRD Transition Report 1999 (forthcoming).

enterprises. Often they are directed toward those companies whose closure would have profound effects on regions and local communities.

32. In the Russian Federation some industry examples illustrate the scale of this problem:

33. Steel: obsolete steel plants are avoiding being shut down by paying for only a fraction of their energy bills, which is their largest cost component. Local Governments go to great lengths to keep these companies alive because they are often the largest employer in the city or region. Regional Governments channel implicit energy subsidies to these companies by letting unpaid energy bills accumulate at the local gas and electricity distribution companies. The latter are often under effective control of the regional Governments. These subsidies discriminate against the more productive companies who do have to pay taxes and energy bills.

34. Food and general merchandize retailing: the share of modern retail outlets such as malls and supermarkets is very low because these modern formats tend to be treated unfavourably and have a significant cost disadvantage vis-à-vis the much less productive formats like open air market stands and kiosks. The latter benefit from much lower tax liabilities, less control on the origin of their goods (which not infrequently are illegal imports and counterfeits) and cheaper access to prime locations. Such discrimination is justified on the grounds that many jobs are at stake in the open air, wholesale markets and are an effective way of providing cheap food to the poor.

35. Confectionery: Regional Governments, as in the steel industry, tend to support unproductive plants by effectively waiving their local tax obligations and help them to pay less federal taxes. As a result the few best practice foreign companies are less profitable (after tax) than their inefficient domestic producers .[7]

36. Here solutions should lie in greater consistency and transparency in the use of aids. Social concerns need to be addressed but preference should be made for direct welfare payments rather than indirect industrial subsidies. Competition authorities in the Russian Federation have a major challenge in ensuring compliance with competition laws at the local and regional levels. In addition, the types of subsidies used are highly complex and untransparent which makes proper investigation extremely difficult.

(ii) Mergers and acquisitions (M&As): Deregulation of natural monopolies and public utilities

37. An effective merger regime is a key part of the regulatory framework protecting open and competitive markets. The number of mergers and acquisitions (M&As) within Europe as a whole has accelerated as firms are anxious to expand in industries which have been opened up recently as a result of deregulation and new technological developments. Through mergers and acquisitions, enterprises can improve their competitiveness. However, the experience is that many newly merged entities actually fail. While this can be due to a failure to marry different corporate cultures and to deal with higher costs associated with running diverse activities, it can also be the cause of poor judgements by the relevant competition authorities.

38. Broadly speaking, M&As can be placed under three categories: horizontal, vertical and conglomerate.

[7] "Survival of the fattest", based on a report entitled 'unlocking economic growth in Russia' McKinsey and company, Financial Times, 19 October 1999

39. *Horizontal mergers*: Mergers between firms in the same line of business as well as market with the aim of increasing efficiencies and acquiring market share

Vertical mergers: *In these, firms engaged in different stages of production and marketing, merge. The raison d'être of such mergers is to reduce transaction costs and other costs through internalization of different stages of production and distribution.*

Conglomerate mergers*: This involves mergers between firms in diversified and unrelated business. The merged entities envisage a substantial risk reduction and also the opportunity to exploit different types of economies in the area of finance, resources etc.*

40. In many of the central and eastern European economies, competition authorities have had to approve an increasing number of *horizontal mergers* involving two or more domestic companies. These mergers increase concentration. However, in the majority of transition economies the parties have often argued that because their markets are small, they need to become bigger if they are to compete successfully in the larger European markets. Such judgements, however, should take into account the implications that greater concentration has for consumer welfare. In cases where approval is given, there should be a follow-up of continuous monitoring of the entity and, particularly, its pricing strategy.

Natural monopolies and regulated competition

41. Deregulating and opening markets in electricity, transport, telecommunications, water and municipal services offers consumers greater choice, better service and higher quality. However, competition in natural monopolies is difficult to develop and regulation is needed to ensure that market dominance does not harm consumers. This is especially true with companies that provide the social services on which consumers depend for their welfare and existence. In transition economies as a whole, there has been tremendous movement in the privatization and deregulation of energy and telecommunications markets. But price rises that are too precipitous can be destabilising and can cause social tensions. A strong regulatory force needs to be put in place, which can strike the right balance between the interest of the private investor and those of the consumer.

42. Once at this stage, one of the key questions facing Governments is how to structure, establish and integrate the relevant regulatory bodies. In some cases, the line ministries will be responsible for regulations, in other cases it will be specialized agencies and in other cases a combination of one or other or all three together. To date, establishing these regulatory authorities has proved extremely difficult in all transition economies.

Competence of the regulatory authority

43. The United Kingdom example is often cited as being the most successful in the case of regulating the utility after privatization. But such a system of regulation through independent regulators took several years before it was perfected and even now adjustments are required. In the case of the transition economies, the first task is to establish an appropriate division of labour and distribution of tasks in the area of regulation. Some countries have still to decide whether separate regulators should carry out the regulation or whether the Ministry should do this or it should be done by both. In Bulgaria, for example, the Commission for the Protection of Competition monitors jointly with the State Commission on telecommunications the competition in the telecommunications market.

Separation between public regulation and enterprise functions

44. There is a need to separate the task of regulation from that of the activity of the enterprise. There are widespread differences in the progress achieved towards separation of these functions in transition economies. In telecommunications the separation is under way but less progress has been noted in energy and in the transport sectors. In the case of energy, such powers generally remain the responsibility of the Government, which determines prices after consultation with the relevant energy committee.

45. In many countries, the municipal local authorises still control the price of local services, water, heating, transport, etc. which they also own.

Pricing policy of private operators

46. For those countries that have privatized their operators, the lack of competition will require strict attention by the appropriate authority. One of the most favoured mechanisms used is the price cap. Under this arrangement, rather than explicitly setting prices, regulators mandate permissible price ceilings. The company is free to charge less, but not more. If the telecoms operator or electric company can lower its costs and achieve additional savings, it can reap higher profits. In most cases, however, the regulator mandates both a declining price cap, to induce improvements over time, and a formula that requires the sharing of gains between the company's shareholders and its ratepayers. The supporters of the price cap mechanism argue that it is more market driven as it is based on incentives.

47. However, while price caps do rely more on economic incentives, they are in reality a rate-of-return regulation measured retroactively. If the regulator has underestimated gains from productivity or from monopoly power, and profits seem excessive, the regulator will lower the price cap after the fact. In order to make this judgement, the company needs an accounting system that segregates costs and revenues by line of business, and the regulator needs access to it. In fact, in Hungary, where such a system has been used in the telecom sector, there has been little pressure on efficiency. In addition it has proved very difficult to obtain satisfactory information on the real cost structures of products and services. In the price regulation of electricity, other methods and combination of methods have not proved much better.

The regulatory system should ensure conditions of fair competition between existing operators and new entrants (access to networks, and monitoring of cross-subsidies).

48. The regulator's first task, as noted above, is to ensure that monopolists do not overcharge consumers in services, such as energy telecommunications and transport, which have very strong social dimensions. In time, as prices reflect real competition - as more companies enter the market - the task of the regulator evolves to becoming a watchdog for competition. Its responsibility is thus to improve access and to ensure transparency in operations in order to reduce and prevent cross-subsidization among enterprises.

(iii) European Union Competition Law Harmonization

49. The harmonization of competition legislation in anticipation of membership in the EU has improved the quality of legislation in the region. The States which are negotiating their entry into the European Union (EU) are approximating their laws to entry requirements. In approximating their laws many EU accession countries have undergone a 'screening' to ensure appropriate compatibility. This screening has involved the completing of questionnaires, which examine the approximations of legislation to the Basic Competition

provisions of the Treaty of Rome (Articles 85 and 86). These improvements have arisen because of the rigour in which this work is being done in cooperation between Brussels and the competition authorities in the countries concerned. The competition authorities have benefited from having a 'road map' to follow in competition law and practice which is taken seriously by other parts of the public administration.

50. However, approximation does not mean that competition laws of EU member States are being copied verbatim in the jurisdictions of those countries which are acceding to the EU. In many countries the competition laws followed models of countries at the beginning of the transition before the approximation process began. In Hungary, the Competition Act (Act No. LVII/1996 on the Prohibition of Unfair and Restrictive Market Practices) was modelled largely on German and the general provisions of European Community Competition Law. Harmonization is not a process whereby once reached the process has finished. There will be a constant need to update legislation, for example to align with the recent amendments to the EU competition law with respect to the treatment of joint ventures. It has not been a one- way process either. The reform of laws has gone further in some countries than the EU has required.

51. At the same time the adjustment process is a challenge. First at the technical level, the legal environment cannot always be easily adjusted to fit with new aspects of competition laws; in some cases the constitution will have to be amended. The approximation of laws will also require adjustments in the system of legal education. There are also technical reasons as to why certain laws cannot be transposed into new statutes in the countries of central and eastern Europe. Second, at the institutional level the structure of the competition office –independent professional and transparent – is not easily established. Ideally, it should be composed of the following: a chairman; a collegial body entitled to take decisions but which require the chairman's ratification; and the executive staff who carry out the instructions of the chairman and the collegial body. Independence should be secured both by the right conditions under which the chairman and the collegial body are selected and the terms of their appointments *and* by the right institutional requirements. One without the other is not sufficient. In taking decisions, the authority should ensure that decisions are issued in the name of the collegial body – but signed by the chairman; that decisions are made irrespective of the individual members of the collegial body; that dissenting members can minute their opposition; and that decisions are executed immediately. These practices are important because they have been adopted successfully by other competition authorities in western countries to protect their independence.

(iv) Implementation of competition legislation

52. The task of effective implementation of laws is a critical one for the competition authority. In general the development of competition law is an ongoing process, with States adopting tougher policies as their transition progresses:

53. Poland. The anti-monopoly law was revised significantly in 1994 and 1995 to bring provisions on anti-competition practices, market dominance, and mergers and acquisitions into EU line and practice. The competition authority also began to issue guidelines and communiqués – a common practice among EU members.

54. Russian Federation. The Russian Federation enacted a law in 1995 that banned cartels and enjoined that a group of companies, rather than just individual enterprises, may be subject to anti-monopoly laws. The rules also extended the jurisdiction of laws to cover actions taken and agreements reached by Russian

companies outside Russia's borders. The power of the federal antimonopoly anti-committee to block mergers was also increased, and the maximum fine raised to US$ 250,000.

55. Romania. New competition rules introduced recently in Romania impose heavy penalties on those violating anti-monopoly rules. The courts can hand down fines of up to US$ 86,000, supported by a Government competition office charged with investigating violations and monitoring implementation of council decisions.

56. Although legislation provides the framework for competition policy, its character often owes more to the manner and stringency of enforcement. This depends upon the attitude of the competition authorities and the ruling Government. Until recently, enforcement of competition law has tended to be weak in the transition economies. This can be seen in two areas in particular:

1. Monopoly privatization. A prime concern of competition authorities in the region has been the privatization of former monopolies. Where competition is imperfect, privatization has often meant merely transferring a State monopoly to the private sector or merging two firms, which subsequently acquire a dominant position. This brings little benefits in the form of restructuring or efficiency gains. Some Governments recognized this potential problem and entrusted competition authorities with the power to break up monopolies. However, in practice, authorities often considered this too drastic a measure and have been reluctant to interfere with privatization policy. The authorities have instead pursued State monopolies through enforcement of the prohibition on anti-competitive practices, such as price-fixing and tying arrangements.

   The implementation of policy in this regard has varied within the region, with the competition authority in Poland concentrating its efforts on investigating State firms while the authorities in the Czech Republic and Hungary have tended to pursue private firms.

2. Foreign companies. The anti-competitive practices of foreign firms have often been overlooked by States anxious not to deter much-needed foreign capital and investment. However, the authorities in some States have recently appeared more willing to investigate and penalise foreign companies:

57. Czech Republic. In 1995, the competition office issued fines amounting to US$ 370,000 against Tchibo (Germany) and Dougwe Egberts (Netherlands) for price fixing. The two enterprises had undertaken simultaneous price rises at the suggestion of the Czech Coffee Association, during a world-wide increase in coffee prices

58. Hungary. The competition office has stepped up its enforcement efforts issuing fines amounting to several million dollars per year. One of the largest fines imposed by the office was that of US$ 3.4 million in December 1994 against the local subsidiaries of several foreign coffee companies, including Douwe Egberts, Kraft Jacobs Suchard (Switzerland) and Nestlé (Switzerland). The office also penalised Germany's Eduscho and Tchibo for alleged price fixing in 1994. It was also refused several mergers.

59. Romania. In 1999, the Romanian Competition Council refused to authorize a merger involving Eurotrading Chemicals, a foreign-owned enterprise, which wanted to take over 51 per cent of three trading undertakings, which held a market share of 68 per cent. The Council considered that this dominant position would likely lead to a significant distortion of competition.

60. The region's competition authorities have begun to assert their independence and make politically controversial rulings. For example, the Czech Office for the Protection of Competition in 1997 denied approval to a proposed merger between the country's two largest breweries, Plzensky Prazdroj and

Redegast. Although this would have given them a 40 per cent share of the domestic market, above the 30 per cent definition of dominance used by the authority, local politicians and media argued that the merger was crucial to helping the Czech brewing industry to compete on equal terms with leading west European firms. In 1998, the Russian competition authorities closely scrutinized two controversial oil mergers, between Yukos and Sibneft and between Lukoil and Sidanko.

61. These are positive developments. However, a further stage in enforcement will need to be reached if the development of competition and the benefits are to be fully realized.

Public understanding of competition

62. Competition authorities should develop a communication policy vis-à-vis their populations. In these communications they should encourage the population to take competition seriously and to send in complaints and information about anti-competitive behaviour. One strategy that is being tried in some countries is to involve the public more by making certain investigations over anti-competition in a particular industry, e.g. pricing practices in consumer goods such as automobiles and electricity open to the general public.

Price comparisons

63. The competition authorities should tackle those industries where the prices of goods are higher than equivalent goods in other countries. High prices do not necessarily mean firms are making monopoly profits. Their unit costs may be high because the market is smaller or because of differences in technical and safety specifications. Taxes, exchange rates or barriers to trade may also be a factor. However, higher prices may also be due to anti-competitive behaviour, which the competition authorities should tackle. Anti-competition authorities should undertake detailed price surveys from a number of countries over a number of products and make their findings public.

The Right of appeal

64. When administrative decisions are taken, there must also be an enforceable right for both parties to have access to an independent judge to whom recourse against the administrative decision can be submitted. This must be enshrined within the relevant legislation. In addition, where enterprise feels that they are being discriminated against by public authority, they must have a right of appeal to a strong and independent judiciary.

Role of the judiciary

65. Almost all competition laws provide for appeals or hearings of competition cases in court. Because it is a relatively new area for them and there are few existing case histories in their countries, the judiciary in transition countries is relatively inexperienced in matters of competition enforcement. The anti-monopoly authorities must find effective ways to work with inexperienced judges to ensure the rational development of competition jurisprudence in transition economies.

(v) Public procurement

66. Open competition in public procurement has a major, beneficial impact on the development of private companies. By opening up opportunities to suppliers for Government contracts, open public procurement can create new opportunities for private-sector growth. In addition, open public procurement promotes choice, improves quality of service and lowers price to consumers provided managers in national and local public authorities develop effective procedures and practices for contracting out**,** on a competitive basis, the works and services they require. Where Government departments provide services on goods in competition with the private sector, this process can even result in the commercialization of those departments and their being eventually spun off as private companies. The regulations for ensuring that the appropriate procedures are put in place are critical for these benefits to be realized.

67. However, in several transition economies despite new legislation, much needs still to be done to ensure a level playing field in the competition for Government contracts. In the Russian Federation, for example, although Government contracts are officially submitted to open tenders, they almost invariably end up going to the same ex-Soviet companies closely affiliated with the local authorities. As a result these companies have no incentives to increase their very low productivity. On the contrary, it appears that one of the implicit conditions for obtaining the contract from the authority is that there will be no reduction in employment.[8]

68. Within the European Union the regulation of public procurement markets is not the responsibility of the Competition Directorate-General (DG), but the Internal Market DG, while at the national level it is the provenance of the courts. In many transition economies, however, the competition authorities have been given a role in implementing new public procurement laws. At the Economic Commission level, directives have been published containing rules related to public procurement and specifically to advertising procedures, and selecting suppliers. These affect, in particular, goods, services and the construction industries. These rules are also applied to public utilities, energy, electricity, water, etc. although they are no longer applied to telecommunications in most European Union member States which have liberalized their telecommunications market. It was anticipated that benefits from these directives, would flow from two areas: (i) lower prices; and (ii) the development of new suppliers. The evidence is that, in the first case, these directives have benefited consumers from lower prices. However, with regard to the development of new suppliers, it appears that suppliers from outside the region or individual countries have not benefited as was expected. Generally, in European Union countries the suppliers have remained local.

69. To address these issues, the European Union is considering making rules that are more flexible and reflect commercial realities. For example, under existing rules it is not allowed to discuss the price offered but experience shows that in business the price of the good or service is exactly that which is discussed.

70. The transition economies could learn from this experience and adapt more realistic rules, which follow current discussion on proposed reform of the rules governing public procurement in the EU. It is also important that in their jurisdictions they provide appropriate channels to suppliers who feel that they have been discriminated against in public procurement. In the European Union such complaints are made to the Commission itself and to the national courts where parties have rights to take out injunctions against authorities and can demand compensation. In many transition economies, however, the court systems are

[8] "Unlocking Economic Growth in Russia", Ibid.

still underdeveloped in hearing such complaints and Governments may wish to give their competition authorities special rights *pro tem*, in the area of enforcement.

71. Given the novelty of the subject and the consequent weakness of the court system in dealing with public procurement disputes, it may be worth considering whether, in the transition economies, the competition authorities should be responsible for covering the enforcement of public procurement provisions. In Hungary, for example, the competition authority actively participated in the preparation of the public procurement law and is involved in the work of the Public Procurement Councils established under the terms of the law.

Section III:
Recommendations

72. Some recommendations for follow-up actions should be considered in the light of the strong challenges which the competition authorities face in the regulation and enforcement of competition:

72.1. The regulation of monopolies remains one of the central challenges, which has crucial importance for the environment for investment and for the protection of social services. Confusion over responsibilities between the various arms of the State at the national level and also between the national and local authorities in regulating prices and services remain unresolved. To address this challenge it would be helpful to organize seminars, training and regional networks whereby experience and information are exchanged to eliminate problems and accelerate reform. The United Kingdom has a lead over all UN/ECE member countries in this area and its experience could be helpful to the transition countries in clearly delineating responsibilities, particularly in the regulation of pricing.

72.2. State aids need to be better investigated by the competition authorities at the regional level, especially in the Commonwealth of Independent States; too much emphasis on the national level can overlook the need for work at the local level.

72.3. Within the framework of existing antimonopoly legislations, the breaking up companies that are abusing their dominant position should be pursued more actively by the enforcement agencies in certain transition economies.

72.4. The procedures for open competition for Government contracts should be improved in all UN/ECE countries. Countries should adopt rules that reflect ‘best practices’ rather than actual legal prescriptions which need improvement.

72.5. Implementation of competition legislation can be improved by giving the private sector more rights to appeal against alleged discriminatory practices and anti-competitive measures. This is a new and challenging area but it allows private entrants important access. An independent ombudsman that could deal with discrimination by public authorities could be an important means of addressing such types of discrimination.

72.6. Mergers and acquisitions must be strictly controlled as, once approved, it is difficult to reverse the anti/competitive results: more cooperation both informal and formal, could be developed between competition authorities to ensure that the right decisions are taken and the cross-border competitive effects

of acquisitions are properly addressed. However, at the same time the competition authorities in approving mergers need to take into account the business implications of their decisions and avoid purely legalistic and formalistic rulings. Knowledge of business, its structures and pricing strategies are important areas for more training, as these aspects are critical in making effective decisions on merger approvals.

72.7. A network of competition agencies from the region could be usefully established to exchange experience and information. The competition authorities are addressing similar problems and there should be scope for regular follow-up at international and regional levels. It might be considered useful for competition agencies to develop close institutional ties that could involve the exchange of personnel (i.e. what is often referred to as “twinning”). There are various international, regional and sub-regional bodies that could take on such a role.

72.8. It is important in this regard that the experience of the competition authorities in central Europe, which now operate like competition authorities in established market economies, be used to help the CIS competition authorities. Linkages could thus be made between Czech Republic, Estonia, Hungary, Poland, etc. and individual CIS competition authorities and these central European bodies should be responsible for channelling more technical assistance and other resources into these authorities in order to resolve some of the critical challenges which the CIS faces

72.9. Depending upon the availability of resources, some expert seminars could follow up the Forum, hosted by central European competition authorities. Proposed subjects could be: regulation of the public utilities; State aids; public procurements; competition and FDI; and the role of judges in anti-competitive cases.

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