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## Decentralisation - the enforcement of competition policy in the candidate countries

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# The Enforcement of Competition Policy in the Candidate Countries

The policy of competition development constitutes an important element of the transformation of the economy in the candidate countries, which are constructing their market economies after almost fifty years of central planning. This process requires a new legal system adequate for market economies. That is why all the candidate countries apply competition law or, precisely speaking, a legal system for the promotion and protection of competition consisting of regulations concerning anti-competitive agreements (vertical and horizontal), restrictive business practices, merger and acquisition (M&A) control, unfair competition and state aid.

A distinctive feature of the candidate countries in comparison to the mature market economies of the EU Member States is that they not only need to protect competition but first of all to promote it during the economic transformation. This justifies the significance of competition agencies for the economic policies of the governments in the candidate countries. A pro-competitive economic policy is thus a precondition for the effective enforcement of the legal system promoting and protecting competition.

## Progress by the Candidate Countries

Competition law and competition agencies were established in the candidate countries at different times. Poland was the first country to introduce these regulations and establish an Anti-monopoly Office. The experience gained during the first years of competition law enforcement constituted the basis for the adoption of new competition acts or for major amendments in the existing law. There is no doubt that these changes took place in connection with the requirement of the adjustment of competition laws in the candidate countries to the *acquis*.

Although the competition protection systems in the candidate countries are similar in their basic elements, they vary in substantive and institutional details. A comparative analysis of the main features of competition protection systems in the candidate countries is presented in Table 1. In all the candidate countries - with the exception of Hungary and Romania - competition agencies are independent

governmental agencies. In Hungary the Office of Economic Competition reports directly to the Parliament. In Romania there are two bodies that protect competition: the Competition Office, which is a government agency, and the Competition Council, which is an autonomous regulatory and decision-making body. A debate is possible on which solution offers the competition agencies a better position. The Hungarian option perhaps ensures greater independence but at the same time it limits the participation by people from the competition authority in the ongoing work of the government, which is important for shaping the direction of the restructuring and privatisation of the economy.

Regulations on anti-competitive agreements containing block exemptions are in force in five of the ten candidate countries (Bulgaria, Czech Republic, Estonia, Hungary and Latvia). In the remaining countries (Lithuania, Poland, Slovenia and Slovakia) implementing regulations are currently being drafted which shall contain block exemptions consistent with the *acquis*. In Romania a new regulation on block exemptions has been prepared and will replace the old one.

Another difference in the approaches of the candidate countries to competition rules consists in the statutory definition of a dominant position of a company on the relevant market. In four candidate countries (Latvia, Lithuania, Poland and Slovenia) a dominant position is presumed at a 40% market share level. In the Czech act the threshold is set at a 30% market share. The competition laws in the other countries do not quantify the dominant position. Provisions for counteracting unfair competition, except for the Polish and Romanian acts, are contained in a single legal act concerning the protection of competition.

There are also differences in the thresholds for notifying M&A, which vary from € 2.3 million combined sales in Romania to € 50 million in Poland. The higher the level of the threshold, the more liberal is the approach to M&A control. Statutory regulations on M&A control do not define a clear status for the competitors of the parties to a merger. For example, the Polish Law states that legal interests are held by the notifying undertaking, the acquired company, the

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**Table 1**  
**Comparative Analysis of Substantive Provisions of Competition Law**  
**in Candidate Countries of Central and Eastern Europe**

Country	Competition law			Unfair competition		State aid law & institutions	
	Agreements (block exemptions)	Abuse of dominant position	M&A (EUR m.)	In the competition law	Separate Act	Law	Agency/ Department
Bulgaria	Yes	Yes	Yes	Yes		Yes	Ministry of Finance
Czech Republic	Yes	Yes/30%	Yes		Yes	Yes	Agency
Estonia	Yes	Yes	Yes	Yes		Yes	Ministry of Finance
Hungary <sup>1</sup>	Yes	Yes _	Yes (4)	Yes		Yes	Ministry of Finance
Latvia	Yes	Yes/40%	Yes (45)	Yes		Yes	Agency
Lithuania	Yes	Yes/40%	Yes (1.5)	Yes		Yes	Agency
Poland	Not yet	Yes/40%	Yes (50)		Yes	Yes	Agency
Romania <sup>2</sup>	Yes	Yes	Yes (2.3)	Yes		Yes	Agency/Comp. Council
Slovenia	Not all	Yes/40%	Yes (35)	Yes		Yes	State Aid Commission
Slovakia	Not yet	Yes	Yes (11)	Yes		Yes	Ministry of Finance

<sup>1</sup> Competition agency reports to the Parliament. <sup>2</sup> Agency reports to the Ministry of Public Finance; Competition Council is independent body.

company which transfers its shares and/or a company disposing of its assets. Competitors may be admitted to the notification proceedings by the decision of the President of the Office for the Protection of Competition & Consumers (OCCP). However, they are not granted the full rights of a party to the proceedings, e.g. they do not exercise the right of appeal against the President's decision. Generally competitors are not allowed to participate in the notification, but their objections are taken into consideration in the decision-making process. In the European Union competitors enjoy the full rights of a party to notification, which makes the procedure more open to the arguments of competition protection.

All candidate countries have laws regulating state aid. The difference lies in the competent authority for monitoring state aid. In four countries (the Czech Republic, Latvia, Lithuania and Poland) these competencies were granted to the competition agencies. In Bulgaria, Estonia, Slovakia and Hungary this role is played by the state aid department of the Ministry of Finance, and in Slovenia there is a Commission for State Aid. In Romania monitoring of state aid has been carried out by the Competition Office, which is responsible for an inventory and reporting on State aid issues, and the Competition Council, which is responsible for the authorisation of state aid.

The regulations are new in the candidate countries and thus case law is insufficient to evaluate the effectiveness of enforcement. It should be stressed at this point that due to the requirements of the negotiations

these regulations are already in force in the candidate countries, while they do not exist in the EU Member States.

The harmonisation of competition law and the approximation of these rules in the candidate countries to the *acquis* constitutes one dimension of broader debates on the globalisation of competition protection. These debates are currently going on in the OECD, UNCTAD and the WTO. The most recent is the initiative by the International Bar Association: the Global Competition Forum. The main purpose of these efforts consists in the approximation of the legal regulations to the dynamic process of economic globalisation. It is essential in order for the global companies to avoid unnecessary high costs of cross-border operations in various systems of competition protection. This in particular applies to M&A control and may constitute a significant limitation to global capital flows. Currently, M&A control is time-consuming, and requires the engagement of large groups of lawyers and experts in specific legal solutions, as well as the case law of the countries where the M&A are carried out.

The most recent progress reports by the EU Commission - concerning the approximation of law in the candidate countries to the *acquis* - confirm significant steps forward in the field of competition law. The enforcement effectiveness of the competition agencies remains the main problem. This requires experienced staff in these agencies, for the present mainly in the area of state aid. It should be stressed

here that the European Union provides technical and financial assistance to the candidate countries, which facilitates and accelerates the process of acquisition of knowledge and experience in the field of promotion and protection of competition in the transition economies.

Competition advocacy by competition agencies in the candidate countries is extremely important. The new system of competition protection calls for its promotion among businessmen, lawyers, politicians and economic policymakers. Competition agencies' staff should participate in conferences, seminars and public debates concerning the importance of competition for economic transformation and for increasing the attractiveness of the candidate countries in the global economy. The incorporation of competition protection issues into the curricula of legal and economic studies could be treated as a positive signal. Specialist training in this field will provide well-prepared staff for competition agencies and will facilitate the awareness of the subject among management and company legal advisors. Consequently, this should result in market operations compatible with the competition rules and supporting the concept that competition is the main force for achieving greater economic effectiveness.

### **Restructuring, Privatisation, Inflation and Unemployment**

One of the main tasks of the economic transformation in the candidate countries is the restructuring of ownership (the privatisation of state-owned enterprises), product structure (the approximation of production and demand structures and the elimination of products outside the primary production line of an enterprise), assets (adjustment of the volume and structure of assets to their effective use) and organisation (adaptation of company organisational structure to the new functions).

Product restructuring was a consequence of the major changes in the volume and structure of demand in the candidate countries in the nineties. In many cases this meant a permanent decrease in the demand for particular products and thus the elimination of manufacturers from their product markets. This causes social and political problems related to growing unemployment. A negative externality of product restructuring is thus increasing unemployment, which will be discussed later in this paper.

The restructuring of assets is particularly important from the point of view of the effective allocation of

factors of production. As a consequence of the centrally planned economy the enterprises' own assets exceed the capacity which can be used effectively. This applies in particular to real property and human resources. Employment restructuring, similarly to product restructuring, also facilitates the growth of unemployment.

The data in the EBRD's "Transition Report 2000. Employment, skills and transition" indicate that in the years 1990-1999 the unemployment rates in the candidate countries increased from several to a dozen or so times. In 1990 the highest unemployment rate (6.5%) was registered in Poland. In the remaining candidate countries it was between 0.5% (Latvia) and 1.8% (Hungary). In 1999 unemployment was highest in Slovakia (19.2%), while in the other candidate countries the rate varied from 7% (Hungary) to 16% (Bulgaria).

The increasing unemployment may adversely affect the effectiveness of the enforcement of competition law in the candidate countries. In order to avoid bankruptcy many firms abuse their dominant market position, by unreasonable price increases or by imposing onerous conditions on trade transactions. Firms whose financial condition is poor but whose market and political position is strong put pressure on the government in order to obtain protection against competitive imports. Avoiding bankruptcy may lead to agreements between companies which distort competition on relevant markets. Competition protection agencies are often subject to political and social pressure when they undertake actions against dominant market operators currently experiencing financial difficulties. Similarly the penalties for anti-monopolistic practices may not be sufficiently restrictive.

Tempering the growth of unemployment through limiting the influence of competition on individual firms becomes a prerequisite for administrative decisions on the formation of holdings in selected industries, e.g. the Polish Sugar Group, Polish Coal Holding or Polish Steelworks Group. These undertakings follow the experience of the German crisis cartels founded after the Second World War.

The effectiveness of competition law enforcement in the candidate countries also depends on the level of, and changes in, the inflation rate. The higher the inflation rate the more difficult it is to counteract the pricing policies of dominant market operators. The EBRD's Transition Report 2000 shows that the inflation trends in the countries in question are shaped inversely to the changes in unemployment rates. This

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is consistent with the Phillips curve illustrating the inverted relationship between unemployment and inflation. In 1992 the highest inflation rate (1,076%) was in Estonia. The rate for the remaining countries was between 1,020% (Lithuania) and 10% (Slovakia). In 1999 the highest inflation rate was in Romania (45%) and the lowest in Bulgaria (0.7%). We may generally state that the inflation dropped down from a four-digit rate in 1992 to a two- and single-digit in 1999. Such a significant decrease in inflation allows the competition protection agencies in candidate countries to counteract effectively pricing policies applied by dominating market operators. One could also assume that - to a certain extent - the operation of competition protection agencies, in addition to monetary policy and competitive imports, resulted in tempering the inflation trends.

The above-mentioned facts show that the effectiveness of competition law enforcement in the candidate countries depends to a large extent on macroeconomic trends and the pro-competitive character of the policy implemented by the state authorities. This is an argument for the involvement of competition protection agencies in the process of policymaking and using the agencies to draft the governmental competition development programmes, which form an important element of economic policy.

M&A by both foreign and domestic investors played an important role in the restructuring and privatisation processes in the candidate countries. Competition protection agencies control these transactions and it is important that the notification procedure employs criteria which enable protection of competition but at the same time do not hinder the possibility of the formation of modern technical and economic structures.

### **M&A Presumptions in Candidate Countries**

A characteristic feature of enterprises in candidate countries (rooted in the centrally planned economy) is an extended range of products and services supplementary to their primary production activity. This resulted from the tendency to ensure self-sustainability in the insecure environment of unreliable contractors and suppliers in the centrally planned economy. Product restructuring consists of separating from an organisational structure those units which are not directly engaged in the primary production activity. They may be transformed into affiliated and/or associated companies, or be taken over by investors from similar industries.

Such acquisitions produce synergy effects, which result from the specialisation in production,

technology and marketing activities. The synergy effects arise particularly in connection with the technical differentiation of the individual stages in the value chain which take place before the concentration. The real location of the assets of the parties to the transaction usually improves the effectiveness of their use:

In addition to the aforementioned M&A presumptions, which are specific to the candidate countries, there are also some phenomena in common with the mature market economies. M&A are currently widely used for development by outside investments. Among the major presumptions of concentrations we could mention the following:

- financial,
- entering new product markets through acquisition of companies from outside the sector,
- product specialisation through taking over parts of enterprises operating on the same product market,
- improved allocation of company assets,
- strengthening market position through vertical concentrations.

Implementation of the above-mentioned M&A presumptions should not excessively restrict competition on relevant markets of the parties to the mergers or acquisitions. This however depends on how the distribution is organised. Although the high level of sector concentration facilitates the concentration of the relevant markets, these are nevertheless two separate processes. Such an approach to M&A control is essential for the decisions of competition protection agencies when they bring the notification procedures to a close.

### **Sector and Relevant Market Concentration in M&A Transactions**

The requirement for differentiation between the sector and the market for M&A control in the candidate countries results from the liberalisation of international trade (WTO, European Union, NAFTA and CEFTA). The increasing openness of product and geographical markets (relevant markets) facilitates competition development on an international and/or regional scale. The future accession of candidate countries to the Common Market will result in broadening their hitherto relevant markets. The elimination of customs barriers between the EU and the candidate countries should be treated as a presumption of a new approach to national relevant markets. From this perspective the differentiation

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between the concentration of a sector and a product market is even more justified.

### Definition of a Sector and a Relevant Market

Literature on business concentration, market research, the enforcement of competition law, and in particular the control of capital mergers and acquisitions incorporates a differentiation between a sector and a market.<sup>1</sup> This differentiation is also introduced in order better to explain and understand the factors which influence the business strategy and the process of economic globalisation.

The notions of a sector and a market are understood as "two sides of each economic system of exchange. Sectors provide supply and markets offer the demand".<sup>2</sup> Sector is defined using competencies, technologies and products manufactured using similar or integrated techniques and technology. Products manufactured by one sector may have various applications resulting from their utility, and thus a single sector may provide supplies to more than one relevant market.

Although there is no precise definition of a sector, it is assumed that it is a group of companies applying similar techniques and technology and having a similar value chain.<sup>3</sup> Thus all the companies operating in a particular sector will have similar key features: skills and competencies, technology, value adding processes and operations, raw materials, channels of supplies, distribution channels and products based on similar technology. The competitive edge of a company within a sector depends on the better quality of the above-mentioned features in comparison to other sector operators. This can be achieved through appropriate configuration and co-ordination of the key elements of the competitive edge.

Consumers and their needs define markets. Consumers are not interested in the method of configuration and co-ordination of the key elements of the competitive edge within the sector, but they evaluate the utility, quality and price of the products sold on the market. Market as a demand side of the economic

system is usually characterised by the following key factors: utility, quality and price of goods, customers (common features for distinguishable groups of customers), customer requirements (concerning the product features and the conditions of their purchases), distribution channels (availability of goods and terms of commercial transactions), competitors (manufacturers of identical goods or substitutes thereof). The competitive edge of a sector is revealed on the market where consumers purchase goods that suit them the most. A market may also accommodate competitive substitutes manufactured outside the sector in question.

Definitions of relevant market in the competition laws of the candidate countries in principle are consistent with the notions in the above quoted publications. In the Polish law a relevant market is defined as, "...product markets, which due to their intended use, price and characteristic features, including quality, are regarded by the buyers as substitutes, and are offered in the area where, due to their nature and characteristic features, barriers to entry, consumer preferences, significant differences in prices and transport costs, the conditions of competition are sufficiently homogeneous" (the Polish Law on protection of competition and consumers, Article 8, sec. 8).

### Concentration of a Sector and a Relevant Market

In the M&A notification it is essential to specify the market positions of the parties to a merger on the relevant market (product and geographical). Assuming that parties often operate on more than one market, we should speak of markets relevant for the parties to a merger.

Specification of a relevant product market requires:

- as narrow a definition as possible of a group of products which are identical or close substitutes due to their utility, quality and price;
- taking into consideration the volume of exports and imports for individual product groups.

Practically when analysing a multi-product structure of production and sales of the parties to the merger, only products exceeding 10% of the entire output are taken into consideration. In order to specify the relevant market it is necessary to analyse the volume of imports and the influence of tariff and non-tariff barriers to imports. The existing import barriers and their importance for the level of competition on the analysed markets are important for the system solutions aimed at the development of competition on the market.

<sup>1</sup> George Stonehouse, Jim Hamill, David Campbell, Tony Purdie: *Global and Transnational Business. Strategy and Management*, John Wiley & Sons Ltd., 2000, chapter 2; Yvan Allaire, Mihaela E. Firsirotu: *L'entreprise stratégique: penser la stratégie*, Gaetan Morin Editeur, Boucsgerville, Canada 1993, chapter 4.

<sup>2</sup> Ibid.

<sup>3</sup> Ibid.: "Value chain is a sequence of actions leading to the final value of a company product".

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Concentration in the sector may influence the concentration on the product markets, but this may be avoided if:

- a competitive import constitutes an important element of supply on these markets;
- distribution is organised by operators from outside the sector;
- distributors exercise strong bargaining power in relation to the suppliers from the sector.

The distribution organisation is essential for the market power of companies with a competitive edge in the sector. Distribution may be organised in the following manner:

- a company may have its own distribution channels, which strengthen its market position; the level of concentration of the product market depends on the reach of these channels: the bigger the market segment covered by the distribution channels of a single producer, the greater is its market power;
- there may be independent distributors on the market who have long-term contracts with manufacturers, often for exclusive and/or selective distribution or franchising; the greater the number of such distributors, the more probable the possibility of transferring the competitive edge from the sector to the product or geographical market;
- the distribution channels may be independent of the manufacturer, whose market power depends upon the bargaining power of the distributors.

The bargaining power of the buyers (distributors or end-users) is strengthened by the following factors:

- great number of large and powerful customers buying a particular product;
- the availability of substitutes;
- the possibility of the up-stream integration of the value chain;
- customers' access to information on the volume and structure of supply on the particular relevant market served by the sector.

The size and dynamics of the competitive imports, the organisation of distribution and the bargaining power of customers may effectively restrict the competitive advantage of the company in the sector and prevent its transfer to the relevant market. That is why the competition law in the EU and the majority of candidate countries contains regulations aimed at the protection of competition in distribution. It is particularly important because the concentration in the sectors should not excessively restrict competition on the markets.

### Barriers to Entry to the Sector or Relevant Market

There are two reasons why in evaluating the market effects of M&A greater attention should be paid to the potential competition in the sector and on the relevant market than to the competition existing in the moment of transaction notification. Firstly, the potential competition may effectively prevent the abuse of the competitive advantage in the sector and on the market gained as the result of the transaction. Secondly, the fulfilment of all the formal requirements of the transaction, including the approval from the competition protection agency, initiates the complex sequence of technical, technological, economic and organisational steps in the M&A transaction. Reorganisation, the re-allocation of assets, the approximation of the operating principles of the parties to the merger - all this requires time. The synergy effect will not appear immediately after the formal requirements have been satisfied. This may cause temporary weakening of the competitive edge of the new company or group in the sector and on the market.

Evaluation of the potential competition consists in the analysis of barriers to entry to the sector and the relevant market. The following types of barriers to entry have been distinguished:

- regulatory;
- structural;
- strategic.

The regulatory barriers consist in an obligation to obtain certificates, licenses and concessions before the production starts and the goods are marketed. They are aimed at the creation of quality and safety standards or the limitation of the number of operators on a particular market. Barriers of this type are particularly visible if the state policy favours companies already operating on the market. Many of the regulatory barriers have been abolished in the candidate countries, which was one of the major tasks in the process of economic liberalisation.

Structural barriers, also called technological and economic barriers, are related to the technology and costs of production (economics of scale), market promotion of a new product or the demand for particular products. These barriers result from:

- differentiation of products on a particular market,
- absolute cost advantage of current market operators over the newcomers,
- savings due to the economies of scale of production (services).

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Strategic barriers may be created by companies operating in the sector or on the market in order to discourage their potential competitors from entering their field of operation. The well-established businesses in the sector or on the market may undertake steps to construct the structural barriers. They may introduce pricing policy, consisting in the limitation of price rises or sales below costs in order to decrease the attractiveness of entering a particular market. They may also - using their own distribution and supply channels - close the market to the potential competitors. Actions of this type are generally deemed as being anti-competitive and are thus prohibited under competition law in all the candidate countries.

Observing the competition protection agencies in the candidate countries one could gain the impression that in many cases the concentration of a sector and a market are treated as the same phenomenon and that the analysis of the existing competition is more important than the potential one. This may result from the fact that the still underdeveloped distribution networks in the candidate countries allow for the transfer of a strong position in the sector to market domination. Moreover, it is easier to analyse current market competition than potential competition.

### Conclusions

Competition development policy constitutes an important element in the transformation of the candidate countries, building their market economy. Essential for this process is a new legal system relevant to the needs of a market economy.

Although the competition protection systems in the candidate countries are similar in their basic elements they vary in substantive and institutional details. These differences cover: location of competition agencies in the administrative structures, level of the implementation of the EU block exemptions, definition of dominant position on the relevant market, turnover ceilings requiring notification of M&A and rights of competitors to participate in the M&A notification.

The harmonisation of the competition law in the candidate countries and its approximation to the *acquis* falls within a wider debate on the need for the globalisation of competition rules. This applies in particular to the M&A.

The latest progress reports of the EU Commission on the approximation of national laws to the *acquis* indicate a great improvement in the area of competition law.

The European Union provides technical and financial assistance to the candidate countries, which

facilitates and accelerates the process of gaining knowledge and experience in the field of the promotion and protection of competition in economies under transition.

Competition advocacy by competition agencies in the candidate countries is extremely important. It should be appreciated that the issues of competition law have been incorporated into the curricula of legal economic studies.

The increasing unemployment may adversely influence the effectiveness of competition law enforcement in the candidate countries. Competition protection agencies are thus often under political and social pressure when they undertake actions against companies with a dominant market position and simultaneously undergoing financial difficulties. Similarly the penalties for monopolistic practices may not be sufficiently restrictive.

The effectiveness of competition law enforcement in the candidate countries also depends on the level of, and changes in, the inflation rate. The higher the inflation rate the more difficult it is to counteract the pricing policies of the companies with a dominant market position.

M&A has played a significant role in the restructuring and privatisation of the economies of the candidate countries. It is important to apply appropriate criteria in the notification procedure. They should facilitate the protection of competition without restricting the possible development of the modern technical and economic business structures.

Competitive imports, the organisation of distribution and the bargaining power of customers may effectively restrict the competitive advantage of a company in its sector and prevent the transfer thereof to the relevant market. Thus the competition law in the EU and in the majority of the candidate countries contains provisions protecting competition in the field of distribution. This is particularly important because the concentration in the sectors should not excessively restrict competition on the markets.

When assessing the market effects of M&A greater attention should be paid to the potential competition in the sector and on the relevant market than to the evaluation of the competition existing at the moment of notification. Reorganisation, re-allocation of assets and the approximation of operational principles of parties to the merger require time. The synergy effect will not appear immediately after the formal requirements have been satisfied. Consequently the competitive edge of the new company or group may be temporarily weakened.