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EFFECTS OF EUROPEAN COMPETITION POLICY REFORM FOR CENTRAL EAST EUROPE – AN INSTITUTIONAL PERSPECTIVE

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1. Introduction

Firms in the new member states of the European Union (EU) in Central East Europe (CEE) have either emerged from a system of economic planning (as privatised firms or part of such) or are newcomers. In any case, all firms today operate in a more or less competitive environment within the space of the enlarged European market place. Alas, their performance is still weaker than that of their competitors in Western Europe: levels of labour productivity are still much lower and only slowly catching up in Europe's East. Firms are only able to secure their competitiveness when calculating with much lower levels of labour costs than in the West. A switch in technology paired with the necessary intensity of capital deepening would be necessary to bring firms in CEE to the levels of competitiveness that allows for wages and earnings to catch up to western levels. Moreover, a comparison of total factor productivity between firms in East and West shows that the productivity gap is not only rooted in the strategic decision of firms to choose a labour-intensive production technology. Rather, inefficiencies in the allocation of resources is still prevalent at the firm-level in the East. In an earlier study, we found that enormous progress with the introduction and maintenance of the new competitive order in the then accession countries was made, but also that quite a variety of national differences prevailed (Hölscher/Stephan 2004).

From standard industrial organisation theory (the structure – conduct – performance concept) and grounded on the Schumpeterian paradigm, we can assume that intensity of competition and firm-performance are closely linked. Recent empirical literature involving firms in CEE convincingly show a positive the link between firm performance and product market competition or takes the shape of an inverted U-curve (see e.g. Carlin et al., 2003, for a literature review). Our own research indicates that next to human capital issues in general and managerial expertise in particular, the capital deepening issue accounts for a large share of the productivity gaps of firms in the East (Stephan, 2006).

The aims and objectives of this study are to answer the question whether the recent reforms in European competition policy are likely to help

improving the effectiveness of competition policy in Europe to thereby increase the intensity of competition and hence competitiveness in the East. Following this introduction, we critically review the reforms in European competition policy. Part 3 discusses the likely effects of those reforms on policy effectiveness in CEE with particular emphasis placed on their local situation and regional particularities. The final part then concludes with some critical remarks about the recent reforms and discusses the future prospects of productivity catch-up in the current environment of competition policy.

2. The reforms of EU competition policy

Traditionally, the concept for competition policy in Europe was based on the West German *ordo*-liberal model of anti-cartel legislation within the social market economy. This meant that a set of prohibitions was established in order to prevent the abuse of market power and other anti-competitive practices. These regulations were enforced by a rigorous procedure, which left the European competition agency, the directorate general for competition at the EU commission (DG Comp), as the ultimate politically independent decision-making institution, which had the sole power to e.g. grant exemptions from prohibitions where overriding economic objectives were at stake. With these powers of jurisdiction, DG Comp could operate almost independently from the European Council and the governments of the EU member states. Basically every agreement between firms was illegal until it was explicitly approved by the Commission, either in that clearance was granted, because it did not violate the codified prohibitions, or by granting an explicit exemption.

This procedure created its own bureaucracy with administrative overload and delays in decision making. Proposals for reform had previously been halted by DG Comp's fear that any step into that direction would lead to a restriction of its powers. On the other hand, the growing power of this institution became most visible when in 2001, the fines imposed exceeded with € 1,870 in one year the sum of all fines in the entire history of cartel law enforcement with the EU. It comes a bit as a surprise that DG Comp subsequently launched its own deconstruction at the apparent peak of its might. In addition, the implementation of the new modern competition policy package came on the verge of EU enlargement. The commission's official rationale was that enlargement would create even further overload for Brussels and that the burden should be shared between the authorities of all EU member states. This point will be re-visited after a brief review of the components of the modernization package.

Effective since May 2004, the EU competition policy concept has fundamentally changed with an explicit move to a more pro-active competition policy in general (EU 2004a) and the introduction of regulation 1/2003, most prominently altering Articles 81 and 82 (EU 2004b). This regulation replaced regulation 17/1962 and is widely seen as the biggest change in competition policy over the last 40 years – sometimes even referred to as "legal and cultural revolution" (Ehlermann 2000). *Prima facie* this modern concept of competition policy introduces decentralization, as the European Commission refers much of its powers to national agencies (EU 2004c).

In a nutshell, the most important components of the reform package include the setting-up of the ECN consisting of the 25 national competition authorities and DG Comp at its centre, the "more economic approach" to all aspects of competition policy, the legal exemption rule 81/3 removing the system of pre-approval of firm co-operation, and the move to pro-active investigations and sector inquiries without the necessity of prior suspicion of illegal action.

This reform has raised a significant discussion amongst experts: at the most general level, critics such as Möschel (2000) and Deringer (2000) hold that the new system may result in a loss of critical information for DG Comp. Furthermore, markets may be expected to become less transparent to third parties like competitors, suppliers, as well as consumers, and, what is even more, legal certainty for companies planning cooperation is held to be compromised (e.g. Bartosch, 2000). On the other side, Schaub (2000), an advocate of the new reform, stresses that the reform has the potential to better structure European competition policy by strengthening consultation and cooperation between the national agencies themselves and between those and DG Comp.

The spirit of modernization emphasizes a European culture of competition and draws a picture of co-operation and co-ordination, where the ECN assists both the national agencies and DG Comp. In that sense, the Commission "escapes" its own agency constraints by replacing itself by the network (where it however still assumes a leading role). By establishing close collaboration and mutual consultation between all relevant European competition institutions, Schaub (2000) holds, the ECN could potentially strengthen information symmetry, coherence of judgements, and reduce conflicts between the institutions. This in turn may reduce transaction costs both in judg-

ing cases and in dealing with complaints from economic agents. Not least, and in particular with respect to the new EU member states, the ECN may then also be expected to both raise the pressure upon national institutions to converge in their actions and may increase potentials for institutional learning.

Wilks (2005) compares this new institution with the European Central Bank's (ECB) board of governors: the 25 national agencies would cooperate with the defined goal of ensuring competition like the ECB is targeting price stability. This analogy however is misleading, as for the ECB, a system of 'one country – one vote' was introduced and obviously there is only a single currency within the Eurozone. If the power over competition policy is referred to the national agencies of the network, then the capability of practical action will be distributed asymmetrically. Next to DG Comp, the network will most likely be dominated by the strong and most renowned agencies like the UK's Office of Fair Trading, the German *Bundeskartellamt* and maybe the French authorities. We suspect that the new EU member states will be the weakest link in the ECN, because competition culture is less develop there. "Those NCAs [National Competition Agencies] are underresourced, have limited experience and expertise, face large-scale cultural and industrial challenges, and are working with inexperienced courts who are often 'illiterate' in antitrust thinking", as Wilks (2005) speculates. If this speculation turns out to be correct, the modernization package is in fact a potential threat for European competition culture and eventually the Lisbon strategy.

The second most controversial component of the reform of EU competition policy pertains to the legal exemption rule in cartel law, in which companies have to self-assess whether cooperation is legal or rather forms an illegal cartel. Previously, firms were able to request formal approval of cooperation and hence be granted legal certainty and subsequently immunity against fines. The whole system is turned around in that now companies and nation states produce a self-assessment and can go ahead with their plans as long as the NCAs do not interfere. In a nutshell: whereas in the past, all was forbidden that was not explicitly allowed, today, everything is allowed that is not explicitly forbidden. In a critical review of this reform component, Bartosch (2000) holds that this newly installed regulation significantly increases legal uncertainty: in economic terms, this may leave potentials for dynamic innovation and technological development via cooperation unused. This would be particularly detrimental for Central East Europe, as here, dynamic economic development is needed whilst companies do not have the information and historical precedence to be able to judge whether cooperation is legal or not.

The other components of the modernization package are less disputed, as in general, they give more powers to the national authorities and national courts, which now can act deliberately on their own suspicions and their informants are granted immunity (leniency programme). Also, decisions are now to be made under a more prominent consideration of economic issues such as power on relevant markets, the extent and effectiveness of entry-barriers, and dynamic economic efficiency. Rather than focussing on a pure legal application of market share thresholds, on exclusively the legal criteria for an existence of antitrust agreements, and on the sheer lawfulness of state-aid, the focus of the 'more economic approach' (as discussed by Schmidtchen, 2005) is on the economic effects of competition-related issues, including benefits of 'dynamic efficiency' at the level of the economy. In respect to state aid, DG Comp has recently launched a "public consultation on measures to improve state aid for innovation" (EU, 2005a), in which "market failures which are currently hampering the innovation process" are addressed (Kroes, 2005, p. 5). It is in particular state-aid that proves to be a problem in the case of the new EU member states (Dias, 2004, with a focus on steel-industry Lienemeyer, 2005, and on the next EU enlargement cases Casteele, 2005).

As the next step, the Commission intends to reform the state aid rules to encourage member States to contribute to the Lisbon Strategy by better focusing aid on improving the competitiveness of EU industry. This state aid action plan targets issues including more aid for R&D, innovation, and risk capital for small firms (EU, 2005b). The Commission also aims to simplify and streamline procedures, so that less aid will have to be notified, relevant rules will be easier to apply, and decision-making will be faster. This action plan will compliment the new competition and antitrust policy in Europe. This is a further reason for the relevance of the study here, as an assessment of the factual effectiveness of current practice of competition policy is a precondition for any complimentary action.

3. Institutional view of competition policy and reform in CEE

It is so far too early to empirically test whether the implementation of the modernisation

package in 2004 had a significant and unambiguous impact on the effectiveness of competition policy in the transition countries of CEE. From an institutional point of view, however, some doubts arise.

The introduction of market competition in most countries of CEE started with systemic transformation (some countries had introduced competition-related legislation already before 1990, but those laws were incompatible with the system of economic planning and were hence never enforced). The most important role model for CEE competition legislation in fact was that of Western Europe in general and the West German *ordo*-liberal model of anti-cartel legislation within the social market economy in general. This meant that a set of prohibitions was established in order to prevent the abuse of market power and other anti-competitive practices. Initially, these regulations were enforced by national competition agencies that had been newly installed or were established by converting existing departments from the former central panning administrations. In any case, the legal systems all posited that basically every agreement between firms was illegal until it was explicitly approved, either in that clearance was granted, because it did not violate the codified prohibitions, or by granting an explicit exemption.

Amongst the CEE countries that opted for the then-prospect of EU membership, the new regulations had soon to be reformed again in two steps: first to fulfil the conditions of the Europe Agreements and second to conform the provisions of the respective chapters of the *acquis communautaire*. Amongst the CEE countries, Poland, the Czech Republic, and Hungary are interesting cases in point in terms of enactment and effective enforcement of comprehensive competition laws: Poland amended its national competition law in several steps since the late 1980 and enacted the "Act on Competition and Consumer Protection" in 2000. The modern Czech Republic's competition law was first drafted in 1991 and after two amendments in 1992 was harmonized with European law with the "Act No. 143/2001 on the Protection of Competition" in 2001. Hungary also aligned its national competition law to suit the conditions of a market-based economic system already in 1990 and after four subsequent amendments enacted the so far final amendment to the "Act XXXVI on the Prohibition of Unfair Market Practices" to match the *acquis communautaire* in 2001. All three countries have installed competition agencies as politically independent offices. In fact, the officials in the then-transition countries fully acknowledged the necessary contribution that competition can make to systemic change very early on in the 1990. This is suggested by several statements made at the OECD Global Forum on Competition (see report by Kronthaler/Stephan/Emmert, 2005).

At first sight, NCAs in CEE are today well resourced in terms of budgets and staffing. And, when joining the Union, the Central East European economies were required to introduce the complete legal competition policy framework of the *acquis communautaire* into their national laws. But this is like having enacted a competition law on the books (*de jure*) and having little effect on markets (*de facto*). Staff working in the agencies needs time to catch up to the new requirements, and the most capable experts will tend to be attracted into private sector law firms and consulting firms offering several times their former salaries (and the Commission has likewise dried up the market to staff DG Comp). "This loss of quality staff may explain why there is some criticism from executives and counsel as to the quality of decisions coming out of some of the NCAs. Sometimes basic antitrust principles are not applied or an unfortunate anachronistic formalistic approach to antitrust law is applied" (Riley, 2005a). It is the set of very special particularities in the new member states that make the application of a western-style competition policy so difficult in formally socialist economies: Eastern NCAs tend to be much more burdened with work on cases related to monopolisation and state-aid which is an after-effect of the particular concentration of firms in the past and the fact that privatization of those large firms alone does not guarantee the emergence of profitable firms in a competitive environment. Furthermore, NCAs in the East are much more burdened with merger cases than their counterparts in the West due to the sheer volume of foreign direct investment that has flown into the emerging region. These burdens have had the effect that Eastern NCAs were not able to devote as much time to cartel busting and the identification of abuse of market power as would have been necessary to reach Western levels of antitrust effectiveness. Finally, NCAs in the new member states remain to establish a powerful politically independent track record to be able to vigilantly apply competition rules to the still very substantial economic activity of the state sectors (Riley, 2005b).

4. Discussion and conclusions

Will the reform package in Europe likely result in a more effective implementation of competition policy in all European countries as well

as on a supra-national level, or did the reforms mainly solve the institutional overload for DG Comp whilst overburdening national agencies and firms alike when having to self-assess the legality in light of the 'more economic approach'?

The issue of reduced legal certainty for firms remains disputed and only reality will be able to show whether inter-firm co-operation will in fact be hampered to hence reduce R&D and innovation in Europe. Whilst enterprises in the West probably have the necessary experience with economic activity in a competitive environment, firms in the new EU member states in CEE will on average not and hence have to spend more on consultancies than their competitors in the West. We may hence assume that this part of the reform package may well even further reduce cost competitiveness for enterprises in CEE.

The ECN will serve to deepen co-operation amongst NCAs and will make it easier for NCAs to fulfil their increased institutional responsibility. This will become obvious e.g. when NCAs more frequently discuss cases and acquire expertise and related experience even where cases remain at a national level. This may be particularly important for NCAs in CEE: here, the particular institutional problems may be moderated by way of close co-operation with their western counterparts and the assessment of cases in the light of the 'more economic approach' may become easier to handle. In particular, DG Comp as the network's centre acquires the opportunity to develop and more precisely define the concept of more weight to economic rationale in competition policy.

Finally, pro-active investigations and sector inquiries conducted by DG Comp for the supranational level will also serve to benefit all NCAs: experience with competition policies in assessed sectors can be shared and policies aligned across the enlarged European economic space.

In sum, the reforms appear to contain the necessary amendments to improve the conditions for effective competition policy in Europe, this in particular with respect to the specific problems in CEE. The legal exemption rule, however, may well be assessed to be less preferable in particular for NCAs and firms in CEE, because here, the necessary experience is simply not available yet there.

In so far as the European Union is geared towards converging to a level playing field in competition policy, the reform package may well turn out to be effective. In so far as the objective is to better the conditions for catching up in terms of economic development, the possible disadvantages for NCAs and firms in the East may prove the reform package to be less advantageous: this is not to say that reduced competition is the preferred option for the East; rather, all properties of competition policy should be fully understood and institutionally sufficiently backed to result in effective outcomes.

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EUROPOS KONKURENCINGUMO POLITIKOS REFORMOS ĮTAKA VIDURIO IR RYTŲ EUROPAI – INSTITUCINĖ PERSPEKTYVA

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Santrauka. Naujų ES narių bendrovių konkurencingumas mažesnis negu Vakarų Europos įmonių, tad Vidurio ir Rytų Europos (CRE) bendrovės turi jį didinti, taikydamos intensyvesnį darbą užtikrinančias technologijas. Straipsnyje bandoma įvertinti, ar tai tikrai užtikrins didesnį visos naujosios suvienytos Europos konkurencingumą, ar CRE ir Vakarų Europos įmonių kooperavimas susijusiuose sektoriuose leis sumažinti konkurencingumo didinimo kainą, pirmiausia – naujosioms ES narėms? Išsamesnis visų konkurencingumo politikos ypatybių supratimas turėtų padėti pasiekti efektyvių plėtros rezultatų.

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