Competition policy in times of crisis

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INTRODUCTION

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1. Times of severe economic crisis bring about a severe questioning of market mechanisms with unfailing regularity. The Great Depression is the most telling example, as countries, one after another, resorted to protectionist policies, which further aggravated the crisis. However, beyond international trade, the rejection of market mechanisms also affected competition policy. In the country where it could be believed to be most deeply entrenched – the United States – it was briefly reversed by President Roosevelt through the enactment of the National Industrial Recovery Act in 1933, until the Supreme Court reversed these policies in 1935 and widespread public resentment against the high prices charged by government-sponsored cartels led to a complete policy reversal in 1936, with the enactment of the Robinson-Patman Act.

2. In theory, the case for a temporary softening of competition policy in extreme crisis times is not completely unfounded and it would be a mistake to ascribe this temptation exclusively to a poor understanding of economic mechanisms. For instance, it has sometimes been argued that in times of crisis, the degree of uncertainty faced by firms compels them to adopt highly flexible technologies, which are not the most cost-effective. According to some authors, cartels may in some circumstances allow stabilise firms’ environment and thus stimulate the adoption of less flexible more efficient technologies, thereby increasing total output.¹ The real test is therefore an empirical one, in order to measure which of the output-reducing or potentially output-increasing effect of crisis cartels dominates. An answer can be found in a recent econometric study of American industry at the beginning of the New Deal: according to the economist Jason Taylor, Roosevelt’s forced cartelisation policy caused output to fall and delayed recovery.²

3. Current challenges are somewhat different, especially in Europe where the branch of competition policy most strongly challenged by the crisis is State Aid control, especially in the financial sector. The European Commission can be commended for treading a fine line between the rigorous enforcement of the relevant provisions of the Treaty and the need for flexibility and a speedy treatment of the most urgent cases. Still, the various cases of aid to the banking sector cast light on the possible tension between the purported goal of State aid control, i.e., avoiding market distortions, and the need for aid to be efficient by preventing a collapse in the flow of credit to the economy. This tension is reflected in some of the early Competition decisions (such as Northern Rock) in which aid beneficiaries commit not to increase the volume of their loans above a certain threshold.

² Taylor (2002).

*The views expressed are those of the author and do not necessarily reflect those of DG COMP or the European Commission.
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In the past, times of severe economic crisis regularly led to the weakening of competition policy. In retrospect, this reaction appears to have deepened the crises it was meant to alleviate, at least in the United States at beginning of the New Deal. This precedent suggests that a backlash against competition policy would be a wrong answer to the current challenges, even though exceptional economic conditions call for flexibility and adaptations. This set of three articles addresses competition policy in times of crisis. Andrea Amelio and Georges Siotis describe the European Commission’s handling of competition cases in the current unusual circumstances. Antoine Winckler and François-Charles Laprévote focus on State aid, and Carlos Winograd tells the story of the long-lasting negative impact of the Argentinian crisis of 2000 on the nascent competition policy.
The following pieces shed light on different issues raised by the adaptation of competition policy to severe economic crises. The paper by Andrea Amelio and Georges Siotis, from the Chief Economist team at DG Competition, provides the Commission’s view on its role in these exceptional times. The evolution of the European Commission’s handling of State aid in the financial sector is analysed in Antoine Winckler and François-Charles Laprévote’s paper. Finally, Carlos Winograd’s paper on the Argentinian case shows that the idea of a temporary softening of competition policies during crisis times, followed by a swift return to normal enforcement once the crisis subsides, might be illusory. As the Secretary for competition and consumer affairs in Argentina, Carlos Winograd played a decisive role in developing competition advocacy and competition policy shortly before the financial crisis shattered the Argentinian economy in 2000. As his article explains, the ensuing weakening of competition policy was all but temporary and it resulted in a lasting decline in the competition culture that had been developed – at the cost of a lot of effort and political capital – in the previous years. Carlos Winograd’s article can thus be seen as a reminder of the need to preserve competition policy even in difficult times, even if it needs to be adjusted to changing circumstances.

References


**APPLYING EU COMPETITION RULES DURING TESTING TIMES: SOME ISSUES**

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1. Economic indicators point to a deep and protracted downturn. As often in times of a deep recession, some have called for a temporary suspension or softening of competition rules. The story is roughly that harsh economic conditions lead to business failures and lay-offs and that relaxing competition rules would give companies some breathing space until the good times return and could also allow firms to orderly re-structure. The wisdom of this policy is particularly strong, it is argued, when the recession is triggered or at least concomitant with a financial crisis as funding for the real economy may dry out, even for viable concerns. Under these circumstances, it might indeed be tempting to think that allowing firms to earn rents through the excuse of market power or granting them state support in circumstances that would otherwise not be allowed would have to be part of a solution.

2. However, relaxing competition rules will reduce the discipline of competition as a triage mechanism between efficient and inefficient firms, impeding necessary adjustment. A downturn requires firms to adopt and change and competition will provide adequate incentives for this to take place. In addition, relaxing competition rules by transferring rents to firms will depress consumers’ purchasing power. This might ultimately delay recovery and resumption of trend growth. As discussed below, past experience indeed provides important insights in this respect.

3. That is not say however that the competition rules should not be implemented with due regard to the relevant features of the current economic environment. As discussed below, state aid rules in particular need to take into account market failures that are specific to the financial and economic crisis. Periods of recession also call for strengthened enforcement towards cartels and exclusionary conduct.

4. This short article thus argues that while relaxing competition policy during a crisis would be counterproductive, existing rules can and should be implemented in light of the specific circumstances of the financial and economic crisis. We discuss state aid, merger and antitrust rules before turning to the issue of whether banking might require a specific competition regime.

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I. State aid

5. Member states can be expected to ignore the consequences of state support that will take place outside their national borders. In the presence of negative spillovers across countries (such that for instance recipients of aids become more competitive against foreign firms), one can anticipate that independent decisions by member states will lead to an excessive amount of aid. The purpose of the EU state aid control is then to allow States to intervene when pursuing well defined objectives of common interest while avoiding distortions of competition, in particular when these distortions occur in other members states. Objectives of common interests can be considered either in terms of equity or efficiency and the Commission has operationalized this approach in terms of a balancing test. Regarding efficiency, the analysis is formulated in terms of the identification of market failures that can be addressed by state actions so that the benefits in terms of the alleviation of market failures can be balanced against distortions of competition.

6. In the current context of plummeting growth and increasing unemployment, there may be a temptation to sustain firms indiscriminately through State support. There is a risk however that injecting public money to sustain concerns that have no viable future in their present form would represents a waste of taxpayers’ money with no associated long-term collective benefits. The support of firms in difficulty will also lead to distortions of competition; first, the provision of aid will involve some moral hazard. The recipient’s incentive to compete and improve efficiency will be impaired as it might expect that state aid will be provided again in the future in case of difficulty. Second, incentives of competitors will also be affected as rents in the markets are allocated by state support rather than business decisions and managerial efforts.

7. Artificially maintaining firms active can indeed have disastrous consequences. The Japanese experience of a long and protracted “L shaped” recession can be directly traced back to the existence of “zombie” banks undertaking “zombie” lending (Caballero, Hoshi, and Kashyap (2008)). Large Japanese banks often engaged in sham loan restructurings that kept credit flowing to otherwise insolvent borrowers, the so-called “zombies”. This had the effect of dampening the adjustment that would occur under normal competitive...
conditions, namely that the “zombies” would have shed workers and lost market share. This led to congestion created by the zombies, reduced the profits for healthy firms, which discouraged their entry and investment. Empirical evidence indicates that “zombie-dominated” industries exhibited more depressed job creation and destruction, and lower productivity. Allowing State support to non-viable concern would create industries plagued by “zombies” at the cost of taxpayers and employment growth; this would only serve to push the onset of recovery further into the future.

8. However, some targeted state support could be appropriate in the presence of significant market failures and there are at least a couple of features of the current financial and economic crisis that may warrant attention from that prospective.

1. Rescue and Restructuring for financial institutions

9. The failure of financial institutions might involve significant systemic effects associated with negative externalities so that the social cost of a bank failure much exceed its private cost. The negative externalities of a bank failure (or the anticipation of it) arise through various channels. First, as banks have extensive exposures to one another, losses of one bank will be borne by other banks (in case of failure or through a reduction in the value of their debt), the position of these banks may in turn be weakened and trigger losses for their own creditor banks. Losses can spread directly through interbank exposures or indirectly through guarantees, credit lines, or insurance against credit risks (Credit default swaps, or CDS) that are being drawn and called. Second, pure informational contagion can arise such that the failure of one bank leads to an adjustment in the expectations regarding the viability of other banks perceived to be similar (even in a simplistic sense).

10. The development of negative externalities across banks is also subject to amplifying dynamics. What can initially appear to be exogenous risk triggers some reaction among banks which generates endogenous risk. To illustrate, following the realization of losses on its assets, a bank may attempt to reduce its leverage and indeed will often be compelled to do so by capital regulation. It will thus sell securities which might trigger a fall in the price of these securities, thereby inflicting a new round of losses on securities portfolios of other banks and generate the need to deleverage further. Alternatively the bank can reduce its leverage by restricting its credit to the real economy, which increases the probability of default of all other borrowers in the economy, again inflicting a new round of losses on their credit portfolio and a similar downward spiral. Note that these kinds of dynamics also apply that actions that ensure the soundness and viability of one bank (micro-prudential measures involving capital requirements for instance) may actually not enhance the viability of other banks or that of the system as a whole, so that micro-prudential measures may conflict with macro-prudential measures.

5. A prudent shedding of exposures from the point of view of a bank in difficulty may be a withdrawal of funds from the point of view of another bank. When a bank faces a credit loss that depletes its capital, a microeconomic prudent course of action is to reduce its overall exposure, including the lending to other banks. As a result, the other banks face a withdrawal of funds and need to find alternative funding or reduce its asset holdings in turn (curtailing lending or selling marketable assets).

Larry Summers (2000) already captured the intuition in a famous thought experiment delivered at the 2000 AEA conference: “Imagine that everyone who has invested USD 10 with me can expect to earn USD 1, assuming that I stay solvent. Suppose that I go bankrupt, investors who remain lose their whole USD 10 investment, but that an investor who withdraws today neither gains nor loses. What would you do? […] Suppose, first, that my foreign reserves, ability to mobilize resources, and economic strength are so limited that if any investor withdraws I will go bankrupt. It would be a Nash equilibrium (indeed, a Pareto-dominant one) for everyone to remain, but (I expect) not an attainable one. Someone would reason that someone else would decide to be cautious and withdraw; or at least that someone would reason that someone would reason that someone would withdraw, and so forth […] Now suppose that my fundamental situation were such that everyone would be paid off as long as no more than one-third of the investors chose to withdraw. What would you do then? Again, there are multiple equilibria: everyone should stay if everyone else does, and everyone should pull out if everyone else does, but the more favourable equilibrium seems much more robust. […] I think that this thought experiment captures something real. On the one hand, bank runs or their international analogues do happen. On the other hand, they are not driven by suppospsite; their likelihood is downed and determined by the extent of fundamental weaknesses.”

6. Evidence that, in times of crisis (economic or otherwise), attempts to generate the need to deleverage much easier to be e

7. This is an issue of equilibrium selection in coordination games. If new information arrives which increases aggregate uncertainty (i.e. a larger dispersion of risk, not a lower expected value in the good equilibrium), then panic equilibria can arise without changing anything in terms of the expected value of the fundamental. Although expected viability of the system is not changed, bad equilibria suddenly become much more attractive for individual depositories from the point of view of strategic uncertainty, i.e., payoff uncertainty seems to create strategic uncertainty in some class of coordination games, leading to a higher likelihood of inefficient equilibrium selection.

3 See Global Competition Policy, December 2008 issue. The latter provides ample evidence that, in times of crises (economic or otherwise), attempts to suspend or relax competition rules are a knee-jerk like reaction.

4 Note that the empirical literature shows that leverage even behaves p
cyclical for investment banks and investment banking arms of universal banks (Adrian and Shin (2009)). This implies that the leverage does not only return to its original level after a loss has been absorbed, but falls below its initial level. Allowing for the fact that lower leveraging may be justified by an exogenous shock, this observation is consistent with the view that banks may actually overreact in their adjustment, which reinforces the downward spiral even more.
12. Hence, targeted support for banks in difficulty might be attractive as a way of alleviating market failures and achieving financial stability. However, these benefits have to be balanced against distortions of competition. Indeed, the rescue of banks (or more generally the support of banks in difficulty) might have the effect of protecting the providers of funds (owners and creditors) and the bank managers from the consequences of past (excessive) risk taking. This in turn raises the issue of incentives from the perspective of moral hazard for the recipient of support. Indeed, the rescue measures might strengthen the expectation that insurance will be provided in future cases of distress and provide renewed incentives for excessive risk taking. Measures aimed at financial stability should thus be designed so as to mitigate problems of moral hazard. The rescue (or support given to banks in difficulty) also affects competitors directly and distorts their own incentives to compete. Indeed, if banks that have not indulged in excessive risk taking observe that their competitors are bailed out, incentives for appropriate risk taking will be further impaired.

13. Many financial institutions (FIs) are too big to fail (TBTF) or too interconnected to fail (TITF) and therefore require public support in the current crisis, as the existence of systemic effects results in the social costs of failure greatly exceeding the private costs to shareholders and creditors. While accepting the need for intervention, it is important to minimize distortions of competition. As discussed above, this involves reducing moral hazard and making sure that state support is kept to the minimum so that competitors’ incentive to compete are least affected. Particular attention should also be paid to distortions of competition taking place across member states.

14. The Commission has thus provided some guidance regarding the most common support measures to the banking sector, namely guarantees, recapitalization and the treatment of impaired assets. This guidance involves in particular indications on the pricing of guarantees and recapitalization schemes that the Commission would consider adequate according to a number of parameters including the risk profile of the recipient, the type of instrument used and the time profile of the pricing scheme (so as to induce termination of government involvement). The Commission has also drawn a distinction among distressed banks between those that are in distress because of a defective business model and those that happened to be distressed because of the systemic effects, while pursuing a fundamentally sound business model. Mandatory restructuring is imposed on the former and the restructuring plans can be designed in such a way as to address problems of moral hazard and distortions in the incentives to compete for competitors.

15. In particular, restructuring plans need first to ensure that there is a private contribution to the coverage of the restructuring costs so that past losses can be supported by the owners, creditors, and managers of the entity receiving support, to the extent possible. Second the plans need to ensure the long term viability of the bank and third, might involve some compensatory measures aimed at reducing effects on competitors.

16. In principle, effects on competitors might not be as much of a concern for financial firms as it might be for commercial enterprises. In the latter case, competitors are normally hurt by the rescue, as they would otherwise have faced less competition. Compensatory measures involving asset disposals and/or capacity reductions can then reduce the extent of the distortion of competition imposed on competitors. For financial institutions, the rescue might actually benefit competitors because of systemic linkages. As a result, compensatory measures that benefit competitors may be less of a concern.

17. Since the beginning of the financial crisis, the Commission has taken about 50 decisions. Half of those concern support schemes and the other half individual banks. In a number of instances, the Commission has imposed modifications of the original plans in order to reduce distortions of competition and ensure a level playing field across member states.

18. Given the extent of the financial crisis and the scope of state support, one can still wonder whether specific regimes which grant extensive rights to an administrator to deal with distressed financial institutions may not be desirable in member states. Some of them have recently adopted these regimes but they have been little used so far. The implementation of these early intervention mechanisms can potentially alleviate the dilemma between fully fledged bankruptcy à la Lehman and a bail-out at taxpayers’ expense. These instruments allow for dealing with systemically important institutions without endangering financial stability. They also prevent minority stakeholders from impeding prompt and orderly restructuring of the distressed institution.

2. Credit flow to the real economy

19. As a consequence of the crisis in financial markets, banks have become much more risk averse than in previous years, and as a result much less willing to provide financing. This tightening of credit conditions not only affects weak companies, it can also affect healthy companies which find themselves facing a sudden shortage or even unavailability of private funding, whether loans or risk capital. These heightened perceptions of risk by financial institutions are all the more problematic since these perceptions may become self-fulfilling: lending dries out because the risk of default is perceived to be higher, which in turn leads to actual bankruptcy of initially sound undertakings and a higher perception of risks. Given what can be seen a temporary mispricing of risk and potential coordination failure, state support addressing these market failures may thus be appropriate.

20. As a consequence the Commission, adopted in December 2008 a “temporary framework for State aid measures to support access to finance in the current financial and economic crisis” (the “temporary framework” or TF) in response to the growing effects of the crisis on the real economy. The adaptation of rules contained in the TF target the specificities and the expected temporary nature of credit tightening.

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8 The idea of bank deleveraging through a partial swap of junior debt into equity may make sense from a state aid control perspective, as it minimizes moral hazard and keeps the state aid to the minimum, but the effects on financial stability are unclear. Hence the need for the different institutions involved to cooperate in these circumstances in order to achieve the appropriate calibration of policy measures.

21. In addition to specific initiatives related to “Green Products”, the TF focuses on the provision of finance to the real economy and the new measures explicitly aim to tackle the current dysfunctional nature of credit markets.

22. More specifically, the temporary framework allows Member States to provide the following types of aid:

- Aid in the form of subsidised interest rates. In particular, the Commission has recognised that interest rate reductions by Central Banks are not adequately reflected into medium and long term interbank rates. The Temporary Framework therefore allows Member States to grant loans whose interest rate consists of the sum of the central bank overnight rate plus a premium equal to pre-crisis spreads between interbank rates and overnight rates, plus a credit risk premium corresponding to the risk profile of the recipient with premia calibrated on those observed pre crisis (as stipulated by the Commission Communication on the revision of the method for setting the reference and discount rates).10 This allows States to provide loans that have been constructed on the basis of pre-crisis conditions in credit markets.

- A lump sum of aid up to €500,000 per company for the next two years which can cover investments and/or working capital. By introducing this possibility within the temporary framework, the Commission has considered that the potential distortion of competition that it may create will be compensated by the positive effects of the measure in the common market. That is, to facilitate a direct and non-bureaucratic access to finance for companies, in particular SMEs, in a period of financial and economic crisis.

- Subsidised guarantees for loans at a reduced premium. The guarantee can cover up to 90% of the loan and it may relate to both investments and working capital loans. Member States can grant a reduction of up to 25% of an annual safe-harbour premium11 to be paid for new guarantees in the case of SMEs and 15% in the case of large companies.

II. Cartels

23. A consistent framework in order to evaluate the impact of downturns (and demand cycle) on the ability of companies to collude has been developed in the economic literature. However, the results do not point towards a clear-cut prediction. Results are sensitive to the modelling of the demand evolution and the inclusion of firms’ decisions on capacity. Thus, the question of whether collusive prices move with or counter to demand business cycles remains a matter of debate.13

24. However, a collection of case studies suggest that during periods of recession, there is an increased tendency for companies to enter into collusive agreements (see Stephan (2009) and OFT (2005)). French Beef, Auctions Houses, German Banks, Carbonless paper, to name a few, are all cartels that were formed during downturns. From firms’ perspective, cartels might be attractive as they allow competitors to ultimately avoid the risk of bankruptcy by dealing with unexpected drop in demand and resulting industry’s excess capacity. Thus “crisis cartels” might arise as a response to the adverse conditions. The likely enhanced attractiveness of collusion during downturns suggests that it would be unwise to relax competition enforcement on that front.

25. Furthermore, from a behavioural point of view, economic downturns might distort the attitude of business people with regard to competition infringements. More precisely, business people might be faced with the risk of losing job or becoming insolvent and this, in turn, might increase the willingness to explore a broader range of options to guarantee profitability, including price fixing. Thus the likelihood of creation of a cartel might be enhanced by this modified attitude which might be common among business people, contributing to align incentives and facilitating the identification of shared focal points. In addition, the expectation of brighter prospects seems to cement the agreement by reducing the incentive to deviate.

26. Past experience is also a useful guide. The pitfalls associated with lax anti-cartel enforcement have been identified during the last great economic downturn. President Roosevelt’s New Deal has been lauded for its contribution to end the Great Depression. However, some measures undertaken under the broad umbrella of the New Deal were counterproduct and delayed the recovery. Recent research has shown that elements of the New Deal that relaxed competition rules delayed the recovery (Cole and Ohanian (2004)). The policies were contained in the National Industrial Recovery Act (NIRA), which exempted industries from antitrust prosecution if they agreed to enter into collective bargaining agreements that significantly raised wages. By impeding adjustment, these exemptions from antitrust rules may have delayed recovery by years. These policies also led to higher prices, hurting final consumers. The main lesson learned from the Great Depression is that anti-slump policies that prevent price adjustments are counterproductive; necessary support to demand and output should not interfere with competitive price setting.

27. President Roosevelt later recognised that suspending antitrust rules had been counterproductive. In the late 1930’s, he stated that: “the American economy has become a concealed cartel system. [...] The disappearance of price competition is one of the primary causes of present difficulties” (quoted in Hawley (1966, p. 412)).

10 Available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52008XC019(01):EN:NOT

11 The safe harbour premiums for SMEs can be found in: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52008XC062(02):EN:NOT


13 For instance, the inclusion of serial correlation in the evolution of demand (i.e. high demand today creates expectations of a high demand tomorrow and a low demand today generates expectations for future falls, like in a cycle) and the hypothesis that expected demand realization is what matters in cartel stability allow Haltiwanger and Harrington (1991) to rebut the result of Rotemberg and Saloner (1986) that collusive outcomes are more stable in periods of falling demand.
III. Mergers in the financial industry

28. This section focuses on banking mergers, as the specificities of the financial industry have been invoked to argue for a relaxation of merger control. In particular, the argument is sometimes made that anti-competitive rents could be a substitute to State support for banks experiencing distress. Relaxing merger control might, in particular, be considered an appropriate tool to shelter banks from distress. For instance, anticompetitive mergers would allow banks to generate rents that would cushion them from adverse shocks, thus reducing the need for State support. Such policy would appear misguided for a number of reasons.

29. First, it may not work. Whereas State aid provides immediate support, monopoly rents might take time to materialize. Net benefits for the merged entity are also uncertain. Empirical studies of banking indicate that the minimum efficient size is reached quickly. Given the size of most FIs, and in particular the distressed ones, mergers would not deliver the gains derived from economies of scale, as the latter have been exhausted. One should be equally skeptical about the potential benefit from exhausting economies of scope. Indeed, the current turmoil is partly due to the fact that Chinese walls to keep distinct activities clearly separate have shown to be ineffective, leading to lack of transparency, agency problems, and conflicts of interests. Thus, in appraising mergers, it should be borne in mind that Chinese walls are either ineffective, or, if they can be effective, then there is no room for scope economies. Thus, a merger can not be defended by a combination of Chinese walls (for prudential purposes) and efficiency claims based on economies of scope.

Second, the duration of the stream of monopoly rents that would accrue from allowing an anti-competitive merger is potentially unlimited. By contrast, State support can be designed to be temporary and non recurrent (within the limits of governments’ ability to commit). It can also be tailored to the specific problems of the bank in distress.

Third, lax merger control would plough the seeds for future systemic crises by contributing to create FIs that are TBTF or TITF.

Fourth, merging weak entities with the hope that a stronger one would emerge as result has proved elusive even in the best of cases. Recent research on Japanese bank mergers that took place during the late 1990’s and early 2000’s indicates that the resulting entities did not turn out financially more robust (Harada and Ito, 2008). These findings are consistent with a view that a primary objective of a merger was to take advantage of the perceived too-big-to-fail policy, rather than to pursue radical restructuring.

Finally, while state aid can be made contingent on financial and corporate restructuring, lax merger control is a license to extract monopoly rents without condition. Rewarding mismanagement by the right to exercise market power would compound problems of moral hazard.

IV. Abuse of dominance: Financial predation

30. A recession period can be expected to increase the overall fragility of companies’ balance sheets and increase the need for outside finance. However, not all the companies are likely to be affected in the same manner. Companies’ intrinsic heterogeneity in terms of financial structure is such that some companies are likely to be in a more fragile condition than others and thus more prone to exit. Companies with more favourable access to finance, in particular large companies for which the asymmetry of information may be less severe, can thus take advantage of the situation and tip competitors toward the verge of bankruptcy.14 Such effects may be exacerbated in the credit crunch. The current circumstances may thus provide a fertile period for exclusionary conduct.

31. Predation is likely to become a more attractive strategy during a sharp downturn as the probability of success of pursuing such strategies is enhanced. This is because downturns decrease the short term expected costs (“sacrifice”) and increase the long term expected benefit, making predation a more profitable strategy. Under these circumstances, the period of predatory behaviour is expected to be rather short. Financial weakening of the pray is facilitated leading to timely exit, which in turn implies that the predator is also suffering limited losses. Furthermore, the expectation of an end of the recession makes both the ability to recoup and the length of the recoupment period more favourable.

32. Recession periods, however, do not facilitate identification. If predatory prices are already difficult to identify in normal times, recession does not make the task easier. Separating the price effect of a sudden drop in demand from predetermination might be difficult. Furthermore, courts might be more reluctant to accept predatory price. The Australian case ACCC v. Boral 2003, 195 ALR 574 is one example. The ACCC argued that Boral’s prices were predatory. However, in the appeal, the court accepted that low prices were due to a severe recession in the building industry combined with overcapacity in the concrete masonry products industry.

33. All in all, cases of financial predation may be more likely to materialise during downturns and periods of credit crunch. At the same time, establishing the existence of an abuse is also more difficult, and thus potentially easier to challenge in court. Both elements call for enhanced, rather than relaxation of, enforcement efforts in that area.

14 The recently adopted “Guidance on the Commission’s enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings” (C(2009) 864 final, 9.2.2009) states that (paragraph 68): “If the targeted competitor is dependent on external financing, substantial price decreases or other predatory conduct by the dominant firm could adversely affect the competitor’s performance such that its supply of further financing is seriously undermined.”

Available at: http://ec.europa.eu/competition/mergers/antitrust/94/pdf
V. Competition in banking

34. In addition to a possible relaxation of competition rules in times of crisis, some observers have made the argument that a specific rule should be designed for the banking sector (see OECD (2009) for a discussion). This argument rests on the idea that the degree of competition might affect the probability that a financial institution (FI) experiences difficulties. This may arise in two ways. First, competition affects the value of bank franchises. Faced with difficulties, banks might, in the presence of imperfect monitoring by the regulators and the markets, face the choice of either strengthening their capital base or further enhance risk taking, hoping that positive outcomes will materialize (this is commonly referred to as “gambling for resurrection”). The relative attractiveness of these options depends on the regulatory framework and the scope for moral hazard (i.e., the extent to which shareholders and managers will lose in the event of failure) but also on the value of bank franchises (which would be lost in case of failures). The value of the bank franchise can be seen as the present value of the rents that can accrue from pursuing banking activities and is partly determined by competition. Intensive rivalry might reduce the number of bank franchises and increase the likelihood that, faced with a shock, banks will choose to gamble for resurrection.

35. One can cast serious doubts on the relevance of this effect in light of existing empirical evidence (see OECD, 2009). And indeed, to the best of our knowledge, neither banks nor regulators have suggested that rents in banking were insufficient in the context of the public policy debate surrounding the financial crisis. In any event, allowing for the accumulation of rents in banking for the sake of financial stability is a distant second best relative to direct ex ante prudential regulation.

36. Second, when faced with insufficient prudential regulation, competition between banks may put pressure on prudent banks even if they do not face immediate difficulties. If some of their competitors take excessive risks to generate high current profits, prudent banks may be tempted to gamble in order to maintain their ability to attract funds. But also for this second potential impact of competition on risk-taking, competition policy is the wrong instrument. First, even very lax competition policy (e.g., inactive merger control) is unlikely to eradicate the problem due to the existence of residual competition in global markets. Second, inactive competition policy would bring about unwanted side-effects. Besides the usual monopoly distortions, this policy would also create a banking landscape where “too big to fail” is the norm, thereby exacerbating the problem rather than addressing it. Therefore, if there is recognition that prudential regulation is not strict enough to prevent excessive risk-taking, the logical policy consequence is not to use competition policy to remedy this, but to adapt prudential regulation itself. This allows addressing the root of the problem without being exposed to the detrimental side effects of indirect regulation via competition authorities. In short, while situations are conceivable where competition may increase risk-taking among banks, lax competition policy would more likely exacerbate than solve the problem.

37. This short article has argued that market discipline has an important role to play in driving restructuring during periods of recessions so that relaxing competition policy during would be counterproductive. However, the note also argues that existing rules can and should be implemented in light of the specific circumstances of the financial and economic crisis.

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15 Clearly, this presupposes that the banks’ owners and depositors can not assess whether the higher returns generated by other banks originate in excessive risk-taking or whether they are simply managed more efficiently. Otherwise, prudent banks would not be benchmarked with them.
The ongoing economic and financial crisis is putting not only Europe’s banks, but also its fifty-years old institutions under unprecedented pressure. National rescue plans for banks have been put in place in emergency and with limited coordination. The regulation of EU financial institutions, a key element of the Single Market on financial services, has been found wanting. Tensions have emerged among Member States amid allegations of return to “protectionism” and reports of severe difficulties suffered by several European countries, in particular in Eastern Europe. The level and priorities of an EU budget limited to 1% of its GDP never seemed less adequate to deal with the current economic circumstances. Despite these numerous shortcomings, the European Commission, as the executive body of the European Union, has tried, in the words of its Communication for the 2009 Spring European Council, to find a common approach for “driving European recovery”.

Because financial institutions were largely at the origin of the current crisis, they were the first to have been negatively impacted and to have needed massive state interventions to ensure their survival. The figures are staggering: between mid-2007 and end February 2009, there has been a total of USD 293.7 billion in asset write-downs by European-based banks and total announced State interventions (including guarantees and liquidity assistance) in Europe had reached an estimated € 3 Trillion in April 2009, amounting to 24% of the EU’s GDP.

For the European Commission, which the EC Treaty designates as the watchman in charge of preventing an inter-State race to subsidies, State aid control has been a key tool to intervene in the financial crisis. The fact that Europe is the only regional organization to control the subsidies granted by its Member States to their companies raises the stakes even more. Since September 2008 and the intensification of the crisis following the fall of Lehman Brothers, the Commission (and the EU in general) came under pressure either to bend or to suspend the State aid rules altogether in order to pursue other imperative public policy objectives, such as the stabilization and the recovery of the European economy. In other words, the watchman was invited to take the wheel of the European economy.

This article shall examine how well the EU, and in particular the Commission, has been able to reconcile its various (potentially competing) policy objectives in its handling of financial institutions pursuant to State aid rules over the last six months. It will be shown that the Commission has indeed managed, in an impressive number of decisions, to take into account other public policy imperatives while maintaining and respecting essential principles of its competition policy (I.). However, the spillover of the crisis into the real economy and the adoption of more radical state interventions are likely to put State aid control under even more pressure in the next few months (II.).

In other words, while the Commission has until today managed to clear most state aid decisions to the financial sector, it has done so on an urgency basis: most decisions will thus need to be reviewed by the Commission in the next few months. The real test is still to come and it is unclear how the Commission can continue navigating between the key objectives of saving institutions that are too big or too important to fail while saving the key competition and level-playing field principles.

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4. The authors thank the research assistance of Clare Moriarty. The views expressed are those of the authors and do not necessarily reflect those of the law firm or its clients.
I. The Commission’s reaction to the financial crisis in State aid cases: Principles and pragmatism

6. Although, in the past, State aid control was founded on the premise that competition and other public policy objectives went hand in hand in the context of a systemic crisis (1), the Commission has displayed additional pragmatism in order to adapt State aid control principles to the realities of the current crisis (2).

1. Reconciling competition and other public policy objectives in a systemic crisis

1.1. Conflict or convergence?
Public policy goals for State aid control in a systemic crisis

7. In a systemic crisis, the EU institutions in charge of State aid control and financial stability must face several imperatives. As the executive body in charge of ensuring respect for the EC Treaty, the European Commission must apply its relevant provisions on State aid, starting with the general prohibition of State aid (Article 87(1) EC) and the stand-still obligation, which renders any aid implemented before the Commission’s authorization illegal. Exceptions to the prohibition are determined by the Treaty and interpreted strictly by the Commission. In particular, Article 87(3)(c) of the Treaty allows the Commission, under certain conditions, to authorize certain interventions in favor of companies in difficulty. The Commission determined these conditions in its 1999 and 2004 Rescue and Restructuring guidelines.18

8. EU institutions, including the Commission, must however pursue several public policy goals, most of which also derive from the EC Treaty:

- The integration of the Single market is a key goal of the EU that is, in particular, embodied in the principles of free movement of services (Article 49 EC) and free movement of capital (Article 56 EC). Despite a significant amount of legislation concerning financial institutions19 and the gradual imposition of the single passport for cross-border institutions, the completion of the Single market remains, to a large extent, an unfinished project, with several sectors (from clearing and settlement to retail banking) still characterized by high national barriers.20
- Consumer protection is also an important goal of the EU, and is mentioned in Article 153 EC. Although the Directive on bank guarantees is based on a different legal basis, the idea of raising the minimal protection on individuals’ deposits during the crisis clearly stems from this wider political objective.21
- The wider goal of growth and employment mentioned in Article 2 of the EU Treaty22 is particularly relevant in times of unprecedented economic crisis. It explains the numerous initiatives (not always followed by actions) of the European institutions, from the European Council to the Commission and the Parliament, to foster “European recovery”. In the case of financial institutions, this objective may justify taking measures to avoid a spillover of the crisis into other financial institutions or into the real economy through the credit crunch, the breakdown of the inter-bank market or the loss of confidence in the banking system.23
- Finally, the stability of the financial system is at the heart of the attempts made since October 2008 to repair the world financial system, as illustrated in the EU by the de Larosière report’s proposals for financial regulation.24 However, the role of the EU remains, in theory, rather secondary to the national authorities, as illustrated by Article 105(5) EC which states that the ESBC only “contributes” to this objective next to national regulatory authorities.25

9. In addition to these goals, the EU has had to take into account two additional constraints imposed by the circumstances:

- The importance of communication: in a context of heightened market volatility, rumors or a badly handled press release may, in the space of only a few hours, effectively destroy the credibility (and the value) of a share;
- The importance of speed: the reaction of financial markets, but also of banks, and even individual households to the crisis has been much faster than in previous crises. A typical example of this is the speed with which, often through withdrawals on the Internet, certain banks in difficulty have seen their deposits basis decrease in October.

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21 See Directive 1994/19/EC and proposal by the Commission to increase from €20,000 to €100,000 the minimum protection for bank deposits, COM(2008)661, October 15, 2008 and IP/08/1508, 15 October 2008.
22 “to promote economic and social progress and a high level of employment” (Article 2 EU Treaty)
25 Article 105(5) EC states as follows, “The ESCB shall contribute to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system”.
1.2. The Commission’s decisional practice: Reconciling competition and other public policy objectives

10. A look at the decisional practice of the Commission before the crisis reveals how it managed to avoid an open conflict between these various public policy objectives. The principal assumption was that these objectives went hand in hand and could be pursued together. The Crédit Lyonnais decision provides a striking example of the defense of this convergence theory by the Commission in the case of a financial institution. The French authorities, which had poured in a massive (even for today’s grandiose standards) € 40 billion between 1994 and 1996, justified their intervention by pointing to the systemic risk that would have resulted, had the Crédit Lyonnais institution gone bankrupt. The Commission rejected this argument in the following terms: “The possibility of credit institutions which are structurally non-viable being penalized and, where appropriate, expelled from the market… is a fundamental element in ensuring the confidence of economic operators […] the objectives of competition policy and those of prudential banking policy cannot be mutually incompatible, since both are designed to achieve a common end, namely the development of a competitive, healthy banking sector.” In other words, expelling “bad apples” was (or should be) a common goal of the prudential authorities and the competition watchdog.

11. As a natural consequence of this theory, the Commission consistently rejected the requests (made, in particular, in the Crédit Lyonnais and GAN cases) to apply Article 87 (3) (b) EC to individual banking cases. This provision provides that State aid is to be deemed compatible with the common market if it is designed to “remedy a serious disturbance in the economy of a Member State.” In the Crédit Lyonnais case, the Commission justified its rejection of the application of this article on the ground that the purpose of the aid was “to resolve the problems of a single recipient, CL, as opposed to the acute problems facing all operators in an industry.” Thus, even though this rejection did not entirely close the door to the possibility of invoking Article 87 (3) (b) in the case of a systemic crisis involving all players, the Commission made it clear that this provision was not intended to prop up “too big to fail” institutions.

12. Between September 2007 and September 2008, the Commission followed the same line of reasoning in systematically refusing to examine State aid measures under the rubric of Article 87(3)(b). In particular, in three cases displaying very different individual situations and State interventions (Northern Rock, December 2007, temporary liquidity support and guarantees; IKB, February 2008, risk shield provided by the State-owned KfW; Sachsen LB, liquidity granted by State-owned Landesbanken and subsequent sale to another Landesbank), the Commission rejected the application of a restructuring plan and opened a formal procedure that lasted several months. However, these decisions are also evidence of some newfound flexibility adopted by the Commission due to the mounting crisis. For instance, the temporary authorization of the liquidity supports to Northern Rock was taken in the (then) record time of eight days.

2. Since October 2008: Pragmatism and respect of key competition principles

2.1. Displaying pragmatism – The Commission’s adaptation of the State aid rules since October 2008

13. By October 2008 and the fall of Lehman Brothers, the tension between the competing objectives of financial stability and State aid had been mounting, with open clashes between Member States on the first wide-ranging rescue plans, such as the Irish plan, and emergency rescue operations being set up over one or two week-ends, such as the Fortis rescue. In an exceptional (and, to this date, unprecedented) meeting, Heads of State of the euro area stressed, on October 12 “the need for the Commission to continue to act quickly and apply flexibility in state aid decisions, continuing to uphold the principles of the single market and of the state aid regime.” The same statement however called for the need for Member States “to act in a united manner and avoid that national measures adversely affect the functioning of the Single market and other Member States” – which corresponds exactly to the justification of the EU State aid regime.

14. Since then, the Commission has adopted three major Communications on the application of State aid rules to the current crisis (the Banking Communication, the

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27 In contrast, the ECB’s position has rather been to insist on clearly “differentialising between procedures leading to antitrust and banking supervision decisions” and on “allocating powers to authorities in accordance with their respective objectives”; see ECB Opinion CON/2005/58 of December 23, 2005 and ECB Opinion CON/2007/17 of June 18, 2007.


30 See Case NN 70/07, Northern Rock, [2008] OJ C-43/1.

31 Case C 10/2008 (ex. NN 7/2008). An Article 7(4) conditional decision was issued on 21 October 2008, which has not yet been published.

32 State aid C 9/2008 (ex CP 244/07 and ex NN 8-08) – Germany Sachsen LB, paragraph 75.

33 Summit of the euro area countries: declaration on a concerted European action plan of the euro area countries, 12 October 2008, paragraph 5, subparagraph 3 at http://www.uc2008.fr. See also paragraphs 5, 6, 8 and 10 of Presidency Conclusions of the Brussels European Council, 14/368/08, CONCL 4, Brussels, 16 October 2008.

34 Summit of the euro area countries, supra, paragraph 5, subparagraph 1.


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Recapitalization Communication and the Impaired Assets Communication. It has also adopted close to 50 decisions, including more than 20 decisions on individual rescue plans, which represents an unprecedented level of activity in the area of State aid for banks.

a. The Application of Article 87(3)(b) to a systemic financial crisis

15. The principle novelty of the Banking Communication, and of decisions following its adoption, was the Commission’s willingness to apply Article 87(3)(b) in the name of the current financial crisis and to authorize aid aiming at “remedying a serious disturbance” in the economy. The Commission has read this provision as allowing it, if necessary, to avoid the application of some of the conditions imposed by the Rescue and Restructuring Guidelines. Nonetheless, each application of Article 87(3)(b) must be examined on an individual basis, taking into account objective criteria, in particular, the evaluations of national authorities responsible for ensuring financial stability (in particular the Central Bank of the relevant Member State).

16. In practice, all authorization decisions taken by the Commission since October 2008 have been based on Article 87(3)(b).

b. Various instruments authorized by the Commission due to the current crisis

17. The Euro area summit of 12 October 2008 called on governments, central banks and supervisors to use all instruments at their disposal to solve the crisis. The Commission’s Communications and its subsequent practice illustrate the wide array of interventions that may be authorized under State aid rules:

- **Guarantees** may cover a wide part of the financial institution’s overall liabilities, thus allowing them to be refinanced when inter-banking markets are in effect shut down. Most Member states have put in place such general guarantee schemes, for instance in the UK, Germany, Ireland and France. In some cases, **ad hoc** guarantees were set up for individual institutions.

- **Liquidity assistance** was also largely used at the beginning of the crisis, usually through special liquidity lines provided by Central Banks. In the Northern Rock case, the Commission set out four criteria that could be used to distinguish State aid from other liquidity interventions of Central banks.

- **Recapitalization** might either be set up in favor of individual institutions or in general schemes.

- **The winding-up** of financial institutions (and their sale to third parties) is also a possible State intervention, in particular, if the subsequent sale is made below market price.

2.2. Maintaining the principles of competition

18. The flexibility permitted by the application of Article 87(3)(b) has not, however, called into question the main principles of State aid control, at least in principle. On the contrary, throughout the present crisis, the Commission has taken the opportunity to reaffirm the fundamentals of EC State aid law.

a. The Principle of Non-Discrimination

19. The principle of non-discrimination based on nationality is one of the fundamental freedoms guaranteed by the EC Treaty (Article 12) and the Commission has consistently refused to derogate from its application during the present crisis. Thus, in the early days of the crisis, the Commission obliged the Irish government to modify its rescue plan in order to ensure compliance with this principle. It follows that, as a general

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38 In reality the Commission shifted its approach a number of days prior to the Communication of the 13th of October, having authorized, on the 10th of October, the Danish support plan on the basis of Article 87(3)(b), see case NN 51/2008, Guarantee scheme for banks in Denmark, October 10, 2008.
41 For instance the Northern Rock or Dexia guarantees.
42 The Commission considered that the emergency liquidity assistance granted by the Bank of England did not constitute State aid as it was “secured against high quality collateral, to which “margins” ("haircuts") were applied against the risk of falls in the price of the collateral, which is assessed on a daily basis, and against a penal interest rate, which was above the rate applied to its standing facility”. Also, the measures were taken at a time when the bank did not have access to its normal resources and when it was solvent. Furthermore, the measures were taken at the Bank of England’s own initiative and were the first intervention by the authorities. See Commission Decision, Rescue aid to Northern Rock, C(2007) 6127, 5 December 2007, paragraphs 32 and 33.
rule, an aid scheme must not include nationality as a criterion for eligibility. In particular, foreign subsidiaries must, in principle, be permitted to apply.48 This is particularly important in view of the absence of an integrated, pan-European, rescue plan for banks.

**b. The Appropriateness of the Aid**

20. In order to be compatible with Article 87(3)(b) the aid must be appropriate, that is it must address the difficulties of the financial institution receiving the aid. For example, if an institution faces liquidity problems, the measure in question must aim at facilitating its access to the capital markets. In practice, despite the great diversity of measures (guarantees, re-capitalization, credit lines, loans), the appropriateness of a measure has rarely, if ever, been contested by the Commission to date.

**c. The Necessity of the Aid**

21. In applying this principle the Commission aims to ensure that the aid is strictly limited to what is necessary and that a lesser or less distorting aid would not have resolved the problem in question. Key issues examined under this assessment are:

→ the duration of the scheme;

→ the existence of contributions from the private sector or the beneficiary and;

→ the remuneration of the State intervention by the recipient, where the Commission largely defers to recommendations of the ECB governing Council.49

22. A key parameter in this assessment will be the risk profile of the beneficiary. In its Recapitalization Communication, the Commission drew a clear-cut distinction between fundamentally sound banks and banks in difficulty, the latter being subject to a more detailed assessment and harsher measures, in particular, the need to submit a restructuring plan (as provided for in the Rescue and Restructuring guidelines) within six months. As a result, most of the Commission’s authorizations granted so far have been temporary and subject to the submission of restructuring, or viability, plans.

d. The Proportionality of the Aid

23. Under this heading, the Commission can require that every State intervention be accompanied by compensatory measures in order to offset its effects on competition.

24. In general, the Commission can require:

→ Measures regulating the commercial behavior of the recipient, such as a prohibition on publicity campaigns or limits on predatory pricing practices.50

→ Limitations on the size of the recipient’s balance sheet. This restriction has been widely applied, for instance in the Danish, Irish, Swedish and French guarantee schemes.51 The Commission, however, seems more recently to have abandoned such limitations for more targeted restrictions.

→ A prohibition on behavior that would not be compatible with the objective of the guarantee. This heading can justify, for instance, restrictions on management remuneration.52

→ A prohibition on paying the dividend to shareholders other than the State. In its Recapitalization Communication, the Commission limited this restriction to the case of banks in difficulty. In most cases, however, and although it has repeatedly reaffirmed that there would be no bias against public ownership (i.e. nationalization), the Commission insisted it would favour mechanisms that encourage redemption of State intervention.53

II. Same crisis, new challenges: towards heightened tensions between State aid control and other policy instruments?

26. It has been practically six months since the fall of Lehman Brothers and the dramatic global interventions of early October. Since then, despite signs of easing on the inter-banking market, the situation has shown little signs of returning to normal. On the contrary, the financial crisis has spilled into the real economy, both in the US and in Europe, with unprecedented speed. State interventions are as intense as ever, with budget deficits forecast to reach 6% of GDP in France, 8% in the UK and 10% in the US. New plans are being

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48 It is nonetheless possible to reserve the aid to institutions having a certain level of activity in the relevant member state. See Case N 560/2008 Support for the credit institutions in Greece; case N 512/2008, DeutschlandRettungspaket für Kreditinstitute in Deutschland, Case N 512/2008, Urgent measures to guarantee the stability of the Italian banking system, Commission Press Release IP/08/1630.

49 For guarantees of less than 6 months, flat rate of 50 basis points, with an additional premium based on individual CDS spreads above 6 months. For recapitalization, the Commission’s rates of 6 to 9.3% for hybrids and more than 10% in individual cases. See Recommendations of the Governing Council of the ECB on the pricing of guarantees, October 20, 2008; Recommendations of the Governing Council of the ECB on the pricing of recapitalizations, November 20, 2008.


drawn up to cure the financial system of its toxic (or “impaired”) assets. While the Commission has had to extend its review to schemes involving the real economy, the most massive and challenging State aid files are still those concerning the financial sector. In this regard, the Commission must deal with increasing tensions between the traditional objectives of State aid control and other general policy objectives (1.). The Commission will have to take significant decisions on important technical issues, which will certainly test its political will to face the crisis while at the same time maintain the EU law (2.).

1. Increased stakes and new questions

1.1. Does it actually work? The economic imperative

27. Six months after the first massive State intervention in the financial system, the question of the effect of these interventions remains uncertain and politically loaded. Public opinion is increasingly questioning the bailout of “bankers” at the taxpayer’s expense, while each day brings distressing news of redundancies and growing unemployment in the real economy.

28. For State aid control policy, the question of the efficiency of the aid is, in theory, a core criterion of compatibility that is recalled in paragraph 15 of the Banking Communication. In its assessment of aid efficiency, the Commission has, until now, mainly focused on the capacity of aid to rescue the beneficiary and avoid a collapse that could lead to a meltdown of the entire financial system. Six months later, the goal appears to have been reached: Europe has so far averted a spectacular bankruptcy similar to Lehman Brothers, although certain institutions have been de facto nationalized (Northern Rock) or partly wound down or re-sold to competitors or private investors (Bradford & Bingley’s, Roskilde Bank, IKB).

29. A more difficult issue, both in theory and in practice, is to ensure that banks receiving State aid end up lending to the real economy. In their rescue plans, several Member States have inserted provisions compelling the beneficiaries to increase their overall lending to the economy. In theory, assessing the issue under the State aid rules is far from easy: in State aid control, the rule is rather to require from aid recipients that they reduce rather than increase capacity. The Commission’s practice in the current crisis reflects this ambivalence. The Banking Communication (paragraph 27) provides for competition safeguards limiting the size of the recipient’s balance sheet, and therefore the amount of additional loan production, although a footnote to the same provision tempers this recommendation by recalling the need to safeguard “the availability of credit to the economy notably in case of recession”.

30. In the Recapitalization Communication, the Commission went a step further and recommended the imposition of safeguards by States to ensure that the injected sums are used for the purpose of lending to the real economy. However, this objective was limited to “fundamentally sound banks”; in contrast, the Commission continued to insist that distressed banks should be subject to a restructuring plan including—presumably—production limitations.

1.2. Will it stand up in Court? The legal imperative

32. Since October 2008, and until very recently, all Commission decisions authorizing aid to banks were taken during the preliminary procedure (i.e. without an in-depth investigation, although most were taken for a temporary period of six months. Although the appeal period is not yet over for most of them, it is equally interesting to note that, so far, none of them appear to have been challenged before the Community Courts. In February 2009, a Court case in an unrelated matter, Deutsche Post/Commission, served as a reminder that the Commission’s margin for “flexibility” under State aid rules remains limited by the provisions of the Treaty and the jurisprudence of the Courts. In particular, the Court recalled that based on settled case law, the Commission is compelled to open the formal procedure when it faces “serious difficulties”.


55 Banking Communication, OJ C 270, 25 October 2008, paragraph 15: general support measures must be “well-targeted in order to be able to achieve effectively the objective of remedying a serious disturbance in the economy.”

56 See for instance the case of Aegon N.V., C(2008) 7734, 27 November 2008, where the Commission allowed recapitalization as an emergency measure, not only to support Aegon through the crisis (paragraph 57), but also to strengthen and restore market confidence in the Dutch financial sector.

57 For instance, the French guarantee scheme, in exchange for the re-financing of the Société de refinancement des activités des établissements de credits (SRAEC), provides for an obligation for each recipient to increase by 3 to 4% by December 2009 its overall financing to the French “real economy”. This scheme was considered compatible with Article 87(3)(b) in Commission Decision C(2008) 6617, 30 October 2008.

58 For instance, the Rescue and Restructuring guidelines, OJ C 244, 1 October 2004, require capacity reductions, either for loss-making activities (see paragraph 35 of the guidelines) or as compensatory measures aiming at reducing undue competition distortions (see paragraph 39 of the guidelines).

59 See Recapitalization Communication, supra, paragraphs 5 and 39.

60 See Impaired Assets Communication, supra, paragraph 5: decrease by 0.8% in December 2008 compared to November 2008.

61 Case T-388/03, Deutsche Post AG v Commission, 10 February 2009, not yet published.
in its assessment. Furthermore, the admissibility threshold for a challenge against a decision taken in a preliminary phase is lower than in the case of a decision taken after a formal procedure. The risk of numerous Court challenges to recent Commission decisions can therefore not be excluded.

33. Another legal issue facing State aid recipients is the risk of challenges before national Courts against potentially illegal aid. Pursuant to the standstill obligation under Article 88 (3) EC, aid that is implemented before its authorization by the Commission is illegal and may be recovered by national Courts. If the illegal aid is, in addition, incompatible with the EC Treaty, its recovery must be ordered by the Commission and national Courts. Thus, given the urgent nature of certain State interventions, it cannot be excluded that the standstill obligation could be invoked against them.

34. The legal issue is particularly sensitive in cases of complex M&A transactions that are implemented following, or in parallel to, State interventions. In such cases (such as Fortis, Dexia, Bradford & Bingley’s), the combined effects of the stand-still obligation and the length of the formal procedure are hardly compatible with the requirements of speed in a highly unstable market environment and legal certainty demanded by the buyer, who will usually demand a definitive decision. Put bluntly, an excessive delay in the EC authorization process might simply turn out to be a deal-breaker.

35. In this respect, the recent opening of a formal procedure in the Dexia and ING cases is noteworthy: in both cases the Commission reconciled the need for a more in-depth investigation on complex issues (such as valuation of assets covered and contents of the restructuring plan proposed) with the requirement for authorization of emergency measures (purchase of toxic assets by the Dutch State in ING; sale of the US monoline company FSA in Dexia).

1.3. What about the Single market? 
The competition imperative

36. Maintaining competition within the Single Market is at the heart of the State aid regime. However, in times of massive State aid intervention, the way towards this objective is fraught with pitfalls. This is particularly true in the banking sector, which was, and still is, characterized by numerous barriers.

37. A first issue is the handling of complaints by competitors relating to the alleged use of State funds for aggressive commercial expansion at the expense of the complainant’s market share. In the Dexia and Fortis guarantee cases, the Commission, after receiving such complaints, imposed additional behavioral constraints on the remuneration offered by the two banks on certain saving accounts. In the ING case, the Commission imposed on ING an obligation to “refrain from expansion of its business activities that it would not have pursued if it had not received the capital injection” and to “refrain from mass marketing invoking the recapitalization measure”. Although these constraints did not go as far as determining the actual rate served on these accounts, this option, as well as the option of price regulation, is expressly mentioned in the Banking Communication. In an extreme but not altogether improbable scenario, more State aid would thus result in more price regulation and, possibly, in the setting of a single reference price, which would of course be at the expense of competition.

38. An even more daunting task will be the preservation of the Single market amidst numerous and massive State interventions. Even if the Commission successfully managed to avoid the most blatant of discriminations early on in the crisis, European rescue plans remain national in nature and therefore predominantly benefit the domestic institutions of each of the Member States concerned. In the absence of a European rescue budget, the principle of “Home country regulation” turned into a principle of “Home country subsidization”. In the words of a learned commentator, “Banks may be cross-border in health, but they become national again in sickness”. A perfect example of this phenomenon was the Dutch government’s decision to take control over ABN Amro and the other Dutch assets of the Fortis group in October 2008, thus leading to a partial dismantling of one of the main cross-border banks in Europe. It is a fact that despite the historically low valuations of the sector, very little cross-border consolidation has taken place since the beginning of the crisis, with the exception of a few deals (such as BNP Paribas – Fortis). How can the Commission encourage the integrationist trend? Could, for instance, a “premium” be applied in examining a State aid case where a cross-border solution is proposed?

39. A third challenge will be the handling of nationalizations or quasi-nationalizations. The Commission’s position on this issue has evolved from simply recalling that Article 295 of the

64 See Case C-199/06 CELF v SIDE [2008], 12 February 2008.
65 For an example of an unsuccessful invocation of the standstill obligation, see the Fortis decision of the Brussels Appeal Court, R.G. No 2008/KR/350, December 12, 2009, paragraphs 78-79.
66 A indicative 18 months under Regulation No 659/1999, and in practice, due to the procedural requirements of OJ publication and third parties consultation, a minimum of three to four months.
71 See Banking Communication, supra. See, in particular, paragraph 25 which states that Member States have to take appropriate steps to ensure a significant contribution from the beneficiaries; paragraph 26 which states that the exact contribution of beneficiary banks depends on a non-exhaustive list of factors; and paragraph 27 which deals specifically with the imposition of behavioral constraints in order to avoid undue distortions of competition.
The Treaty is neutral towards the property regime in Member States to explicitly recognizing nationalization as a possible option in its Impaired Assets Communication. Indeed, the main issue in the framework of State aid control is whether the State acted as a market operator and, in case the answer is negative, whether the State intervention is compatible with the Treaty. In particular, the Commission has insisted in its earlier guidelines on sufficiently high levels of remuneration of State capital, usually in the form of specific dividends paid out to hybrid equities, as an incentive for the swift redemption of the State presence. It is not entirely clear how this policy of favouring exit mechanisms for the State can be reconciled with the “neutrality” principle. It is also not entirely clear how public ownership can, in the short-term, not give an advantage to institutions over privately owned banks (except maybe in those countries where the credit worthiness of the State is undermined by the crisis).

2. The Commission faces key tests on issues to come

2.1. The delicate issue of impaired assets

40. Over the past few weeks, the focus of State interventions on both sides of the Atlantic has turned to the much more controversial issue of the handling of toxic (or impaired) assets in the banks’ balance-sheets, that is widely seen as a key precondition for re-starting the credit flows to the real economy. Even before the wide-ranging US plan announced on March 23, several countries had announced ad hoc toxic asset plans that consisted in purchasing these assets and placing them in one or several “bad banks”, or guaranteeing their value while keeping on them banks’ balance sheets. Prior to these announcements, the Commission had already authorized much more limited schemes under the form of “risk shields” for certain Landesbanken (West LB, IKB) and a Spanish system of purchase of triple-A securities through a mechanism of reverse auction.

41. In its Communication on Impaired Assets of February 25, the Commission laid down new rules on the analysis of toxic asset schemes. A first innovation of this Communication is its proactive intent: while the Commission, in its previous Communications, had merely supported the Member States’ efforts to rescue their banks, this time it takes a new step forward by actively promoting the treatment of toxic assets and their disclosure in all European banks.

42. The Communication itself is structured around five key principles:

→ Transparency and disclosure: the Commission calls for banks to demonstrate openness as to the state of their toxic assets, if necessary by forcing disclosure. A key issue here is the valuation of the assets in economic terms, based on the DCF method. In particular, the Commission will require an extremely detailed valuation for each asset category (if necessary by vintage and by seniority group), carried out by an independent expert using a methodology approved by the relevant regulatory authorities. In principle, the transfer price should be the economic value. The amount of aid will be the difference between the transfer price (in principle the economic value) and the market value.

→ Burden sharing between the State, shareholders and creditors: the Communication recommends a first loss rate of 10%. The Commission intends to calculate the adequate level of remuneration of the asset relief scheme by reconstituting the amount of capital or risk weighted assets that have been freed up by the asset scheme and applying to this amount a level of remuneration that would be higher than for recapitalization.

→ Aligning incentives for banks to participate: the Commission recommends an enrolment window limited to six months during which banks would be able to come forward with asset baskets eligible to be covered by asset-relief measures and after which no asset relief would be possible.

→ Eligibility of assets: the Commission suggests that Member States use several asset baskets. While toxic assets stricto sensu (in particular, assets linked to the US mortgage market) could usually be considered eligible, Member States could add other categories linked to the specific situation of their national economy, as well as a “flexibility” basket of up to 10-20% of other assets.

→ Restructuring and return to viability: the Commission will require six-month reports by the intervening State on the beneficiary’s return to viability and an in-depth restructuring plan if the amount of the aid is higher than 2% of the recipient’s risk-weighed assets.

43. In its present state, the Communication leaves open a number of questions that will have to be dealt with in the Commission’s future decisional practice. In particular, given the sophistication of the products concerned, it might be queried whether the ambition of determining the “real” value of these assets (in other words of succeeding where most banks have failed so far) is entirely realistic. Secondly, it remains to be seen whether the six-month deadline proposed in the Communication to deal with the issue of toxic assets is credible. In particular, the idea that an immediate disclosure of the degree of impairment of assets is feasible without any future readjustments might be challenged by the facts. The challenge will be to reconcile the constraints of the formal

72 See paragraphs 23 and 38, as well as section 1 of Annex II.
73 Announced initiatives in Europe in particular concern ING (with a State guarantee on more than USD 35 billion of assets), RBS (for more than £ 320 billion) and Lloyds (for more than £ 290 billion).
75 This pro-active approach was repeated in the Commission’s Communication for the Spring European Council, supra, page 4, “It is time for action to break the cycle of declining confidence and unwillingness to lend… To restore confidence in the banking sector as a whole, banks with impaired assets should disclose them to the competent authorities”.
76 Discounted cash-flows.
77 At the time of this article, the Commission has applied the Impaired Assets Communication only twice, in its Dexia and ING decisions supra.
procedure that will probably be needed for this complex valuation with the Communication’s stated goal of quickly restoring the credit flows into the economy.

44. A possible solution to these issues could be for the Commission to relax the rules of the Communication (in particular on the valuation of assets) when a market-based auction of the assets has been chosen. This solution, inspired by the auction scheme announced in the US and by the position taken by the Commission on privatizations, could give some flexibility to the system as well as some incentives to the private handling of toxic assets.

2.2. Restructuring plans

45. The second difficult issue that will have to be tackled by the Commission will be the submission by several financial institutions in the months to come of a number of restructuring plans that will need to be assessed. So far, based on the information publicly available, at least 18 restructuring plans will have to be submitted to the Commission in the next few months. It is likely that many other restructuring plans will have to be submitted by beneficiaries of asset relief schemes, as the threshold used by the Commission to require restructuring plans in such schemes (2% of the risk-weighted assets) appears quite low. The Commission’s assessment will raise a number of difficult questions.

46. First, the Commission has so far contended that only “banks in difficulty”, in contrast to “fundamentally sound banks”, had to present restructuring plans. However, this clear-cut distinction has been increasingly put under pressure by the worsening of the position of certain “sound” institutions. For instance, in the case of Commerzbank, which was initially considered a “sound” bank, it seems that the Commission asked the German authorities for a restructuring plan.

47. Second, a key issue in restructuring plans is the beneficiary’s return to long-term viability. This requires a thorough assessment based on forecasts that must be based on detailed market studies and should cover at least five years. In the current economic crisis the establishment of such forecasts will probably be challenging. The requirement of pessimistic scenarios, which might be compared to the “stress tests” currently realized in the US and in a number of Member States could, taken to the extreme, lead to contradictions with the Commission’s own forecasts on economic growth in the EU and to the potentially destabilizing conclusion that most recipients should be liquidated.

48. Third, a key issue will be the one of the restructuring and compensatory measures to be taken in these restructuring plans. These measures usually consist of asset sales that allow competitors to gain market share at the recipient’s expense, thus offsetting the anti-competitive advantage granted through the State subsidy. It is however questionable whether this model may be applied in a systemic crisis, where all players might be forced to sell and few might be able to buy. In this case, the requirement for compensatory measures might lead to a further worsening of the valuation of these assets and therefore of the recipient’s financial situation. A possible solution would be for the Commission to be more flexible on the time-scale of these asset sales.

III. Conclusion

49. Six months after the unprecedented government interventions, it is probably too early to draw full conclusions on how well the European Union’s State aid regime has been able to adapt to the circumstances of the crisis and to the other political imperatives pursued by the EU’s institutions. One fact is however certain: by showing some flexibility, and even creativity, in the application of the Treaty provisions to the current crisis, the Commission has managed to avoid defaults triggering a major bank failure due to use of the State aid procedure, while maintaining the State aid rules, despite calls near the beginning of the crisis for application of the State aid rules to be suspended. The exceptional nature of the legal basis invoked by the Commission (Article 87(3)(b)) should also make it easier to revert to a more orthodox State aid control regime once (hopefully) the crisis is over.

50. In the meantime, however, huge challenges will have to be met, with the debate moving away from the rescue of institutions and towards the handling of the structural failures that caused the crisis and which may hamper the return to normal market conditions. Dealing with banks’ toxic assets and restructuring plans will be a daunting task, which the Commission will have to perform in a political climate that may turn – just as in the US after the AIG rescue – increasingly hostile to bank rescues. To meet this challenge, in contrast to the US authorities, the European executive body will have neither a budget, nor proper regulatory functions to deal with the crisis. In fact, State aid control is, in practice, the main tool at the Commission’s disposal when trying to impose a consistent way of dealing with the crisis. The very near future might test the efficiency of this tool like never before.


82 See Commission’s Guidelines rescue and restructuring of undertakings in difficulty, supra, paragraphs 17 and 35-38. Of particular interest in this regard is paragraph 35, which states that, “The restructuring plan, the duration of which must be as short as possible, must restore the long-term viability of the firm within a reasonable timescale and on the basis of realistic assumptions as to future operating conditions. Restructuring aid must therefore be linked to a viable restructuring plan to which the Member State concerned commits itself. The plan must... include, in particular, a market survey”.

83 For instance, in the Crédit Lyonnais case, the Commission required asset reductions amounting to around 50% of the beneficiary’s total balance sheet size. Requiring a restructuring of this scale would probably be impractical or impossible in the current market conditions.

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78 Or of the company owning the assets.

79 The Commission considers that an open tender is an acceptable alternative to a detailed valuation of the asset sale in order to consider that the criterion of the market economy investor is met, see XXIIIth report on competition policy 1993, 1994, p. 270. Commission Decision of 30 April 2008, 2008/719/EC, OJ L 239 Austra-Bank Bugienland, p. 32.

80 Based on information released by the Commission, restructuring plans were required in the following cases: Sachsen LB, West LB, Bradford & Bingley, Northern Rock, Dexia, Fortis (if the government guarantee is drawn), KfW, Ethias, Hypo Real Estate Holding, Bayern LB, Nord LB, IKB, Bank of Ireland, Anglo Irish Bank, ING, Aegon, SNS Reaal, Banco Privado Portugues, Carnegie Investment Bank.
ARGENTINA IN THE EYE OF A PRACTITIONER

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I. Introduction

1. For decades less developed economies confronted the major challenges of economic and social development, mainly through macroeconomic policies. For many volatile and crisis prone countries monetary stability and balance of payments management were the mainframe of the economic policy agenda. The dominant role of macro policies has also shown in most developed economies until the eighties. In the latter, macroeconomic crisis, speculative attacks on the currency and deep banking crisis did not disappear but became increasingly rare events in the economic life of these nations. This was true until very recently when the mature economies have experienced the epidemics of emerging markets life.

2. Over the past decades the dominant view on the agenda for developed and more recently for emerging economies has moved gradually from macroeconomic to microeconomic reforms. The former mainly aim at overall stabilisation, while the latter focus on the rules and institutional environment prone to foster market competition, by reducing barriers to entry and enhancing market transparency.

3. Today there is a wide consensus that market competition benefits economic performance in the long run by encouraging efficiency through productivity gains and increased incentives for innovation. Institutional design and regulatory reforms focus increasingly on fostering competition in economies where privatization has been a dominant trend as well as in countries where public ownership (control) remains an important feature (e.g. France and UE competition policy). In this framework, competition policy is increasingly understood as a set of policy instruments rather than the traditional anti-trust approach. Regulatory reform, an intensive area of policy making in the recent period, has been developed in the framework of a competition policy approach. This trend in the content of regulatory reform and practice emerges strongly in European countries.

4. Does the current financial crisis and the resulting severe economic turmoil affect these current trends? Is the recent consensus on the major role of competition policies in fostering collective welfare in question? Will the practice of competition policies in the compact of economic policy be affected? Will the political arena postpone competition policy activism and its perceived long term benefits in favour of shorter run macro suavetage cum corporatist objectives? Nowadays, when every press report on the current financial and economic turmoil highlights a new rescue package in different countries of the globe, the potential collapse of a major financial institution and the need to save a legendary champion of a particular industry, these questions seems more than timely.

5. A contagion effect of massive interventionist pressure comes from the financial sector and contaminates the defensive lobbying activity of one sector after the other? From the automobile, to steel and in due course the agricultural sector have a reasonable argument to queue for public funds? It may be argued that if financial and banking management are the source of the current disorder, being corporate, regulatory or both compounded; why should the other (productive) sectors of the economy suffer the destructive damage without state action? The most diverse arguments, going from the strategic sector approach to regional employment arguments, seem to emerge and appear potentially valid in the eye of the lawmakers? A dangerous political economy game may be detonated with uncertain consequences on social welfare.

6. Are we living the crisis of the hegemony of the market view on the organization of economic life? Is it the prominent and finally expected emergence of the massive market failure approach and the reversion of the market reform approach? Or is it more a show that robust regulation should be fostered with a particular concern on the selectivity of instruments to preserve market mechanisms? We may differentiate between the prevention of potential contagion effects of the financial sector (and interventionism to avoid over-destructive financial collapse) versus protectionist policies in favour of the incumbents of non financial sectors, in the domestic scenario or in the international trade arena.

7. Where can we draw useful lessons for these potential conflicts in the policy agenda? It has been argued that the Big Depression of the 1930s and the Japanese crisis of the 1990s should boost pessimism of competition policy activists in the face of the current crisis. In this paper we will expose the experience of Argentina, an eccentric society with a distinctive preference for chronic crisis.

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84 Non-linearities in the relationship between competition and innovation highlighted by Aghion et al. (2002) will be reviewed in the second section.

This country has entered the group of emerging economies in recent decades after experiencing one of the most impressive development stories in the late 19th century and the first decades of the 20th century. Argentina was among the 10 richest countries in the world (income per capita) in the 1920s. But Argentina is also known for its institutional instability since the 1930s: political, monetary and fiscal disorder, chronic inflation since World War Two, hyperinflation in the 1980s and early 1990s as well as recurrent speculative attacks on the currency, balance of payments crisis and debt defaults.

Persistent economic instability showed in a low growth, highly volatile output and employment, as well as in an entrenched political disorder leading to recurrent shifts in political regimes, with a succession of failed democratic experiences disrupted by ever more violent military administrations. Since 1983 Argentina experienced a democratic regime, but could not end its secular bias to economic crisis. What about competition policies in such an environment of frequent crisis with its disruptive effects of lobbying for survival, through corporate and trade union defensive practices? Furthermore, these policies are undertaken in a weak institutional set up that facilitates capture and cronyism.

This paper will present the experience of launching intensive competition policies in Argentina, including merger control, market deregulation and competition advocacy in the late 1990s and early 21st century. We will discuss a number of actions developed in an extremely short span of time and show that even in the conditions of persistent crisis, competition policy may be politically palatable, despite the defensive actions and active lobbying of powerful incumbents. But creative political economy management is not immune to the level of pressure ignited by ever increasing short term losses in the waiting for the announced (politically sold) longer term (dynamic) gains of competition policy activism.

Reversion of the leading role of the competition parties is a certain possibility. Then remains the issue of potential hysteresis concerning the future strength of the pro competition tribe and institutions for the time when the crisis recedes. This article is divided in 5 sections. The second section that follows, briefly discusses the underlying arguments that explain the trade off between short term benefits of protectionist incumbents (systematic rescue policies) versus the longer term expected welfare gains of competition policies. The third section presents a brief discussion of competition policies in times of crisis. The forth section includes a rapid account of Argentine crisis prone historical economic life. The fifth section presents the genesis and experience of competition policies in this country through a set of selected cases in the most diverse areas of the economy. The sixth section contains the conclusions.

For links between competition and development, see: Ahn (2002), Lachmann (1999) and Rey (1997).

The term innovation is used here as an indicator not only of technological change but also for the introduction of new products (Aghion et al., 2002).

In Aghion’s model, competition could finally boost innovation and growth because firms are trying to “escape competition”. This effect is more evident in “neck-and-neck” industries, in which oligopolistic firms have no competitive advantages. The point is that competition may reduce current rents faster (neck-and-neck) than future rents increase incremental profits that justify R&D expenditures in order for a firm to become a leader.

II. Competition and economic performance

1. A view from the literature

While there is broad consensus that competition increases static efficiency, there is an on-going debate on whether competition is necessary for dynamic efficiency and growth. Standard microeconomics shows the value of competition resulting in static allocation and productive efficiencies. However, one of the main contributions of competition to development is the incentive to be dynamically efficient (Bresnahan; 2001; Ellig, 2001).

Traditionally, efficiency analysis was based on static welfare comparisons (Harberger, 1954), showing that resource allocation is optimal when agents take their decisions using market information. Contestability theory (Baumol et al., 1982) showed that perfect competition efficiency results may also be attained under monopoly conditions (one firm). The key question becomes the absence of entry and exit barriers, rather than the presence of a large number of small agents.

The role and effects of competition on static efficiency has been subject to criticism, mainly based on the assumptions of perfect information (no asymmetries) and costless transactions. Vickers (1995) argued that competition under information asymmetries is far from being fully understood and that the results, typically analysed through principal-agents models, are ambiguous. If incentives are misaligned, the cost functions are not necessarily minimised and efficiency may be harmed.

Other critics focus on the relationship between competition and incentives to invest. Competition has usually been seen as an environment where economic rents disappear. In this case, it has been argued, there would be no incentives to innovate. Simple models assume perfect capital markets, so that the Modigliani-Miller theorem applies and the innovation path is determined by the total net present value of monopoly rents from innovating. Product market competition in these models is unambiguously negative.

Recent research, however, challenges these theories. Endogenous growth literature has focused on the effects of corporate governance on innovation and growth. Nickell (1996) and Blundell et al. (1999) report positive correlations between competition, productivity growth and innovation. Aghion et al. (2002) have shown an inverse-U relationship between product market competition and patenting activity in the case of UK firms. Too much competition may harm innovation as much as too little competition may do. Carlin et al. (2001), report that growth of sales is related to the number of competitors with an “elasticity of demand” indicator. Firms with competitors fighting for a market share have shown faster growth rates in sales than those with no competitors. This line of research points to more subtle effects that drive investment decisions, showing that although some decisions are positively correlated to competition, the net effect may be ambiguous.
17. In this new generation of models, innovation depends not only on future rents, but also upon the difference with pre-innovation rents (incremental profits). Elig (2001) highlights complementary views about the dynamic effects of competition: Schumpeterian, Austrian, evolutionary, path dependence and the resource view of the firm. All of these theories express basically the same idea: market power is not necessarily a consequence of anticompetitive behaviour, and concentrated markets may produce efficient outcomes when innovation, network effects and specialised resources (like knowledge) are involved.

18. These findings are at the core of the discussion in the anti-trust arena of the United States and Europe nowadays. Many authors draw attention to simple rules of anti-trust or traditional approaches about how markets work in the “new economy.” In some industries, concentration is a natural consequence of technical progress and the way competition works, so punishment could be a misleading strategy. Under certain conditions, like technology uncertainty, firms may compete for the market through network effects and externalities. Evans et al. (2001) argue that little static competition in industries could hinder vigorous dynamic competition.

19. This point may be relevant for developing countries. Concentration measures are not a necessary condition for intervention and sometimes are less relevant than most practitioners may think. Small markets and scale economies naturally admit few players. So the relevant question in terms of competition is whether there are barriers to entry or any other condition that weaken the minimum threshold of contestability in that market. Gal (2002) and Winograd (2003) discuss the case of competition policies and institutional design in small open economies.

20. There are many empirical studies linking competition with changes in productivity. Comparative case studies of selected industries in the United States, Japan and Europe (Baily, 1993; Baily and Gersbach, 1995) show that global competition with best-practice producers enhances productivity. Nickell (1996) and Disney et al. (2000) used several indicators of competition in productivity regressions and found that competition increases productivity levels and growth.

2. Empirical findings

2.1. Competition law enforcement

21. The negative impact of anti-competitive conduct on consumers and economic efficiency is difficult to measure. Some crude estimates of the overall social costs of monopolies have been made (e.g. Posner, 1975). More precise evidence is available for individual cases.

22. Cartels raise prices above their competitive level, reduce output and labour productivity. Consumers pay higher prices or forgo the cartelised products (see OECD, 2002, 2003). Resolving other anti-trust torts, such as vertical constraints and abuse of market dominance, also increases consumer welfare, productivity and innovation. For example, following the abolition of resale price maintenance for manufacturers of certain pharmaceuticals in the United Kingdom, supermarkets reduced prices by between 25 and 50 per cent (OECD, 2002). Competition law enforcement may also prevent damage caused by abuse of dominance, such as predatory pricing, exclusive dealing and tying which can deter market entry. It should be stressed that, except for cartel conduct, a case-by-case approach is needed.

2.2. Restructuring monopolies and safeguarding structural reform

23. Competition law enforcement can help restructure monopolies, bring innovations and significative price cuts. For example, in the United States the Sherman Act of the 1970s helped restructure the national telephone system. The 1984 divestiture initiative separated manufacturing, long distance, and local services operations of the US telephone system. Fierce competition may have stimulated further innovations, such as fibre optics.

24. Competition law enforcement is also a fundamental component of successful structural reforms. Co-operative behaviour or dominant positions induced by regulation will not simply disappear because of less regulation. Delivering a strict application of competition law is very important. The enforcement of competition law should apply to any anti-competitive action that can undermine reform.

25. Competition law should be applied to all sectors of the economy. Many sectors claim, however, their own particular set of competition rules or competition enforcement authority, on the grounds of their uniqueness. One should be very

89 Evans and Schalamensee (2001).
90 Competing standards in electronic services or high-tech industries seem to reflect this behaviour.
91 Competition is not necessarily a process entailing a large number of players. This issue is important as regulatory reforms have often been guided by the prejudice that “more is better than a few”.
92 Based on a sample of 676 UK firms over the period 1975-86, Nickell (1996) found strong evidence that competition (measured by increased numbers of competitors by lower levels of rents) led to higher productivity growth. Using a more recent and much larger data set of around 143,000 UK establishments over the period 1980-1992, Disney et al. (2000) show that market competition significantly raised levels and growth rates of productivity.
93 Posner estimated the social cost ratio in proportion to sales turnover in the United States around 14 per cent in medical services, 13 per cent in optical industry, 19 per cent in transport, 20 per cent in oil refinery, and 20 per cent in airlines.
94 Fourteen case studies done by competition agencies in OECD countries showed that cartel overcharges varied between 5 to 65 per cent, with the median being around 15 to 20 per cent (OECD, 2002). OECD (2003) illustrates that the international trade of 16 large cartel cases exceeded USD 55 billion. Historical studies also point to the economic damage caused by cartels. For example, in the United Kingdom price fixing was common in three-quarters of British industry until the adoption of the Restrictive Practices Act in 1956; these cartels reduced annual labour productivity growth by 0.8 percentage point (OECD, 2002).
95 The reforms led to price cuts of long distance toll and international services by 17-50 per cent during the 1984-96 period (OECD, 1999).
cautious with the introduction of sector-specific competition laws or sector specific enforcement agencies as they may adopt an approach to competition that is overly congenial to the industry’s traditional mode of operation instead of promoting the competitive regime that regulatory reform typically aims at. Sector-specific agencies may also resist the pro-competitive thrust of reform because of self-interest. Indeed, an agency whose chief purpose is to regulate an industry may have incentives to ensure its own survival by keeping regulation in place. Capture problems may also tend to emerge more frequently under these institutional arrangements. Success and failure in pro-competition initiatives highlight the critical role of institutional design and political economy arguments in the development of regulatory reforms, in particular in the relative political clout of incumbents (firms and unions) versus potential new entrants and consumers.

2.3. Competition advocacy

26. Many studies on OECD countries illustrate the positive effects of competition advocacy leading to more competition, higher efficiency, lower costs of entry and expansion, and more competitive and efficient industry structures (Ahn, 2002). The United States has been a leader in competition-based structural reform (see Annex 5.A1 for more details). Two fundamental regulatory features of the United States are the pro-competitive policy stance of regulatory regimes and the openness and contestability of regulatory processes. Will the strong institutional lobby in favour of pro-competition actions and practices survive the pressures emerging from the current crisis with the natural aversion to short run economic and social costs?

27. Economic reform based on competition enhances economic performance, resulting in gains in labour and capital productivity, and lower prices due to lower operating costs. Moreover, labour, capital and total factor productivity increased. Reforms stimulated firm restructuring which in turn also improved productivity. It favours the introduction of new technology, such as fibre optic and digitalised networks in telecommunications. It forced firms to eliminate excess capacity, as in electricity.

28. Gains in reformed sectors spill over to other sectors, either through demonstration effects or because the reformed sectors supply important inputs. Improved, unbundled, and customised services permitted customers to improve productivity. Guaranteed delivery time in transportation facilitated more efficient supplier-producer relationships such as just-in-time inventories. Development and application of sophisticated pricing, routing and logistical software in formerly regulated sectors had important demonstration effects in other sectors. And their pioneering developments reduced the costs and improved the quality of new technologies, facilitating their adoption in other industries.

29. Regulatory reform by increasing competition also improved the dynamic allocation of resources and investment, possibly also leading to long-term gains in productivity. Pro-competition initiatives in the financial sector have also improved the functioning of capital markets (in less volatile days), increasing the efficiency of investment.

30. Regulatory reforms also may have significant macroeconomic effects. They may lower prices, benefiting both business and final consumers. Lower input prices may in turn lower output prices. Lower prices and greater price flexibility in turn may have contributed to price stability. In most reformed sectors, employment has increased in the long run after initial declines due to restructuring. Moreover, employment has been reallocated to more efficient firms within the sector. Increased output and income in the reformed sectors also may raise output and employment in the rest of the economy.

III. What about competition policies in times of crisis?

31. If competition policies have a positive impact on productivity, and provide welfare gains why should we be concerned by the potential disruption of these policies? As stated in the previous section, the theoretical and empirical literature highlights the favourable effect of competition policy activism on productivity and growth, as well as on collective welfare. If certain caveats and controversies have been discussed, the general consensus is that competition has a significant positive impact in the long term. In sectors under a process of restructuring non negligible costs may emerge in the short term. We thus observe a temporal sequence of costs and benefits of competition policies, the former coming first and the gains later.

32. The political economy of competition policies should account for this temporal profile in order to maximize the success of the policy agenda. In times of deep macroeconomic crisis the short run economic and social costs for the incumbents are magnified, as well as their lobby for survival. It is certainly harder for the lawmakers and civil society to

96 Transportation deregulation in the US offers examples of sector-specific agencies applying the general competition law inconsistently. Though originally charged with ensuring competition, the US Interstate Commerce Commission and the Civil Aeronautics Board became a means for maintaining cartels. For several years after the US airline industry was deregulated, jurisdiction over airline mergers remained with the Department of Transportation, rather than the anti-trust agencies. The Department approved several combinations leading to significant market power in several city-pair markets despite vigorous objection from the anti-trust authorities. The same recently happened in the case of a railroad merger approved by a special Board within the US Department of Transportation. In Australia, the general jurisdiction competition agency is slated to become the residual “regulator”, in order to avoid the problems inherent in relying on sector-specific enforcement bodies.

97 Until the recent financial and economic crisis the pro-competition policy stance in the United States ensured that regulations are based on market principles. Regulation has usually been used to establish conditions for competition rather than to replace competition. Pro-competition policies were based on strong competition institutions. The openness and contestability of regulatory policies weaken information monopolies and the powers of special interests, while encouraging entrepreneurship, and the continuous search for better regulatory solutions.

98 In the US case, the combined size of reformed sectors is relatively small – 5 per cent of GDP – but the benefits of productivity growth in those sectors may have contributed to improvements in productivity performance in the economy as a whole.
discriminate the compounded cost of the crisis cum the transitory costs of competition policies. Furthermore, the short run aggregate costs may be politically non manageable. And the role of competition policy may then be severely questioned, the CP actions subject to stronger political interference and eventually the institutional set up may be reversed.

33. In times of financial crisis one essential issue should be borne in mind: in a nutshell crude proposition, competition practice has to account for the basic difference of the financial (banking) industry, from the other sectors of the economy. The bankruptcy of a bank due to a fundamental business mismanagement or due to a run (panic) does not affect only the institution in question. It may also produce an extensive contagion onto other originally sound financial firms, now also in risk of bankruptcy. In turn, liquidity freezes and the rest of the economy will be facing severe losses.

34. If an incumbent firm of another industry fails, its competitors will not be affected, and well on the contrary they may benefit absorbing the market left by the bankrupt player. If the firm exiting is relatively inefficient compared to the rest of the industry, the consumers may benefit from the resulting reallocation. In the case of the financial industry, a run on the banking sector may kill more efficient players as well as less efficient.

35. This fundamental difference between the financial industry and other sectors of the economy may justify state intervention and public policy may disregard relative efficiency of the financial firm. In the face of a run and the resulting liquidity crunch, a more efficient bank may face a higher risk of bankruptcy, relative to a less efficient institution, due to a temporal profile (maladjustment) of its credit flows. Furthermore, the public agencies may not dispose of precise information of the relative efficiency of financial firms in distress, and the risk of contagion with the potential costs for the rest of the economy overpower these considerations.

36. Accounting for the risks in times of crisis and the particularities of the banking industry should not deter the exercise of competition practice by the concerned agencies. In view of this, it would be better to concentrate public initiative in the resolution of the financial distress to alleviate the liquidity squeeze falling on the rest of the economy. The latter policy should be favoured relative to the desperate easing of state aid to business and the passive acceptance of anti-competitive mergers (ACM) across non financial sectors of the economy. But a reasoned degree of flexibility and political ear should be present when economic distress and social anxiety abound. Beyond the schumpeterian arguments of creative destruction and potential efficiency gains in contractions, anti-competitive initiatives will have to be discussed by the competition policymakers trying to bias the choices towards the less damaging.

37. Direct aid (DA) may be preferred to bad mergers directed to save firms due to regional concerns or arguable strategic considerations. The losses to consumers coming from anti-competitive mergers may give rise to more permanent effects (market power and rents) than direct aid that could have a transitory character. The DA may set limits in time and extract restructuring concessions from the receiving firm enhancing less distortions to the competition game. However, this favourable aspects of direct aid relative to ACM do not always prove true: very often the aid extends in time and gives incentives for the beneficiaries to invest heavily in the lobbying industry. Inefficient firms may be benefitted and efficient ones handicapped. Furthermore, a bad demonstration effect may arise inducing a contagion where one sector after the other will be queuing for public funds.

38. Political economy arguments should not be neglected in the road to foster competition policies. This is all the more true in times of deep economic distress. The winners of directed aids and subsidies are concentrated in sectors and regions and invest strongly in voicing their interest, whereas the losers tend to be more passive and their costs less visible in the short run. The battle of the competition agencies for public support is not obvious. A mandatory assessment on the competition impact of the DA or parent initiatives will be a good instrument to foster the public debate. The potential costs of anti-crisis measures (welfare losses in the longer term) may be discussed in the political arena and reach the general public. Preferred options may thus be considered.

39. But when political and social distress prevail the competition tribe should beware of crusaders inflexibility. It may put in risk the whole agenda and the institutional set up of competition policies. This is the more true in countries with severe institutional fragility. Not an easy game, but who thought it should be easy?

IV. Argentina in historical perspective: Chronic instability and crisis

40. The long period of the history of Argentina spreading from the end of the 19th century to 1930 is known as the “Golden Age”. The country showed a rapid development, regular elections even if democratic institutions were not consolidated until 1916, improving social indicators and low illiteracy, massive immigration and a high level of financial development as well as a strong integration to world markets (finance and trade). These features were the premises to promote Argentina among the richest countries in the world in these days.  

41. Nevertheless, history may teach the hard way that good initial conditions can revert into deceiving outcomes in the longest run. Figure 1 reports per capita GDP for Argentina in comparison with industrialized and emerging economies between 1900 and 2006. The picture is striking: until the 40s, the Argentinean growth was sustained and income per capita either higher or very close to the most developed economies of the time. In 1910 the income per capita of Argentina was around 25 per cent lower than that of Australia and the United States, and 20 per cent lower than the United Kingdom, the

richest economies of the time. GDP per capita was then similar to Canada, 15 per cent higher than Germany, 25 per cent higher than France, 60 per cent higher than Italy, twice that of Spain, three fold the income per capita of Japan and Portugal, and five times that of Brazil.

42. These numbers remained barely the same up to the late forties (the US diverged upwards relative to the rest), but thereafter, as shown in the figures below, these comparative economics show a fundamental change. Argentina was not able to follow the virtuous growth pattern of European and then booming countries, such as Japan and Brazil. In 2006 the income per capita of Argentina was 30 per cent of that of the United States, 40-50 per cent of that of Western Europe, Australia, Canada and Japan, whereas still 60 per cent higher than that of Brazil (against a fivefold multiple in 1910).

43. This puzzling process of relative decline has a counterpart in chronic political and economic disorder. In 1930, in the ideological mood of the European political scene, the first military coup of modern Argentina takes place disrupting democratic institutions. Thereafter 6 military coups – and a number of army rebellions – ever more violent, were undertaken until 1983 with the return to durable democracy, starting with elected President Alfonsin and regular elections for the last 25 years.

44. Military regimes will alternate with democratic ones, in the backstage of persistent monetary and fiscal disorder, chronic high inflation, balance of payments crisis, speculative attacks on the currency, debt defaults and short lived stabilization programmes. The alternance between military and democratic regimes is in general detonated by situations of macroeconomic distress. The armed forces are called to restore economic and political order, and in due course the failure in economic management opens the road to elections and the turn to a democratic time. The latter will again be interrupted by an economic crisis and the return of the military party of order.

45. A durable democratic regime and regular elections did not dissolve the bias towards economic instability of Argentina, that experienced two bouts of hyperinflation in 1989 and 1990. Table 1 below presents a summary of the main political and economic events of the last hundred years, showing intense volatility in the last 60 years.

Table 1
Political, Economic and Financial Crises in Argentina

<table>
<thead>
<tr>
<th>Date</th>
<th>Political Regimes</th>
<th>Economic and Financial Crises</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900-1930</td>
<td>Democracy</td>
<td>1912-1914 Bank Crisis</td>
</tr>
<tr>
<td>1930-Sep</td>
<td>Military Coup (Uriburu)</td>
<td>1930-1932 World Crisis</td>
</tr>
<tr>
<td>1930-1943</td>
<td>Military Regime</td>
<td></td>
</tr>
<tr>
<td>1943-Jun</td>
<td>Military Coup (GOU)</td>
<td></td>
</tr>
<tr>
<td>1943-1946</td>
<td>Military Regime</td>
<td></td>
</tr>
<tr>
<td>1946-1955</td>
<td>Democracy</td>
<td>1952 Inflation - Currency Crisis</td>
</tr>
<tr>
<td>1955-Sep</td>
<td>Military Coup (Leonardi)</td>
<td></td>
</tr>
<tr>
<td>1955-1958</td>
<td>Military Regime</td>
<td></td>
</tr>
<tr>
<td>1958-1962</td>
<td>Democracy</td>
<td>1959 Currency Crisis</td>
</tr>
<tr>
<td>1962-Mar</td>
<td>Military Coup (Guido)</td>
<td></td>
</tr>
<tr>
<td>1962-1963</td>
<td>Military Regime</td>
<td></td>
</tr>
<tr>
<td>1963-1966</td>
<td>Democracy</td>
<td></td>
</tr>
<tr>
<td>1966-Jun</td>
<td>Military Coup (Ongania)</td>
<td></td>
</tr>
<tr>
<td>1966-1973</td>
<td>Military Regime</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1975-1985 High-inflation</td>
</tr>
<tr>
<td>1976-Mar</td>
<td>Military Coup (Videl)</td>
<td></td>
</tr>
<tr>
<td>1978</td>
<td>Quasi-war with Chile</td>
<td>1981-Apr Currency Crisis</td>
</tr>
<tr>
<td>1982</td>
<td>War with the UK</td>
<td>1982-Jul Speculative Attacks</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1990-Feb Hyperinflation - Currency Crisis</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1995-Mar Currency Crisis - Bank Crisis</td>
</tr>
<tr>
<td>2001-Dec</td>
<td>Presidential turnover</td>
<td>2001-Dec Currency Crisis - Debt Default</td>
</tr>
</tbody>
</table>

Figure 1.a
Per capita GDP (international 1990 million dollars), 1900-2006

Figure 1.b
Per capita GDP (international 1990 million dollars), 1900-2006

Source: Historical Statistics of the World Economy (Maddison, 2009)
46. Table 2 reports some key statistics, such as inflation, GDP growth and financial intermediation as measured by M3 to GDP, for Argentina and the United States, from 1960 to 2005. These figures highlight a comparative view on the degree of volatility of the Argentine economy in recent decades. Three sub-periods were selected: 1960-1983, i.e. from the aftermath of a balance of payments crisis cum military rebellions until the end of the last military regime; 1984-1991, i.e. the high inflation and hyperinflation period; 1992-2005, i.e. from the last stabilization plan (convertibility plan) to the aftermath of the 2001-2002 deep economic crisis.

Table 2
Comparative figures of the Argentina and USA economy, 1960-2005

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<thead>
<tr>
<th></th>
<th>Argentina</th>
<th>USA</th>
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<tr>
<td>Inflation Rate (CPI)</td>
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</tr>
<tr>
<td>Mean</td>
<td>97.59%</td>
<td>928.59%</td>
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<tr>
<td>SD</td>
<td>112.68%</td>
<td>1131.28%</td>
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<tr>
<td>Growth Rate (GDP)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>2.84%</td>
<td>0.76%</td>
</tr>
<tr>
<td>SD</td>
<td>4.43%</td>
<td>5.83%</td>
</tr>
<tr>
<td>M3/GDP</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>26.67%</td>
<td>18.53%</td>
</tr>
<tr>
<td>SD</td>
<td>5.04%</td>
<td>5.16%</td>
</tr>
</tbody>
</table>


This table reveals the extreme instability of Argentina, that shows in low and volatile growth, skyrocketing inflation and the experience of hyperinflation as well as a process of financial destruction (disintermediation).

1. The 2001-2002 crisis: Currency collapse, debt default and poverty

47. The benefits of stabilization brought by the Convertibility plan, launched in 1991 after the second hyperinflation episode experienced in Argentina were gradually reverted during the 90s. Under the policy of a currency board monetary arrangement, an economic cycle of boom and bust will develop: a first phase of price stability, strong growth and falling unemployment cum political support for the incumbent administration of President Menem will take place. A second phase, of economic contraction, rising unemployment, growing fiscal deficits and rising public debt as well as deteriorating external conditions, will follow.

48. Starting from 1995, a series of emerging economies financial crises (Mexico in 1995, Asia in 1997, Russia in 1998 and Brazil in 1999) brought out foreign capital in?ows to Argentina, the current account de?cit increased fueled by the overvaluation of the peso and persistent deficits in public finance. Market confidence receded and speculative attacks on the currency became a persistent threat to financial stability. A severe fear to float the currency, coming from the long lived trauma of inflation and hyperinflation, of voters and thus of politicians led to a policy trap. With a high level of debt, a contracting economy, an overvalued currency and adverse international conditions, limited instruments to respond to the economic challenges of the time were left. Under this economic straightjacket, a new government headed by President De la Rua was elected in 1999.

49. Figure 3 reports the quarterly values (in dollars) of fiscal and current account deficits of Argentina since the early 90s. The combined effects of external and domestic pressures are resumed in Figure 2, representing key macroeconomic data for the 1992-2008 period. The plot reports quarterly values for GDP and the inflation rate: the economy entered a recession in the third quarter of 1998 and experienced a deep depression between the fourth quarter of 2001 and the second quarter of 2002. Between 1998 and 2002 output per capita fell by over 20 per cent (12 per cent between 1998 and 2001). At the peak of recession, price levels skyrocketed to a 2-digit quarterly inflation rate, with market analysts discounting a possible return to frightening hyperinflation.

Figure 2
GDP (billions of pesos at 1993 prices) and CPI quarterly inflation (right axis)


Figure 3
Current Account and Fiscal Balance (million dollars)

50. A severe credibility crisis was in motion, speculative attacks on the currency and skyrocketing interest rates distressed the economic life of the country. Capital outflows were out of control and the Central Bank currency reserves were depleted, generating pressures over commercial banks’ liquidity. A run on the banking sector developed and financial collapse became inevitable. At the end of 2001 the government responded to the critical situation with a freeze of bank deposits to stop the run on the financial system. The popular response to these measures was a wave of civil disorder. President De la Rua resigned after two years in office, and in the midst of severe political turmoil 4 interim Presidents followed in a few weeks. Finally President Duhalde (Governor of the Province of Buenos Aires), was appointed by the Parliament to conclude the mandate of President De la Rua.

51. In January 2002, President Duhalde was forced to abandon the fixed parity with the dollar as well as the currency board regime, and let the currency float. The peso devalued 400 per cent in a short span of time and inflation skyrocketed from low levels of 1-3 per cent per year to 40 per cent in 2002, leading to sharp reductions in real wages of 20-40 per cent depending on the sector of the economy.

52. The financial distress had a devastating impact on the real economy of the country, showing in rapidly rising unemployment and poverty reaching very high levels. Figure 4 reports the data of unemployment, poverty, and extreme poverty rates from 1988 to 2006. All the indicators show a pattern of deterioration at the end of 90s, exploding in late 2001 and 2002: after the highs of the hyperinflations of 1989-90, from levels of unemployment and poverty of 5-7 per cent and 13 per cent, respectively, in 1993-94, to around 15 per cent and 20 per cent in the period going from 1998 to the first half of 2001. In the period extending from the end of 2001 and 2002 in the height of the economic collapse unemployment exceeded 20% and poverty spread to 40% of households.

53. Starting from 2003, and propelled by an extremely favourable international environment cum robust public finance policies of sustained fiscal surpluses, Argentina entered a period of remarkable recovery. GDP showed rapid growth of 7-9 per cent in the years 2003-2008, while inflation stabilized at a higher level than the pre-crisis pattern of 8-20 per cent, and unemployment and poverty rates reverted slowly towards the pre-1998 level. What comes next in the volatile path of this nation?

V. Competition policy in Argentina

54. Developing countries, even those with a relatively small private sector, may benefit from the enactment of anti-trust legislation and the creation of a competition agency in various ways.101

→ A competition agency may become a centre of expertise in anti-monopoly policy and can help to develop deregulation, privatisation, and restructuring plans that could improve the performance of the market economy.

→ Competition law enforcement improves the business practices of state enterprises by subjecting them to clearly defined principles concerning avoidance of abuse, dominant position or other anti-competitive actions.

→ Competition law enforcement can help the state agencies – procurement – to obtain better goods and services at lower prices while compelling enterprises to strive for greater levels of efficiency.

→ Competition law enforcement can fight guild-type policies prevalent to local service, which resist social and economic changes thus leading to enhance competition and efficiency gains.

55. In developing and emerging economies, although progress has been made through reforms during the past decade, competitive market structures still have to be implemented through competition policy. In Latin America most countries have had legal frameworks since the seventies (Chile), or eighties (Argentina, Brazil, among others). But they lack the institutional strength and reputation that characterise these instruments in OECD countries. The process is difficult and needs a better understanding of the challenges involved. Moreover, excessive distortionary regulation still persists in Latin America. In what follows we will discuss the case of Argentina and competition policies in the midst of a chronic bias to scenarios of economic crisis.

1. From anti-trust to competition advocacy

56. Argentina set up a Competition Law and a specialised competition agency (Comisión Nacional de Defensa de la Competencia, CNDC) in the early eighties. In the mid-90s, competition policy started as a policy tool. The most salient case of this period was related to the country’s biggest firm, the oil company Yacimientos Petrolíferos Fiscales (YPF). However, even though extensive privatisation took place in the

Figure 4
Unemployment , Poverty, Extreme Poverty Rates

Source: INDEC – Encuesta Permanente de Hogares.

100 Data on “Gran Buenos Aires” region.
101 Since the early 1990s, there has been an accelerated world trend toward the adoption and strengthening of legislative measures designed to create and promote a market economy. The four key policy measures have been privatisation, restructuring, deregulation (including elimination of price control) and adoption of competition legislation.
1990s, competition policies (CP) were not a fundamental element of the political agenda, and effective initiatives were rare and non-systematic. Under the new government taking office in 1999, competition policy acquired more importance, becoming a first order tool of economic policy aimed at enforcing better market regulations. Furthermore, under the fixed exchange rate regime (Convertible Law) established in 1991 – and, hence, the low degrees of freedom to respond to changes in relative prices – the role of competition policy became crucial: it was one of the few policy instruments available to gain efficiency and international competitiveness. We should recall that the economy had entered a phase of economic slowdown and growing financial stress since the end of 1998.

57. The need for a better institutional framework in competition policy prompted the government in 2000 to evaluate the preferred design in an environment with structural institutional fragility. A decision was taken to develop a multiple agency model in regulation with the objective of inducing a certain degree of competition for reputation between regulators aimed at reducing the incentives for capture.

58. The immediate antecedent of legislation regarding competition policy in Argentina is Law 22.262 (August, 1980). This norm established that all conducts that limit, restrict and distort the normal functioning of markets are to be analysed by the CNDC. This law mentions, but does not define “general economic interest”, a concept linked to what economists refer to as total surplus. The law that created the CNDC failed to define the proper place of this agency in the institutional hierarchy and the necessary degree of independence. Moreover, the legislation did not regulate mandatory ex-ante mergers and acquisitions control. Nevertheless, the CNDC decisions contributed to the growth of CP as an instrument.

59. A new law passed in 1999 (Law 25.156 and Decrees 1019/99 and 85/2001) introduced ex-ante control of merger and acquisitions. Further provisions defined more precisely the limits of the legislation and made possible its application (Resolution 40/2001). This law was complemented in 2001 by a Decree (396/2001) establishing limits to economic operations that needed ex-ante control. The latter piece of legislation was aimed at a more focused use of the existing resources on highly relevant M&A, excluding second order operations that drain scarce human capital and unnecessarily increase transaction costs (and opportunities for corruption).

60. In 1999 the newly elected government created a higher instance, the Secretary for Competition and Consumer Affairs – Secretaría de Defensa de la Competencia y Del Consumidor (SDCyC). The CNDC was made dependent on this agency, thus establishing a clear hierarchy. The multiple agency scheme was developed by the creation of the Tribunal of Competition – Tribunal de Defensa de la Competencia (TDC). This tribunal was endowed with financial and jurisdictional autonomy, as well as autonomy. The CNDC later to become the independent the TDC, was assigned to investigate and punish conduct that could damage general welfare. In this new institutional design, SDCyC could operate as a complement to the TDC (in line with the UK model). This “double agency” model has several advantages over a single agency scheme, if higher aggregated administrative costs. First, each agency exerts control over the other. It is expected that the SDCC will act like an attorney and the TDC like a judge. This scheme has proved to work well in many countries, including the United States. Second, a two-agency scheme minimises the probability of capture, by increasing the cost of capture and benefiting from competition in the reputation of the regulators. Third, both agencies work towards similar goals and can, in a way, “compete” for better results.

61. Until the reform of the legislation instituted in 2001, too many operations had to be revised by the CNDC. This produced a congestion of administrative procedures that ended up in some operations being approved tacitly or stuck in the middle of the process. Furthermore, less operational time was left for the relevant M&As. With the new scheme, the TDC does not have to deliberate ex-ante on operations that are not of prime economic importance. Thus, the government expected that the CNDC would become more efficient.

62. The experience of Argentina reveals two main stages in establishing a functional CP. The first lasts until 1999 when CP was limited to react to private claims. For instance, acting against anti-competitive behaviour occurred only after a private company raised the case against another company, and never ex-officio. The second stage started at the end of 1999. The newly established SDCyC decided to press ahead with intensive and pro-active competition policies, i.e. deciding ex-officio. After the 1999 reform of the legislation, regulatory issues were tackled more efficiently. This is well illustrated by the case of Endesa in electricity as well as other technically and politically complex anti-trust and regulatory initiatives (see below).

102During the 1990s, the government undertook an extensive and rapid programme of privatisation of state firms, in a large number of sectors of the economy such as, electricity, oil, postal services, telecom, transport, water distribution, etc. The political economy of these reforms and its popular support in the 1990s can only be understood considering the previous history of state provision of services in Argentina. The decades’ long experience was predominantly unsuccessful with severe deficiencies of governance, low productivity, overstaffed firms and serious problems of corruption and capture. State-owned companies’ huge structural deficits had a significant negative impact on the macroeconomic performance of the country. Given the initial conditions, thus, privatisation rapidly improved performance and services in a number of sectors of the economy, such as energy and telecom. In certain cases, such as electricity, the reduction of prices was also significant, contributing to lower input costs and thus to competitiveness. See Larraín and Winograd (1996) and Celani and Winograd (2003, 2005). In other sectors, such as highways, postal services, and transport, the results of privatization were not satisfactory. In the privatisation of airports, no consideration was given to the rationale of potential competition in the industry.

103There were two previous laws passed by the Congress: Ley N° 11.210, (1923) and Ley N° 12.960 (1946). The first one was intended to fight against trusts integrated by meat processing firms and the second was a review of the former.

104It should be noted, however, that given the fact that the thresholds for M&A controls are fixed in nominal pesos, the inflationary burst experienced since the collapse of the convertibility regime and the sharp devaluation of 2002 have progressively increased the number of operations subject to official review. To address this problem, the adjustment or indexation of thresholds’ values could be envisaged.
63. With the successful intervention of the SDCyC in the case of electricity companies, this agency became crucial in settling regulatory issues regarding public utilities, as well as many other instances (telecommunications, postal services, airports and ports).

2. Competition advocacy and regulatory reform

64. With the creation of the SDCyC and its active role, regulatory reforms in electricity, credit card systems, football, postal services, telecommunications, were quickly approved. The following is an overview and a brief summary of actions developed in the years 2000-01.

2.1. Electricity distribution

65. The Argentinean energy market was privatised and modernised in the early nineties. Reforms in the electric sector included the vertical separation of generation, transport, distribution and commercialisation. As transport was divided into regional monopolies, distribution was structured in the same way. In distribution, by regulation, the metropolitan area of Buenos Aires was divided into two halves and independent monopolies were established using a yardstick competition approach. The two privatised companies were named Edesur and Edenor, for the southern and northern areas respectively.

66. The Spanish firm Endesa was a major shareholder of Edenor in partnership with the French company EDF and Astra, an Argentine oil company later sold to Repsol-YPF. Edesur was controlled by the Chilean energy conglomerate Enersis. In 1997 Endesa bought Enersis, inheriting the control of Edesur. The latter company thus turned into a major shareholder in both distribution companies of the metropolitan area of Buenos Aires.

67. In 2000 the competition authority, the SDCyC, decided to launch an active competition initiative to separate Endesa’s property in the two firms through a disinvestment operation. When Endesa became a major shareholder in both companies, the fundamentals of the regulatory framework based on yardstick competition were jeopardized.

68. How would economic interests be affected by the concentration of control in the distribution and commercialisation markets? This operation raised issues such as access to the distribution network for third parties, and the reinforcement of the proper incentives for the sustainability of the electrical sector. After an investigation, the SDCyC recommended that Endesa’s property be separated, leaving it to Endesa to decide in which company it would keep its participation and in which company it would sell.

69. This recommendation initiated a new phase in regulatory reforms in Argentina giving rise to a new approach in regulation and competition policy, as well as bringing a significant gain in reputation for the newly created agency. Since then, most regulatory reforms required the participation of SDCyC and increased the chance of applying CP principles. The SDCyC’s participation in regulatory reform policies has transformed the way most people involved understand the scope for CP. Regulatory reforms in the postal sector illustrate this point.

2.2. Postal services

70. The public postal operator in Argentina was privatised in 1997. The privatisation process consisted of a concession with a universal service obligation covering the whole nation and a few regulated prices like simple letters and small packets.

71. One of the main concerns in the sector was the emergence of growing competition in the ultra-rapid services like messengers and corporate segments given the absence of (legal and technological) barriers to entry. This competition eroded part of the financing mechanism implicit in the universal service obligation and the tariff structure of the new private operator.

72. In 2000 the discussion concentrated on setting up a new regulatory framework that could be consistent with the needs of the official operator and the main competitors. The main operator Correo Argentino alleged that the situation was not sustainable and proposed the establishment of entry barriers that would limit the work of small companies in messengers markets as well as more rigorous controls over the rest of the companies. Additionally, the main operator lobbied for restrictions imposed on the rest of the operators (its main competitors) and the setting up of reserved areas of business (stamp emission, for instance) for the main operator, where regulatory (legal) guarantees would be established. All these arguments were based on a very ambiguous and debatable regulation framework. The other operators competing directly with Correo Argentino also lobbied for entry barriers but tried to avoid restrictions in the competition arena with the latter. Indeed, a very natural political economy of market regulation.

73. By mid-2000 Correo Argentino announced a merger with OCASA, the second company in the market. This initiative was the result of a financial crisis of the main operator whose debt to the government amounted to more than USD 200 million. Correo Argentino and OCASA submitted the operation to the CNDC as required by the prevailing Law of Defence of Competition.

74. The CNDC rejected the merger based on welfare considerations. The operation would have reinforced a position of market dominance, and the CNDC argued that the companies had not given evidence that the merger would produce any efficiency gains. Market information did not support the thesis of ruinous competition. As Table 5.1 shows, after privatisation production expanded almost 30 per cent between 1997 and 2001 and prices declined (Table 5.2). The contraction of activity in 2001 was due to the economic slowdown (CNC Annual Report, 2002).
### Table 5.1
Postal services in Argentina – Physical output

<table>
<thead>
<tr>
<th>Services</th>
<th>Number of units (000s)</th>
<th>Year</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
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<th>2001</th>
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<td></td>
<td>611 090</td>
<td>651 255</td>
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<td>772 648</td>
<td>750 183</td>
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<td>149 263</td>
<td>166 366</td>
<td>204 956</td>
<td>223 390</td>
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<td>Corporate services</td>
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<td>2 297</td>
<td>3 570</td>
<td>4 406</td>
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<td>Credit Cards dispatches</td>
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<td>1 188</td>
<td>1 179</td>
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<tr>
<td>Total</td>
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<td>801 814</td>
<td>866 767</td>
<td>1 021 512</td>
<td>1 052 945</td>
<td>992 467</td>
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<tr>
<td>Telegraphic services</td>
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<td>7 287</td>
<td>7 809</td>
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<td>3 153</td>
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<tr>
<td>Total</td>
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<td></td>
<td>812 373</td>
<td>880 199</td>
<td>1 032 962</td>
<td>1 063 043</td>
<td>1 002 351</td>
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*Note: Items do not add up to totals as minor services are not shown. Source: CNC (2002).*

### Table 5.2
Postal services in Argentina – Prices

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<tr>
<th>Year</th>
<th>Average price $¹</th>
<th>Variation (annual change in per cent)</th>
<th>Consumer price index (annual change in per cent)</th>
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<td>-35.9</td>
<td>9.9</td>
<td>-37.4</td>
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</table>

¹ Calculated by CNC as an average of certain types of standard services. Nominal prices are in pesos. Recall that from 1991 to 2001 the exchange rate parity was fixed and constant.

² Deflated by the CPI.

*Source: CNC and authors’ calculations.*

### 2.3. Telecommunications

75. The SDCyC argued that erecting barriers to entry meant regulating through instruments independently of results. This approach was an important break-through that challenged the established consensus. In contrast with SDCyC, the regulator (Comisión Nacional de Comunicaciones) was inclined to accept a heavier regulatory burden, a _classical_ reaction of sectoral regulators and potential vested interests in the process. A more complex and somehow arbitrary (discretionary) regulatory framework enhances the role and legitimacy of the sectoral regulator. The SDCyC proposed a competition-based neutral approach to universal service financing. The regulatory framework developed by the SDCyC addressed the compulsory universal service and its costs — leading to intensive lobbying for distortionary barriers to entry-based regulation – through the design of a fund with contributions from all players proportional to their income as is currently applied in the telecoms industry. This proposal of regulatory reform did not reach the approval stage in Parliament, but the consolidation of excessive market power in the hands of one player was avoided by refusing the merger.

76. To sum up, the interventions of SDCyC and CNCD contributed to improving the debate as to what should be the best regulatory policy for the postal sector. First, arguments leading to stringent (distortionary) regulations to improve business performance of the main operators were defeated. Second, the proposal to impose entry barriers restricting informal and illegal operators was rejected. The SDCyC argued that increasing the barriers to entry would only aggravate the problem of informality in the market. The solution was to improve the regulatory technology to control operators without lessening competition. Years later Correo Argentino was nationalized, but had to continue the competition game established by these agencies practice.

77. The role of SDCyC in the telecom reforms was different from that in the reform of postal services. In the former the regulator incorporated several tools of competition policy in the regulatory framework (mainly essential facilities use). The role of SDCyC was to strengthen and drive the reform process while promoting a rational use of pro-competitive instruments to attain dynamically efficient regulation.

78. Decisions that affect economic interests should be appreciated beyond their mere economic purpose (Noll, 1989). In telecommunication, as in other sectors, all parties try to protect their own interests. During regulatory reform, lobbying may be very intense as reforms may affect the future market structure and thus expected rates of return of incumbents and potential entrants. Reforms in well developed political systems need to be based on negotiations and public discussion to sustain the whole process. The telecommunications reform in Argentina is an illustration of this case. Its main objective was to eliminate all entry barriers and to stimulate the erosion of monopoly rents by implementing the essential facility principles. The SDCyC focused on the analysis of the long-run effects of the reform, bringing international experience in telecoms liberalisation from a competition policy perspective, as well as inducing all parties to engage in transparent negotiations.
79. While the shared goal of the reform was to open the market, the Communications Secretariat and the SDCyC debated on the use of instruments. Many regulators view market liberalisation as an instrument to maximise the number of operators rather than welfare. From a competition policy perspective, this approach is questionable as the number of players is endogenous and the objective function should maximise aggregate welfare (Kahn et al., 1999).

80. The international experience in the telecoms industry suggests that an aggressive use of the essential facilities doctrine may not lead to better market outcomes (NERA, 2000). In Argentina, the sectoral regulator expected lower concentration ratios and larger participation of small players through the elimination not only of legal entry barriers but also of economic and structural barriers. The first proposal in place declared almost all network elements as essential facilities without carrying out a rigorous market analysis. 

81. In the case of this initial approach of the sectoral regulator, the SDCyC intervened favouring a regulation that would be sustainable in the long run. The trade off between maximum competition in the short run (sectoral regulator’s approach) and long run efficiency (competition policy approach) needed to be carefully considered. Under the regulator’s approach, instant competition would erode rents and make the industry more efficient. But in presence of economies of scale and scope the number of players is finite and the market characterised by a non-atomic industry structure. It should be noted that the instant erosion of rents may foster exit, but not necessarily entry.

82. Despite the political need and pressures for a swift reform, the development of a regulatory framework required a consistent microeconomic foundation. The latter would take into account both the need for opening the market in the short run (lowering prices as an immediate effect) as well as considering the incentives to invest in the long run, using the essential facility principle correctly.

83. The implementation of the essential facility propositions contributes to the proper understanding of the economics of regulation in practice. The owners of the network try to block the use of its facilities by third parties (the so called open access scheme), based on property rights and investment incentives arguments. But access is rather a matter of use than a problem of property. The main argument for open access is that social benefits from competition cannot be internalised by the firm acting as a profit maximiser. Competition leads to lower prices but also provides variety, thus improving welfare.

84. If regulation favours unbundling, the question remains as to how far the regulator should go. In telecoms, international experience shows that regulators went as far as they could (European Union, United States, and small economies like Australia and Argentina). The implementation required intensive political, technical and legal resources since the incumbents reacted strategically by delaying implementation. In all these countries, regulatory reforms in telecommunications were very time consuming.

85. The fact that parts of the telecommunications network may not be economically duplicable is not a sufficient condition to impose the essential facility rules. A market definition problem needs to be solved first (see ITU, 2002 and Gual, 2002). The enforcement of the unbundling of parts of the network should be based on economic foundations rather than legal arguments.

86. The competition approach emerges as the best tool to respond to the fundamental questions of regulation in practice: CP integrates demand and supply conditions, with both sides of the market being relevant for a proper design of open access rules. This procedure prevents policy makers from making two types of errors. The first one is to overshoot: declaring essential facilities where market conditions suggest that demand and supply substitutability are present, for example through alternative technologies. This consideration could be very important in corporate markets. The second type of error is that of not declaring essential facilities where competition is impossible and anti-competitive behaviour may emerge. In telecommunications, the second error has been less frequent than the first one. The SDCyC did not succeed in incorporating these criteria into the Decree 764/2000 of telecom regulation.

2.4. Newspapers and publishing

87. In 1945, newspaper and magazine distributors in Argentina were assured territorial exclusivity of their shops – the Law 12.921 prevented competition in the same region or area. Moreover, this Law established a set of regulatory restrictions like a margin over the total shop sales or revenue. This type of anti-competitive regulation had been popular in many countries in the post-war period. In the metropolitan area of Buenos Aires the wholesale distribution of magazines and newspapers was concentrated in an independent private body called Magazine Distribution Centre (MDC) comprised of publishing companies along with representatives of the two stages of distribution in this market – distribution networks and shops or retail “kioskos”. The distributors (each supplying a number of shops or retail stores) acted as monopolists in a given area, supplying final stores, the latter with a certain market power depending on the size of their area. Licences for entry were jointly regulated by the MDC and the Ministry of Social Security and could not be cancelled. The MDC had wide powers, including that of restricting the circulation of a magazine. The latter was a credible threat when an editor developed an alternative retail distribution scheme or a subscription system that led to bypassing the established network. The MDC could also manage the allocation of risk among the different participants by implementing the rule of plain devolution of unsold newspapers and magazines. The editors had to run all the risk of unsold stock. Concerning the distribution of business margins, according to industry information, editors got half of the final price, and the other half was attributed to the distribution network.

105 The use of the unbundling obligation is interesting in this regard. For a critical assessment of the US Federal Communications Commission’s (FCC)’s regulation and its likely impact on welfare see Hausman et al. (1999) and Jorde et al. (2000).

106 For adequate application of pro-competitive measures in telecommunications, see ITU (2002), Jauk, (2000), and Australian Competition and Consumer Commission (1999). Recently the FCC changed some the requirements of unbundled network elements for local carriers (FCC 03-36, August, 2003).

107 For a discussion of creating effective competition in telecom markets, see Shepherd (1998).
The regulation then in place for the retail stores or “kioskos” granted a perpetual right of operation to an individual (not a company) with no right of transfer to third parties, whereas no individual had the right to run more than one store. Thus, regulation simultaneously forced an atomistic market at the retail level, while guaranteeing a cartel in the upper stages of distribution. The number of stores was close to 5,000 in the metropolitan area of Buenos Aires and La Plata (population, 5 million). Entry restrictions at this end of the sales market were decided by an entity under the direct control of the shop owners. As in the upper stage of distribution, the incumbents were regulating entry.

The regulatory framework established in 1945 prohibited magazine and newspaper retailers to develop other activities. Customers could not buy at night because retail regulation imposed a closing time of 8 p.m., except for a few shops in Buenos Aires. But in spite (or because) of the heavy regulatory burden, high levels of informality and illegal sales points developed.

In 1999, a regulatory reform, aimed at fostering competition and greater transparency, was undertaken. Elimination of entry restrictions;

Elimination of privileges such as territorial exclusivity and prohibition of multi-purpose shops including magazine and newspaper retail;

Assessment of possible anti-competitive behaviour.

The underlying principles of these reforms were that competition increases welfare, and that entry barriers generate inefficiencies and do not prevent but increase informality. The benefits of the reforms were:

Direct advantages:

Modernisation of distribution and retail channels incorporating supermarkets, gas stations, small business and other types of distribution induced by competition, including automatic machines;

Wider coverage areas for distributors and the elimination of sale time restrictions;

Lower retail costs due to economies of scale and scope.

Indirect advantages:

Creation of new job opportunities, including for autonomous workers wanting to become retailers;

Development of a transparent (costless) market for the transfer of property rights;

Better environment for tax auditing by the state administration;

Improved opportunities for independent editors opening access to a larger client base at lower cost;

Increased freedom of expression and diversity of opinion.

Resolution MEyOySP N°416/99.

The case of the newspaper industry shows that the application of CP principles in regulatory reforms may induce large benefits. Initially both entrepreneurs and trade unions feared that competition would cause the loss of market share and jobs, but in the course of reform strong arguments emerged that deregulation would promote the expansion of the retail sector, broaden the freedom of customers and thus improve welfare. The resistance of incumbents to reform based on the rationale of CP is not unusual and should not be neglected. The political economy of successful reforms needs to anticipate the reactions of the relevant players. While deregulation may hurt some businesses, it improves the conditions for others, and creates room for new entrants leading to welfare gains through product variety.

2.5. Condominiums in Buenos Aires

The administration of condominiums is carried out by independent companies or by the proprietors in the building. The parties agree by contract to delegate some authority to the administrator or manager. This relationship has many features of a typical principal-agent problem. The manager possesses relevant information on costs and the incentive to carry out the job, while the neighbours lack the same set of information without incurring sizeable costs. The condomini, the principal, are represented by a Council or a collegial body who is in charge of auditing the manager’s activity.

As the principal-agent theory suggest, the asymmetry of information may cause market distortions due to misaligned incentives. Managers may not be as efficient as they should be from the point of view of the Council. A typical example of potential dispute is the level of monthly maintenance expenses.

In Argentina, the SDCyC noticed that consumers’ representatives – as well as non-governmental organisations – complained against significant and unexplained differences in the level of maintenance expenses between condominiums.

A project was launched to study the determinants of the expenses of the condominiums in Buenos Aires. The SDCyC set up a web-based system aimed at weakening the information asymmetry by comparing different parameters considered “reasonable” explanations of “true” expenses levels. The first step was the determination of these parameters. Using official information on the location and characteristics of buildings of more than five floors, the SDCyC used a randomly generated data base of 1,035 cases. The second step was to estimate econometrically the relevance of every parameter and then to select the most relevant and statically consistent estimators of a hypothetical expense, given some characteristics.

The study revealed a very significant dispersion in the levels of expenses and – as expected – the particular relevance of a certain number of variables. These results could be used for a manager or a Council participant to estimate how far the expenses were from the “standard level” predicted by the model. The simple model was freely accessible for the population on the web and produced an intense debate with the almost furious reaction of the incumbent condo administration firms.
98. Competitive systems are based on information symmetries and on the wide access at low cost of this information for large numbers of decision makers. This study revealed that there is room to improve the supply of relevant information and thus market transparency simply by choosing the correct variables and showing the results appropriately.

3. Competition Policies, Crisis and Hysteresis

99. The set of selected actions presented here show a diversity of initiatives in a country without a previous long experience of competition policies. These policies go from regulatory reform, to competition advocacy, and consumer policies. A combination of a new legal framework, the development of the appropriate institutional set up, a strong commitment with the agenda of the team in charge of competition policies, and a particular focus on human capital (in economics and the legal professions) contributed to the success of these policies in the adverse economic and political conditions confronted. We should also highlight the crucial role of the choice and sequence of the actions engaged. In view of the extremely fragile financial situation of the country strong initiatives in the banking industry were left aside and mergers were analysed having in mind the potential disruption (panic and contagion) that could be provoked in the economy.

100. Initiatives such as the condominiums information and transparency project, do not represent a solution for a structural problem in heavy sectors such as infrastructure or telecoms, neither a fundamental regulatory reform. However, these actions may have a strong impact on the reputation of these agencies showing closeness to the common citizens needs. In this case, the positive effect shows in the short run benefits, contrary to most actions in the field of competition policies where the perceived welfare gains tend to be concentrated in the longer run. The explosive reaction of administrators only reinforced the credibility of these agencies. The reputation building benefit has a positive contagion effect on other more classical actions that may require trust to smooth the waiting for future gains. Other actions of the sort have been extremely helpful to get the agency agenda closer to the general public and gather public support. In turn, politicians and members of the Executive become more attentive to other technicalities and longer term gains of the CP agenda. The CP institutions became increasingly asked for advice and participation by other government agencies.

101. The dialogue and persistent pedagogy, on the fundamentals of competition policies and its objectives, with the members of Parliament and the heads of departments of the executive branch have a relevant place in explaining the resilience of these policies. In a country with an extremely weak tradition in the competition policy culture, fragile institutions, as well as a secular practice of intensive lobbying, capture and cronism, a continuous interaction with the representatives of civil society, consumer associations, the corporate sector as well as with the press is certainly required for potential success. Under conditions of economic crisis and political pressure on this policy agenda, building the reputation and credibility necessitates a good balance of flexibility and policy consistency.

3.1. Extreme crisis, political stress and hysteresis

102. If the activism of competition policy compensated the threat to this agenda posed by the protracted macroeconomic crisis faced by the country since mid 1998, the extreme stress resulting from the financial collapse of 2001-2002 will severely disrupt these policies. Massive macroeconomic disorder, popular distrust, social and political anxiety led to a cascade of macro-policies that tended to disregard the competition agenda. The pathology of the invasive short run views, all the more natural in such an environment of collapse after years of crisis, became hard to resist for the fragile competition institutions.

103. The teams in charge of the competition agencies changed. Voluntary resignations and changes brought by the new national authorities produced a gradual loss of precious human capital that was later hardly replaced by newcomers. Eventually, a symbolic measure will reveal the preferences of the new incumbents: the Secretariat of the Defence of Competition was named Secretariat of Internal Trade. The latter was the previous name of the department of the Executive coming from the forties, an expression of a school of interventionist views alien to the regulatory culture and practice introduced in the recent period.

104. Various factors explain the decline of the existing skills developed by these agencies: on the one hand, the wages of the high skilled members of the agencies suffer a sharp decrease as the rest of the public sector employees. But even more important was the loss of the motivation previously engraved in the belonging to the competition agencies. If the heads of these agencies are less committed to the CP agenda, and despite the difficulty to recruit knowledgeable professionals in the field, a number of well intentioned and trained officials work in different levels of these institutions.

105. The process to establish a fully independent Tribunal that should replace the existing CNDC, started in 2001 has been stalled and does not show progress. On the positive side, we observe that the Law of 1999 and the reform of 2001 are still in place, and attempts to reform the Law introducing important restrictions in its scope, such as the notion of strategic sectors where the rules of competition regulation would not apply, did not prosper.

106. Were the negative consequences of the economic crisis on the competition policy agenda and institutions transitory or rather more permanent? May the distortions and pressures brought by the extreme distress produce a phenomenon of hysteresis in the path of competition policy making? If the answer to this question cannot be definitive, we observe persistence in the relative decay of the practice and reputation of the CP institutions. A basis for this proposition can be obtained through the rankings of the competition authorities recorded by the Global Competition Review. If somehow subjective this information seems certainly of interest.

107. In 2001 Argentina was around the middle of the ranking (performance), better placed than Brazil and Mexico, and close to Spain. In 2003 the country was last in the record of 26
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authorities showing a sharp deterioration of its position in terms of credibility and practice coherence. This situation did not show changes since then and Argentina was placed in the last position of 38 institutions ranked in 2007. We should highlight that in the period 2003-2008 the economy showed a GDP annual growth rate of 7-9 per cent per year, as well as a sharp reduction of unemployment and poverty. The improvement of the general economic conditions did not bring a reversion of the path divergence in competition policy practice ignited by the extreme stress of the times of severe crisis.

VI. Concluding remarks

108. In this paper we discuss the conduct of competition policy, as well as the institutional resilience of the concerned agencies in times of crisis. The interest on the lessons that can be drawn from Argentina hinges on the chronic and varied history of economic and political crisis of the country. We have reviewed the two main policy areas, namely competition law enforcement and competition advocacy, and stated the current consensus on the temporal sequence of costs and benefits of competition policies.

109. The empirics on the impact of competition policies on economic performance shows a consensus on the positive effect on productivity and growth in the long run. In the short run competition policies may bring the costs due to restructuring. In times of crisis, social and political anxiety tend to overprice the short run, leading to high pressures on competition institutions and its practice. Lobbying for survival of incumbents, firms and unions, may become an hyperactive industry and the containment of the push to distort competition policies is a hard task. The voice of active short run losers may dominate the rather silent and diffuse legions of long term beneficiaries. Furthermore, things will be even more difficult where institutions are weak and the practice of capture more viable. Investing in lobbying may thus turn into a high yield industry.

110. There is an essential argument to be borne in mind when designing CP in the midst of economic turmoil: the banking industry is critically different from the non financial industry. In the case of the former, the collapse of a firm may lead to contagion and contaminate the whole industry. Massive economic and welfare costs for the economy may result. On the contrary, in the latter non financial industries competitors may benefit from the exit of an incumbent. A careful handling of competition actions focused on the banking sector should be called for in times of crisis.

111. A brief account of the secular crisis prone behaviour of Argentina was then presented, with recurrent economic and social disturbance, extreme monetary disorder, speculative attacks on the currency, debt defaults as well as political instability. The experience of Argentina with the institution building of competition agencies and the conduct of CP was then analysed. Active competition policies were only developed 10 years ago in an extensive range of markets and resorting to a diverse set of instruments. The initiatives extended from infrastructure sectors to more unusual markets such as newspaper distribution and expenses of condominiums. The

infrastructure sectors (airlines, energy, railways, telecom, toll highways, water distribution, etc), were privatised in the 1990s, but in many cases the regulatory frameworks were deficient and rigorous competition policies were not adopted. Under a regime of fixed exchange rates with reduced degrees of freedom to respond to sharp changes in relative prices, the role of active competition policies gained particular relevance.

112. But the development of effective competition policies and a competition culture leading to sustainable long term welfare gains require skilled human capital as well as credible institutions. The political will to develop both is a necessary condition. A long term effort is required to establish robust competition as a fundamental given of the business environment. The threat of competition or its effective action tends to bring innovation and greater efficiency as well as a continuum of business changes that produce losers and winners in the market place. It is thus clear that the political economy of competition policies cannot be neglected if one wants to maximise its probability of success.

113. Argentina experienced a protracted period of recession and political frustration since 1998, followed by an extreme economic and financial crisis in the years 2001-02. In an environment of high macroeconomic instability the conduct of competition policies, that inevitably requires systematic and rigorous fine tuning, is a difficult challenge. The urgency of stabilisation drains most of the political energy and when excessive conflict of objectives and interest emerge, competition policy may lose the battle in the policy arena. This is more likely to be the case when institutions are weak.

114. To increase the probability of survival of CP through times of severe economic distress, creative policies are required. The political scene should not be neglected and the practice, as well as the rhetoric of competition policies, should account for the strain that permeates the political decision making process. The task of systematic reputation building, and a practice that combines flexibility and coherence, should be fostered. A rigid crusader approach should be tempered in times of crisis, because it can prove extremely damaging for the institutions of CP. Competition policy initiatives that transmit short run benefits to the citizens (voters) may be crucial for the legitimacy of CP, and the continued support of incumbent politicians.

115. However, as shown in this paper, despite the investment of well targeted political and technical capital, the success for the CP in times of crisis cannot be guaranteed. Extreme strain may derail the practice and the return to a prominent role of the competition policy culture may be jeopardized. The loss of competition policies and the decay of its agencies may not be a transitory effect of the crisis and become a more permanent phenomenon. A syndrome of institutional hysterisis could thus emerge and the return of bonanza may not be enough to bring back CP to the forefront of the economic agenda.

109. The growing role of competition policies in Europe in the recent period may also be linked to the restricted set of macroeconomic policy instruments at the national level that prevail in the euro zone.
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Mallon R., J. Sourrouille (1975)


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