How to strengthen competition advocacy through competition screening

Geraldine EMBERGER, Directorate-General Competition, unit A-5

I. Introduction: The role of competition advocacy

Competition advocacy is together with competition law enforcement in individual infringement cases a very important pillar relied upon by competition agencies around the world when protecting effective competition. It is generally accepted that competition enforcement and advocacy are complementary since fighting private restrictions can only be successful if supported by advocacy removing or preventing public restrictions. By way of example, pursuing price fixing by private operators or the abuse of a dominant position can only be effective long term if the regulatory framework itself does not facilitate behaviour contrary to Articles 81, 82 of the EC-Treaty. Advocacy and enforcement are further mutually enhancing. The experience and market knowledge obtained by a competition agency through the handling of merger or antitrust cases may support its advocacy efforts and make them more credible. (1) The most evident example demonstrating the importance of competition advocacy is the process of liberalisation experienced by developing and developed countries all over the world. The gradual opening to competition of traditionally regulated sectors, which often used to be monopolised and where incumbents often retain a fair degree of market power, revealed the need to completely adapt the regulatory framework governing the different sectors (e.g. energy, telecoms, postal sector, transport, etc.).

Depending on the objectives competition advocacy measures may take the form of publications of guidance aimed at improving the understanding and acceptance of the competition rules by the addressees. One particular effective form of advocacy, on which this article will focus, consists in the active involvement of competition agencies in the regulatory impact assessment (RIA) process leading to the adoption of new laws and regulations or in the involvement of competition agencies in hearings before sector regulators or parliamentary committees, or as amicus curiae in court proceedings.

II. The interface between legislation and competition: possible conflicts

Although most regulation is neutral to competition, conflicts may arise in individual cases. The most evident kind of restrictions is represented by outright restrictions or even elimination of competition, which may arise if a whole sector is exempted from the application of the competition rules. Examples are rules excluding the defence industry from the application of the competition regime for reasons of national security or rules imposing retail price maintenance for reasons of consumer protection. A prominent example is further that of certain regulations in professional services, such as services provided by architects, lawyers, notaries, engineers, which constrain these providers in the parameters of competition they can use. Regulation may further restrict competition by determining certain parameters of the competitive process, e.g. by setting minimum quality standards for certain products or services. These rules may reduce the degree of differentiation between suppliers and decrease their incentives to compete vigorously as competitors align their offer towards the minimum quality. (2) Last but not least, the regulatory framework may also contain provisions which allow state subsidies which distort competition.

Restrictive regulation as outlined above may for example cause higher market concentration, e.g. if it leads to asymmetric costs, thus forcing certain players to exit the market. It may also increase entry or exit costs with the effect that new entrants may take too long to achieve the minimum efficient scale to operate on the market. Furthermore, certain types of regulation may reduce the vigour of competition or even induce competitors to collude, e.g. through increased transparency. National regulation may also grant ‘advantages’ to certain companies, which may not legally qualify as State aid, but have the same effect. Finally, regulation may reduce consumers’ or suppliers’ choice, e.g. by rising switching costs or by affecting innovation, or diminish the offer of new products, e.g. by too stringent product standards.

(1) The sector know-how gained in large merger cases is particular relevant in this respect. Competition authorities have to analyse competition impacts ex ante, which is also required in the assessment of draft legislation.

III. How to address conflicts through competition screening

One particularly effective means to influence economic regulation and legislation is the participation of competition authorities in the drafting of legislative proposals in particular through regulatory impact assessment (RIA). This form of competition advocacy is sometimes also referred to as ‘competition screening’. As part of their screening activities competition agencies typically provide comments, opinions and suggestions on draft bills or the conditions of privatization projects. The advantage of this method is that it establishes a constant dialogue between legislators and competition authorities and that it allows the former to intervene and influence legislative proposals with a view to avoiding or mitigating the effects of unnecessary or excessive restrictions of competition from the start (upfront approach).

The need to screen regulation as to its impact on competition has been widely discussed at international level. The OECD Council on 15 March 2005 adopted the ‘OECD Guiding Principles on Regulatory Quality and Performance’ (1) replacing the 1995 Recommendations (2). The guidelines start by recommending that new and existing regulation should be systematically reviewed with a reference to competition and that RIAs should be used to assess the effects of regulation on competition objectives and market openness. Important research into competition screening has also been undertaken by the International Competition Network (ICN). In its 2003 report to the Annual Conference in Seoul on ‘Competition Advocacy in Regulated Sectors: Examples of Success’ (3) the Capacity Building and Competition Policy Implementation subgroup (CBCP1) evaluated the degree of success of specific competition advocacy initiatives in six different sectors: electricity, gas, telecommunications, railways, air services and maritime transport. The most effective advocacy tools used by competition authorities were found to be their advice to regulators on e.g. market definition and specific competition impacts, their ability to issue binding or non-binding opinions on draft laws and to authorise participants in the bidding process (e.g. in the context of privatisation).

There are also many national competition authorities in the EU, which are active in competition advocacy and screening. Member States must not adopt any legislation which requires, favours or reinforces the effects of agreements, decisions or concerted practices contrary to Articles 81-87 of the ECT (or secondary law based on these provisions). (4) The European Court of Justice (ECJ) in its jurisprudence in the CIF case (5) has recently confirmed the duty of a national authority to disapply national legislation requiring or favouring infringements of Article 81 ECT, or reinforcing the effects of the anti-competitive conduct. Some national competition authorities have a particularly strong record of using that tool to open up heavily regulated markets. The Irish (6) and the Finnish Competition Authority (7) for example, played an important role in driving liberalisation of network industries in these countries. The Danish Competition Authority (DCA) is regularly screening markets to identify dysfunctional (‘black’) ones, applying a set of competition indicators. In the UK in all government offices have to assess the impact of legislative acts they propose on competition, by answering to nine questions (known as the ‘competition filter’). (8)

(2) See ECJ in Case C-198/01 Consorzio Industrie Fiammiferi [2003] ECR I-0000, paragraphs 45 and 46.
(3) For the Irish Competition Authority; see John Fingleton’s speech on ‘Enforcement and advocacy in regulated markets’ at the Italian Competition Day in Rome on 9 December 2003.
(4) The advocacy role of the Finnish Competition Authority (FCA) was significant in making initiatives to deregulate the closed Finnish markets during 1988-1995, in particular in telecommunications. Before membership in the EU, the FCA primarily took structural initiatives to open up markets such as liberalising imports, abolishing licences and reforming technical standards; other initiatives focused on abolishing monopolies and restructuring state-owned enterprises. See for example the 2004 ICN Report on interrelations between antitrust and regulatory authorities, addressed to the third annual conference in Seoul. It is available at http://www.internationalcompetitionnetwork.org/seoul/aers_sg3_seoul.pdf.
(5) Sources of information available for policy teams include the Cabinet Office guidance, available on its website at http://www.cabinetoffice.gov.uk/ and the OFT guidance, available on the OFT website; available at http://www.nao.org.uk/ria/ria_introduction.htm. In the financial year 2004-2005 the OFT responded to more than 140 requests for advice. The majority of these were for new regulatory proposals but about 20% were repeat requests as proposals moved through the policy development process.
IV. The EC approach to competition screening

1. General legal framework

One of the objectives mentioned in the Treaty on the European Community (‘ECT’) is an open market economy with free competition (Article 4.1). Consequently, Article 3 (g) ECT gives the Community a clear mandate to ensure that competition in the internal market (the territories of the 25 EU Member States) is not distorted and to promote competitive markets. There is thus no doubt that competition policy aspects have to be considered when drafting new EU legislation.

2. Competition screening through Regulatory Impact Assessment (RIA)

At Community level all legislative and policy proposals set out in the Commission’s Legislative and Work Programme (CLWP) are subject to Regulatory Impact Assessment (RIA). Upon the initiative of the Directorate General for Competition, the revised Impact Assessment Guidelines for EC legislation endorsed by the Commission on 15 June 2005 (12) include for the first time a specific test used to assess competition impacts as part of the overall economic assessment. In considering whether public intervention at European level is appropriate, drafters of legislation have to examine whether the proposed regulation does not create more harm for consumers than benefits. For example, a consumer protection regulation which is meant to make up for market failures such as information asymmetries or lack of buyer power may interfere directly with the ways companies compete. Some of these rules (e.g. maximum prices or minimum quality standards) may have unintended side-effects as they reduce the variety of innovative goods and services and create entry barriers, excluding certain providers from the market. The question has to be asked whether the intended consumer protection level can also be achieved by alternative means other than regulation (e.g. voluntary information requirements for suppliers of certain goods or services).

Once the decision to regulate has been taken the drafters of the proposal have to assess the overall economic impacts including competition impacts. The particular questions, which they have to consider in this context are the following:

‘Does the (legislative) option affect EU competition policy and the functioning of the internal market? For example, will it lead to a reduction in consumer choice, higher prices due to less competition, the creation of barriers for new suppliers and service providers, the facilitation of anti-competitive behaviour or emergence of monopolies, market segmentation, etc.?’ (see table I on page 29 of the IA Guidelines).

In short, drafters of legislation are asked to consider what restrictions of competition may directly or indirectly result from the proposal (e.g. restrictions on entry, limiting the use of competition parameters, etc.) and whether there are less restrictive means available to achieve the same legislative objective. Annex IX to the Guidelines (13) in its chapter 9.2 describes different impacts on competition in the internal market (the EU 25), pointing drafters of legislation to rules which have the potential to cause the greatest distortions of competition. The emphasis is on sectors relevant for economic growth and competitiveness, that is, innovation intensive and high value added sectors as are network industries, such as financial services, or the energy sector. The following types of regulation are considered to be particularly relevant for competition screening (non-exhaustive list):

- Legislation on liberalisation, industrial policy and internal market measures
- Legislation introducing special commercial rights (e.g. IPRs) or exempting certain activities from the application of the competition regime
- Legislation on sectors pursuing environmental, industrial or regional policy goals having an effect on economic activities
- General regulation (e.g. corporate law) having a commercial impact, notably by limiting the number of undertakings in a certain sector.

Within these four types of regulations there are three main categories of rules which may potentially impact on the competitive process:

i) Rules providing for a non-application of the competition rules;
ii) Rules which directly interfere with companies’ commercial conduct and

(11) The 2005 Work Programme can be accessed at http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2005/com2005_0015en01.pdf; Acts falling under the executive power of the Commission (e.g. Commission Block Exemption Regulations, enforcement decisions), Commission internal guidelines, best practices and Green Papers (since the latter are a basis for discussions rather than policy documents) are not subject to IA.
iii) Rules which indirectly impact on various competitive parameters.

The possible content of these three categories of rules, their potential negative impact on competition as well as examples for possible alternative options are further explained in a guidance paper published by the Directorate General for Competition in autumn 2005, and available on the website of the Directorate-General. (14)

An example of the first category (non-application of the competition rules) is the implementation by the 25 Member States of the EU of three recently adopted directives on waste management, introducing an obligation for companies to recycle their waste observing specific conditions. The Commission recently published on its website a comprehensive guidance paper to advocate competition-enhancing implementation by Member States. (15) The guidance paper does not prescribe a particular form of implementation but simply explains the competition effects of the different options, advocating against solutions which would induce market sharing or price fixing, and in favour of allowing competition between several waste management systems. The example shows that it is possible to implement competition and environmental policies in a mutually reinforcing way.

Examples of the second category (direct interference with business conduct) are rules restricting the business conduct of service providers, such as television operators, including quantitative restrictions on TV advertising or content quotas. These rules pursue legitimate objectives such as the protection of minors or cultural diversity. However, if applied without distinction to all service providers they risk having a chilling effect on new business models such as pay-per-view or digital TV, reducing the ability for newcomers to compete with established players. A differentiated application of these rules could avoid competition restrictions while still assuring protection of viewers.

The third category (indirect interference with business conduct) refers to regulation which unduly restricts access by competitors to important resources in concentrated markets (e.g. raw materials, land, IPRs or know-how on production methods) or favours incumbent suppliers at the expense of new entrants (e.g. by requiring the fulfilment of certain environmental performance targets in the energy field, which can only be met by incumbents). These rules may ultimately limit the number of offerings and lead to higher prices. In order to avoid these conflicts, it is recommended to avoid regulation which de facto favours established providers. Especially in the liberalised sectors such as telecoms, postal services or public transport, regulation should provide that suppliers are selected on the basis of transparent, non-discriminatory and objective procedures.

V. Conclusions

As can be seen from the above consideration, competition screening remains strongly on the agenda, not only at European level, but also at national and international level. There are strong indications that competition friendly legislation can indeed make a significant contribution to economic growth and competitiveness, and delivers benefits to consumers. (16) The OECD is currently working on a report evaluating different methods of including competition as part of regulatory impact analysis, the follow-up of which will be discussed in the summer of 2006.

In the light of recent experiences at EU and national level there are a number of elements, which can improve a competition authority’s chances to successfully advocate competition-friendly regulation. First, it is important that the competition authority is given a clear mandate as competition advocate and its rights and duties in this respect should be laid down in competition law and — if appropriate — also in sector legislation. Second, if unnecessary regulatory restrictions have been identified, competition agencies have to be able to propose alternative solutions, which meet the purported legislative objectives.

Furthermore, given that competition agencies usually have limited resources, it is decisive that they set clear priorities when engaging in competition advocacy. This involves in a first step the identification of certain types of rules, which typically impact on competitive conduct or market structures (see for example the list provided in a guidance paper on competition screening of Directorate General for Competition). In a second step, the agency will select certain sectors, which it wants to monitor, e.g. because they display a high degree of concentration, or because they are in a critical stage of liberalisation.

(15) Available at http://europa.eu.int/comm/competition/anti­trust/others/waste.pdf
(16) A recent OECD report on the benefits of liberalising product markets concludes that aligning the stance of domestic regulations on that in the least restraining country could lead to an increase in GDP of 1 ½ to 3% in the OECD area; see report of 2 December 2005, ECO/WKP(2005)50; ‘The Benefits of Liberalising Product Markets and reducing barriers to International Trade and Investment in the OECD.’
A further decisive aspect, which improves acceptance of competition advocacy is ownership. The competition agency should aim to export knowledge on competition law and policy to the drafters of legislation, for example through specialised training sessions or staff exchanges (e.g. the French DGCCRF engages in this type of competition advocacy activities aimed at spreading specific skills across a range of governmental ministries and departments). More generally, competition agencies need to convince legislators that competition policy principles and other legislative objectives, such as consumer protection or environmental goals, are not only compatible but even mutually enhancing. This is a more long-term goal, which it will take time to achieve, but it is worth pursuing. Legislators and regulators are often reluctant to accept comments from external sources but will be more prepared to consider competition aspects if presented by their own staff.

Turning these various elements of competition advocacy into practice is a challenging task. Therefore, it is very important that competition agencies continue to exchange views and share their experiences on competition advocacy in international organisations and networks such as the OECD or the ICN.