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Market Opening: Regulation vs Competition?

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Market opening: regulation vs competition?

Competition and the European social model go hand in hand.

After all, according to Article Three of the Treaty on European Union, "a highly competitive social market economy" is one of the Union's goals.

A combination of social concerns and economic liberty can also be found in the very origins of competition law.

The arch father of competition law, Senator John Sherman, blamed trusts for "breaking down" competition.

He also called trusts "evil" and accused them of causing inequality in wealth and opportunity.

Trusts, Senator Sherman said, "aggregate to themselves enormous wealth by extortion which makes the people poor."

Wealth generating poverty is a theme that's still very much alive today - see Thomas Piketty.

There is no contradiction between competition, and a social market economy.

You need rules or otherwise the free market will become self-defeating. This idea is supported across the political spectrum.

In the European Commission, we have had commissioners from various political backgrounds. All have vigorously enforced competition.

To answer the question in my title straight away: competition and regulation, too, go hand in hand.

Now, not all parts of the economy and society are open to competition. Defence, and the police, remain the responsibility of the state, because this better serves the public good.

Or take natural monopolies and single operated services. There is no competition *on* the market – but there can still be competition *for* the market here.

If there is no open market – for instance prior to liberalisation – there is no competition.

Then, there is also no competition enforcement.

One cannot enforce what doesn't exist.

We introduce competition, because it makes markets work better, for the benefit of consumers.

A company on an open market has to tempt customers with lower prices, better services, or innovative products.

Once you let the genie of competition out of the bottle, a great many wishes can come true: growth, jobs, choice, innovation.

The trouble with genies is – you should not allow them to get out of control. As John Sherman noted, unfettered competition can lead to private monopolies destroying competition.

To prevent this from happening, we have *ex ante* regulation and *ex post* competition enforcement.

Competition enforcement can be adequate to safeguard competition. But often, regulation is necessary to open markets to competition in the first place.

Today, I would like to look at the interplay between regulation and competition enforcement by discussing several sectors: rail, telecoms, energy and aviation.

For each sector, I'll look at the legislative action Europe has taken to open these markets.

I'll discuss the sector-specific regulation needed to make sure that new entrants have access. Access to railway tracks, electricity grids and telecoms networks for instance.

I'll also show how competition enforcement on these markets interacts with regulation.

I will look at successes and goals of competition.

For each of these sectors, I'll also look at the crucial European angle.

Because in Europe, when opening markets, it is not just about breaking the market power of former monopolists to create national markets. It's also about breaking down national barriers to open up European markets.

But before I start, an important point.

Just to make it clear, today I am not discussing privatisation, but market opening. There is no legal obligation to privatise. But all companies operating on the market have to abide by competition rules, whether they are state or privately owned.

Rail

So, how did we open up the rail sector? Breaking up the infrastructure was not an option – a typical case of natural monopoly.

In Europe we don't have continent-wide competing railway infrastructure. For historical reasons, we have a patchwork of national and regional railway lines.

In the US, railway barons raced across the Great Plains to connect the Atlantic and the Pacific with railway lines of their own.

In Europe, there are no great plains to speak of. The closest thing to the First Transcontinental Railway was the Orient Express.

This was the brainchild of the Belgian engineer George Nagelmackers. His vision in the 1880s was a luxurious European train service from London to Istanbul.

George didn't have to blast through mountains to lay thousands of miles of track to achieve his goal. Instead, he had to negotiate with railway track owners in every single country.

Nagelmackers didn't have to worry about herds of buffalo stampeding across the tracks.

He had to worry about the national differences in rules, gauges and technology.

Plus ça change, the French would say.

Breaking up national infrastructures to open up markets would have caused even greater fragmentation. Instead, we separated infrastructure from transport, and allowed multiple railway operators to compete on a single network.

We did this by introducing regulation. Three successive rail packages have gradually achieved:

- separation between the management of rail infrastructure and the provision of rail services;
- progressive opening to competition of railway transport services;
- harmonisation of national railway systems aimed at interoperability. The market for international rail freight transport has been fully open since 2007, and for international rail passenger transport since 2010.

But we can't say we have a European market, or even open national markets.

Most domestic markets are still closed, and domestic rail services represent ninety-four per cent of all EU rail travel.

Only Sweden and the UK have fully opened their own markets. Germany, Austria, Italy, the Czech Republic, Spain and the Netherlands have opened theirs to a limited extent.

Even though there is no EU requirement to open domestic passenger markets, the Commission estimates that forty per cent of the domestic market is open to new entrants.

This is true both for competition *on* the market, and, to a lesser extent, also for competition *for* the market, through tendering for public service contracts.

To open up the railway market it was also necessary to establish railway regulatory bodies.

There are now twenty-five rail regulators in Europe. These not only deal with practicalities and safety issues. Their work also has a bearing on competition. For instance, these regulators have to make sure that all companies have "fair and non-discriminatory access to the rail network." This core principle of access is enshrined in EU rail market legislation.

Enforcement in rail

So, the role of regulation is clear, but what about enforcement? The Commission safeguards this principle of access through competition enforcement.

In 2003, we issued a prohibition decision against the Italian incumbent Ferrovie dello Stato, because it abused its dominant position by refusing to grant competitors access to Italian infrastructure.

This prevented a German operator from providing an international rail passenger service to Milan.

In a 2013 margin squeeze case, we found that Deutsche Bahn prevented other railway companies from competing profitably on the markets for rail freight and long distance passenger transport.

Deutsche Bahn had applied a favourable pricing system for traction current to its own subsidiaries.

Earlier this year, we issued a statement of objections because we suspect the Lithuanian rail incumbent of keeping competitors off the tracks *by simply removing the tracks altogether*.

These cases show a number of things.

First, there are not a large number of EU-wide rail cases, which underlines the fact that we do not yet have a completed European rail market

Second, these cases are examples of vertically-integrated companies using different means to prevent newcomers from access to tracks and customers.

Third, European regulations open markets. Competition enforcement keeps markets open.

Successes in rail

So, it is clear that regulation and enforcement reinforce each other to keep markets open.

But how successful has the opening of the railway market been?

First, competition brings down prices - we see this on commercial lines where incumbents now face competition. For instance: NTV on Milano-Roma, WESTbahn on Wien-Salzburg, LEO Express and Regiojet on Praha-Ostrava, and HKX on Hamburg-Koln.

Second, competition increases the use of rail.

In markets open to competition, passenger growth exceeds fifty per cent over a ten year period.

On the route Roma-Milano, where NTV operates alongside Trenitalia, the transport-share of rail grew from thirty-six per cent in 2008 to sixty-six per cent in 2012.

Finally, competition improves quality and availability of services, and passenger satisfaction. We have seen this in various markets.

On the flip side of these successes, incumbents possess a competitive advantage and still dominate the market.

In Germany, Deutsche Bahn still controls over seventy per cent of the rail freight market (tonne-km) and roughly ninety per cent of the rail passenger market (passenger-km).

Newcomers don't always last. In December 2014, InterConnex in Germany ended its Leipzig-Rostock services.

And incumbents are quick to enter newly-opened markets abroad. While the French domestic market is not open to competition, state-owned SNCF holds interests in a number of rail passenger companies operating outside of France such as Eurostar, Thalys, NTV (Italy) and WESTbahn (Austria).

Barriers to entry are great, caused in part by the huge investments required.

Crucially, we have no European market.

National borders pose the same problem as in George Nagelmackers' day. Different signalling systems, and the need to change drivers and conductors when crossing borders pose obstacles, as they did in the nineteenth century.

Enforcement alone will not open these markets.

Regulatory changes can improve competition *for* the tracks and competition *on* the tracks.

To this end, the Commission presented its Fourth Railway package in 2013.

We proposed:

To fully open domestic markets to competition, including mandatory competitive tendering for public service contracts.

To impose stricter rules to institutionally separate infrastructure managers and railway operators.

To improve interoperability by harmonising 11,000 technical rules. The Member States and the European Parliament should decide the fate of the Commission's Fourth Package proposal by the end of 2015.

Unfortunately, Member States have not received the proposals with open arms. Especially smaller Member States fear neighbouring incumbents will dethrone their state-owned operators.

This makes it all the more important to enforce EU competition rules within the existing legal framework.

Opening up telecoms

So let me move on to an area where I believe we have had clear success: telecoms.

How does this differ from rail?

We have opened up the telecommunications market comprehensively and speedily in several legislative packages, starting in 1988 and culminating in 1998 with full liberalisation.

By the way, this process started with a competition regulation adopted by the Commission.

A similarity to rail is that companies with significant market power have to allow competitors to use their networks.

This applies especially to fixed telecoms, where we needed regulation to open the market. In mobile telecoms, by contrast, we safeguard competition through enforcement.

Because the market power of telecom incumbents derives especially from their old copper infrastructure, access regulation applies in practice to fixed telephone landlines.

By contrast, there is no access regulation in mobile telephony, because incumbents did not have an insurmountable initial advantage, so there were many competing new players from the outset.

Indeed, we have seen new phenomena such as network sharing.

In telecoms, too, national regulatory agencies enforce a regulatory framework which encourages competition and guarantees basic user rights.

In telecoms, we see how some of these user rights also stimulate competition between mobile telecoms providers.

For instance, phone numbers are portable: you can keep your phone number if you switch providers.

The maximum duration of an initial contract is twenty-four months. These consumer rights make it easier to switch operators, which stimulates competition.

As in rail, regulation and enforcement reinforce each other in telecoms. Regulation and competition enforcement follow the same substantive principles for the analysis of markets and the identification of dominant operators.

As in rail, recent telecoms cases focus on incumbents barring competitors from networks or squeezing their margins.

Examples are *Deutsche Telekom* (2003, margin squeeze), *Telefónica* (2007, margin squeeze), *Telekomunikacja Polska* (2011, refusal to supply) or, most recently, *Slovak Telekom/Deutsche Telekom* (2014, margin squeeze and refusal to supply).

Another concern is market partitioning. In the *Telefónica/Portugal Telecom* case (2013), the parties agreed not to compete in each other's home country.

Success in telecoms

So, how successful has market opening in telecoms been?

As a result of liberalisation and enforcement action, we have seen a dramatic increase in competition. In fixed telecoms, the market share of incumbents declines every year. It is now on average forty-two per cent.

In mobile telecoms, consumers can choose between a number of different operators.

European consumers and businesses can now obtain quality services at affordable prices.

Basic broadband is universal in Europe. High-speed fixed broadband (at least 30 Mbps) is available to sixty-one per cent of the EU population. Competition has also increased investments.

In France, for example, the entry of a fourth operator in the mobile market in 2012 reduced prices and induced all operators to increase investments.

What is more, alternative telecom operators are today the main investors into new fixed networks. To win over consumers with more coverage and better quality, mobile operators have rolled out on average three to four different nation-wide networks.

These national networks also point to a problem.

We have an open telecom market, but we don't have a European telecom market.

Most benefits of competition in the telecom sector only materialise at national level.

Radio waves ignore borders, but national telecom regulators allocate spectrum.

This is a problem for market integration and true cross-border competition. There are significant differences in the availability, duration and conditions of use and transfer of spectrum.

Despite the common framework, there are national differences in market regulation, rules and obligations.

The enormous potential of a true single market of over 500 million Europeans remains unexploited. Consumers and businesses suffer the consequences.

Telecom operators cannot provide telecoms services at the European level.

As a customer, I can't get a mobile subscription in a different member state.

Many people just switch off their phones or block data transmission when they go abroad, to avoid paying a fortune in data roaming costs.

President Juncker has called for the creation of a digital single market, by breaking down national barriers in telecoms regulation, copyright and data protection and in the management of radio waves.

This will allow EU consumers and businesses to obtain telecom services regardless of national borders.

Effectively integrating markets will also help us exploit the full potential of the EU economy.

In coverage of fixed next generation access networks (NGA) and deployment of 4G/LTE mobile technologies, the EU still lags behind the US.

This is mainly because the US benefits from a single non-fragmented telecoms market for 320 million people, and from a single spectrum and regulation policy, as opposed to twenty-eight separate national markets in the EU.

Not everything in the US telecoms markets is so satisfactory. The prices for fixed broadband are among the highest in the world, most likely due to a lack of competition.

So we should strive to have the best of both worlds.

Healthy competition in a true single telecoms market will stimulate operators to invest and to provide high-quality services at affordable prices, and to increase variety and choice for consumers and businesses.

Liberalising Energy

Whether for rail or telecoms, a crucial aspect of market opening is clear, and that is the access of competitors to networks and consumers.

This is true not only for rail and telecoms, but also for the energy sector.

The EU started to open up the energy markets in the 1990s, and has introduced several legislative packages.

We opened the energy market mainly by adopting regulation, allowing third parties access to networks and making it easier for customers to switch providers.

The energy sector brings me to another observation about the interaction between competition and enforcement.

Enforcement is not just a matter of upholding the law. Enforcement can also provide useful input to find new and better rules to make markets work better.

For instance, our energy sector inquiry launched in 2005 still found many competition problems.

Our inquiry revealed that incumbents remained dominant on national markets. It remained extremely difficult for third parties to access networks.

Many customers were locked into long-term contracts, and market partitioning agreements formed obstacles to market integration. So, in 2009, in the Third Energy Package, we introduced measures very similar to Telecoms and Rail:

We required companies to unbundle energy production and supply activities from network and transmission activities.

The Third Energy Package also enhanced regulatory supervision by member states and cross-border cooperation between regulators. In energy, too, we see how enforcement complements regulation.

This is clear from a dozen antitrust cases we have brought. In these cases we addressed problems with market integration and downstream customers.

We also tackled the various ways used by incumbents to keep competitors from accessing networks.

For instance, hoarding of gas transmission capacity (RWE and ENI), strategic underinvestment in and transmission capacity (ENI and GDF), long-term booking of network capacity (EON and GDF) and pre-emptive reservations of capacity on the electricity grid (CEZ).

In our most recent competition enforcement activities, we seek to reinforce and complement the Third Package by further opening markets and improving access to infrastructure.

During the mandate of the previous Commission, we have also focussed on Central and Eastern Europe, where market opening is less developed. For example, we have opened proceedings into Gazprom and brought cases such as OPCOM in Romania, and BEH in Bulgaria.

Like telecoms, energy has open markets, but European integration of these markets is still lacking.

The next step forward will be a resilient Energy Union with a forward-looking climate policy. The Commission will introduce a comprehensive set of regulatory initiatives. Competition law enforcement will actively accompany this process. We need an Energy Union:

First of all, to create a true internal energy market. Energy networks are natural monopolies and supply markets can be quickly dominated. But within a more integrated and better connected continent, industry will have more opportunities to compete.

Strict enforcement of the Treaty's competition rules will ensure that private company behaviour and national subsidies will not interfere with the free flow of energy or undermine the internal energy market.

Second, we need an Energy Union for security of supply. For gas, several European countries still largely depend on one single supplier. Sufficient interconnection capacities can help to diversify sources.

Third, we need Energy Union to improve sustainability. Renewable energy sources such as wind power and solar energy must be better integrated into the market. They are easier to manage on a larger, European grid.

Aviation

I've discussed rail, which has patchy liberalisation and barely a European market.

I've discussed telecoms and energy, which have open, but national markets.

The most successful opening to date, however, is aviation.

Aviation is now both fully deregulated and European in scope.

Aviation also used to be a heavily regulated market.

Countries protected their national airlines. National airlines monopolised major international routes, making it almost impossible for newcomers to enter the market.

Member States could block fares - unilaterally.

Member states dictated where you flew, when you flew, what plane you flew and at what price you flew.

Even so, in aviation, competition got off to a flying start.

We opened up the aviation market quickly, and completely, and across Europe, in three successive packages. The third one was adopted in 1992.

We opened this sector mainly through regulation, such as the airport slot allocation regulation or the ground handling directive. But parts of the market are unregulated – such as the construction of airports.

We permitted any airline meeting common safety, nationality and fitness criteria to operate from anywhere in the EU.

We lifted airline ownership restrictions inside the EU.

We opened up routes between all airports.

We allowed airlines to set their own fares.

Opening up this market also required regulation for safety and security, passenger rights and employment conditions.

To ensure competition, we also needed to regulate the ancillary services on which air traffic depends. Rules concerning insurance requirements, airport charges, ground handling services, slot allocation and computer reservation systems.

And in 2008, we introduced regulation 1008, which addressed remaining problems of competition and helped to reinforce the internal market and establish a level playing field.

As in rail and telecommunications, competition enforcement complements regulation.

Here, too, competitor access to markets is key. What networks are to telecoms and rail, take-off and landing slots are to passenger travel by air.

Newcomers need them, if they want their business to "take off," so to speak.

At Heathrow, a pair of slots is valued at thirty million euro a pair. In the One World Air Alliance case, airlines BA, AA and Iberia ultimately offered commitments to make Heathrow slots available to competitors.

Successes in aviation

Liberalisation in aviation has been a success

The number of cross border routes has doubled.

The number of airports has increased: sixty per cent of Europeans now live within a two-hour drive of at least two airports.

Admittedly, some live within ten minutes of two airports. That's not a good idea either, and we attack these anomalies under State aid rules.

Above all, liberalisation has made low cost airlines possible.

In the 1970s and 1980s, air travel was a luxury. In the mid-1980s, lots of people had never set foot in a plane before. Now, it's like taking a bus.

Passenger numbers have increased by nearly fifty per cent in ten years' time (1997-2007).

In 1992, low cost airlines had only 1.5 per cent per seat market share.

In 2011, low cost airlines had 42 per cent market share. In that year the low cost airlines took over the incumbents.

As in rail and telecoms, there is a clear link between competition and investment.

Competition by low cost airlines has put pressure on the incumbents to invest by opening new routes, by increasing flight frequencies, and by introducing innovative new services such as self-check-in, fast track security, and e-tickets.

Conclusion

So, where does this leave us in the matter of competition versus regulation?

In Europe, we do not intend to put the genie of competition back into the bottle.

Because in Europe, we still see competition as the best road towards prosperity.

This is why we have introduced European legislation to open markets.

Not just within the member states, but also between the member states.

At the same time, and that touches on the theme of this conference, we do not believe that market forces should run completely unchecked.

We believe regulation is necessary to create a level playing field.

Access, affordable prices, switching, innovation, investment and interconnection are the new key words.

And whether it is sector regulators overseeing their sectors, or the Commission and NCAs safeguarding competition: independent referees are necessary to enforce those rules.

Without referees and a rule book, competition becomes self-defeating.

Much like giving all the players in a football game their own whistle.

So, this is why, in the future, we will continue to push for open European markets through a combination of regulation and competition.

For instance, the creation of a Digital Single Market involves breaking down national and other barriers in telecoms regulation, copyright and data protection rules, and the management of radio waves.

To create an Energy Union that can guarantee security of supply, we need to pool resources, and to put infrastructure in place to safeguard an integrated market, an integrated market that should include renewables and so-called capacity mechanisms.

Ladies and gentlemen,

I started with John Sherman, but I would like to end with the European origins of competition enforcement.

In Europe, too, the trusts were one of the big social and economic issues of the day in the early 20th century.

Austrian lawmakers of the *Belle Époque* condemned cartels as an additional private tax on citizens, which is an astute and quite modern-sounding observation.

In my own country, in the early 1900s, in a little book entitled *Trusts and Cartels*, the Dutch social democrat Wibaut pessimistically predicted trusts would end up dominating national economies.

His solution was to *nationalise* them. I think we have found a better solution.