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THE DEVELOPMENT OF COMPETITION POLICY IN CENTRAL AND EASTERN EUROPE: U.S. TECHNICAL ASSISTANCE

We are witnessing a tremendous and historic effort by the new democratic governments of Central and Eastern Europe to transform their economies to market systems. Since private sector growth in these economies is unlikely to absorb immediately all of the displaced workers and other resources of the government-owned enterprises, any rapid transformation from public to private ownership is likely to lead to substantial short-term unemployment.

In a recent address to the World Affairs Council, Deputy Secretary of the Treasury John Robson catalogued some of the disadvantages facing former command economies in attempting to leap the distance to the goal of free markets. He included:

> . . . the paucity of managerial and basic business skills; the shortage of indigenous capital and the likelihood that capital flows from the outside will come cautiously; the absence of functioning banking and financial systems; the collapse of trade with virtually all of their previous export markets; the unsteady, fragmented and frequently fractious new democratic governments; and the disruptive tension of ethnic rivalries.[1]

Robson concluded, "In the face of these considerable obstacles, it is not reasonable to expect the economic reform process to be tidy or brief." For many of the reasons noted above, as well as others, simply transforming state-owned enterprises into private enterprises may be delayed or may not be sufficient for consumers and workers in those countries to enjoy the benefits of competition. To this end,

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[1] Remarks by Deputy Secretary of the Treasury John E. Robson, World Affairs Council, Washington, D.C., April 8, 1992, p. 4.

agencies set up by the governments of those countries for the purpose of competition policy enforcement are likely to be critical in establishing and maintaining competitive markets.

The Federal Trade Commission and the Department of Justice are cooperating in a program funded by the Agency for International Development ("AID") to provide technical antitrust and consumer protection advice to the newly-formed democracies of Central and Eastern Europe. Currently, the program covers Poland, Czechoslovakia, Hungary, Bulgaria, Romania, Estonia, Latvia, and Lithuania. The technical assistance consists of four major types of activities: (1) placement of long-term resident advisors; (2) short-term assistance missions by additional attorneys and economists with particular expertise in specific industries or anticompetitive practices being addressed by the antimonopoly agencies; (3) internships in the United States to provide government officials from Central and Eastern Europe with a broader understanding of the implementation of competition law; and (4) regional workshops on enforcement issues.

The FTC and DOJ each have one professional working long term in Czechoslovakia and in Poland. The purpose of this assistance is not to tell the governments of these countries what to do, but instead to provide technical assistance on how we analyze key economic concepts and carry out investigations. Despite the differences that may exist between these countries and the U.S., analysis aimed at understanding the economic incentives for, and the results of, actions taken by economic actors can help to answer the ultimate question posed by all

antimonopoly laws -- do the actions of an enterprise result in consumer harm or inefficiency through unilateral or collective practices likely to result in an exercise of market power monopolistic or collusive practices? Accordingly, we, and the governments in Central and Eastern Europe, believe our technical advice can be useful in helping make wise policy decisions in the long run, without telling the agencies how they "should" act in any particular case.

Our technical assistance program is only in its eighth month of operation; but we are pleased to have established what we at least perceive to be excellent working relationships with the Polish Antimonopoly Office and the three Competition Offices of Czechoslovakia. As a result, we have been able to witness first hand the progress and success of these offices as they work to promote competition law in their respective countries.

From the outset, these agencies have sought to establish their role in combatting anticompetitive practices, helping in the formation of a competitive structure for a market economy and integrating competition policy as a key element of general economic policy. These are goals which all of our agencies strive to promote, and we can both appreciate and respect the successes of our Central and Eastern European counterparts as they meet the tremendous challenges put to them in a time of radical political and economic change.

The first major competition-related activity taking place in the Central and Eastern European countries is the privatization of the thousands of state-run industries, and there are many issues flowing from the privatization process which are fundamentally "competition" issues. Some governments require their privatization agencies to consult with competition authorities when drawing up their privatization plans, and our overseas personnel have had the opportunity to participate in these discussions. Given the newness of the market economy in these countries, the observation has been that many of those involved in the privatization process, especially managers of enterprises that are potentially subject to privatization, have some preconceptions and private objectives that are not always consistent with a competitive market structure.

For example, some of the state-run enterprises appear to be pleased with their ability to independently set their own prices, but do not seem to want to accept the quid pro quo of being privately owned and responsible for their own financial viability. These enterprises frequently argue that they are somehow special and should continue to be linked to the government; and that they need special government subsidies or protection to avoid bankruptcy. Alternatively, some of these firms argue that if they must undergo privatization, they should be privatized only as monopolies and not be split up into competing units. Many managers have stated that they need to remain big if they are to compete with foreign firms that they perceive as being much more efficient. While the "big is bad" school of antitrust thought has waned in the U.S., few American

antitrust scholars would contend that big is necessarily good. This may be especially true in former command economies where these enterprises did not achieve their present size by demonstrating their superior business skill and acumen, but rather for political or bureaucratic reasons.

In addition, the privatization plans of these enterprises often call for the continued tenure of the present managers, and attempt to guarantee for a fairly lengthy period after privatization such things as: employment levels, housing, and other benefits associated with the existing enterprises. Such guarantees, with their concomitant costs, can make it difficult for the newly-privatized firms to react to competitive conditions and operate efficiently. If not checked now, they may lead to delayed benefits from privatization.

Perhaps most disturbing, some enterprises often argue for the imposition of high tariffs or low quotas for imported competing products. They argue that they need such protection because their products cannot compete against the more efficiently produced foreign goods. Foreign investors also often seek tariff or quota protection against imports as a precondition for agreeing to participate in a joint venture. In some cases, these import restrictions may be necessary, at least temporarily, to allow new ventures in an infant industry to get off the ground. Nevertheless, such claims by domestic enterprises and foreign investors must be reviewed carefully. Firms that receive such protection have less incentive to become more efficient relative to foreign competitors. Also, temporary protection has a way of becoming permanent since over time

various interest groups become accustomed to the protection and fight to maintain the status quo. FTC staff studies of import restraints in the U.S. have invariably shown that the cost of the restraints per job saved is extremely high. There is little reason to expect different results in the new free market economies.

While natural monopolies likely will not be privatized, there is some question as to what constitutes a natural monopoly. We have been able to share our knowledge about what industries traditionally have been viewed as natural monopolies and the ways to regulate them. For industries that are likely to be regarded as natural monopolies, such as electricity and some forms of telecommunications, we have shared our experience with regulation and deregulation in these and other sectors. In addition, we have provided information on the methods of regulation which have, in our experience, best promoted efficiency.

In industries where privatization is not in doubt, information about the structure of those industries in other countries can assist the new antimonopoly agencies in determining how much competitive restructuring various industries can sustain. For example, many countries in the world have food processing sectors that are far more concentrated than the agricultural producers from whom they buy their produce. In Central and Eastern Europe, there is much concern that a few middlemen or food processors may be able to exercise monopoly buying power over farmers.

One type of food processing industry, for example, had been split into 78 independent, single-plant processors during

privatization. The antimonopoly committee was subsequently asked to allow some of those plants to combine. We were able to supply information about the scale of processing in that food industry as it has evolved in the U.S. and Western Europe, a scale that is significantly larger than plants in Central and Eastern Europe. We found, for example, that the 78 processing plants produce what 10 plants in the same industry produce in the United States, and that plant scales in Western Europe are even larger. This information may aid the antimonopoly committee in its assessment of the competition implications of the request to allow some consolidation in this industry.

Active cooperation and even collusion among firms competing in the same market was often encouraged in centrally planned economies. Now that enhancing competition has become part of the economic reform program in these countries, such cooperation can be counterproductive, and our representatives have stressed that challenging collusion among competitors must be a major priority if competition is to succeed.

The antimonopoly agencies can educate business people about the illegality of horizontal collusion and the importance of competitive behavior by successfully prosecuting one or two well-publicized horizontal collusion cases. However, the way some antimonopoly laws are written or interpreted can make prosecution of collusion difficult in this transition period. In one instance, for example, we were told that the presidents of several major plants in a basic industry had established a "club" to discuss prices. The

antimonopoly statute, however, was apparently not broad enough to apply to the club, because it was registered as an "ordinary association" instead of an "economic entity", and its members were individuals not corporations. In the U.S. the members of such a "club" would be subject to prosecution for horizontal price fixing, which is per se illegal and a criminal offense. As these agencies gain experience by bringing more antitrust cases, they are likely to find enforcement gaps in their law and will, by finding a means to fill them, develop a stronger competition law and enforcement procedures. We view our role as providing information on how the U.S. would enforce competition policy in such scenarios.

Dominant firm oversight is a prominent feature of antimonopoly laws in Central and Eastern Europe. Since large state-owned monopolies are a legacy of communist regimes, public concern over the potential for abuse of monopoly power after liberalization of prices has given special importance to the dominant firm provisions of the antimonopoly laws. Most of the new laws are modeled on the law of the European Community (EC), which prohibits abuse of dominant market positions and authorizes regulation of dominant firms found to have violated competition laws.

When dominant firms are found to be charging prices that are deemed to be too high, some antimonopoly agencies in Central and Eastern Europe are authorized to impose price regulation. The EC, while asserting its power to regulate dominant firm prices, has rarely exercised that power; and antitrust authorities in the U.S., instead of regulating prices and outputs, have focused on the

encouragement of competitive market structures that lead to competitive prices.

Our reasons for not regulating prices are many -- a desire to encourage competitors to compete vigorously by not taking away gains when they succeed, informational problems limiting the ability of government regulators to determine the competitive price level, distorted incentives resulting from setting prices at a wrong level, a lessening of the informational role of prices in attracting new investment and entry, etc. -- and our representatives have communicated those considerations to the antimonopoly agencies they are advising. At the same time, we recognize that the antimonopoly authorities are charged with enforcing their own laws, which may require them under some conditions to regulate prices of dominant firms. We would expect, however, that as internal competition expands, as trade barriers are lowered, and as market institutions are put in place, the Central and Eastern European countries will be less inclined to question price decisions rendered by unfettered market forces, and will focus their enforcement efforts on anticompetitive actions that prevent the entry of new firms or unfairly raise the costs of their rivals.

One feature of dominant firm legislation in most of the post-Communist countries is reliance on a threshold level of market share for a presumption of dominance. Our representatives, reiterating what we have said in our comments on draft antimonopoly laws in Central and Eastern Europe, stress that market share standing alone is not necessarily a reliable indicator of market power. While many

dominant firms in those countries are creatures of the monopolistic policies of communist governments, penalizing a firm simply for high market share, especially for actions that would be legal if the firm were not declared dominant, might discourage aggressive competition by firms that are successful because of superior efficiency or innovation.

In one particular case, a joint venture was being proposed between an American firm and the only manufacturer of a type of capital equipment that had significant safety requirements. As a condition of its participation in the joint venture, the American firm was demanding the right to require customers to purchase service and parts from the manufacturer. The antimonopoly agency expressed some concern about the competitive implications of this requirement and our advisors were able to provide information about a merger case in the U.S. involving the same industry, which helped in weighing the negative and positive aspects of the restrictions. It has been our experience that control over service and parts may sometimes be necessary to maintain the quality and reputation of some types of capital equipment, especially equipment for which safety and reliability are important. But at the same time, such requirements might raise barriers to entry into the market for the capital equipment by increasing the need to enter at two levels. It has also been our experience that safety and reliability concerns can often be met by means that do not restrict competition, such as the implementation of minimum standards and certification procedures. This information was presented to the antimonopoly agency and is a

good example of how, without suggesting a "correct" answer to a particular problem, we provide the range of our experiences -- our "lessons learned" if you will.

Price discrimination is another common complaint. One manufacturer, for example, complained to the antimonopoly office about discrimination by one of its key suppliers. The supplier was requiring the manufacturer to make purchases through its retail distributor, and thus denying it the discounts that were granted distributors and long-term contract customers. Again, our experts were able to provide a conceptual background for the analysis by discussing the role of transactions costs and risk sharing, which might provide cost-saving efficiency explanations for volume discounts in some cases.

Our representatives have also held discussions and seminars on basic matters relating to enforcement of competition policy and on aspects of U.S. antitrust law, both substantive and procedural. Subjects have included measures of concentration, problems of market definition, natural monopolies, cartel conduct, and exclusionary practices. Procedural subjects have included evidence gathering techniques, pre-merger notification filing requirements, and ways of detecting cartels and proving their existence.

A number of short-term assistance missions by attorneys and economists with particular expertise in specific industries have supplemented the work of our longer term overseas personnel. For example, in October, the Polish Antimonopoly Office requested expert advice on competition in the newspaper industry. A DOJ economist who

is an expert in the newspaper sector went to Warsaw for one week and worked with our overseas personnel to explain the U.S. criteria for evaluating newspaper mergers with Polish Antimonopoly Office staff.

In December of 1991, the FTC sent an attorney and economist team for one week to Warsaw to provide expert consulting on competition policy in the energy sector. One of the results of the work of the FTC experts was to establish an extended system of communication between the Antimonopoly Office and the FTC and to provide continuous expertise from the FTC on restructuring plans.

In March of this year, a team of FTC and DOJ experts visited the Hungarian Competition Agency in Budapest. The subjects of discussion with the agency officials included consumer protection issues, antitrust enforcement techniques, regulatory issues, and criminal antitrust enforcement.

An FTC team also went to Czechoslovakia this past March. The team principally discussed competition issues in the automotive industry with the Federal Office, sharing information on our experience over many years of that industry. The attorney and economist team also discussed the types of information necessary to analyze whether prices are anticompetitive and to analyze alternative means of restoring competitive pricing.

Most recently, I was in Sofia, Bulgaria with a team of attorneys and economists from the FTC and the DOJ where we had the opportunity to visit with the Committee on the Protection of Competition. Four members of the team stayed in Bulgaria for two weeks to consult with

the Committee and to discuss the U.S. approach to antitrust and consumer protection cases.

As part of our program to provide antimonopoly officials with first-hand experience in competition law enforcement in the U.S., we have to date hosted as interns (with separate AID and foundation support) the then Vice-Chairman of the Slovak Antimonopoly Office, and the Director of the Antimonopoly Policy Department of the Polish Antimonopoly Office. Our goal has been to provide these interns with a broad-based understanding of both the structure and operations of the FTC and the DOJ.

We also hosted week-long visits by Minister Imrich Flassik, the Chairman of the Federal Office for Economic Competition in Czechoslovakia, and by Dr. Anna Fornalcyzk, President of Poland's Antimonopoly Office. And in March 1992, the FTC and DOJ sponsored a region-wide workshop on competition analysis principles and investigative techniques in Vienna, Austria.

Our Central and Eastern European Technical Assistance Program has given us a splendid opportunity to be "present at the creation" of the antimonopoly agencies in these countries, and it has given us a greater appreciation of the tremendous accomplishments of our own forerunners in setting up efficient and workable investigative and operating procedures, which we too often take for granted.