Department of Justice

THE IMPLEMENTATION OF COMPETITION LAWS IN CENTRAL AND EASTERN EUROPE: LESSONS FROM THE U.S. EXPERIENCE

REMARKS OF JAMES F. RILL
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION
U.S. DEPARTMENT OF JUSTICE

BEFORE THE INTERNATIONAL CONFERENCE ON COMPETITION LAW AND POLICY

TATRANSKA LOMNICA, SLOVAKIA
October 3, 1991

Introduction

It is both a pleasure and an honor to be invited to join you today in this beautiful mountain setting. Only two years ago it would have been very difficult to imagine such an expert group convened here to discuss common concerns about competition law and policy. Even last year, it would have been difficult to imagine the impressive progress that already has been, and soon will be, achieved in the emerging market economies of Central and Eastern Europe.

I am here today to discuss the importance of developing a sound enforcement policy to guide the implementation and interpretation of competition laws.

The process of drafting, considering and enacting competition law has rightly been foremost in the minds of many of you these past months. Honest, free debate on important issues of competition policy has resulted in the enactment of sound competition laws in Czechoslovakia, Hungary, and Poland. The task now facing those Central and Eastern European countries with laws in place is how to make them work in practice to ensure the achievement of the intended result -- the creation and maintenance of prosperous market economies that are based on free competition among private enterprises.

My primary message here today is that sound competition law enforcement, working in close coordination with the privatization process, should promote the creation and maintenance of healthy, market-based economies.

Conversely, competition policy should not be designed to pick winners and losers among competing firms; and, very emphatically, it should not be a mechanism for protecting inefficient firms from aggressive competition. I would like to take a close look at some of these provisions, and to offer some policy-based observations about how these laws might be enforced to yield the best results.

Before I do that, however, I would like to note now, and to elaborate at the conclusion of my remarks, that whatever enforcement policy decisions are made and pursued by the Central and Eastern European competition authorities, much work will remain to be done. It is my opinion that gathering as a group, as we have today at Minister Flassik's initiative, is a valuable tool for ensuring good and consistent results in competition policy in an increasingly interdependent world economy.

I therefore would suggest that a variety of future programs could be pursued by the group convened here today. Specifically, this group could formalize regular, ongoing consultations between our respective competition authorities,

and create working groups to study issues of competition law and policy that are of particular interest to Central and Eastern European countries. In addition, I would suggest that particular attention be paid to training judicial officials who will be charged with enforcing your competition laws. I will return to these suggestions later, but want to raise them now, to provide a framework for my remarks about the process of law enforcement, a process that requires constant study and vigilance.

What demands our attention in particular, and what I would like to discuss today, is the extent to which antimonopoly laws can be either over-enforced or under-enforced. As our 100 years of experience in the U.S. suggests, competition laws may be interpreted and enforced so stringently that innocent, pro-competitive behavior is punished, or they may be interpreted and enforced so loosely that culpable, anticompetitive behavior goes unpunished. In the first case, consumers will suffer as entry by new firms and aggressive, procompetitive behavior by existing firms is discouraged by heavy-handed litigation and regulation. In the second case, consumers will suffer in an altogether different way, as firms conspire or combine to raise prices and eliminate consumer choice. The crucial task facing the competition authorities is to reach an appropriate policy balance in an area where the correct answers are not always obvious.

The language of the new Central and Eastern European competition laws provides a good starting point for discussion of these issues, but the heart of the matter will be what the competition authorities do with that language.

I should emphasize that it is difficult to generalize in any way about regional issues in Central and Eastern Europe. The new competition laws, for instance, vary from one another, as much as their underlying economic and political conditions vary from each other. Without overlooking the significant differences beteween the northern tier countries, I do wish to address some basic issues of competition policy raised by the new competition laws of Central and Eastern Europe.

These new laws generally are broad and flexible. They have been designed to apply to a wide variety of different economic circumstances and commercial arrangements, many of which cannot yet be imagined or anticipated. In the years to come, these economies will experience a proliferation of new product and service markets, and will attract foreign investment -- bringing new business and commercial arrangements that will raise novel competition issues that the new laws must address. In addition, many of the laws wisely specify a role for the competition authorities in the privatization and demonopolization process.

It is vital that competition law enforcers send clear and principled messages to the market about the way in which competition laws are to be enforced.

Today, I wish to discuss five basic enforcement principles that I believe are important regardless of the specific terms of any given competition law -- as each of the laws we will discuss here contains provisions that are subject to various interpretations on these points. I will return to explain each principle in some detail, but first I want briefly to summarize them, as a framework for further discussion.

It is important, first, to adhere to the rule of law, such that competition laws are applied in a non-discriminatory and transparent manner; second, to distinguish carefully between conduct that is in fact anticompetitive and conduct that merely constitutes hard but fair competition; third, to define markets in such a way that so-called "dominant" firms in fact possess real market power; fourth, to distinguish between business agreements that are horizontal and agreements that are vertical; and fifth, to avoid trying to regulate prices directly through the enforcement of competition laws.

Background on the Role of the U.S. Department of Justice

An important distinction between the two U.S. federal agencies, and between the Department and many of your agencies, is that the Department's enforcement decisions must be enforced in lawsuits before the U.S. courts, where the Department acts as prosecutor. The Department identifies and investigates possible antitrust violations and is entitled -- and expected -- to exercise prosecutorial discretion. This is a critical element of our work, and we have issued several sets of guidelines over the years to explain our interpretation of the laws and the basis for our enforcement policies. But our decisions to challenge particular business conduct or transactions can be enforced only by orders issued by the courts, which, as a practical matter, produce a large body of the interpretation of our laws.

Principles

The Department has had over a century to derive its current enforcement policies. I believe that we have evolved, though not always in a straight line fashion, toward a rational and economically sound approach to enforcement. Our policies continue to evolve as we learn more about our markets and as market conditions change. We can identify, however, several principles or lessons that work to guide our analysis and interpretation of the Sherman and Clayton Acts. I offer them here, in the hope that they might also guide yours -- as many of the issues we face are the same.

1. **Adherence to the Rule of Law.** The first principle, adherence to the rule of law, is quite basic. It directs that the competition laws, whatever their terms, be applied even-handedly and fairly to all market participants, based upon the nature of the conduct in which they are engaged.

Eliminating arbitrariness in enforcement and instituting clarity and certainty in prosecution are essential to creating a stable economy and an effective deterrence program. The decisions of entrepreneurs to invest and to compete vigorously turn on their confidence that competitive conduct will be rewarded, anticompetitive conduct will be punished, and the rules will be applied in an even-handed fashion to all market participants.

A key feature of the U.S. system is its independent judiciary. We in the Department of Justice have to prove our cases in the courts, as would any other litigant. Our Constitution has created a system of checks and balances that ensures independent judicial decision-making -- thereby secuiring the primacy of the rule of law.

2. **Competitive vs. Anticompetitive Conduct.** The second principle is that not all monopolies are alike. Enforcement agencies must distinguish between monopolies that have achieved and maintain their position through aggressive, hard

competition or because they provide a new and competitive service or product -- and those monopolies that achieved or maintain their position through anticompetitive practices or governmental arrangement and protection. This distinction is important to the U.S. economy. It is probably even more important to the emerging market economies of Central and Eastern Europe, where it is critical to maintain incentives for private entrepreneurs to enter new markets so that the transformation to a free market economy will succeed.

A producer that identifies a need that is not being met and enters a market with a new product provides one of the most important mechanisms by which consumers receive good products at low prices. If the producer is successful, it sells large quantities of output and earns high profits. Consumers have a product that they did not have before, and their lives are improved.

An antimonopoly enforcement agency, however, might be concerned that the entrepreneur, producing a new product with little or no competition, has achieved a "monopolistic" or "dominant" position (since many of the new laws define dominance by market share). The agency may note that the firm is earning high profits and conclude that consumers would be better off if the producer were strictly regulated by the agency and forced to sell the product at lower prices.

The agency might be correct, but only in the short term. The long-term problem with this enforcement strategy is that it is the very prospect of significant profits that attracts new firms into the market in the first place. Investors, domestic or foreign, who observe that the government of a country will usurp the benefits of innovative behavior will not endure the trouble and risk of making the initial investments. The country's economy can stagnate, and consumers can suffer.

The economies of Central and Eastern Europe contain dominant, even monopolistic, firms that have achieved their status, not by producing good products at low prices, but because they were created as state monopolies and protected from competition.

The issue of these monopolies will have to be dealt with through the privatization process, which one hopes will act to foster competition. Before or after privatization, however, these monopolies may seek to maintain favored competitive positions through the use of vertical integration, refusals to deal, and long-term contracts to deny to potential entrants either critical inputs or distribution channels.

These kinds of behavior are properly subject to attack under any of the new competition laws of Central and Eastern Europe. Article 5 of the Polish law, for example, forbids a firm in a dominant position from "refusing to sell or purchase

commodities in a manner discriminating (against) certain economic subjects when there are no alternative supply sources or outlets," and there are similar provisions in the laws of the CSFR and Hungary. Using these provisions to attack this kind of monopoly or dominant firm behavior can improve the working of the market and protect consumers.

3. **Delineating Markets and Dominant Firms.** The third principle involves one of the most complex areas of competition policy enforcement -- delineating or defining markets and dominant firms. Market definition is at the heart of competition policy, and it plays a critical role in two aspects of the new competition laws of Central and Eastern Europe.

All of the new laws contain specific restrictions on the conduct of a firm with a dominant position. It is particularly important that enforcement agencies delineate markets such that a firm labelled "dominant" truly possesses market power, rather than simply a high share of sales in an arbitrarily defined market. If enforcement authorities and courts are too anxious to attach the label of "dominance" to a firm -- if the firm's temporary success in entering a new market brings on a series of government controls and strictures -- then firms will lose the incentive to succeed in the market, and consumers will be deprived.

It is important that markets be defined using careful economic analysis rather than relying on the short cuts of using, say, the historical categories outlined by government statistical agencies for quite different purposes. All products that are close substitutes from the buyer's standpoint should be included in the market. To take a hypothetical example: in the United States, business people may speak of "the midwestern aluminum market." Government statistical agencies and private business publications may publish entire volumes of data on "the aluminum industry."

But if other products -- say, tin or steel or plastic -- are close substitutes for aluminum from the standpoint of buyers, those products must be considered in assessing the possible market power of aluminum producers. Conversely, if "the aluminum industry" in fact includes many different products that are not close substitutes from either a consumption or a production standpoint, then a firm that is truly dominant in one of those smaller markets may have a very small share of "the aluminum industry" but have the power to increase prices to certain specific classes of customers.

The definition of the market from a GEOGRAPHIC standpoint requires a comparably careful and subtle analysis. Again, the temptation from the availability of government statistics may be to assume that the boundaries of geographic entities -- cities, states, republics, nations -- are synonymous with the boundaries of geographic markets. But this assumption may be incorrect.

As Mr. Bartik of the Czech Republic Authority for Economic Competition has written, "it will be necessary to outline the . . . relevant market according to where goods and services actually meet and at what distances the seller still finds the opportunity for sales, in view of transport and other costs."

It may be rather easy for a firm with a large market share, however transient, to be labelled "dominant" under some of the new laws. Section 21 of the Hungarian law, for example, has several market power-related criteria for dominance -- including that the firm has "no significant competition," or that the product or service is available elsewhere "only under much less favourable conditions" -- but it also defines as dominant a firm with a market share of 30 percent. The CSFR and Polish laws are broadly similar to this, in referring both to fact-sensitive measures of market power and to measures of market share as criteria for dominance.

In the United States, we are moving away from strict market share tests for determining the existence of market power. To the extent that the Central and Eastern European laws turn on precise market share thresholds, it will be important for antitrust enforcers to define markets such that these thresholds at least apply to the group of products and geographic area that actually would be affected. In that way, one can be sure that only those firms with market power are treated as dominant firms and only those mergers that would truly limit competition are restricted.

4. **Horizontal vs. Vertical Agreements.** The fourth principle is to distinguish between types of business agreements. Horizontal and vertical agreements are different phenomena, with different economic implications, that consequently require different kinds of analysis.

A competition law that does not distinguish between the two will cause serious confusion and could result in policies that stifle efficiency and innovation.

Horizontal agreements among competing firms to set a high price, to reduce output, or to allocate customers or territories are among the most pernicious of antimonopoly violations. They also can be among the most difficult to detect and prosecute. This is why U.S. law treats certain forms of such agreements harshly: they are illegal <u>per se</u> --

that is, the parties may not seek to demonstrate any benefits flowing from an agreement -- and those who engage in them may be subject to criminal prosecution and jail time. Both per se illegality and criminal treatment are pursued in the hope that some participants, fearing criminal prosecution, will conform their conduct to the requirements of the law.

Vertical agreements among firms can resemble the horizontal ones superficially, though they can have very different consequences. Where they do not involve firms possessing market power, we find that they are often used in pro-competitive ways -- to facilitate entry into a market, for example, or to insure the quality of a product as it is resold. Because vertical agreements may be used in either a pro-competitive or an anti-competitive manner, they tend, for the most part, to be analyzed in U.S. courts under a "rule of reason" analysis that seeks to determine whether a particular agreement will help competition or harm it and, if it will do both, to determine which effect is the stronger.

Among the laws that I have examined, the Hungarian law makes a clear distinction between horizontal and vertical agreements, but the CSFR and Polish laws do not. As I have mentioned, for the most part, the U.S. statutory law also does not, but over the years -- though not without difficulty -- our

case law has embraced the distinction. I believe that it will be important for enforcers in these countries to sharply differentiate between the two types of agreements so that entrepreneurs will have a clearer idea of what constitutes permissible behavior.

7. **Avoid Controlling Prices Directly.** The last principle I will discuss today is that governments in general, and antimonopoly enforcers in particular, should seek to minimize the resources they devote to controlling prices directly. In the long run, prices will be lower and the economy more efficient if prices are allowed to find their competitive equilibria, rather than being directly regulated by government action.

Not all "high" prices are alike. Some accompany the introduction of a new product on the market; some are the result of cartel agreements or monopolization. In the first case, the possibility of charging high prices is what attracts new producers, and if there are no barriers to the entry of other producers in to the market, such high prices ultimately will attract new entry with lower prices and continued product innovation -- an attractive result.

In the second case, consumers must pay more for, and thus consume less of, the affected product than they would in a competititve market -- an unattractive result.

There may be legitimate reasons for the continuation of direct controls in the developing market economies of Central and Eastern Europe. Controls on particular goods may buy the government more time to pursue the crucial transition to a market economy. With entry conditions frequently so difficult that high prices cannot effectively do their job of attracting new firms, some limited price controls may be necessary -- at least for some limited period of time. I do not disagree with or minimize any of these considerations; nor could I deny that we in the U.S. have occasionally resorted to the direct control of prices (though not through our antitrust laws and seldom without adverse consequences.) I would simply emphasize what you all know very well: that the excessive use of price controls will destroy the incentive structure needed to drive a market economy.

Proposals for Future Work

As I mentioned at the beginning of my remarks, it seems to me that our group here today could benefit from continuing the associations and discussions begun at this conference; and I want to take this opportunity to congratulate Minister Flassik for his initiative in bringing us together.

Ongoing Consultations. I would go further to suggest that this gathering of competition authorities be formalized in some way. There are other international organizations for the discussion of competition issues, of course, and much good work has been -- and will be -- done at the OECD, through the Partners in Transition program and otherwise. But I am aware of no organization that provides an opportunity for regular dialogue among the competition authorities of Central and Eastern Europe on issues of particular concern to those authorities.

Because many of the goals you share are similar and developments are proceeding at such an impressive pace, I believe that a continuing dialogue through regular consultations would benefit everyone.

Working Groups. Indeed, one possible function of this group could be the study of particular issues facing the emerging market economies of Central and Eastern Europe. Working groups could be developed to investigate in depth common questions among you, such as:

- o <u>The Collection of Relevant Market Information</u>; how to collect and record market information, including methods of discovery and data processing.

- o The Methods and Techniques of Cartel Detection; how to draw difficult distinctions between innocent economic behavior and anticompetitive conduct, and how to engage in fruitful investigations of business practices, including pricing.

- o The Definition of Relevant Markets; how to approach the issues and implications of cross-border markets, information sharing and cooperative enforcement.

- o The Functions of Private Trade Associations; how to evaluate the procompetitive and possible anti-competitive effects of the activities of private associations of businesses, including the exchange of technical information, market information and standard setting.

- o Education Program for New Market Entrants; how to explain competition laws, develop dependable enforcement guidelines and answer inquiries about how a free-market economy can work, in an effort to give new market entrants the confidence they will need to compete vigorously.

To the extent that the U.S. Department of Justice, I am sure the FTC, and other Western competition authorities can assist you in such studies, through consultations or, for that

matter, continuing participation in the groups themselves, I hope you will avail yourselves of our offers of support. Included in the DOJ-FTC technical assistance program, for instance, is a plan to provide support on specific subject-matter projects, as well as more general, longer-term assistance.

Judicial Training Conference. Another area in which I believe the Central and Eastern European competition authorities might usefully work together is the in the training of judges to familiarize them with principles of competition policy and laws, and the economic theories underlying them. In the U.S., there are a variety of organizations that present training conferences for the U.S. judiciary. If our experience would be helpful in this regard, I would be happy to share more specific ideas for such training, as well as materials on some of the courses offered to U.S. judges.

Training Conference for Other Government Officials. This group may find it useful to present a training seminar in competition principles for government officials responsible for government procurement, privatization, and trade policy. While these officials may not be directly involved in competition policy enforcement, their actions often have effects on competition in the U.S. economy, and I suspect they could have

similar effects in your economies as well. The Department of Justice and FTC have an active competition advocacy program that includes such training to improve consistency and understanding of competition policy within our government as a whole.

I do not presume to propose the foregoing list of possible work as a formal work plan. Rather, I have suggested some ideas for coordinated effort that seem to me to be practical, timely, and relevant to the interests of Central and Eastern European competition authorities. My hope is that these ideas will form a basis for informal discussions during the next two days, and that some of them ultimately will form part of a cooperative effort among all of us here today toward achieving what I believe to be our common goal: the creation and maintenance of efficient, competitive market economies in the newly democratic nations of Central and Eastern Europe.

Conclusion

Let me close by saying that I stand in awe of the courage displayed by the peoples of Central and Eastern Europe in seeking to rebuild their -- your -- economies on market principles, safeguarded by the rule of law. I hope that my remarks today have adequately communicated my personal respect, and my government's respect, for the splendid job you are doing, and our commitment to working with you as the next stages of economic reform and competition policy get underway.

I would like to take this opportunity to thank our gracious host, Minister-Chairman Flassik, for his generous Slovak hospitality, and for bringing us together in this lovely place to cement ties of personal friendship and international cooperation, in a cause to which I have devoted my 30 years of professional life. Minister Flassik has done an extraordinary job of organizing a conference that, I believe, we all will look back upon as an historic event and a model for future cooperative efforts.

Thank you very much.