ESSAY: Restraints by Regional and Local Governments on Competition: Lessons from Transition Countries

John Clark

Follow this and additional works at: http://brooklynworks.brooklaw.edu/bjil

Recommended Citation
Available at: http://brooklynworks.brooklaw.edu/bjil/vol25/iss2/25

This Article is brought to you for free and open access by BrooklynWorks. It has been accepted for inclusion in Brooklyn Journal of International Law by an authorized editor of BrooklynWorks. For more information, please contact matilda.garrido@brooklaw.edu.
SYMPOSIUM ESSAY

RESTRAIANTS BY REGIONAL AND LOCAL GOVERNMENTS ON COMPETITION: LESSONS FROM TRANSITION COUNTRIES

John Clark*

The Organisation for Economic Co-operation and Development (OECD) has, since 1992, engaged in an extensive program of outreach to non-Member countries in several fields of economic policy, including competition policy. Until the past few years, the OECD's outreach was directed toward the transition countries of Central and Eastern Europe and Central Asia. Initially, much of the work involved assistance in drafting laws and regulations effecting competition policy. Later the focus changed to enforcement—to perfecting the techniques employed in competition analysis.

The OECD settled on the "case study method" as an effective means of focusing on relevant issues in competition analysis. Four or five seminars were, and still are, conducted annually in which cases from transition countries are discussed in detail by participants from the OECD and transition countries. The seminars provide useful insight into the types of cases that are common in these countries, and the trends in the cases over time. This Essay focuses on one type of case—against bodies of regional and local governments for anticompetitive acts—that has a somewhat unique character in transition countries. There are lessons that one can draw from these cases, however, that could prove useful to emerging market economies in other parts of the world.

Transition countries—countries whose economies were

* Consultant, Organisation for Economic Co-operation and Development.
until the beginning of this decade centrally managed, with all or most productive assets owned by the state, have faced heroic challenges in their efforts to develop market economies. Within a few short years they had to accomplish the privatization of huge amounts of state-owned assets, the creation of a legal system that provided for rights of private property, means of corporate governance and enforcement of contract rights, and a system of regulation of the marketplace, consistent with the promotion of competition wherever possible. Not the least of these priorities was the enactment of a competition law and the development of an effective competition policy.

Many transition countries moved quickly to write a competition law. Several such laws were in place by 1992. The laws shared many common elements: prohibitions of abuse of a dominant position and restrictive agreements that lessened competition, and some form of merger control, though in the merger area there was substantial variation among countries. The enforcement body was usually in the form of a commission, either placed within one of the government ministries or, less often, given nominal independence. The competition agency had adjudicative and enforcement powers, subject to appeal to the courts. By 1995, some transition countries began to write "second generation" competition laws. The new laws often provided for a more comprehensive form of merger control and enhanced powers of information gathering and enforcement for the competition agency. Significantly, the new laws in several Central European countries now approximate the competition law of the European Union, as those countries pursue membership in the European Union.

In at least one respect the competition laws of many transition countries were unique. They contained a fourth "substantive" violation in addition to abuse of dominance, restrictive agreements and merger control: anticompetitive acts by bodies of government. To be sure, most competition laws apply either explicitly or implicitly to entrepreneurial conduct by government, but these provisions in transition country laws by their terms applied to regulatory and governance functions as well. It is not difficult to understand the historical basis for

---

1. This group includes, for purposes of this discussion, the fifteen former Soviet republics, the four Visegrád countries (Poland, Hungary, and the Czech and Slovak Republics) and Bulgaria, Romania, and Slovenia.
such provisions. Bodies of government at all levels had been the principal, if not the only, economic actors under central planning. Old habits would die hard. It was considered necessary to explicitly forbid interference by these bodies with the new discipline of the marketplace.

I. THE LAWS

The competition law of the Russian Federation was emulated in some respects by other former Soviet republics. Articles 7 and 8 of the Russian law applied to bodies of government. Article 7, as it now exists in the current law, amended in 1995, provides in part:

Federal organs of executive power, organs of executive power of RF [Russian Federation] subjects, and organs of local self-government shall be prohibited from issuing acts and/or performing actions restricting the independence of business persons and creating discriminatory or, conversely, favorable conditions for the activity of individual business persons, where such acts or actions have resulted or may result in restraint of competition and/or infringement upon the interests of business persons or individuals . . . .

Article 8 provides in part:

Agreements (concerted acts) by a federal organ of executive power, organ of executive power of RF [Russian Federation] subjects, and organ of local self-government with another such organ or with a business person shall be prohibited and shall, in the established manner, be held invalid, fully or in part, whatever their form, where they have resulted or may result in restraint of competition and/or in infringement upon the interests of business persons or individuals . . . .

Thus, Article 7 prohibits unilateral anticompetitive acts by a
governmental body and Article 8 prohibits anticompetitive agreements involving a governmental body. These provisions are equivalent to the prohibitions of abuse of dominance and restrictive agreements by private enterprises.

Article 6 of the competition law of Ukraine forbids "[d]iscrimination against business entities by government and administrative organs." The article sets out specific acts of discrimination that are prohibited, including prohibiting the organization of new enterprises, forcing businesses to join associations or to enter into specific contracts, interfering with the marketing of goods across regions, and granting discriminatory tax benefits. The article also prohibits agreements by government bodies having the same effects.

Article 18 of the competition law of the Czech Republic provides:

1. State and local administrative authorities may not restrict or eliminate economic competition by employing their own provisions, apparent support or other methods.

2. Compliance with the obligations defined under paragraph (1) shall be supervised by the [competition agency]. Based on evidence and analysis of results, the [competition agency] may demand that authorities of state and local administration rectify the faults.6

Other transition country laws that have, or until recently had, similar provisions include Georgia,7 Hungary,8 Slovak

7. On Monopoly Activity and Competition, June 25, 1996, ch. 5 arts. 16-26 (Geor.).
8. Act No. LVII of 1996 on the Prohibition of Unfair and Restrictive Market Practices, June 25, 1996, ch. 8 art. 63 (Hung.). The Hungarian law was amended in 1997, however, and the new law does not contain such a provision.
Republic, Bulgaria, Romania, Lithuania, Latvia, and Estonia.

II. ENFORCEMENT

There has been no systematic study across countries of enforcement of these articles applying to governmental bodies, but anecdotal evidence indicates that those provisions were heavily enforced in several countries in the early years after enactment of the competition law. This resulted in a substantial number of cases and enforcement actions. In recent years the number of cases seems to have declined in some (but not all) countries. The decline could be caused by any number of factors, but two appear to be likely: first, in the transition countries whose market economies are more mature, bodies of local and regional government appear to have withdrawn progressively from their traditional roles as managers of the economy. Second, of those violations that do occur, more are being resolved informally by the competition agency and the offending body, resulting in fewer formal cases.

In the early years of these laws, many of the cases against government bodies involved regulatory discrimination in situations in which the local authority was both operator of some or all of the assets in the relevant market and regulator of that market. Cases in transportation, energy, and telecommunications markets were common. The local authority as regulator would discriminate in favor of itself or its affiliate as operator. These cases have declined in number in countries where privatization is complete and national regulatory schemes have been established, but in others this type of case is still fre-

---

11. On the Protection of Competition, June 24, 1994, arts. 17-28 (Rom.).
quent. In many countries, including non-transition countries, local and regional authorities continue to provide some services and to act in some capacity as regulator. Local transportation (taxi, bus, passenger rail), energy, and waste removal and disposal are such markets.

In 1997, the OECD conducted a comprehensive analysis of 125 cases decided by the Russian Antimonopoly Committee between 1994 and 1996. Of these 43, or 34%, involved infractions of Articles 7 and 8. The conduct was further classified as follows: 25%, inappropriate licensing or issuing of permits, or refusals to do so; 16%, discrimination in favor of or against particular entities (with respect to fees, contracting, etc.); 16%, interference in business activity (price setting or establishing priority of supply); 14%, restriction of movement of goods between areas; 12%, improper orders for transfer of property; 7%, improper granting of administrative authority to an economic subject; and 7%, imposition of fees on trade. Of the 43 cases, 37% concerned actions by regional executive bodies and the remainder involved local executive bodies. There were no cases involving federal bodies in the group.

A few typical cases involving restraints by local and regional governments in transition countries are as follows.

A. Lithuania—Bus Transportation

The Municipality of Klaipeda granted concessions to forty-eight private bus operators to provide passenger bus service in the town. It also introduced a tax on these operators for the privilege of operating in the center of town. The Municipality was also the founder of one of the private bus operators, and for this operator the Municipality provided a subsidy for carrying certain passengers and exempted the operator from paying the tax. The Competition Council determined that this conduct

16. See id. at 56.
17. See id.
18. See id.
19. These cases were presented at various OECD case study seminars held for competition enforcement personnel from transition countries (on file with author).
violated Article 6 of the competition law, and requested that the Municipality cancel the discriminatory subsidy and tax exemption.

B. Russian Federation—Shipment of Scrap Metal

The Head of Administration of the Tula region imposed restrictions on the ability of generators of metal scrap to sell and ship their scrap to entities located outside the region. In particular, entities situated within Tula could not ship their scrap to outside purchasers without the consent of two local scrap recyclers, and the Tula branch of the railroad could not allocate freight cars for such shipments without the consent of these two enterprises. The Tula Territorial Office of the Russian Antimonopoly Committee determined that these actions by the Regional Administration violated Articles 7 and 8 of the Russian antimonopoly law and ordered the Administration to cease the conduct.

C. Latvia—Trading of Privatization Certificates

As part of its program of privatization, the Latvian government issued privatization certificates (PCs), which could be used to purchase property to be privatized and which could be traded on the open market. The law permitted any enterprise to obtain a license to trade in PCs, and more than 100 firms obtained such licenses. Another law, however, limited the number of banks that could maintain PC accounts to three specific banks, and as the result of other circumstances, one of the three banks effectively enjoyed a monopoly in the maintenance of PC accounts. This monopoly, in turn, conferred an overwhelming advantage to the bank in the market for trading PCs. The Latvian competition agency entered into negotiations with the Ministry of Finance for revisions of the regulations governing the trading of PCs.

D. Slovak Republic—Solid Waste Removal and Disposal

An association of fourteen municipalities and seven private enterprises was formed to build and operate a solid waste landfill, which because of the scarcity of other sites and available capital was the only operating landfill in the area. The association also agreed, however, that all collection and trans-
portation of solid waste within the member municipalities would be conducted by one firm. The Slovakian Competition Authority correctly concluded that two separate markets were involved—collection/transportation and disposal of solid waste—and that competition could exist in the former. It ordered that the association eliminate the restriction to a single enterprise for collection/transportation.

III. ANALYSIS AND EXTRAPOLATION TO NON-TRANSITION COUNTRIES

The transition country competition laws specifically applying to governmental bodies are broad in scope and design, but there are practical and political limits to enforcing them. Very few of the cases that the OECD has observed have involved national agencies or regulators. As noted above, of 125 such cases in Russia, none involved national bodies. There are at least two reasons for this. First, in virtually all countries, including non-transition countries, there is an express or implied exemption from the competition law for conduct that is explicitly authorized or required by national statute. Second, and at least as important, in transition countries and in many others as well, the competition agency is not politically strong enough to confront another agency of the national government. The transportation, communication or energy ministry, for example, usually has vastly more power and influence than the competition agency at the national level in transition countries.

In many countries the competition agency faces political realities at the regional and local level as well. The balance of power may still not be in the competition agency's favor.\(^{20}\) In any case, the competition agency does not have at its disposal the full range of investigation and enforcement powers that it can apply to private enterprises. It is difficult to demand the production of information from another government agency, and to impose and enforce binding prescriptions on such a

\(^{20}\) An extreme example is Russia. Because of its huge size (there are 11 time zones in Russia) there are dozens of regional offices of the Russian Antimonopoly Committee (recently reconstituted as a ministry). Because of their distance from Moscow, the regional offices are almost autonomous, though it is not a situation that they prefer. They are an arm of the national government, but they may not be as politically strong as the regional governments that they may have to control.
body. The laws of some transition countries, in fact, permit the
competition agency only to petition the offending governmental
body for relief.  In any event, binding orders or, in the ex-
treme, fines, are often not politically feasible.

The agency, then, is left to attempt a favorable resolution
through negotiation and voluntary agreement. Yet in this situ-
ation—where the competition agency is relatively weak com-
pared to its government adversary—the laws explicitly forbid-
ding anticompetitive conduct by government bodies are never-
theless most useful. The fact that the competition agency has
determined that the local body has violated national law and
has said so publicly in a decision (or can do so, if it hasn't yet),
strengthens the agency's hand significantly in negotiations.
That these laws exist, even if they are not fully enforceable,
has had a salutary effect in transition countries in their efforts
to eliminate competitive restraints by local and regional gov-
ernments.

What are the implications of the transition country experi-
ence for emerging market economies in other parts of the
world, where similar laws explicitly banning anticompetitive
conduct by governments do not exist? The situation in transi-
tion countries is unique in some respects. The tendency toward
anticompetitive restraints by governments is probably stron-
gest in the transition context, but such restraints exist in every
country, and they are likely to be common in all emerging
market economies. The explicit prohibitions of anticompetitive
governmental conduct in transition country laws are not likely
to be found in, or added to, existing competition laws else-
where, however. Indeed, they are gradually being eliminated
from second generation transition country laws. As noted
above, however, the principal benefit of such laws for competi-
tion agencies in transition countries has been to strengthen the
moral authority of the competition agency in its attempts to
eliminate such restraints. Competition agencies in other coun-
tries enjoy a similar, if more diffuse power, especially in their
dealings with local and regional governments.

22. Interestingly, in a few cases the Russian Antimonopoly Committee imposed
a fine on another government body.
23. As noted above, second generation laws in Hungary and Latvia have omit-
ted such provisions. See supra notes 8, 13.
The transition country experience with restraints by governments on competition highlights two conditions that are generally applicable. First, such restraints exist everywhere, especially in transition and emerging market economies, and eliminating them should be a priority of competition agencies in these countries. Second, while competition agencies usually do not have sufficient authority to prosecute such conduct in the same way that they can prosecute private restraints, they have considerable authority as public advocates for competition, and by using it aggressively and skillfully can achieve much to eliminate restraints on competition by other government bodies.