

Swiss Competition Commission

Israel's Antitrust Authority

SURVEY ON COMPETITION LAW IN SMALL ECONOMIES

Special Project for the 2009 ICN Annual Conference

1. Analytical Framework

The application of competition law in a small economy brings into play the notion of the State (“law”) and the notion of a social fact (“economy”). While the economy is given and constitutes a fact of life, the State which has the power to adopt the legal system governing the functioning of its economy, is created by law and defined by boundaries which may not coincide with the “size” of the economy. The “effects doctrine” translates the mutual international understanding that each State has the right to organize its market and to protect it, if it chooses to do so, against anticompetitive behaviour that affects it, independently of the place where this behaviour originates, and independently of the fact that a small economy may more often be exposed to anticompetitive behaviour which originates in another State.

These observations give rise to the general question which can be formulated as follows:

Does the size of the economy affect the application of competition law, and if so how?

The basic objectives of competition policy are similar for large and small economies. In both, competition policy is designed to protect and promote the competitive process. The competitive process is not an end in itself but a means to an end as it promotes improvements in efficiency which in turn lead to welfare gains for society. However, a small economy faces an inherent tension in the development of its competition policy in that many of its industries:

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- *Can support only a small number of competitors and are therefore highly concentrated;*
- *Contain many firms that struggle to attain minimum efficient scale when catering solely to domestic demand.*

For this reason, a liberal trade policy is more important for a small economy than for a large one as it can reduce the disadvantages of small size both through increased exports (thereby improving the ability of firms to achieve scale economies) and imports (thereby promoting competition). A small economy also needs to ensure that regulatory policies are not contributing to barriers to entry and exit within its markets. In sectors where competition is severely limited, regulation is needed to limit the potential costs imposed by the presence of market power.

Also, competition law in a small economy needs to comprise a set of flexible instruments that can be applied on a case-by-case basis to reduce competition concerns while promoting economic efficiency. Competition law should evolve in a manner that allows for increasing attention to be paid to efficiency considerations.

The question raises at the outset the problem of the definition of the size of a (small) economy. It then can and must be restated in more concrete terms, depending on the context in which the question comes up.

2. The Notion of a “Small Economy”

For the purpose of this Survey, an “economy” in the context of competition law refers to a distinct legal jurisdiction, defined by borders and governed by legal institutions empowered to enact and enforce a competition law regime.

The “smallness” of such an economy depends on the framework in which we operate the comparison. Possible criteria to be used include, inter alia, the following:

- Size of the economy, in terms of GDP;
- Size of the territory, in which the economy “takes place” and its geographic location;
- Population in absolute terms, or population compared to the neighbouring economies;
- Legal, cultural, social and historical differences compared to the neighbouring economies;
- Comparative importance or size of the undertakings, or of the number of global players which have their seat in the territory of a small economy, etc.;
- Degree of regional economic integration, including entry barriers, dependence on international trade, economic ties with neighbouring countries.

Analysis of the above abstract criteria brings us to the following questions, most notably:

- Are the abovementioned criteria adequate in your view?

The abovementioned criteria are adequate, as they comprise the full set of factors indicating whether an economy should be deemed as small or large. However, not all of them need to be

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observed in order to draw a conclusion as to the size of the economy. In certain cases, high entry barriers and high levels of concentration might be observed in a country with large territory and population, making the economy small due to these obvious obstacles hindering its effectiveness and competitiveness in global terms. In other cases, the size of the respective country may limit the potential number of global players operating on its territory. Or perhaps the political and cultural features of a certain economy, its legal, social and historical specifics might render it small.

- How do you define your economy (“large” or “small”)? By which standards? How do you define the size of your neighbouring economies or major trading partners?

The Bulgarian economy is a free market economy. It is based on the principles of free market initiative and fair competition. The Bulgarian Competition Law provides for full competition in all sectors of the economy. However, the process of liberalization is at different stages with regard to different sectors. The entrepreneurship and business environment in Bulgaria continues to improve in line with the overall growth of the Bulgarian economy. Lasting macroeconomic stability has provided conditions for economic growth. Yet, certain microeconomic factors, such as high entry barriers, low competitiveness and unfair competition, high market concentration, etc. in some sectors of the economy continue to hinder the competitiveness of some Bulgarian enterprises. In terms of population size, Bulgaria’s population is below 8 million and decreasing, and compared to the neighbouring countries is substantially lower. With respect to GDP, although Bulgaria is one of the fastest growing EU countries in terms of GDP with record growth rate of 7% during the first six months of 2008, at present Bulgaria’s GDP per capita is only 37% of EU average. Bulgarian legislation is in line with EU legislation, but efforts still have to be made in terms of its efficient enforcement. Having in mind the relatively small size of Bulgarian territory and population, as well as the prevalence of small and medium-sized enterprises, the Bulgarian economy should be classified as comparatively small.

3. Anticompetitive Agreements

Anticompetitive agreements are the best analysed and least controversial part of competition law. There will probably be fewer differences in the application of competition law in this respect. But the fact that people and operators know more about each other in smaller economies than in larger ones may make a difference. To this end the role on information, information sharing and networking mechanisms may play a significant role in facilitating collusion. The limitation of the relevant market by state borders may make another difference.

- How, if at all, should such elements be taken into account? What is the importance of open borders in this context? Is there evidence for more oligopolies in small economies? If so, what type of competition policy is best suited to cope with the implications that oligopolies have on competition? Could the enhanced risk of collusion and anticompetitive conduct justify harsher sanctions or a different focus of the competition laws?

It is obvious that in a small economy everybody knows each other and news and information travel fast. In an economy characterized by the power of small circles, it is easy to maintain

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cartels and other collusive arrangements because when “everybody knows everybody else” there is no need for detailed and vulnerable contractual arrangements.

It might be said that oligopolies are more common in small economies. In some cases, an oligopoly might lead to the same results as perfect competition, as measured in terms of prices and output. In other, oligopolies might result in markets where monopolistic prices and output prevail. It is not possible to automatically link oligopolistic structures to undesirable economic results, since competition might well take place within an oligopoly, and oligopolies cannot be deemed per se illegal by a sound competition policy. However, in certain cases, oligopolies might well lead to the creation and exercise of market power, producing the very same undesirable results that are condemned by competition policy when only one company is involved.

Thus, small economies face some challenges. Firstly, the most important task of the competition authority is to differentiate between cartels, which are illegal, and oligopolistic coordination, which is considered to be legal. Secondly, the authority should limit the incentives for firms to engage in coordinated conduct. Thirdly, the authority faces the task of differentiating wealth-enhancing joint ventures from wealth-reducing agreements or cartels.

The Bulgarian Competition Law is based on the EU acquis. This is key to the proper enforcement of the competition rules in a small economy. A small economy’s competition authority should not suffer from an inferiority complex simply because of its size. It has to run a clear and focused competition policy and be prepared to dive into complex cases, investigate and reach conclusions on cartels and difficult issues such as joint dominance. The competition authority also has to be prepared to facilitate entry when someone shows an interest in coming into the market.

Also, the incentive for the violators should be the fine that they avoid. Thus, if the fine is small there is no incentive. Therefore, on that view, in a smaller economy, in order to give a bigger incentive, the fine should be prohibitively high.

- Vertical restraints are often linked to imports in small economies. Does this require or justify a different analysis of vertical restraints, especially of resale price maintenance and of parallel import bans, in small economies? Moreover, could the fact that the risk of foreclosure is higher justify a different analysis?

An effective and economically attuned vertical restraint policy is important because vertical restraints can produce both substantial harm and substantial good. The good part of vertical restraints is clear -- they can be used to enable small firms to enter markets, promote interbrand competition, protect intellectual property rights, encourage optimal amounts of pre-sale information and after-sale service, and prevent free-riding. But it is equally clear that vertical restraints can also be used to raise prices to consumers and to create or enhance market power by allowing firms to raise rivals' costs or facilitate collusion. Vertical restraints normally have a positive effect when they are introduced to solve co-ordination problems; their negative effects tend to prevail in the presence of weak upstream and/or downstream competition. In its policy, the Bulgarian Commission on Protection of Competition (CPC) follows and complies with the EU rules on vertical restraints.

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4. Abuse of Dominance

It is likely that the number of large firms and their respective weight affect small economies more than large economies. State monopolies might also be more common in small economies than in large ones. Economies of scale may call for these sizes and at the same time limit the number of viable companies within the territory of such a small economy.

Since small economies may not be able to accommodate too many competitors in each industry, more emphasis might be put on efficiency considerations.

- Does this mean that a specific regime should apply to the conduct of dominant undertakings in a small economy? Or does this make no difference? Is there a different approach towards collective dominance issues?

A small economy has a stronger incentive than its larger counterparts to limit abuse of dominance, because in a small economy dominance is much more prominent, and more difficult to erode once created, due to the existence of scale economies and high entry barriers. Therefore, regulation is very important. A strict policy should be taken against exclusionary practices taken by monopolies. The competition authority must focus on deterring the creation and maintenance of artificial entry barriers, which limit the ability of new firms to enter or expand.

There should not be any reasons, based on size alone, to regulate the conduct of dominant firms differently in a small economy. Under the present Bulgarian Competition Law, an undertaking is considered to have a dominant position if it has a market share above 35% of the relevant market. However, since an undertaking cannot be considered dominant simply because of its market share, in the draft of the new Competition Law the rebuttable presumption of market share has been abolished. Similarly, the CPC does not differentiate its treatment of collective dominance issues from similar cases throughout the EU.

5. Mergers

Competition law enforcers in small and large economies alike, aim at maintaining an effective and efficient merger control regime. To this end, the size of the economy as well as other specific market conditions might affect the optimal design of a merger policy. Subsequently, merger regimes in small economies might exhibit certain features that reflect their specific market conditions and address potential competitive concerns which are relevant to the size of their economy.

This fact may matter with respect to factors concerning the substantive appraisal of the merger, such as the role of imports as a competitive constraint, as well as of the procedural aspects of the merger, such as the appropriate notification duties and thresholds. This may lead to the following questions:

- Are there any differences with respect to the substance of the merger control regime? Are there different justifications for having a merger control regime in small economies?

The enforcement of laws concerning abuse of dominance alone should prove inadequate, since victims of that abuse for various reasons rarely come forward to the competition authority. Additionally, the control of abuse of dominance always comes after the problem,

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and generally addresses only one particular practice, rather than the structural issues leading to the practice. For this reason, merger control is necessary, and those basic fundamentals are valid whether the economy in question is large or small. However, the application in practice has to be developed and adapted to the individual situation in the country.

Should there be different guidelines for geographic market definition? How might the size of the economy affect the application of legal presumptions?

Under the Bulgarian Competition Law, undertakings are subject to mandatory prior notification to the CPC if the aggregate turnover of all undertakings participating in the concentration on Bulgarian territory in the preceding year exceeds BGN 15 million. However, in the new draft law this threshold has been increased to BGN 25 million, which is based on the scale of national economy and the size of the economic undertakings operating on Bulgarian territory. Also, a second cumulative criterion has been added – turnover of each of at least two undertakings which are parties to the concentration or turnover of the undertaking to be acquired on Bulgarian territory for the preceding financial year. The amendment is in line with the ICN recommendations that competition authorities should have jurisdiction only on transactions on the territory of the respective State.

In line with Regulation № 139/2004, the draft law provides for notifications to be made after the signing of the contract, the announcement of the tender or the acquisition of control, but before any actual measures have been taken to execute the contract. The objective is to avoid notifications on concentrations which are only planned to take place or are being negotiated.

Which types of remedies are best suited for small economies?

In its merger policy, the CPC does not adopt a strict set of presumptions, rules of thumb, and “per se” rules (except to clearly illegal conduct). Rather, it applies a case-by-case approach and no follow rules of thumb that do not give enough weight to efficiency considerations. It identifies remedies according to the specific issues, the ultimate aim being the preservation of effective competition and market efficiency.

- On the level of the procedural regime, what are the appropriate criteria triggering an intervention or an inquiry into a merger project: turnover thresholds; structural criteria, such as the degree of organisational integration (existence of branches or subsidiaries) of one or both of the merging companies; effect on competition? Should there be a mandatory or a voluntary notification regime, with or without a prohibition to proceed without clearance?

In its inquiry into a merger project, the CPC observes each of the abovementioned criteria. The turnover threshold is always taken into consideration, as well as the structural organization of the undertakings and, of course, the effect of the planned concentration on competition. Also, the lack of a strong competition culture in Bulgaria calls for a mandatory notification regime without a prohibition to proceed without clearance.

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