CENTRE FOR EUROPEAN REFORM

A FAIR REFEREE?
The European Commission and EU competition policy

Alasdair Murray

CENTRE FOR EUROPEAN REFORM

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Alasdair Murray

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The views expressed within do not necessarily reflect those of GPlus, BT or Centrica.

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The European Commission, as the decision-maker on state aid as well as on merger and anti-trust cases EU-wide, is not a one-person referee; nor does it take its decisions on the spot. Cases are dealt with by an apparatus, with many layers of consultation and responsibility – including the 25 commissioners – and the process is usually a slow one. Still, like the teams and players in a football match, business is looking to the Commission to arbitrate, not to regulate: the rules are known before you enter the game, and the outcome, in business like in football, should be decided on the pitch, by competition among participants. The referee's role is to ensure due process and a fair hearing for all.

But when the competitive conditions are already distorted even before the game begins, how then can the Commission guarantee that famous "level playing field"? And is it at all possible, or indeed desirable, for the EU's competition watchdog to remain impervious to arguments that are not necessarily found in the referee's handbook? Just as every gesture of the man in black at the centre of the pitch is watched closely by spectators, cameras and commentators, the competition commissioner is under constant scrutiny. What more can he or she do to reassure stakeholders and guarantee the predictability of Commission decisions, creating the right conditions for business and competition to thrive?

It is on these important questions that this report by the Centre for European Reform aims to encourage debate. As political and communication advisers with a particular interest and expertise in competition matters, GPLUS EUROPE supports this objective.

Michael Tscherny

Partner

GPLUS EUROPE

www.gpluseurope.com

Foreword

BT is pleased to support this CER pamphlet as a valuable contribution to the ongoing debate on the nature and extent of regulation, anti-trust law and competition policy. Well known for our consumer business in the UK, BT operates globally in over 170 jurisdictions providing business-to-business services, including systems integration, communications outsourcing and a full range of communications products. From our worldwide activities and experience we see the challenges facing many different parts of the communications and information technology industries, since we participate on many levels of the value chain.

The paper makes a welcome connection between the European agenda that will drive growth, innovation and productivity (the Lisbon goals), and a pro-active competition policy. Coherent competition policy across Europe is in danger of being fractured through the decentralised application and enforcement of the law and policy by national authorities and courts.

The democratic debate about competition policy that has been generated is to be welcomed, while the consistency and coherence of the system needs to be ensured. This debate about policy now needs to be resolved so that the many different actors that are part of the enforcement system at the national level understand the purpose of the law, within the wider context of more general public policy objectives. It is vital that a pro-active competition policy is applied consistently throughout Europe so that its benefits can be felt by both consumers and businesses alike.

Timothy Cowen

General Counsel

BT Global Services

Foreword

Competition is the lifeblood by which Europe's economy will thrive and grow. But competition must be fair and non-discriminatory. Governments have a particular responsibility to ensure that their actions do not favour companies of one country over another.

The political analysis in this pamphlet is a clear warning that interventionist and protectionist policies cause barriers to trade, stifle innovation and make the goal of a single market less attainable.

Governments have genuine social concerns and responsibilities in the transition to fully competitive markets, but their actions can and should be implemented within an EU market framework. The competition rules, and their implementation, must be transparent and allow new market participants to emerge.

Mergers and acquisitions can be a sign of a healthy market, particularly if they result in a realignment of market structures or partial divestment to new entrants. Some monopoly infrastructures, like energy networks, are by their nature subject to insufficient competitive forces, and will need regulated access to enable competitive markets to develop. Improving the conditions for new entrants and ensuring that state aid is not bolstering the position of inefficient incumbents is a topic that must be addressed if we are to build a prosperous single market.

Finally, as a company providing energy and other services to millions of homes and businesses in Europe, Centrica is delighted that the redefinition of European competition policy discussed in this report is based on "putting the consumer first". Only by consulting with and listening to customers will competition authorities achieve the right level of consumer protection, through encouraging fair and sustainable competition.

Colin Lyle

Director, European Policy

Centrica Energy

1 Introduction

Competition policy is one of the EU's greatest success stories. It is also one of the most integrated areas of EU policy-making. While the EU's Council of Ministers sets the broad parameters of competition policy, the European Commission has possessed sole responsibility for both investigating and ruling on individual cases since the creation of the then European Economic Community (EEC) in 1957. Once the competition commissioner takes a decision, it normally sails through the rest of the Commission. Only the European Court of Justice (ECJ) can overturn a Commission decision on a competition case.

Thus the 350 officials (650 staff) working in the competition directorate-general (DG) – but above all the competition commissioner – possess huge power. In recent years, the commissioner has taken on some of the world's biggest companies, including GE, the US conglomerate, and Microsoft, the software firm. The competition commissioner has also had to stand up to the EU's largest member-states over subsidies paid illegally to favoured companies. The Commission has repeatedly clashed with the French government over aid granted to companies such as Electricité de France, France Télécom and Alstom. As former competition commissioner Karel Van Miert quipped to his successor, Mario Monti, when handing over the post: "Now you will have to get used to being thought of as Europe's most powerful man."

An effective competition policy is vital to the long-term health of the European economy. Competition increases the incentives for firms to reduce costs, cut prices and improve the quality of their products. It encourages the reallocation of capital from less to more productive firms. It ultimately benefits not just consumers through lower prices and better products, but also businesses who gain from greater competition between suppliers.

Recent economic research has underlined the importance of competition in helping to increase productivity and thus long-term economic growth. The Organisation for Economic Co-operation and Development (OECD), for example, finds that low levels of competition in some EU markets are a key factor behind Europe's relatively poor productivity record (in comparison with the US) over the last decade. The OECD concludes that improved competition could boost productivity by between 2 and 6 per cent in the core eurozone countries (France, Germany, Italy).[1] The International Monetary Fund has suggested that reforms leading to an increase in competition could boost overall GDP in the EU by as much as 7 per cent in the longer term.[2]

[1] *OECD, 'OECD economic surveys: 2003 Euro area', July 2003.*

[2] *Cited in UK Treasury, 'Joint initiative on regulatory reform', January 26th 2004.*

The EU's competition regime has traditionally focused on three elements: anti-trust, mergers and state aid control. The EU's anti-trust rules (articles 81 and 82 of the EU treaties) – which date back to the EEC's foundation – are designed to regulate agreements between companies, and to prevent cartels from distorting the market. The Commission can prosecute and fine companies which breach these laws; for example, if a group of companies agree to limit the supply of products to boost profits or to carve up markets between themselves. Furthermore the Commission can take action against companies which it believes are using their 'dominance' within a market to shut out rivals, for instance by signing exclusive distribution or licensing deals. The Commission's decision to adjust these anti-trust rules to take account of new markets, such as the information technology industry, has sparked great controversy, most notably in the Microsoft case (see chapter 4).

The EU's rules on mergers only date back to 1990. The Commission has the power to either block a merger, or force the companies involved to withdraw from certain markets, if it believes their union will lead to a decline in competition within EU markets. The Commission has blocked four mergers in the last five years, most

notably the $42 billion proposed takeover of US industrial company Honeywell by GE, which provoked huge criticism from across the Atlantic in 2000.

Finally, the EU – unlike any other political authority – has rules restricting what governments can pay in the form of subsidies to businesses. The state aid rules (based on articles 87 and 88 of the EU treaties) ban subsidies which distort cross-border competition by giving certain businesses an unfair advantage. They are designed to prevent member-states from pursuing policies that impose economic costs on other countries by unfairly favouring their own industries.

The EU's competition rules used to be fiercely contested. In the early 1990s, for example, proposed mergers such as that between the Franco-Italian aerospace firm ATR and Canadian aircraft manufacturer De Havilland provoked fierce debate both within the Commission and between member-states (see chapter 2). In the last decade, however, the Commission's competition decisions have increasingly become viewed as routine. While individual cases have occasionally caused some controversy, competition policy has largely become the preserve of specialist lawyers and economists. The EU has undertaken a series of reforms designed to make its decisions more predictable and transparent. It has also sought to remove politics from the competition cases. Senior Commission officials report that competition decisions are now largely rubber-stamped by the college of commissioners, the Commission's chief decision-making body.[3] EU governments also have less room to interfere with competition cases at a national level. As a result of EU reforms, every member-state now possesses an independent competition commission to handle national cases.

[3] *Alasdair Murray, 'An unstable house? Reconstructing the European Commission', CER, March 2004.*

However, in the last couple of years EU competition policy has once more become a political battleground. The Commission has come under attack from two sides. First, some member-states – most notably France – have become increasingly critical of what they regard as the Commission's over-zealous application of competition rules. They argue that the Commission is undermining the competitiveness of the EU economy by stopping the emergence of 'European champions'. In contrast, competition authorities elsewhere, especially in Japan and the USA, do not stand in the way of mergers which help the companies involved to compete more effectively on the global stage.

The French government further argues that the Commission's rigid approach to state aid policy is unduly restricting its ability to save jobs in struggling companies such as Alstom (see next chapter). Finally, the French (and many on the left of the political spectrum) claim that EU competition rules – coupled with the liberalisation of key utilities such as energy – are threatening the provision of universal public services.

At the root of this critique is a fear that the Commission's excessive liberalism is preventing governments from countering the effects of 'deindustrialisation' – that is the flight of industry to lower cost economies such as the new EU member-states or Asia. The French debate also reflects the country's current obsession with 'declinism' – France's apparent waning economic and political power. The French increasingly see the Commission as an apostle of Anglo-American liberalism; the Commission's approach to competition thus poses a direct challenge to 'European' values. Some on the French left – most notably former prime minister Laurent Fabius – intend to campaign for a 'No' vote in the forthcoming referendum on the EU's constitutional treaty, in part because the treaty fails to curb the Commission's powers over competition policy.

The Commission has also come under fire from critics on the other side of the Atlantic, but for almost exactly opposite reasons. Many US businesses and policy-makers regard Commission decisions, such as those to block the merger of GE and Honeywell in 2000, or to fine Microsoft in 2004, as evidence of its excessively interventionist and illiberal approach. They argue that the EU is infringing US

sovereignty by taking actions against American companies which go against the judgements of US courts on the same cases.

Above all, there is a growing suspicion that 'Europe' is acting in a deliberately anti-American manner, using its economic powers to try and check US predominance. Lawrence Lindsey, a former director of the White House's National Economic Council, recently warned that the reputation of the Commission's competition DG is in danger of sinking to that of "their comrades who administer the EU's Common Agricultural Policy: anti-American, anti-consumer and anti-globalisation".[4]

[4] *Lawrence Lindsey and Marc Sumerlin, 'An acid test of Monti's motives', Financial Times, September 22nd 2004.*

The Commission must stand firm in the face of such criticisms. If it cedes ground to its opponents, the Commission risks undermining the coherence and effectiveness of EU competition policies. The Commission would also suffer a further erosion of its own powers, to the detriment of its ability to police the EU's single market. This is not to argue that the Commission is right in every decision it makes. As this pamphlet shows, the Microsoft case in particular raises a number of difficult questions about how competition authorities should treat fast-moving and innovative markets. But such difficulties do not imply that the Commission's approach to competition policy is fundamentally wrong.

The Commission has made a number of important reforms in recent years, partly in response to criticism from the Court of Justice, and partly to deal with a rising caseload. But it needs to do more to enhance the effectiveness and credibility of its policies. For example, the Commission should improve its record of recovering illegally paid state aid. Above all, the Commission should continue to refocus its competition policies on supporting the EU's economic reform goals. Until recently, the Commission predominately acted as a competition 'policeman', following up complaints about the behaviour of individual companies or reacting to a merger deal. The Commission must now become an advocate of the benefits of competition, both inside its own bureaucracy and in the wider EU. This means the Commission should place a greater focus on sectoral investigations: it should actively seek out barriers to competition in the most important parts of the EU economy. And it must place much more emphasis on the interest of consumers when taking competition decisions. This is the best way for the Commission to guarantee the continuing success of EU competition policy, and to ensure that it effectively promotes the long-term competitiveness of the EU economy.

2 Colbert's ghost

Over the last few years, a number of EU governments have sought to weaken the Commission's grip over state aid and competition policies. These member-states, led by France and Germany, want greater freedom to intervene in their domestic economies. They make two main complaints about the status quo. First, they argue that the Commission's over-zealous application of competition rules is penalising European industry by preventing the creation of 'champions' able to compete on a global basis. They claim that the Commission frowns upon large-scale mergers between EU companies and does not permit member-states to support 'strategic' industries. Furthermore, they point out that the EU is the only jurisdiction that has formal rules controlling industrial subsidies. In contrast, the US Congress can vote to pay subsidies to businesses whenever it wants.

Second, the Commission's critics claim that its competition policies prevent governments from taking action to stop the process of 'deindustrialisation'. They argue that the relocation of companies abroad poses a major threat to the long-term prosperity of the EU, which governments should be allowed to counter. The heads of government of France, Germany and the UK asked the Commission to investigate this supposed problem ahead of the spring European summit in March 2004.

As befits the birthplace of Jean-Baptiste Colbert, France has led the calls for the Commission to allow member-states more freedom to intervene in the economy. Colbert, Louis XIV's chief minister, is commonly regarded as the father of interventionist economic policies, and his approach continues to find an echo in modern French politics. French prime minister Jean-Pierre Raffarin told

French business leaders in May 2004 that he intended to develop a "strong industrial policy" to counter deindustrialisation. Raffarin added that not "every country can be present in every sector, but industry must remain a strong point of our economy. This does not mean France will be nationalistic, individualistic and egotistical, but that it will be open to projects with our European and other partners."

Similarly, the (outgoing) French finance minister Nicolas Sarkozy – once regarded as economically liberal – now insists that France should follow a "voluntarist" policy of intervention in the economy, because "neither France nor Europe can become industrial deserts... It is not a right for the state to help industry. It is a duty." During 2004, the French government has attempted several times to put such views into practice. For example, in April 2004 ministers successfully thwarted a bid for the French pharmaceutical company Aventis from Swiss-based Novartis, by persuading another French company, Sanofi, to increase its own offer by 14 per cent.

But France is not alone in its criticism of the Commission's handling of state aid and competition policies. Germany has led a vocal campaign against Commission 'interference' which it fears is threatening the German economic 'model'. For example, the Commission successfully outlawed state guarantees to Germany's regional banks, which enabled these banks to borrow more cheaply than their private competitors and thus offer cheaper loans to their customers. The Commission has also attempted, although so far without success, to end share-voting rules which protect Volkswagen from takeover. In the lead up to the appointment of a new Commission in the summer of 2004, the German government lobbied strongly for the creation of a 'super' commissioner to oversee all economic policy-making. The German government hoped that 'its' commissioner, Günter Verheugen, would take this post and thus water down competition and single market proposals that might threaten the short-term interests of German industry. However, the new Commission president, José

Manuel Durão Barroso, resisted German pressure and appointed Verheugen to the less powerful industry portfolio instead.[5]

[5] *Alasdair Murray, 'Barroso's galacticos? The new European Commission', CER briefing note, August 2004.*

French and German concern over the direction of EU competition policy led the two governments to try and forge a new approach during 2004 – one that would give them greater freedom to support domestic industries. The governments also announced that they would promote more mergers and joint ventures between major French and German corporations.

However, this attempt to devise common competition and industrial policies quickly descended into acrimony. Sarkozy refused to allow Siemens, the German industrial conglomerate, to play any role in the rescue of Alstom (see box on pages 14-15). This decision reputedly led Chancellor Gerhard Schröder to call Sarkozy "extremely nationalistic". Meanwhile, Wolfgang Clement, the reformist German economic minister, castigated French interference in the Aventis takeover as a "relapse into statist, interventionist policies".

Following these public disagreements, France and Germany postponed the publication of a paper outlining their new industrial policy. Schröder suggested instead that the two governments should invite industrial leaders to the regular Franco-German summits, to discuss possible collaboration. However, even this more modest proposal provoked scepticism among the very businesses it was supposed to benefit. For example, Bernd Pischetsrieder, chief executive of Volkswagen, dismissed the idea of developing Franco-German industrial policies as "nonsense".

These Franco-German divisions demonstrate the problems inherent in trying to draw up a 'European' industrial policy. Governments invariably intervene to support their own companies, often to the detriment of rival firms elsewhere in the EU. 'European' champions are frequently national champions in disguise. This is the reason the

EU developed state aid and competition rules in the first place – to ensure businesses could operate on a level playing field across the EU.

Moreover, recent cases, such as the rescue of Alstom, reflect political expediency rather than any real attempt to revive the industrial policies of the 1960s and 70s. French commentators have contrasted the actions of the current government with the policies pursued by Georges Pompidou in the early 1970s. Pompidou sought to modernise the French economy through a series of grand public works: his government invested in infrastructure such as motorways, telephones, the electricity grid and even a space programme. In contrast, Chirac's government seems mainly interested in reaping the short-term political gains from saving jobs, rather than developing a long-term strategy. The French government is yet to escape the suspicion that it supported the Sanofi merger because the pharmaceutical company's chief executive is a long-standing friend of the French president. An opinion piece in the French newspaper *Le Monde* has witheringly described Chirac's industrial polices as marked by a "degraded pompidolisme". Without conviction, and above all without coherence".[6]

[6] *Eric Le Boucher and Martine Orange, 'Un pompidolisme chiraquisé', Le Monde, May 13th 2004.*

Some French thinkers and politicians have begun to flesh out a more intellectually coherent approach to reforming EU competition policies. For example, Dominique Strauss-Kahn, the former French finance minister, has floated the idea of redefining competition rules to allow the creation of European actors able to compete globally, in a report prepared for Romano Prodi, the outgoing Commission president.[7] Similarly the Institut Montaigne, a centrist French think-tank, recently called for the EU to relax its competition rules "above all when the markets are global" and take much more account of possible efficiency gains from the merging companies.[8]

[7] *Dominique Strauss-Kahn, 'Construire l'Europe politique – 50 propositions pour l'Europe de demain', April 2004.*

[8] *Institut Montaigne, 'Régulation: ce que Bruxelles doit vraiment faire', June 2004.*

However, such arguments do not add up to a convincing case to water down EU state aid and competition policies. There is little evidence that the Commission regularly blocks mergers which would otherwise create European champions. The Strauss-Kahn report can only cite one example from 1992, the Commission's decision to block the merger between ATR and De Havilland. As Mario Monti argued in a response to French criticisms of EU policies, the Commission has permitted a string of recent French-led mergers – such as oil groups TotalFina and Elf, Air France and KLM, and supermarket groups Carrefour and Promodès – all of which could be viewed as potential European champions.[9] French politicians can only, with possible justification, criticise the Commission for its decision to block the merger between electrical manufacturers Schneider and Legrand in 2001. The European Court of First Instance subsequently overturned this decision in 2002 due to flaws in the Commission's reasoning (although in relation to its analysis of markets other than France). The Commission may make mistakes in its analysis, but there is no evidence it systematically blocks 'strategic' mergers.

[9] *Mario Monti, 'Les bizarres complexes d'une France qui gagne', Le Monde, July 17th 2004.*

Furthermore, the critics of the Commission's competition policies have failed to provide an intellectually coherent alternative. Most suggest that the Commission should take into greater account the 'global' nature of competition faced by 'strategic' industries. But what industries should be classified as 'strategic': pharmaceuticals, biotechnology, telecoms, car manufacturers? Fifty years ago coal and steel would have been at the top of this list. And how should the Commission analyse such strategic factors when it is considering a merger? Some analysts argue that long-term oil and gas reserves are strategically vital to the EU. But does this mean that the petrol stations owned by merging energy companies should also be exempt from normal competition rules? The defence industry, which raises understandable sensitivities over sovereignty, is exempt from EU competition rules – although even here the trend is towards greater competition.[10] Companies should make better use of the existing defence that a merger will create 'efficiencies', which will benefit EU consumers (see chapter 3). Politicians and businesses cannot expect a merger to be waved through simply because they label it strategic.

[10] *Daniel Keohane, 'Europe's new defency agency', CER policy brief, June 2004. The Commission unveiled new plans to liberalise certain parts of the defence industry in September 2004.*

[11] *European Commission, 'Fostering structural change: an industrial policy for an enlarged EU', April 20th 2004.*

Equally, there is little evidence that Europe is suffering from a sustained period of deindustralisation that would justify a change in EU competition and state aid rules. A recent Commission report found no proof of a decline in employment, output, productivity growth or a rising trade deficit, which would suggest that the European economy is suffering from a widespread loss of manufacturing.[11] Certain sectors are struggling in the face of intense global competition – most notably shipbuilding, textiles and mining. The decline of these industries has caused disproportionate economic pain to some European regions. But overall the European economy is faring well and continues to attract substantial levels of foreign direct investment (FDI). The United Nations Conference on Trade and Development's latest World Investment Report found that FDI flows into the EU-15 fell by 21 per cent to $295 billion in 2003, in line with declines in other developed economies. However, this figure remains substantially above an average of just $96 billion a year between 1992 and 1997. Moreover, France continues to attract the most FDI among the major European economies, some $47 billion in 2003, only slightly below $49 billion in 2002 and more than the US received in the same year. European firms did invest more overseas in the same year, some $337 billion in 2003. But investment is not a zero sum game: the European economy should benefit from investments which raise the overall levels of trade. FDI helps to support economic growth in developing countries, increasing the potential size of the markets for European exports.

France and Germany have repeatedly complained that the new member-states are accelerating deindustrialisation in western Europe through 'unfair' tax competition – and have floated the idea of setting minimum corporate tax rates for the whole EU. In September 2004 Sarkozy went one step further. He called on his fellow EU finance ministers (including those of the new member-states) to withhold funds to countries such as Estonia, which has a zero rate of corporation tax on profits which remain within that country's borders. "I don't understand how some countries can be rich enough to cut their taxes – to zero for some – and at the same time explain to others, that is the countries that joined Europe earlier, that they are poor enough to need structural funds that we provide with taxpayers' money," Sarkozy argued. However, even Germany baulked at a plan designed to withhold subsidies to the much poorer east European countries. As Frits Bolkestein, the outgoing internal market commissioner, told a conference in Prague in May 2004, the spectre of deindustrialisation is "just the latest wheeze to try to stave off competition, notably from new EU member-states, instead of making the most of enlargement's opportunities".

The strongest argument against a revival of interventionist industrial policies is that they do not work. French industrial history is littered with expensive failures: Bull, the French computer company, is estimated to have received some €7 billion in subsidies since its creation as part of the *plan calcul* in the 1960s. Yet, the company has had to cut its workforce from 46,000 in 1988 to just 8,000 now. The company was granted some €1.7 billion in restructuring aid in 1994. A decade on, Bull is set to receive a further €520 million subsidy to help it stay afloat.

Even supposedly successful rescues, such as Air France or Renault, cause damage elsewhere in the economy. Industrial polices do not save jobs on a net basis and inflict considerable costs on other businesses. Government bail-outs and subsidies mean capital is distracted from where it would earn the highest returns. This raises the cost of doing business for all but the lucky few recipients of state patronage. Moreover, investors who fear that the rules of the market do not apply are likely to seek out a better return for their capital elsewhere in the world. As a result, fewer jobs are created than would otherwise have been the case. One economist argues that for every 100 jobs saved through government intervention, 110 are lost or not created elsewhere in the economy.[12]

[12] *Eric Chaney, 'Industrial policies: Basta!', Morgan Stanley, June 2004.*

The Alstom case

The French government's €2.5 billion rescue of Alstom exposes many of the difficulties the Commission faces in trying to crack down on illegal state aid. Alstom was once France's blue chip engineering firm, building turbines for electricity generators, cruise ships and, most famously, high-speed trains such as the TGV and Eurostar. However, the company almost went bankrupt in September 2003. It only stayed afloat due to an emergency €1.2 billion loan from the French government.

The Commission was sceptical about allowing France to proceed with a rescue, and angered that the government had failed to secure prior permission for the subsidy. However, during the months that followed the initial rescue, the Commission came under sustained political pressure to permit the company's survival. For example, then finance minister Nicolas Sarkozy made clear that the Commission would be to blame for up to 70,000 job losses should it block the bail out. He told Alstom workers in May 2004 that "the construction of Europe was not designed to create an industrial desert".

The Commission wanted to put in place tough conditions before giving the green light to the rescue plan. Ideally, it wanted Alstom to sell a number of subsidiaries to its competitors as a compensatory measure for the state subsidy. However, many of the markets in which Alstom operates have few competitors. Thus the sale of a subsidiary could pose competition problems. For example, only two companies – Siemens and Canadian firm Bombardier – compete with Alstom in the high speed trains market.

As a result, the Commission had to broker a complex deal with the French government before approving the aid. Alstom will have to sell some subsidiaries. But to avoid competition problems, the Commission has requested that in certain sectors it seeks a series of 'industrial tie-ups' within the next four years. Meanwhile, the French government will have to sell its stake in the company – acquired as part of the rescue – within the same time frame.

Siemens, Alstom's main European rival, has already expressed its displeasure with the agreement and is considering an appeal. Siemens believes the remedies imposed on Alstom do not go far enough in compensating rival firms. Moreover, the French government and the Commission seem to have a different understanding on whether an 'industrial tie-up' means that Alstom has to cede management control over a key subsidiary to a rival.

Many analysts are still sceptical about Alstom's long-term survival. But the French government, and particularly Sarkozy, benefited from the rescue. Sarkozy greeted the final agreement with a victory tour of Alstom's factories in Belfort and La Rochelle, which helped boost his poll ratings.

3 A transatlantic rift?

Some EU governments and businesses maintain that the Commission's tight grip on competition and state aid policy is harming European companies. At the same time, US policy-makers increasingly claim that the Commission is becoming overtly anti-American in its competition decisions.

In the last few years, the European Commission has had to weather a storm of criticism from the other side of the Atlantic over its conduct of competition policy – most notably its decision to block the GE/Honeywell merger in 2000 and impose anti-trust remedies on Microsoft in 2004 (see below). US businesses and policy-makers claim that the Commission is far too interventionist: they say its threshold for taking action in merger and anti-trust cases is set too low and that the EU 'penalises success'. Furthermore, they claim that it pays too much attention to competitors and too little to the needs of consumers when reaching its decisions. In contrast, the US Supreme Court has made clear that US competition policy is "for the protection of competition not competitors". Finally, the Commission's US critics believe that unscrupulous American companies are using the EU as a 'second chance' court, by bringing actions against their rivals which have failed in America.

The EU and the US have never entirely seen eye-to-eye on competition policy. But the Bush administration has brought the differences into stark relief. The Bush presidency has adopted an extremely *laissez-faire* approach to economic policy in general, and big business in particular. US competition authorities are thus loath to intervene, preferring if possible to let the market correct any competition problems. Equally, the administration has adopted a strongly unilateralist stance on all aspects of external policy. That means it is uncomfortable with decisions made by non-US authorities that affect US individuals or businesses – including Commission competition judgements. The rightwing Cato Institute recently spelt out these concerns in the Microsoft case, accusing the EU of "second guessing and overriding the judgement of both the judicial and executive branches of the US government in a matter that concerns management decisions made in the US by a US company".[13]

[13] *Robert Levy, 'A welfare state for aggrieved market losers', Cato Institute, March 25th 2004.*

Such US-EU divisions have led some commentators to predict a widening transatlantic rift over competition policy. Lawrence Lindsey, the former president of George Bush's National Economic Council, recently warned that "anti-trust policy is one area in which European motives are becoming increasingly hard to defend, even for committed Atlanticists".[14] Meanwhile, Jonathan Zuck, president of the US Association for Competitive Technology, has written that "if the ECJ upholds the European Commission's decision [on the Microsoft case], the rift will deepen and threaten the future of global business".[15]

[14] *Lawrence Lindsey and Marc Sumerlin, 'An acid test of Monti's motives', Financial Times, September 22nd 2004.*

[15] *Jonathan Zuck and Laurent Reussman, 'The transatlantic rift in anti-trust law', International Herald Tribune, August 16th 2004.*

The EU's merger reform

The EU's practical handling of merger policy has never been as interventionist as some of its US critics allege. Since 1990, the EU has only blocked outright 18 mergers out of more than 2400 cases notified (and none since 2001). Although direct comparisons with the US are difficult – in the US only the courts have the power to block mergers – such figures do not suggest that the EU is acting in a greatly more interventionist manner.

But the EU has also brought its theoretical approach more into line with the US by adopting a new merger regulation, which came into

force in May 2004. The main purpose of the reform was to close an apparent 'gap' in EU merger policy. The EU's original merger test was based on the concept of 'dominance' within a specified market. This meant the Commission could prohibit mergers which might lead to the creation of a dominant firm that was able to raise prices and/or cut back output with a negative impact on consumers. Equally, the Commission could prohibit mergers where the decline in competition might result in a small number of firms tacitly colluding to raise prices.

However, it is also possible that a merger may reduce competition without leading to the creation of a single dominant firm, or tacit collusion between a number of firms. A merger could change the structure of the market in such a way that without any co-ordination between rival firms, prices would still rise. The European Court of Justice exposed this gap in the EU's merger policy in 2002 when it overruled the Commission's decision to prohibit the Airtours/First Choice merger. The Court argued that the Commission had failed to provide sufficient evidence of tacit collusion (and set the bar for proving such collusion in the future very high).[16] However, the Court did not dispute the possibility that the merger of the two travel firms might lead to a decline in competition without any co-ordination between firms.

[16] *David Walton, 'Transatlantic merger policy put to the test', Global Economics Paper no. 101, Goldman Sachs, November 7th 2003.*

The Commission thus began a review of the EU's merger regulation with the aim of closing this gap. The US merger test, which states that a merger should not "substantially lessen competition", has always provided flexibility to deal with this kind of case. Some member-states, led by Britain and Ireland, made it clear that they wanted the EU to fall exactly into line with the US approach by adopting the US phrasing (as these countries had done for domestic mergers). However, other governments such as Germany objected, concerned that the removal of the dominance test could invalidate their domestic competition case law.

As a result, the new EU merger regulation contains a compromise between the two sides. The EU will prohibit mergers: "If they significantly impede effective competition, in the common market... in particular as the result of the creation or strengthening of a dominant position".[17]

[17] *Council regulation on the control of concentrations between undertakings (the EC merger regulation), January 20th 2004.*

[18] *Derek Ridyard, 'The Commission's new horizontal merger guidelines: an economic assessment', RBB Economics, February 2004.*

Some competition specialists argue that the new test is too broad. Thus the Commission could block more mergers than in the past and even apply the test to anti-trust cases. Moreover, they claim that the new test leaves the Commission with too much discretion, increasing the uncertainty over future merger decisions.[18]

The Commission has clarified its approach to merger policy in its (first ever) set of guidelines.[19] These guidelines address most of the concerns outlined above: they make clear that the new test only applies to mergers; they stress that the Commission's main concern in assessing a potential merger is the effect on consumers; and they clarify that the Commission will not employ tougher criteria than the US when deciding whether to launch an investigation. As James Rill, former US deputy attorney-general for anti-trust, commented: the EU's new merger regime is now designed "as close as it could get to the US system without copying the whole caboodle".

[19] *European Commission, 'Guidelines on the assessment of horizontal mergers under the Council regulation on the control of concentrations between undertakings', February 5th 2004.*

The EU's new merger regulation also allows for the first time companies to argue that efficiencies from a deal will benefit consumers – a line of reasoning that US competition authorities have long permitted. These merger efficiencies include cost-savings leading to lower product prices, and also the pooling of research and development expertise resulting in the development of new products. However, the Commission's merger guidelines indicate that it is still sceptical whether efficiencies will in general "counteract the adverse" competitive effects of a merger. The Commission insists that such efficiencies must be both timely and verifiable.

Thus, the EU has largely brought its merger regime into line with that in the US. This does not mean that the EU and US will reach identical conclusions. Competition rulings often come down to a fine matter of judgement. John Vickers, chairman of the UK's Office of Fair Trading, has noted that the Federal Trade Commission – the US competition authority – is frequently split three to two on its decisions. Nor does it mean that the Commission never makes mistakes: as the European Court has concluded in recent cases such as Schneider/Legrand.

The Microsoft case

The Microsoft case has exposed some important differences in how the Commission and US competition authorities deal with anti-trust cases in fast-moving markets. The Commission concluded in March 2004 that Microsoft had acted anti-competitively in two different ways. First, the software giant had abused its market power by deliberately restricting 'interoperability' – the ability of different pieces of software to work together – between personal computers running its products and servers running non-Microsoft software. Second, it had tried to force rivals out of the new market for media playing software by fully integrating its own programme into Windows systems. The Commission concluded that these were "very serious abuses which act as a brake on innovation and harm the competitive process and the consumer, who ultimately ends up with less choice and facing higher prices".[20]

[20] *European Commission, 'Commission concludes on Microsoft investigation, imposes conduct remedies and a fine', March 24th 2004.*

The Commission decided to impose three separate remedies on Microsoft: it demanded a record fine of €497 million as punishment for its anti-competitive behaviour; it asked Microsoft to share information with its competitors to improve the interoperability of its software with servers; and it forced the software firm to offer a version of Windows without the media player attached.

These remedies sparked transatlantic tensions – despite the fact that they are unlikely to make much difference to Microsoft's profitability. Analysts point out that the fine represents less than 1 per cent of the company's available cash. Microsoft will still be able to sell versions of Windows with its own media player attached, at exactly the same price as versions without the player. At the time of writing (October 2004), it was also possible that the European Court could suspend the penalties until it has heard Microsoft's appeal. If this happens, the Commission's remedies are likely to have no effect, since the appeal will take several years and software markets are very fast-moving.

However, US critics raise two strong objections to the precedent set by the Commission's ruling. First, they argue that the Commission is forcing Microsoft to share secret and valuable technology with a competitor. Thus, the Commission is undermining a company's intellectual property rights. Microsoft's settlement in the US requires the company to provide information which will help rival systems operate more efficiently with its software. But it stops short of forcing Microsoft to share the software code protected by property rights. However, the Commission rejects this criticism, it claims that its remedy is in line with that agreed in the US and that it does not involve Microsoft sharing the source code which forms the basis of the Window's system.

Second, critics argue that the ruling could make any new function that a dominant company adds to its products illegal. Thus Nokia, the mobile phone company, might face competition authority action for integrating messaging or imaging software into its mobile phones.[21]

[21] *Craig Winneker, 'Dialogue of the deaf in competition cases', E!sharp, July-August 2004.*

Such an approach could not only increase uncertainty for major companies producing new products, but also curb innovation. In appealing against the decision, Microsoft has argued that it would reduce incentives for research and development and, perversely, force the company to offer a more primitive product to its customers. Hew Pate, the outspoken US assistant attorney-general for anti-trust, has claimed that the Commission's decision "risks protecting competitors not competition in ways that may ultimately harm innovation and the consumers that benefit from it".[22] Pate points to the fact that US courts considered imposing a similar remedy on Microsoft, but concluded that there was no firm proof that tying products harms competition, except when the practice is used to extend an existing monopoly.

[22] *R. Hewitt Pate, 'Comments on Microsoft decision', US Department of Justice, March 24th 2004.*

The assessment of competition issues in fast-moving markets, such as IT and telecoms, is proving a major headache for policy-makers – as the next chapter will show. At the time of writing, the Microsoft case – which might help to establish a precedent – hung in the balance. But until the Commission succeeds in establishing clear and consistent guidelines for dealing with such cases, it should err on the side of caution when making anti-trust provisions. As Bo Vesterdorf, president of European Court of First Instance, asked the Commission at the start of Microsoft appeal: "Isn't it kind of dramatic to impose a remedy in which you do not know the results, with all the complications it is going to bring?"

4 Redefining European competition policy

Traditionally, EU competition policy has been reactive: the Commission's main aims have been to prevent mergers which would reduce competition, clamp down on anti-competitive behaviour or stop the payment of illegal state aid. In the last couple of years, the EU has undertaken a series of reforms to improve the efficiency, transparency and predictability of its enforcement of competition rules (see chapter 6). At the same time, the EU has begun a process of economic reform with the goal of improving the overall competitiveness of the European economy. At the Lisbon summit in the spring of 2000, EU leaders agreed to make their labour markets more flexible, stimulate innovation, encourage entrepreneurs, spend more on research and development and complete the single market. Competition policy is supposed to support the EU's economic reform programme, for instance by ensuring that companies can operate on a level playing-field in newly liberalised markets such as telecoms and energy.

As a result, the competition directorate-general is beginning to see its role as more than simply policing mergers and anti-trust cases. Rather, it is seeking to raise the overall level of competition within the EU's single market. As the Commission explained in a recent paper, it wants to "actively remove barriers to entry and impediments to effective competition that most seriously harm competition in the internal market and imperil the competitiveness of European enterprises".[23]

[23] *European Commission, 'A pro-active competition policy for a competitive Europe', April 20th 2004.*

The Commission will need to change the way it conducts competition policy if it is to meet this ambitious goal. It should place much more emphasis on scrutinising the barriers to competition posed by regulation – both at a national and European level. The competition directorate-general must also become a stronger advocate of competition, not only within the Commission, but also in its dealings with the member-states.

Competition investigations

Senior competition officials privately admit that the Commission has in the past focused too much on competitor complaints. They question the benefits of devoting a large proportion of resources into following up the grievances of the 'number two' in a market, such as the long-running investigation into Coca-Cola's tactics in the soft drinks market. Such complaint-led investigations leave the Commission vulnerable to US criticism that it favours competitors not consumers when reaching competition decisions. Equally, investigations which focus on the alleged anti-competitive activities of one company are unlikely to uncover wider competition problems, especially regulatory barriers.

Thus the Commission wants to make greater use of sectoral investigations – where it looks into the workings of a whole market rather than the actions of an individual company. In some member-states sectoral investigations are a common tool. In the UK, for example, the Office for Fair Trading has recently conducted investigations into high street pharmacies and private dentistry, and made recommendations to liberalise these markets. Such investigations consider whether individual firms are behaving in an anti-competitive manner. But equally importantly they explore whether rules and regulations are impeding competition unnecessarily. Excessive or poorly designed regulation – whether private or public – tends to bolster the market power of incumbent companies by making it difficult and costly for new players to enter the market.

Businesses often prefer the sectoral approach to competition enforcement, in part because the investigations are less aggressive:

the competition authority does not need to employ 'dawn raids' to gather its information. However, critics argue that sectoral investigations are simply 'fishing' expeditions that usually prove a waste of time and effort. The Commission's few attempts at sectoral investigations have proven very time-consuming. For example, the Commission launched an inquiry into airport landing fees in 1995, but only completed the case in 2001. In contrast, the complainant in an anti-trust investigation has an incentive to supply information which can reduce costs and times.

The Commission is trying to reduce the risk that sectoral investigations drag on needlessly by introducing clear timelines. But the EU lacks a framework for deciding when to begin a new investigation. Its recent communication on 'proactive competition policy' set out which tools the Commission intended to use to analyse competition problems, such as measures of the concentration of a market. But the document said little about how the Commission would choose its targets for investigation.

The Commission should set out clear guidelines explaining its priorities for future sectoral investigations. The Commission's core principle should be to focus on economically significant parts of the economy where action, whether anti-trust or regulatory, may yield real benefits to consumers. For example, the Commission should consider investigating the retail banking sector, which remains highly fragmented along national lines. Many firms have found it difficult to break into the French credit card market due to tight restrictions on the exchange of banking data, which mean only incumbent banks have a good knowledge of a customer's credit risk. The EU's attempts to use legislation to force open this market have so far floundered on the wide diversity of consumer protection rules and political sensitivities. Moreover, firms operating in relatively liberal markets, such as the UK, fear that any attempt to harmonise rules would result in the EU introducing more restrictive regulations in the guise of protecting consumers. The Commission should use a sectoral investigation to highlight individual rules and regulations that restrict competition in this sector. The investigation should conclude by recommending measures to tackle any regulatory barriers. Such measures could include starting infringement procedures against individual member-states for the violation of EU internal market rules; or the amendment of offending EU regulations.

Putting the consumer first

The Commission should demonstrate more clearly that its competition policies are designed to benefit consumers by making greater use of sectoral investigations. However, the Commission also needs to answer the criticism that it pays insufficient attention to consumers when conducting regular merger and anti-trust cases. Competition specialists complain that the Commission only ever produces a cursory paragraph detailing the potential consumer benefits from individual competition decisions.

In response to such criticisms, the competition DG has recently appointed a consumer liaison officer. The officer's task is to ensure the views of consumer organisations are heard during a merger or anti-trust investigation. But the Commission's desire to include a better analysis of consumer issues is hampered by two problems: the dearth of consumer organisations at a European level; and the failure of the Commission's own health and consumer protection directorate-general (known by its French acronym SANCO) to take competition issues seriously.

The few active pan-European consumer organisations are short of funds and experience, in comparison with their national counterparts. The Commission should help stimulate the growth of more professional consumer organisations in two ways. First, the Commission should encourage national consumer organisations to devote more resources to European issues. Most consumer organisations are still geared to looking at domestic issues even though many key rules and regulations now originate at EU level.

Second, the Commission should make some funds available for consumer research from the fines it collects from anti-trust offences.

The Commission has so far rejected calls for it to follow the practice of some member-states and make consultation with consumer groups a formal part of the competition investigations. Officials privately argue that the data provided by such groups are of insufficient quality to justify inclusion. But without the incentive of guaranteed participation, European consumer organisations will struggle to raise the funding they need to produce good quality reports. Thus the Commission should set a target date, say three years hence, for the formal incorporation of consumer organisations into the competition process.

The Commission should also review its own approach to consumer issues to improve the links between its competition, and health and consumer protection DGs. SANCO focuses on protecting the consumer through rules and regulations, such as those for food production. While the culture of SANCO is not anti-competition, the department has shown little interest in promoting competition as an important element of consumer welfare. For example, SANCO has clashed with the competition DG over the latter's investigation into restrictive practices in the liberal professions, including lawyers, engineers, accountants and pharmacists. SANCO has argued that restrictive practices, such as requiring a high level of qualification, are necessary to protect the consumer from rogue practitioners. The competition DG, however, has concluded the opposite – that many of the rules and regulations are harming consumers by preserving the power of incumbents.

Competition is important for consumer welfare: it ensures that companies strive to meet consumer needs, reduces prices and increases choice. The Commission needs to strike a better balance between protecting the consumer and encouraging greater competition. In the US, the Federal Trade Commission has responsibility for both competition and consumer protection.

This does not mean the Commission should replicate the US model. An independent department could act as a powerful advocate for Europe's consumers in all Commission policies, including for example environmental or single market issues. However, the Commission should create a new 'consumer affairs' directorate-general. The new DG should promote overall consumer welfare, including greater competition, rather than simply 'protecting' the consumer; and it should devote part of its research budget to competition issues, something that SANCO has failed to do.

Supporting innovation

The EU is committed to encouraging innovation as part of its Lisbon economic reform agenda. However, policy-makers are finding it difficult to turn this goal into a reality while at the same time encouraging greater competition.

Traditional economic theory, based on the work of Austrian economist Joseph Schumpeter, stresses the importance of monopolies in fostering innovation. Firms have no incentive to innovate if rival companies, which have not paid the development costs, can immediately copy a new technology or product. Hence companies will only invest in R&D if their inventions receive some protection from intellectual property rights, such as patents and trade-marks.

Furthermore, Schumpeter argued that companies are more likely to innovate if they hold a dominant position within the market. Dominant companies feel more secure about their long-term prospects and are thus more willing to commit the investment needed to develop new products. Schumpeter concluded that since innovation is crucial to long-term economic success, policy-makers should be willing to tolerate the dominance of a small number of firms in dynamic markets.

However, modern economists have challenged Schumpeter's assumptions. They argue that competition is necessary as a spur to innovate and develop new products. Moreover, competition can

encourage the rapid diffusion of successful innovations, which in turn stimulates firms to develop new products.

Recent empirical research largely supports this revised view of the importance of competition in fostering innovation.[24] Studies have found a direct relationship between high levels of competition and innovation. The research suggests that the most innovative markets are those which contain a reasonable number of competitors. When competition is either very low or extremely intense, firms have less incentive to innovate.

[24] *Philippe Aghion et al, 'Competition and innovation: an inverted u relationship', Working paper No. 9269, National Bureau of Economic Research, October 2002.*

Such theoretical insights are helpful for establishing the broad intellectual framework within which competition authorities should work. Policy-makers must protect intellectual property rights so that firms have an incentive to innovate. And they must make sure that such protection does not stifle all competition. But as the Commission's battle with Microsoft demonstrates, the theory provides little practical help to competition authorities in reaching decisions on complex cases.

The Commission should develop much better guidelines on how it treats innovation issues when making competition decisions. In particular, the Commission should define more clearly what are 'dynamic' markets.

In typical markets, companies compete on price and incremental increases in the quality of their products. Competition authorities have long experience of analysing such markets, and can draw on a range of tools to determine whether there are any competition problems. However, markets which are highly innovative are also highly dynamic. Companies compete not by offering rival versions of the same product but by developing entirely new products and new markets. Thus company 'A' may dominate the market for compact disc players, but is now having to cut its prices, because companies 'B' and 'C' are popularising MP3 players.

Competition authorities find it extremely difficult to assess such dynamic markets. Standard competition policy investigations, which analyse a firm's share of an existing market, fail to capture the breadth of competition. Policy-makers must judge whether new markets could be created in the future and assess how these markets could affect overall levels of competition. Equally, competition authorities find it difficult to quantify changes in the quality of a product and the value of such improvements to consumers. Given such a high degree of uncertainty, competition authorities need a very strong case before they intervene.

Innovative markets are, by definition, dynamic. Thus if the rate of innovation within a particular market slows, it indicates either that there are competition problems worthy of further investigation; or that the market is reaching maturity and competition authorities can rely on standard competition policy tools in making their assessment. Consequently, the Commission should work towards developing a measure of the rate of innovation to help it assess whether dynamic markets pose competition problems.

5 State aid and economic reform

Slowly, the EU is redesigning its competition policies to support its economic reform goals. It is also, at least on paper, committed to reforming its rules on state aid. As part of the Lisbon agenda, EU governments are supposed to reduce the amount of aid they pay to industry as a proportion of GDP. Furthermore, heads of government agreed that remaining subsidies should go towards 'horizontal' goals, such as training or research and development, rather than be given to specific sectors or companies. This form of aid is in line with other Lisbon goals, such as promoting innovation, and is less likely to distort the market.

The EU has had some success in reducing the overall level of subsidies. The Commission's state aid 'scoreboard' shows that, among the EU-15, aid payments (excluding railways) have fallen from €70.45 billion in 1992 to €48.75 billion in 2002, or from 1.09 per cent of EU-15 GDP to 0.56 per cent (see table on page 40). Around three-quarters of all subsidies are now directed to 'horizontal' objectives.

At the same time, the Commission has made better use of its state aid powers to eliminate serious distortions of competition in recently liberalised sectors such as energy. The Commission has also established a series of important principles, most notably that state guarantees are a form of illegal aid.

However, the EU's drive to reduce subsidies is slowing, in part reflecting its success over the last decade. The total amount of aid paid fell only marginally from 0.59 per cent of GDP to 0.56 per cent between 2000 and 2002.

Moreover, the Commission is reaching the limits of the EU's law in terms of cracking down on state subsidies. Monti has shown a willingness to try and creatively use EU state aid rules. The commissioner told competition lawyers at a conference in 2003: "state aid lies at the interface of law and economics... I consider it entirely proper that in justified cases the Commission should explore the limits of the law to deal with measures which create clear and important distortions of the conditions of competition."[25]

[25] *Mario Monti, 'New challenges for state aid policy', speech to the European state aid law forum, June 2003.*

However, the Commission ultimately backed away from another bruising battle with the French government over verbal comments to support France Télécom's share price in 2002. The French government had publicly promised to support the company when it ran into financial difficulties and also made up to €9 billion in credit available to help keep the company afloat (although this money was not used). The Commission concluded in July 2004 that such comments constituted state aid because they "created expectations and confidence on the financial markets" and made it cheaper and easier for the company to borrow fresh funds. However, the Commission decided it could not force the repayment of such 'psychological aid' – its own lawyers doubted whether such a ruling would stand up in Court. Instead the Commission has demanded that the company pay back €1.1 billion in unpaid taxes and interest also dating to 2002.

The Commission needs to renew its efforts to clamp down on unfair state aid payments. The greater use of sectoral investigations should help expose barriers to competition, especially in those recently liberalised markets where previously state-owned companies continue to benefit from government support. As Philip Lowe, the director-general for competition, has admitted, the Commission's state aid investigations have largely been restricted to following up complaints.[26] The Commission should be able to set its own priorities and focus its investigations on the most economically important sectors.

[26] *Philip Lowe, 'State aid: the Commission's plan for reform', speech to British Chambers of Commerce, December 1st 2003.*

Restructuring aid

The Commission has recently sought to tighten its rules on the most controversial form of aid – that paid to rescue and restructure struggling companies. Such subsidies only displace the problem elsewhere in the economy, and in particular, onto competing firms. They reward reckless decisions or poor management, diminish normal competitive pressures and promote bad corporate governance. As the Commission states in its new guidelines: "The exit of inefficient firms is a normal part of the operation of the market. It cannot be the norm that a company which gets into difficulties is rescued by the state."[27]

[27] *European Commission, 'Community guidelines applying articles 87 and 88 to granting of urgency and/or restructuring aid to firms in difficulty', May 2004.*

However, the economic downside of this form of aid is often hidden and many European politicians find it difficult to resist saving jobs. The new guidelines, which came into force in October 2004, strengthen the rules on rescuing companies. In particular, the Commission is seeking to apply the "one time, last time" principle more strictly. Companies that have benefited from restructuring aid will not be eligible for any further help for a minimum period of ten years. The Commission has also more tightly defined 'rescue' aid, which must be temporary and reversible lasting a maximum of six months. Such aid can only be paid as a prelude to the restructuring or liquidation of the company. This change in the rules should close a loophole which was exploited by the French government in its rescue of Bull, the computer firm. When Bull ran into financial difficulties in 2003, it was not eligible for aid as less than a decade had elapsed since it last received such funding. Consequently, the French government awarded the company rescue aid, but ignored the six month deadline for repaying such subsidies, enabling the company to stay afloat until the ten-year period elapses at the beginning of 2005.

The Commission has also reduced the proportion of the total restructuring costs that governments can pay in aid. Companies must find a minimum of 50 per cent of the costs from private sources, either by selling subsidiaries, or from loans and new capital from private investors raised in normal market conditions (there are lower thresholds for small and medium sized firms).

The willingness of some member-states to use rescue and restructuring aid remains an anomaly. This form of aid is rarely justified in economic terms. The Commission's new rules should reduce the number of cases in the future. But governments will always be tempted to save jobs with subsidies. The Commission – acting in its role as the advocate of competition – should commission a report which provides sound economic evidence of why such policies are futile. In the long-term, the Commission should tighten the rules so that restructuring aid is only paid in truly exceptional circumstances.

Competition and public services

Public sector unions and many left-of-centre politicians have become increasingly critical of the EU's state aid and competition rules in recent years. They argue that the Commission's tough stance on subsidies, coupled with the EU's pledge to increase competition in formerly state-owned industries such as electricity and gas, is threatening to undermine the ability of member-states to provide comprehensive public services.

Critics claim that EU rules, although supposedly 'neutral' on the issue of how member-states provide public services, are in reality biased in favour of further liberalisation. They cite recent Court of Justice rulings that seem to call into question the subsidies that member-states pay to maintain 'services of general interest', such as energy, postal and even transport services. The critics argue that the EU should adopt a directive that protects services of general interest from damaging competition rules. Unions cite the problems of the UK's railway network and electricity blackouts in Italy as evidence of the dangers of the EU's existing approach to liberalisation and competition.

This debate has been most vigorous in France, where EU competition rules are commonly viewed as part of an attempt to impose a deregulated trading zone, *à l'anglaise*, on Europe.[28] For example, the French think-tank Europartenaires wants the EU to "recognise services of general interest as something more than just a concession, something that is tolerated as long as it is compatible with competition [rules]".[29] The former French prime minister Laurent Fabius has even made clear that the EU's faliure to adopt a directive protecting public services is a reason for voting 'no' in the forthcoming French referendum on the EU's constitutional treaty.

[28] *Eric Le Boucher, 'Peut-on faire l'Europe sociale? Réponse: non', Le Monde, September 12th 2004.*

[29] *Europartenaires, 'In Europe, the public service is in the general interest', January 2004.*

The French government insisted on a clarification of the rules surrounding services of general interest in exchange for conceding ground on energy liberalisation at the Barcelona summit in March 2002. Jacques Chirac subsequently persuaded Tony Blair and Gerhard Schröder to draft a joint letter calling on the Commission to respect the 'special nature' of such services. As a result of these requests, the Commission embarked on a two-year consultation process culminating in the publication of a White Paper on services of general interest in May 2004.[30]

[30] *European Commission, 'White paper on services of general interest', May 12th 2004.*

For the moment, the Commission has resisted the pressure to frame a new directive. The Commission's White Paper concluded that it did not need to take further action. But the debate over services of general interest will not fade away, as Fabius' recent intervention has demonstrated. In particular, the new constitutional treaty contains a clause (Article III-6) which leaves open the possibility that EU might take legislative action in the future.

The case for a new directive is far from proven. Member-states fund and provide public services in very different ways across the EU. A service that one country regards as the sole preserve of the state may be privatised in another. For example, in Denmark private firms provide emergency services, such as the fire brigade, but the state directly manages all prisons. In contrast, private prisons are commonplace in Britain, but the state is the sole supplier of the emergency services. Even France, while highly protective of state-owned services, such as railways, has taken a very liberal stance on its water supply. The EU risks diminishing this diversity by attempting to define catch-all rules in a single directive.

Furthermore, existing EU law allows member-states ample freedom to provide and subsidise important services. Governments can choose whether public bodies or private firms supply services. Since state aid rules are only meant to cover serious distortions of cross-border trade, many locally-based services are automatically exempt. Thus EU rules do not affect aid to municipal swimming pools. The Commission has also stressed that even large subsidies to companies which fulfil mainly local needs – for example hospitals or social housing – would normally be exempt from cumbersome state aid notification procedures.

However, the EU should clarify the outcome of a recent European Court of Justice ruling on services of general interest. In the Altmark case of July 2003, the Court ruled that a subsidy paid for delivering a service (in this specific case, for a German bus service) should be exempt from state aid rules, provided the payment met a number of criteria: the amount of compensation should be clearly calculated and objective; the compensation should not exceed that required for the provision of the service; and the public service element must be clearly defined.

The Court also suggested that governments should award subsidised public service contracts by competitive tender (although it stopped short of making this a formal requirement). The Commission should support this principle and develop guidelines for national and regional governments. Tendering should ensure that the costs of providing subsidies are transparent. It should also help establish the

exact level of compensation required for the provision of the service: companies have no incentive to keep costs low unless they face competition for the subsidy.[31] Such a reform is in line with the EU's commitment, as part of the Lisbon economic reform agenda, to open up public procurement to greater competition.

[31] Phedon Nicolaides, 'Compensation for public service obligations: the floodgates of state aid?', European Competition Law Review, Vol. 25, Issue 11, November 2003.

However, the Commission should also state explicitly that member-states do not have to award such contracts on the basis of price alone – and that they can consider other social objectives according to the preference of their electorates. This should help reassure unions that tendering need not necessarily favour private firms. Moreover, while tendering is good practice for all tiers of government, smaller local authorities may lack the resources or expertise to apply such rules and should be exempt.

Total state aid* (as a percentage of GDP)

	1992	1997	2002
EU 15	0.85	0.66	0.39
UK	0.15	0.34	0.17
Germany	1.39	0.92	0.56
France	0.51	0.85	0.42
Italy	1.44	0.84	0.38
Denmark	0.33	0.6	0.72
Belgium	0.71	0.34	0.37
Portugal	0.47	1.52	0.55
Spain	0.41	0.69	0.16
Netherlands	0.21	0.17	0.19
Ireland	0.45	0.47	0.45

Source: European Commission
** Total aid less agriculture, fisheries and transport*

6 A fair and efficient competition regime

The EU has made great strides in recent years towards modernising its competition system. In particular, the EU has passed a series of reforms, which came into effect in May 2004, designed to allow the Commission to focus its resources on the most important cases. For example, businesses no longer notify the Commission of the many routine agreements they sign with competitors and rivals: companies must now review the affects of such deals themselves. The reforms also give national courts and competition authorities a much greater role in deciding on anti-trust cases which were previously the sole preserve of the Commission.

Many businesses are concerned that the end of the notification system will mean a loss of legal certainty: they can no longer be sure their agreements with other firms might not be in breach of EU competition law. UNICE, the EU employers organisation, has also warned that member-state courts might apply the rules in a different fashion, thereby resulting in the renationalisation of competition law at the expense of the single market.[32] Some firms might seek to 'forum shop', that is to seek out the member-state competition regime where they are most likely to win their case.

[32] *UNICE, 'Comments on modernisation of EC competition law', December 5th 2003.*

It is too soon to pass judgement on whether these reforms will prove a success. The Commission has taken a number of steps to allay business concerns, for example it will provide 'guidance letters' to companies worried about their agreements. The Commission will need to monitor their impact carefully over the coming years. In particular, the Commission needs to demonstrate a willingness to provide guidance to member-state courts on new aspects of competition law. It should also be prepared to use its powers of intervention and take control of member-state anti-trust cases when there is a risk of divergence from EU rules.

Over the last two years, the Commission has also had to undertake a series of piecemeal procedural reforms, largely in response to a string of ECJ defeats. In 2002, the Court overturned three cases because the Commission has failed to follow proper procedures. For example, the Court claimed that the Commission was guilty of "several obvious errors, omissions and contradictions" in its economic reasoning on the Schneider/Legrand merger case. As a result of the Court's criticisms, the Commission has sought to:

★ ***Improve the quality of economic advice***

Businesses have long complained that Commission lawyers, rather than economists, take the key competition decisions. In 2002 (the most recent date for which the Commission supplies data) the competition DG employed more than twice as many staff trained in law (184) than in economics (83). In September 2003, Mario Monti sought to address this criticism by appointing a chief economist – Lars-Hendrik Roller, a former economics professor from Humboldt University in Berlin. The chief economist, who oversees a team of ten industrial economists, is supposed to supply the competition commissioner with robust economic advice on individual competition cases. The Commission hopes the new system will end the suspicion that it relies too much on what the OECD has described as "qualitative judgements and hunches" when finalising cases.[33] However, competition lawyers question whether the chief economist will be able to provide genuinely independent advice, given that he or she is under the direct control of the commissioner. Businesses have also expressed concern about Roller's lack of private sector or competition authority experience.

[33] *OECD, 'Economics survey 2003: Euro area', August 2003.*

★ ***Increase the effectiveness of internal checks and balances***

The Commission has introduced an extra internal check before it finalises its decisions. The judgements of the teams of officials

which prepare merger cases are now subject to an internal process of peer review. The aim is to sharpen the Commission's arguments and prevent the Court overturning cases because of weaknesses in the Commission's reasoning. Competition lawyers also report that the Commission has generally improved the way in which officials conduct the cases, for instance by ensuring they treat external parties politely. The competition DG previously had a reputation for treating third parties in an arrogant fashion. But even Jack Welch, the former chairman of GE, has remarked that Monti and his team approached the company's merger case with "charm, intelligence and an ability to be polite even when being stubborn".

★ ***Strengthen the Commission's fact-finding powers***

The Commission has long had the power to seize documents during 'dawn raids' on the offices of companies suspected of anti-competitive behaviour. Such powers are needed to help fight the most serious cartel cases, when firms can go to great lengths to hide evidence of wrong-doing. For instance, a number of companies, including Hoffman-La Roche and BASF, sought to fix the market in vitamin supplements during the 1990s. They conducted internal audits to ensure that any incriminating documents were destroyed. Meanwhile, directors hid documents detailing the allocation of markets among the companies involved in the cartel at the house of an employee's grandmother.

The Commission has secured stronger fact-finding powers following the recent reforms. It demands increasing amounts of information from companies involved in mergers and anti-trust cases – and can fine those which refuse to co-operate, including third parties. For example, firms must now supply 36 copies of their merger notification, the annexes of such documents alone often amount to 1,000 pages. Understandably, businesses are concerned about the rising expense of providing such detailed information – not least the cost of paying lawyers and other specialist advisers to prepare their Commission filings. However, the Commission has little choice but to adopt a comprehensive approach to its cases, or face further defeats in the Court of Justice.

★ ***Make the merger timetable more flexible***

One of the strengths of the EU's merger regime is the relative speed with which the Commission reaches a final decision. The Commission works to a strict timetable to ensure that the vast majority of companies can proceed with their merger plans within a few months. However, under the new merger regulation, firms involved in complex cases can now ask the Commission to stop the clock (for up to 35 days in total). This should ensure that companies have sufficient time to prepare their own cases and challenge preliminary Commission judgements if necessary.

The Commission pushed through the reforms outlined above principally in response to the Court of Justice's criticisms of its procedures. They are thus designed to ensure the Court will not strike down Commission decisions on procedural grounds in the future. However, the reforms do not answer other lingering concerns about the governance of the EU's competition regime. In particular, the college of commissioners, the Commission's chief decision-making body, can still (in theory) overturn a decision made by the competition DG. Thus the Commission should make two further reforms to ensure the long-term fairness and efficiency of its competition rules:

★ ***Increase the transparency of Commission competition judgements***

The Commission is vulnerable to accusations of political interference in competition policy, because the college of commissioners can vote on every decision. In particular, US companies fear that the college might favour European businesses when taking merger and anti-trust decisions.

In practice, there is no evidence that the college favours European companies or regularly intervenes in competition cases. The Prodi Commission rubber-stamped all of Mario Monti's decisions with

little or no debate. However, the college of commissioners could overrule the decision of the competition commissioner, and even the suspicion of interference is damaging to the credibility of EU competition policy.

The CER has previously argued in favour of establishing an independent competition agency, with responsibility for the day-to-day enforcement of the merger and anti-trust policy.[34] The agency would be independent, although the Commission would retain responsibility for setting the overall framework for competition policy. The Commission would also offer a 'fast-track' appeal process to any company that believed it had been unfairly treated by the agency. The Commission would of course have to explain its reasons for over-turning the agency's decision.

[34] *Edward Bannerman, 'The future of EU competition policy', CER, January 2002.*

The EU should make the creation of an independent agency a long-term goal. However, an agency is not on the EU's immediate agenda. The new constitutional treaty, due to be ratified in 2006, contains no provisions for its creation. The EU has pragmatically decided to continue with the existing institutional arrangements, despite the concerns outlined above.

In the meantime, the Commission could do much to allay suspicions of political interference – no matter how unwarranted – by increasing the transparency of its competition decision-making. The competition commissioner should set out in an open letter his or her decision on a merger or anti-trust case before the case is discussed in the college. The letter should include details of the advice offered by both the chief economist and the official leading the case and, where applicable, explain why the commissioner has reached a different conclusion. This open letter should then be made public after the college has concluded its discussions of the case and taken a final decision. Such a system would confirm that the Commission follows the advice of its competition officials in the vast majority of cases. But it would also force the competition commissioner or the college of commissioners to explain publicly, where relevant, why they have overruled their officials on key cases.

★ ***Develop more just and effective sanctions***

Fines are an essential part of any competition regime. They are designed to act both as a deterrent and a punishment. In particular, all competition authorities impose strict penalties on hard core cartels – where a group of companies agree to fix prices, restrict output or divide markets to boost their own profits. Unlike many member-states, the Commission does not have the power to fine or jail company bosses (which requires criminal sanctions). However, the Commission can fine companies up to 10 per cent of their turnover for anti-trust offences.

Recent research by the OECD suggests that the Commission is imposing tougher fines than in the past.[35] In 2001, the Commission fined ten cartels a total of €1.86 billion. However, the OECD argues that such fines fall short of levels needed to act as an effective deterrent. Moreover, the size of the fine imposed by the Commission, although supposedly based on the gravity of the offence, is not very predictable and can thus seem arbitrary.

[35] *OECD, 'Hard core cartels: recent progress and challenges ahead', April 2003.*

The EU should make the link between crime and punishment more transparent. The Commission should be able to impose a fine based on a multiple of the offending company's illegal gains. For example, the OECD suggests setting this multiple at three times the illegal gains – based on a rule of thumb that only around one third of cartels are ever detected. Such a fining system would be in line with existing practice in the United States and Germany.

Encourage private actions?

One distinctive feature of the US competition system is that companies and individuals, rather than just the competition authorities, can take anti-trust cases to court. It is estimated that around 90 per cent of US competition cases are conducted privately.[36]

[36] *Wouter Wils, 'Should private anti-trust enforcement be encouraged in Europe?' World Competition 26 (3), 2003.*

The Commission is keen to encourage such lawsuits in the EU. It believes the threat of private action should act as an added deterrent to anti-competitive behaviour. For example, the firms involved in the vitamin cartel were found guilty in both the EU and the US of price-fixing and paid out substantial fines. However, in the US the companies also had to pay out substantial damages to 'injured' consumers. Furthermore, the Commission argues that private actions should help its enforcement efforts. Businesses and consumers could bring cases independently of any EU action, leaving the Commission free to focus on the most important cases.

Businesses, however, are far less enthusiastic about the introduction of private actions. They fear it could result in the spread to the EU of a US style 'compensation' culture, where lawyers seek to win damages on the flimsiest of precepts. Such cases are slow and expensive – they may be misused by competitors who go to court in the hope of at least forcing their rival to waste time and money. Moreover, public authorities have a much wider range of enforcement options at their disposal, which might prove more suitable for remedying anti-competitive behaviour than fines.

The arguments against private action are largely based on the US experience. But the EU does not have to copy the US rules in their entirety. For example, the EU need not introduce US style 'class actions' – where lawyers seek to maximise damages by bringing a single action on behalf of large numbers of unnamed consumers. But at present the EU lacks a proper framework for private cases. The EU treaty makes no mention of the possibility of bringing private competition cases. The European Court of Justice has only recently established the principle that individuals or firms can claim damages for anti-competitive behaviour (the judgement in the Courage versus Crehan case in 2001).

Therefore the Commission should do more to help member-states develop consistent rules and regulations regarding private actions. In particular, the Commission should provide guidance on those elements of the US system that member-states might need to introduce to encourage companies and consumers to bring cases. For example, US courts must automatically award triple damages in successful private action anti-trust cases. However, no member-state has adopted such a provision. In the UK judges award damages based on the actual loss suffered by the plaintiff due to the anti-competitive behaviour. While the US system of mandatory damages may provide too great an incentive for lawyers to bring cases, its absence is discouraging private actions in the EU. Similarly, member-states also need to review their rules on discovery – that is the documentation that both sides must make available to help prepare the case. In the US, defendants are required to provide much greater levels of information. However, member-states will need to limit the possibility that some competitors might bring cases simply to force disclosure.

7 Modernising state aid procedures

While the Commission has devoted much time and effort to overhaul its competition rules, it has only more recently begun to update its approach to state aid policies. Many of the problems are similar to those the Commission has grappled with in reforming its competition policies. The Commission has to deal with a rising state aid caseload. Moreover, it is trying to introduce much greater rigour and better quality economic analysis into its work.

Under the existing state aid rules, member-states are supposed to notify the Commission before they pay out subsidies. This notification systems means the Commission spends much valuable time dealing with routine cases. The Commission receives around 1000 notifications of state subsidies each year, around 95 per cent of which are approved. In addition, the Commission launches investigations into around 250 possible illegal aid cases each year, often following complaints from individuals or firms. The Commission estimates that this number will rise by as much as 40 per cent due to enlargement.

The Commission is thus seeking to introduce new guidelines to ensure that it focuses only on the most economically important state aid cases. First, it will take into account the size of the subsidy. Small amounts of aid – while potentially unfair to competitors – are unlikely to distort cross-border trade. The Commission has drawn up new guidelines which would allow governments to pay up to €1 million to any one company over a three year period, without the need to notify. But such aid should not form more than 30 per cent of the total costs of a scheme for large companies, rising to 50 per cent for small businesses.

Second, the Commission will consider whether the sector to which the aid was paid is likely to have a major impact on cross-border trade. For example, a government scheme to pay aid to restaurants may harm businesses in other parts of the leisure sector, but is unlikely to have much impact on the EU economy as a whole.

Finally, the Commission has introduced a number of 'block exemptions' for subsidies that it regards as compatible with the EU's economic reform agenda. These exemptions are targeted on 'horizontal' forms of aid, that is aid available to all (or most) companies for a specific purpose such as training. The Commission has also introduced block exemptions for employment and for small and medium-sized enterprises, including support for research and development. In 2005, the Commission will revise its guidelines for larger-scale R&D subsidies (although it is not introducing a block exemption). Its overall aim is to ensure that such aid encourages greater private investment in R&D. At present, many businesses and officials complain that the current rules are too inflexible, and prevent governments from providing targeted support to R&D.

In the longer term, the EU should undertake a further reform which would help the Commission to focus on the most important cases: it should decentralise some aspects of state aid controls. The Commission has so far understandably resisted such a move, arguing it would create a major conflict of interest by making member-states responsible for policing their own aid payments. Such a conflict of interest is especially acute in terms of recovering illegal aid payments (see below).

However, all member-states have now established independent competition authorities as part of the EU's anti-trust reforms. These competition authorities could also develop into independent national state aid monitoring authorities, applying EU rules on routine national cases. The new member-states already have experience of such bodies: the Commission required the establishment of state aid

monitoring authorities in the lead up to accession (they have subsequently been abolished). Just as importantly, the EU's network of independent state aid monitoring authorities would build up expertise in monitoring and evaluating the impact of government subsidies, helping ensure that member-states target aid more efficiently in the future.

Transparent procedures

These reforms should help improve the rigour of the Commission's state aid analysis. However, in comparison with the way the Commission handles competition cases, state aid procedures are neither especially accountable nor transparent.

The Commission tends to resolve high profile state aid cases by conducting political negotiations with the relevant member-state behind closed doors. Other parties, including the recipient of the aid, have no automatic right to make representations to the Commission or gain access to the files. But encouragingly, the Commission has allowed greater access in recent years. It is now normal practice for the beneficiary of the aid to accompany member-state officials to Brussels. Third parties are also allowed to make comments on the case, but have no formal part in the process.

Companies and consumers, which may be affected by the Commission's decisions, could play a larger role in the investigations. Third party comments and analysis are just as likely to help the Commission come to an informed decision as they do in competition cases. Lawyers are critical of the overall quality of the Commission's reasoning in state aid cases. Until recently, most negative decisions did not even provide evidence of why the aid had resulted in a distortion of competition.

The Commission should make third parties a formal part of its procedures. It should also set out much more extensively in its final case notes the economic grounds of its decision. Such reforms would diminish concerns that the final settlements in the most contentious state aid cases are made on political rather than economic grounds.

Recovering illegal aid

The EU's rules for reclaiming aid that has been paid illegally by member-states are flawed. At the moment, the member-state which made the payment is also responsible for reclaiming the money, normally through its national court system. Thus the existing rules do little to deter politicians from paying illegal subsidies. In the worst-case scenario, the member-state simply recovers its own money, plus interest, at a later stage. Governments incur no costs other than the modest resources devoted to paying out and recovering the illegal aid.

Even when governments do try to recover an illegal subsidy, they often risk forcing the recipient of aid into bankruptcy (this problem arises in an estimated one-third of all recovery cases). Moreover, the Commission points out that new bankruptcy rules, which are designed to give struggling firms a greater chance of survival, are making it more difficult for all creditors, including governments, to recover money owed.

The Commission estimates that less than 40 per cent of illegal aid is ever repaid. It has attempted to increase the pressure on member-states by creating a special unit within DG competition to chase illegal aid. As of February 2004, the Commission had issued 88 recovery orders, including 40 to Germany, 20 to Spain and 8 to France. The Commission can take out an injunction to try and prevent the payment of aid it suspects is illegal. But once aid has been paid the Commission has few powers to force recovery.

Thus the Commission should make two further reforms to improve its record. First, the Commission should increase pressure on member-states by providing clear and timely data on the recovery of illegal aid as part of its twice yearly 'scoreboard'. The data should

'name and shame' those governments which are not making sufficient effort to recover aid. Second, the Commission should make greater use of infringement proceedings against member-states which drag their heels. The EU should also grant the Commission the power to fine member-states which pay out illegal aid, to try and prevent governments repeatedly flouting the rules.

8 Conclusion: The EU's competition agenda in the years ahead

At the time of writing (October 2004), Neelie Kroes was poised to take office as competition commissioner. On paper, Kroes looks an excellent choice – a Dutch liberal, who trained as an economist, with extensive knowledge of both politics (as a former transport minister) and business.

However, Kroes' experience on the boards of a number of multinational companies has also sparked controversy. Critics, including a number of MEPs, claim that the commissioner will face a conflict of interest if she rules on cases which could affect her former companies. The Commission's legal service has warned that Kroes' decisions could be challenged in the courts, if there is the least suspicion of bias. To allay such concerns, Kroes has promised to hand over any cases involving companies she previously worked for to another commissioner (to be chosen by the Commission president). She has also promised never to accept another business post after she leaves office in 2009. These measures should ensure that Kroes can carry out her job effectively and credibly. The EU's only alternative would be to bar anyone with substantial business experience from ever becoming competition commissioner.

As this pamphlet has shown, Kroes takes office at a time when the Commission is facing a series of challenges to its conduct of competition policy. Mario Monti departs the Commission with some businesses and commentators questioning his 'academic' approach to competition cases. In the coming months, several of Monti's more controversial decisions will be revisited in the courts. The Court of First Instance is scheduled to rule before the end of 2004 on whether to suspend the penalties imposed on Microsoft until it has heard the software firm's appeal. In 2005, the Court will rule on GE's appeal against the Commission's decision to block its merger with Honeywell. Meanwhile, two companies – Schneider and MyTravel (formerly Airtours) – which have already won appeals against the decisions to block their respective mergers, are suing the Commission for more than €2 billion of damages.

Kroes' arrival provides an opportunity to change the tone, if not the substance, of the Commission's state aid and competition policies. Kroes hinted as much during her European Parliament confirmation hearing in September 2004. She told MEPs: "I do not consider business to be my natural adversary", comparing her role to that of an impartial referee who knows "the game inside out". Kroes should use her business experience to enhance the credibility of the EU's competition policy. And she should build on the reforms of her predecessor to ensure that the EU's competition and state aid polices support the development of a dynamic European economy.

Summary of recommendations:

★ The Commission must stand firm in the face of criticism that its over-zealous application of competition policy is stopping the creation of European 'champions'. The promotion of such champions does not save jobs on a net basis, and inflicts considerable costs on other businesses.

★ While some US businesses and policy-makers have become increasingly critical of EU competition policies in recent years, the reality is that many of the differences between the two sides have narrowed. In particular, the EU has explicitly brought its merger regulations more into line with the US model. However, the Microsoft case has exposed some important differences in how the Commission and US authorities deal with fast-moving markets. The Commission needs to establish clear guidelines for such cases and apply them consistently.

★ The Commission should aim to raise the overall level of competition within the single market, rather than simply police mergers and anti-trust cases. Thus it should place much more emphasis on scrutinising the barriers to competition posed by regulation – both at a national and European level. The competition directorate-general must become a stronger advocate of the benefits of competition, not only within the Commission, but also in its dealings with the member-states.

★ The Commission should make greater use of sectoral investigations to highlight individual rules and regulations that restrict competition. Its core principle should be to focus on economically significant parts of the economy where action, whether anti-trust or regulatory, may yield real benefits to consumers.

★ The Commission should encourage the development of more professional consumer organisations at the EU level, to help with its competition investigations. The Commission should make some funds available for consumer research from the fines it collects from anti-trust offences; and it should offer consumer groups the incentive of formal participation in competition cases.

★ The Commission should create a new consumer affairs directorate-general, which could act as a powerful advocate for Europe's consumers in all Commission policies. The new DG should promote overall consumer welfare, including greater competition, rather than simply 'protecting' the consumer; and it should devote part of its research budget to competition issues.

★ The willingness of some member-states to use rescue and restructuring aid remains an anomaly. This form of aid is rarely justified in economic terms. The Commission should ask a group of experts to write a report which provides sound economic evidence of why such policies are futile. It should also further tighten the rules to ensure that restructuring aid is only paid in truly exceptional circumstances.

★ The case for a new directive to protect services of general interest is far from proven: existing EU law allows member-states sufficient freedom to provide and subsidise important services. However, the Commission should develop clear rules ensuring that EU governments award subsidies to services of general interest only by competitive tender. It should state explicitly that member-states do not have to award such contracts on the basis of price alone – and that they can consider other social objectives, according to the preference of their electors.

★ The Commission could allay suspicions of political interference in competition decisions by further increasing the transparency of its decision-making. The competition commissioner should set out in an open letter his or her decision on a merger or anti-trust case, before the case is discussed in the college. This open letter should then be made public after the college has concluded its discussions of the case and taken a final decision.

★ The EU should make the link between crime and punishment in anti-trust cases more transparent. The Commission should be able to impose a fine based on a multiple of the offending company's illegal gains.

★ Private competition lawsuits can act as an added deterrent to anti-competitive behaviour and help increase the detection rate. The Commission should provide guidance on how member-states could encourage companies and consumers to bring cases.

★ The EU should undertake a further reform of state aid procedures which would help the Commission to focus on the most important cases: the Union should decentralise some

aspects of state aid control. All member-states have now set up independent competition authorities as part of the EU's anti-trust reforms. These competition authorities could also develop into independent national state aid monitoring authorities, applying EU rules on routine national cases.

★ The Commission should make third parties, such as competitiors and consumers, a formal part of its state aid procedures. It should also set out much more extensively in its final case notes the economic grounds of its decision. Such reforms would diminish concerns that the final settlements in the most contentious state aid cases are made on political rather than economic grounds.

★ The Commission should seek to improve the EU's record of recovering illegal state aid by providing clear and timely data on recovery, as part of its twice-yearly state aid 'scoreboard'. The scoreboard should 'name and shame' those governments which are not making a sufficient effort to recover illegal subsidies. It should also press for powers to fine member-states which pay out illegal aid, to try and prevent governments repeatedly flouting the rules.

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CENTRE FOR EUROPEAN REFORM
NEW IDEAS FOR A NEW EUROPE

A FAIR REFEREE? The European Commission and EU competition policy

Alasdair Murray

The EU's policies for enforcing competition and restricting state subsidies are among its biggest success stories. But the way the European Commission conducts these polices is coming under attack. Some EU governments blame the Commission for being over-zealous and holding back the creation of European 'champions'. Many in the US accuse the Commission of being too interventionist – or just anti-American. Alasdair Murray advises the Commission to stand firm and not water down EU competition rules. Instead, the Commission should modernise EU competition policy through increasing transparency, paying more attention to consumers and, above all, supporting the EU's economic reform agenda.

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