

# Regional Integration Observer

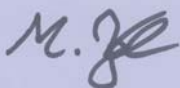
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## Editorial

The third edition of the Regional Integration Observer (RIO) in 2011 is dedicated to regulation and competition issues. Regulation in its different forms, is a tool to enable fair and effective competition between participants of a market and to provide a regulatory framework for certain, formerly state-dominated economic sectors that have been liberalized. The last point especially refers to so-called network industries like energy, telecommunication, civil aviation etc. Regulation has mainly been dealt with on a national level. Still, due to the fact, that a single market exists in the EU and that there is a "Europeanization effect" like in other policy fields, regulation has also become a regional topic. Particularly the European Commission as a supranational actor has pushed liberalization and regulation with the goal of providing more effective competition and to foster a consumer-friendly market structure.

The European Union as a regional organization is surely a frontrunner with regard to regulation and competition issues and with the Commission and the European Court of Justice there are two powerful institutions that have backed this process. Against this background, the question comes up if and how also other countries and regions try to enhance regulation and competition. The articles of this RIO give an overview over important developments in different parts of the world. While the first article provides a more theoretical introduction on what regulation is all about, the other contributions deal with specific country cases like China, ASEAN, MERCOSUR and Ecuador. Of special interest is also the article on the role of competition policy in North Africa and the new opportunities that the political turnovers there could offer. The contributions show that regulation is of growing relevance but they also reveal the problems that exist due to historical, cultural, legal and political reasons.



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*Electricity is one of the economic sectors most strongly influenced by regulation policies.*  
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## Sector-Specific Regulation in the European Union

\* Volker Bache

Regulation can generally be defined as "controlling human or societal behaviour by rules or restrictions". In the context of prior state monopolies, regulation means a set of rules and restrictions designed to enable effective competition in an economic sector characterized by a structurally distortive environment. The concept of sector-specific regulation is best illustrated by outlining its commonalities and differences with general competition law. The goal of sector-specific regulation is to stimulate effective competition on the network level and/or to enable competition on upstream and downstream markets. The goal of general competition law is to safeguard effective competition on markets. The objective of both general competition law and sector-specific regulation is consequently the facilitation of effective competition.

### 1. The benefits of competitive markets

Effective competition has a number of desirable effects for society. In order to maximise their profit, undertakings have an in-

centive to increase the price of their good or service. If such a pricing strategy is effective, it would lead to a transfer of consumer surplus to producer surplus and – due to the lower amount of transactions at the higher price level – a decrease in total welfare. Such behaviour however cannot be successful in competitive markets. Here, consumers would not buy the product or service with such an increased price. This is due to offers made by competing undertakings for similar goods or services. Consequently, undertakings are forced to offer competitive, lower prices. Furthermore, undertakings in competitive markets are incentivized to invest in research and development since better quality is not as easily substitutable and offers a way to achieve a higher price level.

Undertakings operating under competitive pressure are driven towards pricing their goods and services as low as possible in order to gain a share of the market. The lowest possible price level an undertaking can offer without risking losses is generally pricing at marginal cost, i.e. the cost of the

last unit of output. Hence, the undertaking has an incentive to use its resources more effectively in order to lower its costs. According to economic theory a price level equal to marginal cost is Pareto optimal, meaning the price level that maximizes total welfare generated by trading the good or service. Total welfare is the sum of consumer surplus and producer surplus generated by trading on a market. Producer surplus is the difference between the total production cost and the total revenue, whereas consumer surplus is the difference between the aggregated willingness to pay and the total price paid by consumers. Effective competition safeguards both the maximization of consumer surplus and total welfare.

## **II. Market structure and the resulting need of ex ante or ex post control**

Most markets have a tendency towards effective competition. Review of the behaviour of market participants by competition authorities is sufficient to safeguard effective competition in those markets. A competition authority takes action after an undertaking has shown some sort of anticompetitive conduct. Since the governmental control takes place after a breach of competition law has occurred, it is known as *ex post* control. The most important breaches of competition law codified in the Treaty on the Functioning of the European Union (TFEU) are collusive practices of market participants (e.g. cartels, Article 101 TFEU) or anticompetitive conduct of a dominant undertaking (e.g. monopolistic charges, Article 102 TFEU).

### **Natural Monopolies, Network Externalities and Information Asymmetry.**

Some markets however, do not have a tendency towards effective competition. These are markets suffering from a market failure. The most important market failures are natural monopolies, the presence of positive or negative network externalities and significant information asymmetries.

If the production of a good or service is a natural monopoly, a structural barrier exists, which prevents the emergence of competitors. A natural monopoly is defined by a strictly sub-additive cost function. This means it is cheaper for a single undertaking to produce all output demanded than for any combination of two or more undertakings. This is the case for all network industries, like telecommunications, energy (electricity and gas), postal services, transport (railways, air transport, etc.) and water. The main reason for sub-additive cost functions in these industries is a combination of high fix costs and marginal costs approaching zero. An additional user offers the opportunity to distribute the fix costs over more customers, which in turn potentially benefits all other customers.

Generally, a positive network externality is an effect generated by an additional custo-

mer using the network, which benefits all other users of the same network. In case of an additional user of a telephone network all other users of this network's service benefit, because they can now potentially contact one additional person. Similarly, the frequency of public transport will increase in light of additional passengers, which benefits every passenger by offering additional choice regarding travel time and minimisation of waiting periods. Conversely a negative externality is a detriment occurring if an additional user is active on the infrastructure, which is not borne (solely) by the user himself. For example, additional cars on a highway might lead to congestion resulting in slower traffic or even standstill. The need for regulation in the case of positive network externalities comes from the tendency of the market to create only one network serving all customers since this maximises the positive effects. In the case of negative externalities the need for regulation stems from the misallocation of resources created by – from the viewpoint of total welfare – “wrong” individual decisions. Since users do not factor in the detriments caused to others by their usage of the network, they are incentivized to over-use the network. Hence regulation is needed.

Finally, significant information asymmetries occur, if an undertaking has a source of crucial information, which is unavailable to its competitors. This is the case in vertically integrated undertakings including a part of the value chain characterized by a natural monopoly. A vertically integrated undertaking is an undertaking active on several, linked parts of the value chain. For example a vertically integrated electricity company usually includes power plants, transmission and distribution grids and a supply branch. The transmission and distribution of electricity on the respective grids is a natural monopoly since more than one network operator raises the total cost to society without an additional benefit. On the other hand, generation and supply of electricity are normal markets and as such generally competitive. The operation of the grids however, enables the affiliated generation and supply branch of the vertically integrated undertaking to act with an informational advantage on their respective markets. E.g. by operating the grids information about consumption patterns of customers is gathered. This kind of information is unavailable to competitors, but can be utilised to tailor customer-specific offers by the affiliated supply branch, which are more attractive than anything the competitor might offer. Goods and services provided by a natural monopoly are not subject to competition. The undertaking holding the natural monopoly is consequently in a permanent position of power. The customers have no other choice. Similarly, a vertically integrated undertaking with informational advantage gained by operating a natural monopoly has a structural advantage over its competitors in the



*Building of the German Federal Network Agency in Bonn. Source: Bundesnetzagentur*

affiliated up- and downstream markets. In such an environment, *ex post* control of the undertakings behaviour pursuant to general competition law is not sufficient to safeguard the maximization of total welfare and an optimal allocation of resources. Hence, sector-specific regulation takes place before (*ex ante*) these goals are endangered. Basically, sector-specific regulation is designed to facilitate competition on markets despite conditions preventing the emergence of competitors in the first place or – in case this fails – apply rules that force the undertaking holding the natural monopoly to act as if competitors were present. This is achieved by two mechanisms, first market access regulation and second price control. Regulation is called symmetrical if the rules apply to all market participants. It is asymmetrical, when the rules in question are geared towards specific market participants, usually those holding a position of significant market power.

### **III. The regulatory process in theory**

Regulation basically takes place between the government in form of the legislative, administrative and judicial powers, and the companies operating in sectors subject to regulation. These two actors are complemented by the general public. Depending on the theoretical approach taken, the relationships between these actors differ.

The public interest theory postulates that all regulation is undertaken in the interest of the general public. Consequently the regulators task is seen as controlling the companies and protecting the public from overreaching corporate interest. The private interest approach extends the principles of economic decision making (i.e. rational maximization of individual utility) to the behaviour of the regulatory actors. While self-interest preservation in the private sector is expected, this theory locates the same mechanisms within government authorities (e.g. making decision in view of expected votes gained/lost or influenced by personal



career development). The theory of regulatory space suggests that the governmental agencies and the regulated companies bargain for the “right” amount and way of regulation. This bargaining process is possible due to the economic strength and importance of the provided services of the regulated companies. Finally – while not a theory per se but rather a design model – the Anglo-Saxon approach to regulation suggests a government strategy focussed around a specialized regulatory agency. The legislative entrusts an agency with certain relatively limited powers to be used at its discretion, while binding the use to strict formal requirements. The judiciary on the other hand limits itself to review of correct procedure and the alleviation of evident material errors committed by the regulatory agency. This enables the regulatory agency to make powerful decisions and bring its superior factual expertise (in comparison to the legislative and judicial powers) to bear.

The main forms of regulation can be explained as three different tactics. First, there is the classic “command & control”-model utilizing strict regimes of licensing or other forms of direct government influence in an economic sector. Second, there is self-regulation of a market characterized by the government interfering not at all or very little with the market but instead trusting the private actors to sort potential problems out. Sectors governed only by general competition law could be viewed as such. Third, there is the modern approach to regulation, basically identical to the aforementioned Anglo-Saxon model.

#### **IV. The regulatory toolkit in theory and practice**

The most important remedies employed under sector-specific regulation in order to enable/promote competition on upstream and downstream markets are access regulation of the network market, rates regulation and unbundling of vertically integrated undertakings. Here, Germany is being used as an example.

##### **Market access**

Symmetric regulation is the regulation of undertakings irrespective of market power. Since ex ante regulation is, in general, a rather heavy burden on the businesses concerned, it needs to be justified by important goals. The German Telecommunications Act (GTA) knows of three obligations that have been imposed or can be imposed on any undertaking operating a public telecommunications network. According to Section 16 GTA interconnection offers need to be made to other network operators. This promotes interoperability and interconnection between the networks, which in turn enables users of one network to interact with those on others. This limits the effects of positive network externalities (less need to switch network operators) and thus helps to prevent the growing of an operator into

an undertaking with significant market power. This again serves the goal of safeguarding effective competition, which leads to higher rates of innovation and better quality products and services at lower prices. Additionally, Section 18 GTA empowers the Bundesnetzagentur (BNetzA) to impose an interconnection obligation on public network operators controlling access to end users. The aim of this provision is similar to Section 16 GTA, but the burden on the undertakings is higher. Asymmetrical market access regulation requires the dominant undertaking to sell network capacity on a wholesale market and thus enable third parties to become active on the downstream service markets. In other words, the dominant undertaking is forced to enable other parties to compete with it on downstream markets. This is what happened after the initial market opening in Germany.

##### **Rate regulation**

Wholesale price regulation (ex ante) complements market access regulation by preventing the undertaking holding significant market power from abusing its dominance to kill off competitors. If the wholesale prices were not controlled ex ante there would be a high risk of abusive price setting to maintain the incumbent’s monopoly.

Ex ante rate regulation puts a control mechanism in place before the undertaking concerned can offer the product or service at the proposed rate on the market. The GTA knows of two different methods of ex ante rate regulation. First, there is the individual approval of a rate according to Section 30 GTA. Here the BNetzA checks the submitted rate for its consistency with the costs of efficient service provision (CESP). The idea behind CESP is to facilitate as-if-rates, i.e. achieve a price setting of the undertaking holding significant market power as if there were effective competition. The other method of ex ante rate regulation is price cap regulation pursuant to Section 34 GTA. Here the BNetzA groups several products in a so-called basket and sets a benchmark for all products and services included. Ex post rate regulation is governed by Section 38 GTA, which compared to CESP implies looser standards. The rates may not be designed in an anticompetitive manner. The impact of ex post rate regulation is actually rather low. The definite advantage of ex ante regulation is that competitors can be protected before the abuse of dominance actually happens. Within general competition law and similarly with ex post rate regulation the problem often is that the competitors go bankrupt before the competition authority or the courts reach a decision ending the abuse.

##### **Unbundling**

Since vertical integration is a major problem in the energy markets, the remedies designed to cope with it shall be illustrated using the electricity markets as an example. Un-

bundling is the process of isolating the part of a vertically integrated undertaking acting as a natural monopoly from the competitive branches in order to safeguard effective competition on the affiliated markets. The goal is to pre-empt the leveraging of the market power held on the monopolistic market on the associated up- and downstream market. Four types of unbundling shall be introduced: (1) legal unbundling, (2) information unbundling, (3) management unbundling and (4) ownership unbundling.

Legal unbundling means creating separate legal entities for the transmission/distribution and supply/generation branches. Information unbundling aims at preventing information flows from the network operator to the competitive branches. Management unbundling aims at preventing conflicts of interest for the persons in charge of the monopolistic and competitive branches respectively. Finally, ownership unbundling is geared towards a total removal of the possibility of abuse. By forcing the vertically integrated undertaking to either sell the competitive branches of the undertaking or the part acting as natural monopoly, the ties between the branches are cut and any discrimination incentives removed. However, such a remedy is likely to severely affect an undertaking’s right of ownership. Hence there is a strong need for justification of the measure in the individual case. Consequently, the European directives governing electricity offer two different options, less invasive than full ownership unbundling. The vertically integrated undertaking can either (1) retain ownership of the physical grid, but appoint a fully independent system operator for the grid management, or (2) retain ownership of the network operating company, but lose all influence on their business decisions except for general financial planning (Independent Transmission Operator option). These unbundling provisions are geared towards the removal of any incentive to discriminate between supply or generation companies based on their affiliation or non-affiliation with the transmission system operator. As long as the transmission system operator is not fully independent, the mother company will always try to use the leverage granted by the possession of a monopoly in the transmission market on the upstream generation market or on the downstream supply market.

##### **V. Conclusion**

In conclusion, it shall be reiterated that sector-specific regulation and general competition law share a common goal, effective competition, but differ in the methods of achieving this goal. Both approaches complement each other, in case sector-specific regulation fails to address a problem ex ante, the national competition authorities may step in and provide an ex post solution.

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# The Problem with Regional Competition Policy in ASEAN

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## **Overview of the region and Member States**

The idea of creating a single market within the South East Asian region was agreed upon in the Bali Concord II (2003) through the establishment of the ASEAN (Association of South East Asian Nations) Economic Community (AEC) which will be fully in place by 2015. In November 2007, leaders of the ASEAN member states (AMSs) adopted the AEC Blueprint, which sets out the actions to be taken in order to meet the objective. The AEC is an ambitious plan, that will create one of the largest and strongest economic blocs in the world (a population of approximately 600 million with a combined GDP of more than US\$ 1.8 trillion). Unfortunately, as far as progressive regional structure is concerned, ASEAN might not serve as the best model, compared to other regional initiatives in the world. This affects how legal harmonization and regulatory convergence will emerge in the region. One essential regulation that must be in place in order to support the single market is the competition law and policy. The idea of creating a unified market with a fragmented competition law is simply a fallacy. There would be very little point in removing the various internal barriers and national boundaries imposed by governments through liberalization and deregulation, if these governmental restraints were replaced by concentrations, monopolies etc. as well as concerted practices among private firms. However, in a region where the stakeholders still question whether or not they need a single market, the creation of a regional competition law and policy is not yet foreseeable.

To fulfill the goal of a highly competitive economic region, one of the identified tasks is to develop regional guidelines on competition policy, which would be based on country experiences and international best practices. As outlined in the AEC Blueprint, all AMSs will endeavor to introduce competition policy by 2015. The formal "ASEAN Regional Guidelines on Competition Policy" were first published by ASEAN in 2010, yet this document has yet to address the question of enforcement by all AMSs. There is also the "Handbook on Competition Policy and Law in ASEAN for Business", but again, this only serves as an introduction to the basic concept of competition law in a language easily understandable to non-experts. Further, only Indonesia, Singapore, Thailand and Vietnam presently have specific competition law and competition authorities in force. Meanwhile, Malaysia has just adopted a nation-wide competition law, which will be in force by 2012. Other ASEAN Member States have relied on sector policies and general laws (criminal

code) to address competition issues.

## **ASEAN Way, legal harmonization, and regionalism narrative**

There are various reasons why institutionalizing a regional competition policy is even more difficult than setting up the AEC in the first place. First, all ten AMSs are in different stages of economic development. Many of the AMSs are in fact competitors in the global market, for example in attracting foreign investors and in serving as host countries for foreign direct investment (FDI). These have been invoked as the standard arguments for casting doubt on the future of AEC, and create reluctance to introduce a competition law that might be in conflict with the strategy of economic development. Moreover, a rich economic history further shapes difficulties to advance the legal harmonization agenda within the region. Historically, countries in South East Asia are the results of colonial legacy, which in turn places different legal systems and cultures (Euro- American legal conceptions existing alongside customary legal systems). This "hybridity" is also determined by the faith of the region during the Cold War.

Further, it is also interesting to assess the region's development in the aftermath of the Cold War, and the subsequent Asian financial crisis in 1997, when ASEAN began to embark on the path of liberalization. The three basic legal arrangements, which are arguably direct consequences of the end of the Cold War (and the start of the neoliberal agenda), are: ASEAN Free Trade Area (AFTA) -signed in 1992 to introduce the elimination of barriers (tariffs and non-tariff barriers) in trade in goods-, the ASEAN Framework Agreement on Services (AFAS) -signed in 1995 to eliminate restrictions in trade in services- and the ASEAN Investment Area (AIA) -signed in 1998. Following the 1997 Asian financial crisis, the liberalization agenda did not stop but in fact advanced further through the ASEAN Economic Community (AEC) as an important part of the Bali Concord 2003, which envisions a single market. There are, also, informal economic cooperation forums, such as the Asia Pacific Economic Cooperation (APEC) initiated in 1989 (and since 1993 regular meeting became a convention), the ASEAN +3 (China, South Korea, Japan) following the financial crisis in 1997, and the initiation of East Asia Summit in 2005 (whose landmark is the participation of the US and Russia in the sixth summit in 2011). ASEAN has also begun to expand economic liberalization outside of the region, through: ASEAN-Australia-New Zealand Free Trade Area (AANZFTA) signed on February 2009; ASEAN-Korea Free Trade Area in effect as of June 2007, and ASEAN-China Free Trade Area (ACFTA) and ASEAN-India Free Trade Area (AIFTA), both in effect as

of January 2010. In brief, ASEAN has become "the" center of gravity of the global economy that envisions overarching liberalization, at the time when the "West" began to question and reconsider the promise of economic globalization in the aftermath of the 2008 global financial crisis. However, at the same time, there still exist (arguably post-colonial) sentiments to reject full adoption to the "Western values" of liberal democracy and free market under the banner of "Asian values". The discussion concerning democracy is not relevant to the present context, but since most countries have a history of either socialist/communist or authoritarian regimes, there is a general consensus about the strong role of government to intervene in the economy. Some governments still adopt industrial policies that place a large role to state enterprises, government-coordinated economic plans, or the idea of "national champions" or "captains of industry" that cultivate conglomerate practices (including cartels), in which the government becomes the patron of the economy. This situation poses a difficulty to create a common concept of how competition law in ASEAN should be crafted, drafted, and consequently enforced.

This local-political context becomes even more relevant because it affects the shape of ASEAN regional structure through the existence of the so-called "ASEAN way". This normative framework lays the basic principle of non-interference, respect for sovereignty, and consensus decision-making; which in turn resents supranational institution and rule-based decision-making and dispute settlement. It is almost impossible to create a regional-based competition policy without a supranational authority. All of these narratives on regionalism lead to the question as to the future of economic integration in ASEAN and how competition law policy can support such vision. The landmark document of the Bali Concord III, adopted in November 2011, already takes an outward-looking approach of the "ASEAN Community in a Global Community of Nations" while the internal achievement of the AEC itself remains problematic. If ASEAN is to lead the forthcoming "Asian century", it needs to resolve the AEC structure, and regional competition law must become a priority.

## **Devising the most suitable regional competition policy**

Of course, there is no doubt that legal harmonization (and regulatory convergence for that matter) advances and deepens regional economic integration, and the harmonization of competition law and policy lies at the center of gravity. A pragmatic approach is to seek the best method to ensure a regional competition policy is in place within ASEAN. ASEAN is undoubtedly left behind

compared to other regional integration initiatives throughout the world. Still, the internationalization (and regionalization) of competition law has been seriously considered. Basically, there are two issues concerned, which are related: the substance of rules and the structure of the institution.

With regard to the substance of the rule, there are basically two paths to achieve internationalization/regionalization. The first is to create a uniform law that participating countries agree to adhere to, incorporated into a treaty that governs detailed provisions concerning the subject matters. This model was once proposed to be incorporated in the WTO known as the "Singapore issue". The second is to create a harmonized system whereby a treaty is to set out only the basic principles as guidelines and national legislators are expected to further elaborate the rules in each national regulation. In this case, the harmonized rule must accommodate a conflict-of-law rule for cross-border issues. As for ASEAN, the first model is not likely to emerge for the reason that each country has a different level

of economic growth and development. The "ASEAN Way" also prevents any supranational law with legally binding effect. However, even for the second option, there is a need to devise a compliance mechanism to ensure that countries adopt the laws in accordance with the treaty.

Secondly, with regard to the structure of the institution, there are also several paths, namely: (1) an international system through a supranational agency enforcing the rules, (2) the sovereignty model, that applies national rules to competition dispute, but embraces extraterritorial principle for cross-border transactions, and (3) the network model, that is one step beyond the sovereignty model because it also adopts mutual assistance and co-operation agreements or formal protocols, enforcement networks, information-sharing and networking of substantive competition law. The first model of an "international system" is again clearly out of the discussion for ASEAN because any proposal for a supranational institution will be strongly rejected. However, a system based solely on sovereignty would def-

eat the purpose of the AEC and would not go in line with the notion of economic liberalization that has been strongly advocated by ASEAN throughout the years. The most pragmatic approach is to design an institution that creates an enforcement network among AMSs to address barriers to entry in the neighboring markets.

In conclusion, it is still a long way to go before an ASEAN regional competition policy can be fully established. As a first step, ASEAN economic policy makers must realize that competition policy forms an integrated and indispensable part of an effective and efficient economic community. While "single market" refers to the elimination of government-imposed barriers to the market (tariffs, non-tariff, regulations, etc.), "competition policy" refers to the elimination of non-government barriers to the market (namely economic structures and business practices). Both are necessary if the AEC is to be accomplished successfully.

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## Mercosur Competition Defence Rule

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The Asunción Treaty (TA), signed in 1991, created the Common Market of the South, (MERCOSUR), and its preamble established, as one of its aims, the macroeconomic coordination policy, based on the gradualism, flexibility and equilibrium principles.

Moreover, art. 1, states what a Common Market is defined as and mentions as one of its commitments, the macro economic and sartorial policy coordination to ensure adequate competitive conditions between the State Parties. The Treaty also establishes that State Parties will coordinate their national policies, whose aim is to elaborate common rules for commercial competition.

In 1996, the Competition Defense Protocol (PDC) was subscribed, as the first regulatory body regarding the subject, but it was not ratified by all the State Parties in the 14 years since its approval. According to the Mercosur's intergovernmental characteristic and the lack of direct norms, each State Party has to comply by incorporating the act of the MERCOSUR norm into its own domestic legal order to generate rights and obligations.

Nevertheless, in 2002, the PDC was regulated. The PDC prohibits in a general way acts (a) which aim to restrict competition or market access or abuse of a dominant position and also, (b) affect State Party trades, and art. 6 enounces the restrictive competition practice, which without being a limitative enunciation, was characterized very casuistic. At the end of 2010, the Common

Market Council (CMC), emitted the CMC decision N° 43/10, which derogated the Competition Defence Protocol, and approved the Mercosur Competition Agreement.

This new regulation has substantial differences to the derogated Protocol. It is less ambitious because it consolidates the importance of regulatory national frameworks to the efficient system performance, and foresees the elimination of anticompetitive practices through national antitrust regulations. It does not define the prohibiting behavior but it enounces in a general way (anticompetitive practice and economic concentration), because these must be decided according to national norms. The application procedure was substituted by an advisory one that is simpler and easier to put in practice. The enforcement authorities are also national bodies. In spite of this, in the Mercosur Trade Commission, the Competition Technical Committee still exists as a body with competency in the new consultation procedure mechanism. This committee interposes an offer or request for consultation, to make notifications, and intervene in different matters of interpretation or execution of the Agreement.

This new Agreement recognized that free circulation of goods and services between State Parties requires a common instrument to preserve and promote free regional competition as an essential instrument to consolidate a Customs Union, and that State Party cooperation is directly related to free trade. But, instead of creating a regional system, the domestic law and bodies of each State are acknowledged as com-

petent. This occurred even though, at the beginning of the negotiations between the State Parties, Paraguay did not have antitrust rules in place nor did Uruguay have a specific agency or body acting as an enforcement authority. The problem is that consumers suffer the consequences of the lack of competition defence, although it was already recognized through Mercosur's regulation.

It is important to say that in 1997 the Montevideo Protocol concerning Service Liberalization was signed, and is in force since 2005. It proposes a progressive liberalization program as an WTO plus agreement for 2015. There are several phases to complete.

Therefore, one of the most important Mercosur trade challenges is the consolidation of antitrust harmonization rules to achieve a real free trade market. For the actual system to work, coordination and harmonization are the key. As mentioned at the beginning of this article, Mercosur challenges can be overcome with gradualism, flexibility and equilibrium. Therefore, skipping or speeding up instances, could result in not complying with the minimum requirements. We hope this is the beginning of harmonization and a consistent approach to the subject, and an integrated place for the benefit of trade competition, for competitors, citizens and consumers.

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## Challenges for Competition Policy in North Africa

\* Krzysztof Jaros

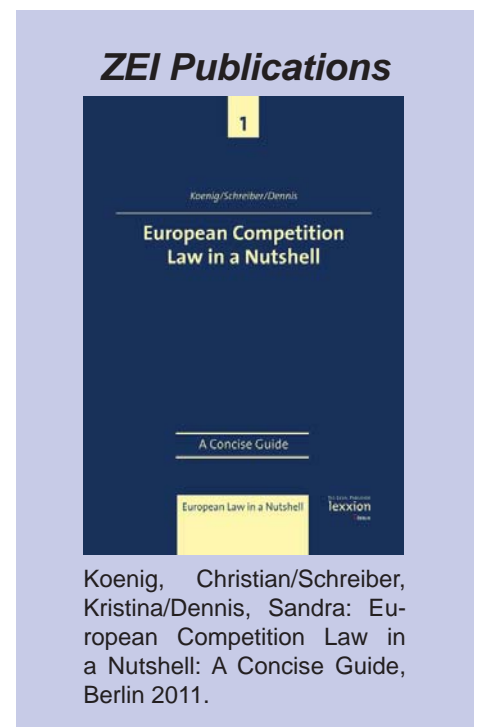
For a long time, it seemed that effective competition policy enforcement in North Africa mattered far more to the EU than to the countries concerned. In fact, the European Commission made sure that competition policy enforcement always figured in the respective Association Agreements and supported the process of institution building in these countries by a wide range of measures such as Twinning programmes. In addition, international organizations such as the OECD, WTO and UNCTAD, the EuroMed Market Programme as well as EU Member States actively supported the development of competition policy.

As a result, competition policy in most of these countries was for a long time seen as an abstract economic policy lobbied for by European officials and experts, whereas many local counterparts were convinced that it would be far better suited for industrialized economies than for the emerging South Mediterranean countries. It is obvious, however, that this perception of competition policy was prevalent because it never provided any benefits to the consumers in these countries due simply to the lack of effective enforcement. In fact, with exception of Egypt and Tunisia, which at least were the first to issue decisions and to impose fines for anticompetitive practices, in the other countries competition authorities for a long time did merely exist on paper, without playing any active role. At the same time, national competition laws were in place, but simply not enforced. A rather poor example of this situation was the Moroccan Competition Council: although established by law in 2001, it was not until the beginning of 2009 that its members came together for their first session. This situation, obviously, seems to be changing and the long years of ongoing support by the international partners were not in vain. In addition, the political tensions – not uprisings or even civil wars – observed in 2011 throughout the region and commonly labelled as the Arab Spring created a climate, which is since very much in favour of further competition policy enforcement. All these events, which were not only targeting democratic reforms or political freedoms but also claiming better living standards through job creation, have their common basis in the citizens' legitimate fight against the origins of poverty and unemployment: corruption, unequal treatment by administrations and courts and, particularly when it comes to Egypt, Tunisia and Libya, kleptocratic elites monopolizing and squeezing out the national economies.

In response, good governance is now even more often seen to be a key factor in changing the current administrative structures, preventing corruption and enhancing fair

competition, thereby creating better conditions for foreign investments. Again, Morocco may serve as an example: With the adoption of the new Constitution in July 2011, the same Competition Council, which could not be effective until 2009, has been appointed as the new independent competition authority, whilst the current reform of the competition law should soon give it the necessary powers to ensure effective legal enforcement. All these developments are promising, but ongoing efforts are still necessary to implement effective competition policy in North Africa. As such, besides improving the skills of competition officials by providing them with adequate training and giving them the chance of making their own experiences during investigations and control procedures, in all of these countries it is still urgently necessary to (1) provide for thorough judicial control of administrative decisions, (2) to clarify the originate competencies and terms of cooperation between competition authorities on the one hand and regulatory bodies on the other, (3) to improve transparency of competition authorities by providing, in advance, more reliable information on the administrative procedures and ensuring motivated decisions and (4) to enhance research on competition law in order to identify inconsistencies with regard to the current legislation and to help developing new legal concepts.

Last but not least, to be commonly accepted as a major player for economic policy, any competition authority needs to engage in competition advocacy and, in this respect, it is crucial to have full support from the national governments. In this regard, it will be particularly interesting to see how competition authorities will further develop under the new governments ruled by Islamic parties, which, with exception of Al-



Koenig, Christian/Schreiber, Kristina/Dennis, Sandra: European Competition Law in a Nutshell: A Concise Guide, Berlin 2011.

geria, have recently won all parliamentary elections or are on the way of becoming the major forces throughout North Africa. In the past, these groups were quite often interested in competition policy issues and, in Morocco, gave support to the reinforcement of the Competition Council, as fair and equal terms for competition are fully backed by Islam. Nevertheless, any answer to this question would remain speculation, but it is clear that times for competition policy enforcement in this region have never been as interesting as now. Hence, it is definitely worth keeping an eye on the developments yet to come!

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# Chinese Regulatory Reform and its Significance

\* Jian Jiang

## **Regulatory reform plays an important role in the growth of China's economy**

In the past thirty years, China has experienced strikingly fast growth with consistent annual rates of around 10%. In 2010, it became the world's second largest economy and since then it has ranked as the largest exporter and second largest importer of goods. These achievements should be credited to a series of regulatory reforms, which can be traced back to 1978. Since then, the Chinese regulatory reform policy has introduced a tremendous transformation: from a centrally controlled system to a more competitive one. A lot of entirely state-owned enterprises have been restructured and the state-owned shares have been reduced. Except for a few strategic industries like the aerospace industry, which still remain predominantly state-owned, competition has been introduced to most parts of the economy and continues to increase. In this economic development process, reforming the old regulation model has played an important role. Though many industries were involved, the most noticeable fields are the network industries. Before the reforms, China's network industries were completely dominated by state-owned enterprises. The goal of regulatory reform was to solve the problems caused by those monopolies, such as monopoly price and low efficiency. Industries like telecommunication, electricity, civil aviation, water supply etc. were involved and segments of them have been regulated to be open to private participation, subject to some ownership restriction.

## **Main sectors touched**

Significant progress has been made in the telecommunication industry. There used to be only one market player – China Telecom –, which was government-owned and completely controlled by the Ministry of Posts and Telecommunication. It was clear that the old business model of China Telecom could not follow the growing demand and its monopoly position was much criticized. 1994 was a turning point for the Chinese Telecom regulatory reform. In this year, China's State Council formally agreed to set up China Unicom, so that the industry structure changed from monopoly to duopoly. However, because the Ministry of Posts and Telecommunication acted as market player (through controlling over China Telecom) and policy maker, the only competitor – China Unicom was squeezed. Fair competition was actually impossible. In order to change this situation, the government established the Ministry of Information Industry, in 1998, as the regulator of telecom industry. In 1999, the attachment of China Telecom to the Ministry of Posts and Telecommunication was removed. After that, in order to accelerate the growth of

national operators and to face competition from foreign operators after China's entry into WTO, China's telecom market has experienced several restructurings during the period from 1999 to 2008. During this period, there were six operators active on the telecom market. From 2008 to 2009, a big restructuring took place again and resulted in three market players: China Unicom, China Telecom and China Mobile. These are the three telecom operators active in Chinese telecommunication market now.

Aside from the progress of regulatory reforms, the benefits of the introduction of more competition in the telecom industry have been proved impressive - China's telecom industry has become the largest and fastest growing telecom industry in the world: with 51 telephones per 100 persons in 2008 compared to less than 3 in 1990; an internet user proportion of 28.8% of population in 2009; and 920 million mobile phone users in 2011. In the electricity industry, the regulatory reform did not proceed as well as in the telecom market. Like all the other industries in China, prior to the reform, the only decision-maker of the electricity industry was the central government, who was responsible for the production, transmission, and distribution of electricity. This system has seriously hampered the development of electricity industry and resulted in severe power shortages. In order to change this situation, the central government began to implement a series of deregulation measures to encourage investment by local government since 1985. Electricity administration at the provincial level was introduced and the regulation of market access and price was relaxed. These measures greatly increased the investment incentive and accelerated the boom of the electricity industry. The shortage of electricity was reduced.

In 2003, the State Electricity Regulatory Commission (SERC) was created as the main regulator for administration and regulation of the electricity and power industry. As in the telecom industry, restructuring was the major method of the government to promote competition in the electricity industry. In 2002 five regional power generation companies and two transmission companies were created and designed to operate as regulated entities. The authorities planned to establish multiple competitive providers in each of the geographic regions, and to gradually allow prices to be more responsive to market forces. But the power transmission and distribution part of the electricity industry is still monopolized by the big state-owned enterprises and severe barriers continue to exist for network interconnection. So the regulatory reform in the electricity industry is still in progress, and there is much need for further measures.

## **Why is there a push for more or less liberalization and consequently regulation?**

From the above we conclude that although a rapid growth has been seen in China's economy, there still exist some problems in the reform course of regulation. First, in some industries there is no independent regulatory authority. A typical example is found in the electricity industry. The industrial regulatory authority - State Electricity Regulatory Commission (SERC) has merely the authority over the issues related with safety and market order, whereas the control over investment and price setting still lies in the hand of the Development and Reform Commission (DRC), a government agency which is subjected to the strong influence of related officials and administrative documents. The separation of power and the character of the DRC lead to a core problem - no true independent industrial regulator exists - which is embodied in problems like a non-transparent decision-making process, high rent-seeking risks etc. Second, there is no sufficient drive to push forward with the liberation in network industries. Many essential segments are not opened to new competitors and the barrier to entry is still seen to be too high to potential entrants. The problem behind the above two problems lies in the prior attention to state-owned enterprises by the government during the processes of opening-up the market. To give priority to the consideration of the benefits to state-owned enterprises, or in other words, to minimize the negative impact to them, result in a criterion which means whether the inducing of competition will threaten the situation of some big state-owned enterprises when the competition level is chosen by the government. This is why we can only see market opening to a certain extent instead of a thorough one.

In summary, administrative methods alone cannot create an effective model for competition when starting with enterprises that have had long benefited from being state-owned. An independent industrial regulator should be defined with clear and independent authorities. They should aim at setting a competitive framework for the market rather than economic intervention. A progress was seen in 2008, when the Chinese Antitrust Law was launched. Competition should be protected, thus the state-owned enterprises should be regarded as market competitors just as private enterprises. Based on this framework, a further push is feasible and a market opening-up for smart regulation is foreseeable, with easy access to essential elements, lower barriers to entry, a diversified competition style, and self-sustained competitive drives.

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# Regulation in the Ecuadorian Electricity Sector

\* Pablo Morales Andrade

Electricity is a commodity of special importance in everyday life. It can be bought, sold and traded as any other commodity but with a specificity, that makes it different from others. Electricity cannot be stored, and the networks must be technically balanced all the time due to physical constraints. With this in mind it is important to acknowledge that about 8 percent of the world's GDP is associated with energy expenditures. This means that electricity is a market of importance. Ecuador suffers from an undeveloped electricity market that affects all of society through bad services, high prices and shortages during low precipitation months. A new vision and development is crucial.

## Historical review

Until the 1950's the electricity sector was rather small and could only cover the necessities of 17% of the population. In 1961 "Decreto Ley de Emergencia No. 24" was issued to create the Ecuadorian Institute of Electrification (INECEL) with the intention of regulating and planning the development of the sector. It also had the faculty of determining tariffs, to construct new infrastructure and to operate all the levels of the supply chain. In other words, a vertically integrated monopoly was created. This change was the result of the obvious state necessity to develop this sector as fast as possible. INECEL conducted the creation of an Interconnected National System. The empiric evidence shows that during the 35 years of existence of INECEL the whole sector became part of the political agenda and was managed without real technical and economic understanding. The tariffs were politically managed and normally did not cover the total cost of the undertakings.

During the 90's the creation of a strong and efficient electricity market became one of the most important goals of any government. The successful reforms of Chile (1982) and England (1990) generated the creation of a new regulatory model around the globe. This new approach intended to answer the difficulties generated from the lack of competition in the market. Ecuador was not an exception, and by October 1996, the "Ley de Régimen del Sector Eléctrico" (LRSE) was published. From then on it was possible for the state to delegate

the different activities of the sector to private companies. The first step towards liberalization was the corporatization of the different undertakings. This means not only changing their legal status but also a complete change of business vision, operating according to commercial principles. Unquestionably, the restructuring of the whole market generated an important growth of this sector. The next step in the liberalization process is the privatization of the undertaking, attracting private investment. However, the political arena was a chaotic place and the privatization process was completely stopped by the numerous interest groups that fought and lobbied against such sales. It is very clear that the global reform of the sector was never a product of social consensus and political understanding. Probably, it would have made sense not to come forward with everything at once without creating a favourable atmosphere for the reforms. The sector needs a major change but the solution of introducing private capital should not mean that public administration is forbidden. The institutional architecture of the liberalized market was not working and changes had to be done.

With this in mind the Constitutional Assembly transformed the whole conception of the sector. The government considers that it must be more active in the way the business is run and that a deregulated market will not work. According to the new national plan of development 2007-2010 the entire sector presented cumulative losses of USD 532 Mio. Eight companies were legally insolvent. The companies of the sector present a very low level of efficiency. The cause was not only the deficit created by the difference between the generation price and the retail price but also a huge amount of nonperforming loans and energy losses. All these reasons made the national government arrive at the idea that the state must intervene directly. Moreover, from now on the regulatory authority will not only give guidelines but also direct orders to companies with regard to administration and investment. At the same time the state has merged companies looking to increase efficiencies and take advantage of synergies and economies of scale and scope.

## Final ideas

The Ecuadorian electricity market has sub-

stantial problems. The biggest is the political incapacity of applying the rules. The legal framework is complete. However, the Ecuadorian electricity market is characterized by a vertically integrated structure. The transmission system operator (TSO) is a legal monopoly that also controls the majority of the produced energy. The policy is to confer more power to direct state intervention, not only as a regulator but also as the most important player of the market. There is a major change in the role of the state. Shall the state be part of the industry or shall it take the advantages from the private dynamics and only regulate where necessary? I believe that the answer to this should come, first from a technical consensus at a legal and economic level, and second, from a political level. The change applied since 1996 was never socialized and there was always a fear of privatization. The Ecuadorian Government is at the moment taking a path that, will not lead to an improvement in this field.

The standard recipe for liberalization failed to work as much as the governments failed to implement it properly. It is difficult to blame the tool when it was never applied. The lack of investment in generation will be covered by direct state intervention and using the revenues from the TSO. Yet, international investment will also be needed. This direct intervention of the state will give strength to the public undertakings, either coming from low rate loans or from other means. No private investor will see this as favourable ground, moreover no investor will endow its resources in favour of the country but in favour of its own interest. In light of the previous review it is undeniable that there is the need for a strong regulatory authority. It should be independent and not subject to governmental decisions. The regulator should apply incentive regulation to generate more efficiency. The remaining question is whether competition law may be a feasible solution for the struggling sector-specific regulation. But, how can there be any discussion if the text of the law is so clear and comprehensible. Obviously, as seen over the last 15 years of the liberalization process, the political agenda prevails over the rule of law.

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