



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 20.4.2004  
COM(2004) 293 final

**COMMUNICATION FROM THE COMMISSION**

**A pro-active Competition Policy for a Competitive Europe**

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### A pro-active Competition Policy for a Competitive Europe

#### INTRODUCTION

A competitive and open internal market provides the best guarantee for European companies to increase their efficiency and innovative potential. Vigorous competition is thus a key driver for competitiveness and economic growth.

Competition policy is one of a number of Community policies impacting upon the economic performance of Europe. It is a key element of a coherent and integrated policy to foster the competitiveness of Europe's industries and to attain the goals of the Lisbon strategy. The new competition regulatory framework entering into force on the day when 10 new Member States join the European Union, i.e. 1 May 2004, enhances the basis for a pro-active competition policy.

This is a fitting occasion for the Commission to set out how it intends to take the new pro-active approach to competition policy forward. At the same time the Communication responds to the Council which has in its conclusions of 11 March 2004 called upon the Commission to report on its new approach.

The EU Heads of Government in their Spring European Council of 26 March 2004, wishing to reinvigorate the Lisbon Strategy, have rightly placed enhanced competition through better functioning markets as well as innovation and R&D to the forefront.

A pro-active competition policy is characterised by:

- improvement of the regulatory framework for competition which facilitates vibrant business activity, wide dissemination of knowledge, a better deal for consumers, and efficient economic restructuring throughout the internal market; and
- enforcement practice which actively removes barriers to entry and impediments to effective competition that most seriously harm competition in the internal market and imperil the competitiveness of European enterprises.

Competition policy complements and reinforces other Community policies contributing to the Lisbon Strategy<sup>1</sup>. In this context, particular attention is drawn to the Communication from the Commission on Industrial Policy<sup>2</sup> for an enlarged Europe, adopted on the same date as this Communication.

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<sup>1</sup> Some Key Issues in Europe's Competitiveness - Towards an Integrated Approach, Communication by the Commission, COM(2003) 704 final.

<sup>2</sup> COM(2004) 274 final.

## 2. COMPETITION POLICY CONTRIBUTES TO COMPETITIVENESS AND ECONOMIC GROWTH

The EU's system of economic governance and indeed the EC Treaty is based on the "*principle of an open market economy with free competition*". In 2000 in Lisbon, the Member States signed up to a programme of economic reforms designed to make the EU "*the world's most competitive and dynamic knowledge-based economy*" by 2010.

Strong competition, encouraged and protected by EU competition policy, is rightly regarded as instrumental for achieving the competitiveness objective of the European Union and the Lisbon Strategy.

### 2.1. Competition drives productivity growth and delivers tangible benefits

Competitiveness is a measure of an economy's ability to create valuable goods and services productively in a globalising world so as to raise the standard of living and secure high employment. Vigorous competition in a supportive business environment is a key driver of productivity growth and competitiveness. However, competition is not an end in itself. It is a vital market process which rewards firms offering lower prices, better quality, new products, and greater choice.

Whilst governments and the public sector have a crucial and legitimate role to play in many spheres of economic activity, competitive markets ensure that the desired range and quantity of goods and services which responds in the best possible way to consumer needs are produced at the lowest possible cost to society. A system of well functioning markets – both in upstream and downstream markets - is an effective mechanism for achieving an efficient allocation of resources. The liberalised telecommunication sector in the EU illustrates the benefits of competitive forces at work<sup>3</sup>. Also in other sectors, like energy, transport or postal services, the Commission has actively pursued a policy of opening the markets to more competition. Furthermore, the horizontal evaluation of Services of General Economic Interest<sup>4</sup> has shown that carefully opening these markets to competition, respecting the public service obligations as independently defined by the responsible authorities, has delivered significant economic benefits to users.

Competition also puts pressure on firms to innovate and to reorganise their business activities in order to continuously improve their cost structure and reap productivity gains. Over time, competition leads to the introduction of improved products and processes, weeding out inefficient firms and reallocating productive resources from retreating or failing firms to new entrants or more efficient competitors. Provided it is underpinned by appropriate mechanisms to promote adaptability of workers and enterprises, this continuous structural adaptation process is beneficial for long-term prosperity.

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<sup>3</sup> The cost of intra-European and long-distance calls has fallen dramatically and the choice of available services has widened significantly since liberalisation. At the same time, the restructuring of the sector has brought new job opportunities and resulted in an increase in employment. Furthermore, liberalisation in this sector has also created a competitive edge for European manufacturers of telecommunication equipment that have thrived in global competition.

<sup>4</sup> Commission Staff Working Paper, SEC(2002) 1420.

Research and innovation are indispensable conditions for productivity growth. Compared to its major trading partners, Europe is lagging behind in terms of innovation performance, as well as research and development (R&D). Lack of competition curbs innovation and can hinder research efforts. Dominant firms may be less inclined to pursue new products and services which merely displace the profits from their existing products. In contrast, firms in a competitive marketplace relentlessly seek innovations to challenge existing companies in high profit markets and better respond to emerging market demands. Moreover, the emergence of new competitors threatens the temporary monopoly profits from innovation and increases the incentive of the firms presently in the market to shorten the innovation cycle. A competitive environment ensures that there is more than one potential innovator in the 'race' to produce a superior product or find a superior process<sup>5</sup>.

Furthermore, in many sectors of the EU economy, competition produces positive effects that can boost the efficiency of an entire industry, including related and supporting industries in the surrounding region. A group of competing local rivals tends to spawn a base of local suppliers and providers of specialized support services.

The benefits of competition also demonstrate the danger in arguments about the creation of "national champions". There is nothing improper in companies growing into a sufficient scale to compete globally. However, this has to come about within a competitive environment and in full compliance with the competition rules. Competition at home enhances a firm's ability to compete abroad.

#### **BOX 1. Evidence linking competition and productivity<sup>6</sup>**

Empirical reports on the effects of various kinds of competition-enhancing policies (e.g., regulatory reforms in different sectors, increased openness to global competition or introduction of competition into service sectors) indicate that competition brings about productivity gains, consumer welfare gains, and long-term economic growth.

Evidence on the relationship between competition and productive efficiency comes from the comparison of the economic performance of countries with efficient vis-à-vis restricted competitive market systems. For instance, measures of competition intensity at the economy-wide level are positively associated with economic development. Furthermore, market competition has been found to significantly raise productivity growth rates. There is also ample evidence that vigorous domestic competition promotes success in international markets.

Comparative case studies in single industries in the United States, Japan and Europe also show that competition (especially global competition with best-practice producers) enhances productivity. Firms with higher market power tend to

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<sup>5</sup> The system of intellectual property rights ensures strong competition to innovate by granting successful innovators with temporary market power over their inventions. When such temporary protection expires intense competition will ensure a rapid adoption of innovations by competitors. Competition also encourages an effective diffusion of successful innovations.

<sup>6</sup> These findings are based on a large number of studies on the link between competition and productivity. For a comprehensive list of these studies see DG Competition's website at [http://europa.eu.int/comm/competition/proactive\\_competition\\_policy](http://europa.eu.int/comm/competition/proactive_competition_policy).

be less productive in relative terms and significant increases in concentration are generally associated with reductions in efficiency and the level of productivity.

Empirical findings do not give conclusive support to the idea that market concentration and reduced competition is conducive to innovation. Evidence suggests that the likelihood of innovation is higher among firms in competitive industries . Fewer competitors and higher average profits are also associated with lower productivity growth.

Anti-competitive regulatory settings in the product market have a negative bearing on productivity. Empirical studies confirm that industrial deregulation and trade liberalisation have positive effects on firm-level productivity. At the level of the economy, results consistently point to a negative correlation between the degree of regulation of market activity and economic growth. Gains from competition-enhancing regulatory reform are also likely to exceed static gains observed in the short run since firms will continue to innovate in ways they would not have under regulation. Some studies have also used simulation exercises to gauge the impact of regulatory environments on growth. Most of these simulations tend to report significant and positive effects of product market liberalisation on the levels and growth rates of the gross domestic product (GDP)

## **2.2. Sound competition policy supports competitiveness**

Competition policy promotes and protects competition. By guaranteeing that firms in the EU internal market compete on the merits, competition policy contributes to creating a level playing field and thereby also encourages new entry into markets.

The recent Report to the Spring European Council<sup>7</sup>, in which the Commission criticised the Member States for the lack of progress in achieving the goals of the Lisbon Strategy, cites weakening productivity growth as the main cause of poor economic performance in Europe. The weak productivity growth in the EU15 (especially when compared to the US performance) has significantly hampered higher rates of economic growth. Whilst important progress has been achieved in terms of market integration since the creation of the internal market, many economic sectors in Europe remain fragmented and are characterised by weak competition and persistently high prices that harm industries and consumers alike.

As a principal factor behind increased innovation and growth in productivity, effective competition between firms in the enlarged internal market must be seen as one of the key elements of a successful strategy to build up a competitive Europe and reinvigorate the Lisbon Strategy.

The goal of a pro-active competition policy is to support the competitive process in the internal market and to induce firms to engage in competitive and dynamically efficiency-enhancing behavior. This implies identifying sectors whose development is held back by lack of competition and which, as a result, do not perform efficiently. The instruments of competition policy prohibit, penalize and deter anti-competitive behavior such as market sharing cartels and help to remove obstacles to competition.

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<sup>7</sup> Report from the Commission to the Spring European Council: Delivering Lisbon – Reform for the Enlarged Union (COM(2004) 29 final/2 (available at [http://europa.eu.int/comm/lisbon\\_strategy/pdf/COM2004\\_029\\_en.pdf](http://europa.eu.int/comm/lisbon_strategy/pdf/COM2004_029_en.pdf)).

Furthermore, while competition rules do not question the mere existence of monopolies, be they natural or not, they prohibit the abuse of a dominant or monopoly position or the creation of such a position by a merger. They also ensure that State measures do not distort or otherwise impede competition e.g. by way of granting State aid.

The primary target of the antitrust rules is to make certain that companies compete rather than collude. Cartels and other similar restrictive agreements distort resource allocation and encourage inefficiency. Antitrust enforcement also prevents dominant firms from abusing their position by engaging in anti-competitive business practices (e.g. exclusion of competitors) so as to maintain or enhance their position in the marketplace. At the same time, these rules need to take into account the distinction between agreements and practices that are overall anti-competitive and those where anti-competitive concerns are offset by pro-competitive effects.

Mergers may allow the newly created entity to exercise market power or more generally harm competition. However, mergers may also make companies more efficient, strengthen their competitiveness and result in cost-savings that are passed on to consumers. Hence, merger control focuses on the small number of mergers that impede the maintenance of effective competition, securing remedies where they are needed to safeguard the competitive process.

State aid measures can be a serious barrier to competition. When employed to bail out failing firms, State aid may seriously disrupt competition and impede the creation of a level playing field in the internal market. There is ample evidence that Member States often subsidize industries in an inefficient manner, and do not sufficiently address market failures in areas such as R&D, training, innovation, and venture capital. An effective control of State aid, using sound economic criteria, ensures that such measures do not distort competition in the internal market. At the same time, the rules allow for great flexibility for aid measures that are designed to address genuine market failures.

Competition policy further contributes to the process of opening-up monopoly sectors (e.g. telecoms, energy, transport) to competition leading to a better deal for consumers and increased investment and innovation. It encourages Member States to lower barriers to entry in all regulated sectors and strengthens the power of consumers without depriving them of the benefits of services of general interest. However, it should also address the issue of legislated protection, such as the licensing of liberal professions, which weakens efforts to prop up competition.

Competition policy – through its instruments of antitrust, merger control, the control of State aid and liberalisation measures – may not in all circumstances have a direct effect on competitiveness. That depends on the firms' own ability to compete. However, a more pro-active enforcement of EU competition policy, reinforcing emphasis on the economic analysis of market structures and behaviours, will help to concretely deliver on the goals of the Lisbon Strategy, by contributing to increased productivity and economic growth, and ultimately raising the standard of living of the citizens of the enlarged European Union.

### **3. REGULATORY FRAMEWORK FOSTERING COMPETITIVENESS AND ECONOMIC GROWTH**

#### **3.1. Three common themes of the reform**

The instruments of EU Competition policy have undergone a review – this process is still on-going for the state-aid rules – and been amended in order to better meet the Treaty objectives as well as the goals of the Lisbon Strategy. Three common themes characterise the new regulatory framework which will enter into force on 1 May 2004:

- competition strategies of enterprises should to the largest possible extent be submitted to a unified legal framework throughout the European Union;
- competition rules as well as their enforcement in individual cases will be based on a more economic effects based approach;
- competition enforcement procedures will become more transparent, streamlined and simplified without losing their effectiveness.

The introduction of a unified legal framework for competition strategies in the internal market has the benefits of creating a level playing field for enterprises while simultaneously facilitating the conclusion of co-operation agreements, distribution and technology licensing agreements as well as merger transactions.

Another common theme of the new regulatory competition framework is the stronger emphasis on economic analysis. Competition policy is adapting to recognize both the teachings of modern economics and the constantly evolving dynamics of markets and the necessary industrial development of Europe. Economic analysis is central because competition policy shapes fundamental economic decisions on investment, consolidation, pricing, and thereby economic performance. It shifts the focus firmly to the economic effects of firm behaviour or of government measures. It helps more generally identify the circumstances in which characteristics such as high profits and substantial market shares are signs of market power<sup>8</sup>.

The third common theme of the new regulatory framework is the improvement of enforcement procedures, whilst at the same time alleviating the regulatory burden on companies, in particular small and medium sized enterprises (SMEs). In the antitrust field, this translates into the abolition of the authorization system requiring the notification of restrictive agreements for administrative clearance and the setting up of a European Competition Network (ECN). The network in which the Commission and the national competition authorities are responsible for the efficient division of work, allows the best-placed authorities to tackle competition cases. For merger control, this implies streamlined referrals to and from the Commission of merger notifications and a more flexible control procedure. Finally, for the control of State aid, the reforms will result in a simplification and acceleration of notification procedures.

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<sup>8</sup> As an example, economic tools allow to better determine whether certain practices such as tying (a strategy where the sale of one product is made conditional on the purchase of an additional product), rebates or territorial restrictions hurt consumers or yield greater efficiency.

A further element which will underpin the new EU competition regime is the better integration of consumers' interests in the competition regulatory structure. To this end, the Commission is also enhancing its dialogue with consumers<sup>9</sup>.

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<sup>9</sup> In particular, in order to extend the dialogue with consumer organisations which play a key role in advancing consumers' interests in the internal market, the Commission, as a first step, has established within DG Competition a function of a consumer liaison officer intended to strengthen the interface between competition and consumer policies.



## 3.2. Reforms recalled and in progress

In the antitrust field, apart from the new procedural framework for antitrust policy, the rules on distribution as well as licensing agreements and the rules on horizontal co-operation agreements have been overhauled. The process continued with the review of merger control which led to the Recast Merger Regulation and a series of guidelines and policy documents explaining how merger control will be carried out in the future. The reform of the control of State aid is in progress with the purpose of progressively refocusing State aid policy towards a more economic approach which aims at eliminating real distortions of competition resulting from State intervention, while leaving the Member States with more flexibility to adopt horizontal measures to support Community objectives.

The new rules, notices and guidelines forming part of the new regulatory framework also provide guidance for enterprises and will encourage them to adopt market strategies that are compatible with competition law.

The salient features of the reform of the three principal instruments of competition policy are briefly elaborated below.

### 3.2.1. *Antitrust*

The new framework entering into force 1 May 2004<sup>10</sup> will result in new economic governance in the EU for antitrust policy. It introduces a single common framework for the assessment of restrictive agreements affecting businesses across borders in the EU<sup>11</sup>. This will have beneficial effects for co-operation agreements, in technology licensing, distribution and other agreements concluded within the whole of the enlarged internal market. The new framework will enable the Member States' competition authorities and courts, alongside the Commission, to apply all EU antitrust rules in their entirety. The new framework is a good example of reducing the regulatory uncertainty for European industry by replacing 25 national standards by one European rule.

Moreover, the new procedural Regulation 1/2003 removes bureaucratic procedures and simplifies the application of legal rules. Unlike in the past when companies had to notify their agreements to the Commission for regulatory clearance, the new framework renders automatically valid all agreements which on balance generate positive effects for the internal market. This is likely not only to bring down the cost of compliance with competition law but will also reduce the administrative burden on business.

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<sup>10</sup> Council Regulation (EC) 1/2003 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, which replaces Regulation 17/62 as of 1 May 2004 (OJ L1, 4.1.2003). More information on these new rules can be found at <http://europa.eu.int/comm/competition/antitrust/legislation/>.

<sup>11</sup> Article 81 of the EC Treaty.

Furthermore, the new framework opens the way for a more decentralised application of the EC competition rules by Member States' competition authorities and courts. Also, the Commission and the Member States have created a European Competition Network (ECN) in order to enhance co-operation and ensure coherence in the application of the EU competition rules. All members of the ECN will inform each other about their formal competition procedures and consult the Commission on envisaged decisions. The ECN also establishes a forum for information sharing and co-operation between the authorities. In this context, it is important that the members of the ECN are adequately resourced and have the capacity to effectively take part in the close collaboration within the Network.

The new framework will also facilitate the direct enforcement of the EC competition rules, before national courts, by consumers and companies that have been harmed by restrictive practices. Companies and final consumers alike should feel encouraged to enforce their rights before national courts, as this can contribute to more intense competition in the internal market. In order to enhance coherent application of the rules across borders the new framework includes a system of co-operation between national judiciaries and public enforcement bodies. For instance, it allows for national judges to ask the Commission for an opinion on questions of EU competition law or for specific factual information. It also empowers the Commission and the national competition authorities, on their own initiative, to submit observations to national courts.

Finally, a number of substantive rules guiding firms' behaviour have been revised to render them more economics-based. In this context, notions of "safe harbours" and "hard core restrictions" have been developed. The process started in 1999 with the adoption of a block exemption regulation and guidelines for distribution agreements, followed in 2000 with the adoption of a block exemption regulation and guidelines on horizontal co-operation agreements.

Companies with little market power, in particular the vast majority of SMEs, are able to act within "safe harbours" mostly defined by market shares. To the extent that enterprises do not exceed the market share thresholds they do not have to worry about the compatibility of their agreements with EU competition law<sup>12</sup>. At the same time, clearly defined "hardcore restrictions" which produce negative effects on the market are normally prohibited. Under EU law, the most prominent examples of detrimental horizontal restrictions without any economic benefit include agreements between competitors which have as their object to fix prices, limit output, or share markets or customers<sup>13</sup>.

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<sup>12</sup> For instance, Commission Regulation (EC) No 2658/2000 on the application of Art. 81(3) of the Treaty to categories of specialisation agreements, OJ L 304/3, 5.12.2000, <http://europa.eu.int/comm/competition/antitrust/legislation>.

<sup>13</sup> Guidelines on the applicability of Art. 81 of the EC Treaty to horizontal cooperation agreements, para. 25, OJ C 3, 6.1.2001, p.2, <http://europa.eu.int/comm/competition/antitrust/legislation>

### **BOX 2. New approach to technology transfer agreements<sup>14</sup>**

Technology transfer agreements and the licensing of new technology ensure dissemination of successful innovations in the economy and enhance productivity and growth. The new Technology Transfer Block Exemption Regulation applies to licensing of patents, know how and software copyright. In line with the general competition policy of the Commission, the new Regulation strictly focuses on those restrictions which seriously damage competition while providing more legal certainty for neutral or pro-competitive agreements. This approach allowed the Commission, firstly, to provide a clear and short list of hard core restrictions that are normally prohibited. This list is narrower in scope than the "black list" of the previous regulation. Moreover, it distinguishes clearly between licensing agreements concluded between competitors, which are potentially more likely to distort competition, and agreements between non-competitors, which are less likely to produce such negative effects. This allowed the Commission to adopt a more lenient policy for a number of frequently used restrictions like output restrictions, customer restrictions and field of use restrictions. On the other hand, the new Regulation offers a "safe harbour" below certain market share thresholds, again distinguishing between licensing agreements between competitors, for which the threshold is lower, and agreements between non-competitors, for which the threshold is higher. For those cases not covered by the safe harbour, a set of guidelines explains, mainly on the basis of economic considerations, how the competition rules will be applied to individual cases.

With these changes, the new regulation will allow for wide dissemination of innovation and give companies greater scope and design freedom

#### *3.2.2. Merger control*

The EU merger control rules have facilitated restructuring of the European industry since their inception in 1989. The EU merger control system is generally recognised as a very efficient and streamlined mechanism which supports and facilitates the restructuring of European industry. Merger activity is part of industrial restructuring and necessary to respond to the challenges of a globalising economy.

The purpose of the merger control rules is not to stand in way of necessary and efficiency-enhancing restructuring, but to ensure that those mergers are stopped or modified that would harm competition. The application, to date, of the merger control rules shows that it has not been an obstacle to creating European companies with sufficient dimension to compete in the global marketplace. In fact, since 1990, the system has resulted in blocking only a very small percentage of mergers - only 18 out of more than 2400 notified mergers. Furthermore, of this total amount, the use of remedies has resolved competition problems in 171 cases, while at the same time having secured a go-ahead of the merger.

The revised Merger Regulation which enters into force on 1 May 2004 will preserve the proven benefits associated with a European one-stop shop providing regulatory control for mergers and acquisitions with a Community dimension, i.e. those above certain worldwide and Community turnover thresholds.

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[http://europa.eu.int/comm/competition/antitrust/legislation/entente3\\_en.html#technology](http://europa.eu.int/comm/competition/antitrust/legislation/entente3_en.html#technology)

Together with the accompanying implementing regulation, notices and guidelines<sup>15</sup>, the new Regulation includes a number of substantive and procedural improvements. One of the principal improvements relates to the substantive test for merger notifications. The new Regulation now contains a clear and unambiguous, effects-based competition test enhancing the capabilities of the Commission to intervene against the small number of mergers that impede competition. Any significant impediment to effective competition likely to be caused by a merger will thus be considered in the competitive appraisal. This ensures that different situations ranging from single dominance to oligopolistic effects (whether co-ordinated or not) which might harm competition in a market can be effectively dealt with.

The new test will be applied on the basis of a comprehensive analytical framework for the assessment of the impact of mergers on competition based on sound economics. To that effect, the Commission has issued a set of Guidelines on the assessment of horizontal mergers<sup>16</sup>. The Guidelines give interpretation and practical application of the substantive test to mergers between competitors, thereby also providing full transparency for merging companies. As part of the competitive assessment, the Commission may now take account of possible efficiencies arising from an envisaged merger (see Box 3).

### **Box 3. Efficiencies in merger control**

As a result of its recent review of the Merger Regulation, the Commission concluded that there were compelling reasons to give more explicit consideration to efficiencies in merger control than in the past. Mergers may allow companies to reorganize their activities or bring together complementary capabilities in ways that induce them to compete harder and thereby counteract the negative effects on competition and in particular the potential harm to consumers that a merger might otherwise have.

The Commission's new Guidelines on the assessment of horizontal mergers therefore specify that the Commission intends to carefully consider substantiated efficiency claims in the overall assessment of a merger, and that it may decide, as a consequence of the efficiencies that the merger brings about, a merger does not significantly impede effective competition.

The Guidelines specify that various types of efficiencies can be taken into account, in particular cost savings in production and distribution but also efficiency gains in the sphere of R & D and innovation, which could lead to new products to the benefit of consumers.

The Guidelines outline a more modern economics based approach to efficiencies that allows the Commission to better distinguish the mergers that harm competition from those that bring more competition

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<sup>15</sup> Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation). More information on the new rules can be found at <http://europa.eu.int/comm/competition/mergers/legislation/regulation/>.

<sup>16</sup> Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings N° C 31, 5. 2.2004, p. 3. OJ L 31, 5.2.2004 ([http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c\\_031/c\\_03120040205en00050018.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/c_031/c_03120040205en00050018.pdf)).

As regards procedural improvements, the new Regulation fully maintains the one stop shop control system, and preserves fixed deadlines for the assessment of mergers by the Commission. In comparison with other merger control systems, these fixed deadlines are highly appreciated by European industry. In order to further reduce the regulatory burden of merger control on business, the new Merger Regulation includes a number of procedural improvements with consequent benefits for business.

The streamlining of the system of merger case referrals is aimed at ensuring that merger cases are normally handled by the competition authority best placed to deal with them, while at the same time keeping to a minimum the number of cases requiring multiple clearances from several agencies. In particular, the new rules include a possibility for the merging companies to request a referral to or from the Commission, prior to any formal notification being made.

The merger control rules in fact have helped EU companies to adapt to the challenges of the internal market and global markets alike. Enlargement, together with the further evolution of the internal market, will further contribute to assimilation and de-fragmentation of European product markets, helping European companies to grow more competitive. The merger rules can also help to facilitate consolidation and cross-border mergers in sectors where national barriers persist.

### 3.2.3. *State aid - reforms in progress*

The reforms aim at refocusing State aid policy towards a more economic approach with the purpose of eliminating harmful State aid, while leaving the Member States with more flexibility to adopt horizontal measures to support, in particular, the Lisbon objectives. Unlike the antitrust and mergers field, these changes are being introduced incrementally by the end of 2006, before the new structural fund regulations come into effect, rather than as part of a single reform instrument. However, at the end of the process, their impact will be just as great.

#### **Continuing reform of the existing State aid instruments<sup>17</sup>**

In 2005-2006, a large number of existing State aid rules come up for renewal, including all the State aid exemption regulations, the regional aid guidelines, the framework for research and development aid and the risk capital guidelines. The environmental aid guidelines expire at the end of 2007. These factors, together with the beginning of a new programming period for the Community's structural funds in 2007, provide an unprecedented window of opportunity for a comprehensive review of the horizontal State aid rules to take account of the horizontal, and particularly Lisbon, objectives, and the new cohesion policy set out in the forthcoming Structural Funds regulations, as well as to consolidate, and wherever possible simplify the rules<sup>18</sup>.

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<sup>17</sup> For information on previous State aid reforms, see the twice yearly State aid scoreboards available at [http://europa.eu.int/comm/competition/state\\_aid/scoreboard/](http://europa.eu.int/comm/competition/state_aid/scoreboard/). The Spring 2004 scoreboard, to be published shortly, will describe State aid levels in 2002.

<sup>18</sup> A specific aspect of future practice concerns some existing employment and training measures which are primarily financed by the social partners themselves through collective agreements which impose a levy on all companies in a particular sector. The Commission will follow the future development of the case law in this field very carefully.

A crucial component of the State aid reform is to redefine regional aid policy in an enlarged Union, reconciling the overall reduction of State aid volumes with the Community objective of economic and social cohesion. The reform is inspired by the conclusions of the European Councils of Lisbon and Stockholm, calling upon the Commission to give clear priority to the least developed regions in conformity with the exceptional nature of regional State aid, and takes full account of the conclusions of the 3rd Report on Cohesion Policy. The underlying economic principle of the reform is that the best way to address regional disparities and increase regional growth rates is by creating the right incentives to economic operators by fostering higher productivity and competitiveness rather than subsidising inefficient firms or causing serious distortions in the internal market. The new guidelines should reflect this principle and, together with the revised horizontal rules will allow greater flexibility so that all Member States are able to address their internal disparities and the Commission will focus on aid measures that distort competition most.

Many of the other guidelines also contain a regional component, allowing higher rates of aid if it is granted to firms located in the areas eligible for regional aid. This is particularly the case of the SME, employment and training aid block exemptions. In order to ensure coherence, a review of these regulations will be conducted in parallel with the regional aid review. As part of this review, the Commission intends to simplify all the existing block exemptions into a single regulation and consolidate them, including a new exemption for certain types of regional aid.

### **Research, development and innovation**

The Spring European Council<sup>19</sup> has emphasised that competitiveness, innovation, and the promotion of an entrepreneurial culture are major drivers of growth. In this context, it has raised concerns over the relative weakness of the European private sector investment in research and development (R&D) and stressed the importance of increasing R&D within the Union. The Commission recognises that in this area market failures may exist which inhibit private investment in R&D and innovation giving rise to slowdown in productivity and competitiveness. The Commission has launched a study to prepare the review of the research and development aid guidelines. In essence, this study is focussing on the role of State aid as an instrument to facilitate the achievement of the Barcelona objective to devote 3% of the EU's Gross Domestic Product to R&D spending. More specifically it will focus on what types of activities should be considered eligible for support, and on appropriate levels of State aid.

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<sup>19</sup> Presidency Conclusions of the European Council 25- 26 March 2004.

The Communication on State aid and risk capital will also come up for renewal in 2005. This has already proven a useful instrument for Member States to provide equity to SMEs in partnership with private investors<sup>20</sup>. The purpose of the rules is to ensure that support for innovation addresses genuine market failures and can be conducted flexibly in particular as concerns innovative SMEs. The review will, among other things, consider requests for greater flexibility in the provision of this type of funding. A balance has to be struck between the objective to focus on the initial market failure of the provision of relatively small amounts of capital to SMEs in their early and start-up phases as well as in SMEs as potential innovators and the risk that greater flexibility may lead to a greater focus on larger amounts of capital at later stages where private capital is more readily available without the need for State intervention.

A Communication planned for 2005 will identify market failures which affect innovation and, to the extent that these are not fully covered, adapt the prevailing State aid frameworks and rules. This will in particular focus on support for SME investment in innovative projects, the recruitment of qualified personnel and the development of intermediaries that provide innovation services: incubators, technology centres, business angels, science parks, innovation consultants, IPR brokers and advisers and technology transfer units are examples.

Before the end of 2004, the Commission will also draw up a Vade-mecum or "Practitioner's guide". This document will provide guidance on measures in support of innovation which can be adopted within the existing State aid regulations and frameworks. On the basis of landmark decisions, the Vade-mecum will also illustrate the Commission's approach to aid measures for innovation-related activities and aid provided through intermediary undertakings.

As regards the procedural aspects of State aid control, the regulatory burden will be reduced. In particular, the adoption of a new implementing Regulation will lead to a general simplification and acceleration of approval procedures. In addition, the Commission is progressively exempting aid from prior notification in areas covering aid for SMEs, training and employment aid or developing simplified procedures for cases of aids which, on the basis of experience would have no significant effects on competition. Thus, at the end of 2003, the Commission adopted a block exemption regulation exempting research and development aid for SMEs from prior notification.

### **3.3. International aspects of competition policy**

The reformed regulatory framework in the antitrust and merger fields also helps European enterprises to stay ahead of the game in the global marketplace, where there are mounting pressures for the establishment of common standards for competition enforcement. Owing to extensive international co-operation on competition policy, driven principally by the Commission's efforts, there is growing convergence of enforcement standards and practices across the continents.

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<sup>20</sup> The Commission Communication on the "[Risk capital action plan](#)" (COM(2003) 654 of 4.11.2003).



The co-operation has flourished, in particular, in the bilateral collaboration between the EU and its major trading partners where the Commission together with its counterparts in the US, Japan and Canada have co-operated on questions relating to policy and investigations. In developing common standards in the global context, the Commission and other competition agencies around the world have made substantial progress within the International Competition Network<sup>21</sup>. In addition, the Commission has also been among the main advocates of negotiations within the World Trade Organization ("WTO") on a framework agreement on competition.

#### **4. ENFORCEMENT PRACTICE SUPPORTING EFFECTIVE COMPETITION**

The reformed framework translates into an enhanced pro-active enforcement of competition law, allowing the Commission to focus its investigations on sectors where there are only a few players, where cartel activity is recurrent or where abuses of market power are generic. It will also focus on State aid cases that inflict most damage on competitors, or seriously impede and delay the necessary industrial restructuring. This necessitates an in-depth analysis of the factual and legal or administrative barriers to competition that most seriously harm consumers and competition in the internal market and imperil the competitiveness of European enterprises.

##### **4.1. Focussed enforcement practice – uncovering competition problems**

Pro-active enforcement will be founded on economic analysis of market structures and behaviour which will help in prioritising the enforcement efforts according to the nature and the gravity of the competition problem and according to the extent a sector or an industry falls behind in performance. This will imply emphasis on “high impact” investigations while scaling down interventions in cases which have a very limited effect on the internal market or on consumers.

Sectoral studies, market investigations and sectoral inquiries will be increasingly employed in order to assess the evolution of key industry sectors and to detect obstacles to competition. Specific tools are being developed for achieving an effective prioritisation of investigations. Obvious criteria to evaluate any given market would be the degree of concentration and indications of collusion, but a range of other indicators such as price trends not connected with developments in cost or demand factors, irregular price differences, lack of innovations or entry, low rate in switching of suppliers by customers, and trends of development in capacity also provide valuable information on the extent to which particular markets perform and deliver benefits for their customers.

New entry into markets constitutes an important element for the competitive process. If barriers to entry are high, this can be a sign of a competition problem in a particular market. Conducting market investigations or sector inquiries will be particularly helpful in detecting entry barriers. The role of the ECN will also be important in this respect. The Commission intends to closely co-operate with the Member States’ competition authorities in uncovering sectoral or market-specific problems and addressing them in a pro-active way.

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<sup>21</sup> For further information see <http://www.internationalcompetitionnetwork.org>.



The new Regulation enables the Commission to generally investigate a sector and publish a report setting out conclusions and recommendations for enforcement action within the ECN. On the basis of such recommendations, the different instruments of competition policy can then be employed to tackle detected problems either in an integrated fashion or by employing the instrument best suited for the particular problem.

Moreover, the Commission intends to launch joint initiatives of competition and de-regulation in sectors where the market analysis reveals that regulatory frameworks or private practices form a barrier to new market entry. In this context, an integrated use of different instruments can best help to tackle practices that deter entry such as foreclosure involving exclusive dealings and market partitioning. Furthermore, mergers foreclosing markets as well as State aid measures used to discourage or prevent entry will be looked at with particular vigilance.

### **The fight against cartels**

Cartels inflict direct and serious damage on consumers as well as industries purchasing the cartelized product as an input, thus endangering their competitiveness<sup>22</sup>. Cartel fighting has immediate and positive effects – cuts in prices, as well as more competition in terms of increased quality and a wider choice of products and services. Detecting and investigating cartels will continue to be a priority action for the Commission. The results of the efforts undertaken over the recent years have been significant. A number of important global price-fixing arrangements have been detected and record fines have been imposed. The high level of fines conveys the Commission's determination to strike at cartel activity. The new regulatory framework will facilitate intensifying this activity.

The fight against cartels can only be successful if companies are deterred from entering into such activity. Credible deterrence rests mainly on three pillars: leniency applications, unannounced on-the-spot investigations, and decisions imposing severe sanctions.

Notably, the EU leniency programme<sup>23</sup> is a crucial element for destabilising cartels, as it creates incentives to end and disclose this kind of secret and illegal behaviour. The leniency programme will therefore be maintained and, if possible, refined in future with the objective of further increasing its effectiveness.

The Commission aims at maintaining and further developing the level of cartel fighting developed over the past years.

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<sup>22</sup> The magnitude of harm from cartels is estimated at many billions of Euros annually. The average gain from price-fixing is 10 percent of the selling price but it can vary significantly across cases. A recent OECD survey shows that the cartel mark-up can be very large, as much as 50% or more. (Source: OECD (2002)).

<sup>23</sup> Information on the leniency programme and guidance on how to launch an application for leniency can be obtained at <http://europa.eu.int/comm/competition/antitrust/leniency>

## **Liberalised sectors**

Similarly the enforcement of the competition rules in the liberalised utility sectors like postal services, energy, telecommunication and transport will be further reinforced.

Following entry into force of the legislative measures to abolish the relevant legal monopolies, other mostly factual barriers need to be addressed. The competition rules contribute to this exercise by removing existing impediments to effective liberalisation. Moreover, the actual liberalisation process needs to be closely monitored in order to prevent incumbents from raising new barriers or pursuing restrictive strategies to protect themselves against emerging competition. It is also important to ensure that they cannot abuse their position or cross-subsidize activities in the newly opened markets with the help of State aid obtained for the provision of services of general economic interest. Ensuring a competition prone market structure and effective access to markets will be particularly important in the energy sector. This will create increased price competition and incentives for new types of energy services and ensure that consumers can reap the benefits of liberalisation.

A pro-active enforcement practice calls for an integrated approach whereby the competition policy instrument best suited is applied in order to create the optimal environment for competition in the newly liberalised market. Depending on the nature of the competition problem, the Commission may have to apply antitrust rules, merger control and State-aid control.

Building on the new antitrust framework, the Commission will be able to co-operate more closely with the national competition authorities. Moreover, it will work together with the national sectoral regulators, which have an important role in putting liberalisation into practice. In this context, enlargement will entail a particular challenge, and the Commission intends to liaise closely with the national competition authorities and regulators in order to ensure full implementation of the liberalisation in the energy, telecommunication and transport industries of the new Member States.

## **Liberal professions and financial services**

Particular attention will be given to competition in areas such as financial services and liberal professions which are also subject to internal market legislation.

The liberal professions are an example of a services sector with a tradition of often burdensome regulation and restrictive practices. Whilst some regulation of these professions is probably required, this should be based on objective criteria of general interest that minimise the harm to competition and consumers. In its recent report<sup>24</sup>, the Commission has invited regulatory authorities in the Member States and professional bodies to review existing rules in order to see whether those rules are necessary, proportionate and whether they are justified. The Commission will also carry out investigations against restrictive practices where appropriate.

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[http://europa.eu.int/comm/competition/liberal\\_professions/final\\_communication\\_en.pdf](http://europa.eu.int/comm/competition/liberal_professions/final_communication_en.pdf)

In the financial services sector, pro-active enforcement is crucial for creating a competitive financial market and for achieving one of the main Lisbon objectives. Obstacles to efficient cross-border clearing and settlement can come from exclusive arrangements between exchanges and clearing and settlement providers. A recent study shows that exclusive arrangements in these areas are pervasive across Europe. Furthermore, the EU market for consumer banking and insurance remains fragmented. Finally, competition in card payments is still taking place in a fragmented manner within national markets, rather than at the internal market level.

#### **4.2. Development of State aid enforcement**

Future State aid policy will continue to focus on the important objective of reducing the overall amount of State aid, while promoting horizontal aid measures of Community interest. In addition to its formal enforcement role, the Commission will further develop the initiative taken in 2003 as regards the identification of market failures and the effectiveness of aid measures. Where individual or sectoral aid is granted, an economic approach will be followed to evaluate the effects of such aid on competition, and allowing to draw on the sectoral know-how of the anti-trust and merger fields.

In particular, the Commission will continue to ensure that State aid control will foster competition and competitive markets throughout the internal market, through the creation of viable competitive structures, taking account of the benefit to consumers and the interest of taxpayers.

In an EU of 25 or more, it will be impossible for the Commission to assess every single distortion of competition resulting from aid awarded at national level. The State aid enforcement will, accordingly, be based on a more rigorous economic analysis of the effects of aid measures on competition. Without prejudice to the full respect of EC law, a distinction may be envisaged between measures which are unlikely to have a significant impact on competition at the Community level, and measures which have to be subject to a detailed and rigorous assessment of their effects on competition in the internal market.

While experience to date suggests that the level of tradability of a particular activity may be a useful starting point, other factors are also relevant, such as the amount of aid, the competitive structure of the markets concerned, the possible market power of the beneficiaries, and the availability of the aid to different operators in the market. The Commission therefore intends to deepen its analysis with a view to translating these concepts into a general guidance to facilitate the design of aid that would, nevertheless, meet the requirements for compatibility with the Treaty rules on State aid.

Furthermore, a test will be devised to identify aid measures which are unlikely to produce a significant impact on competition in the internal market, based on the straightforward principle that in general terms, the smaller the amount of aid, the smaller the resultant distortion of competition. Thus provided the aid is used pursuant to objectives of common community interest, such as research, development and innovation, training, employment, and development of SMEs, it should normally be possible to allow relatively small amounts of aid without the need for a detailed assessment. A new framework to include such a test in the State aid rules is at an advanced stage of consultation with a view to adoption in 2004.

The Commission aims to achieve a reduction in the more distortive types of aid through the adjustment of the applicable rules for certain types of aid as well as the assessment of individual cases. As regards the regional aid rules, the recent reduction of the levels of aid allowed for large, mobile regional investment projects in the Multi-Sectoral Framework was adopted in response to strong concerns expressed by Member States about the distortive effects of high levels of this type of aid. Similarly, the current review of the guidelines on State aid for rescue and restructuring of enterprises in difficulty is focused towards the major distortions and damage that these types of aid measures inflict on competitors and the internal market.

In dealing with individual cases, the aim has been to identify cases where aid may give rise to serious distortions of competition in the internal market and, in so far as possible, to focus its resources on these. Examples include State aid, which take the form of fiscal advantages, unlimited or implicit guarantees, particularly in the financial services and energy sectors and the use of State aid in recently liberalised sectors. The Commission also seeks to ensure that State aid control forms part of an integrated competition policy, so that, for example, when considering the need for compensatory measures from a company receiving restructuring aid, it takes account of the potential effects of different types of measures on the competitive structure of the markets concerned.

As regards procedures, the Commission will review the need for further changes in the light of the experience acquired following the implementation of the new regulation which is currently at an advanced stage of elaboration. It will also consider the possibility of further block exemptions for certain types of aid as well as a simplification of the procedures by which block exemptions are adopted.

## **5. CONCLUSION**

Effective competition in the EU internal market makes, through improved productivity and innovation, a decisive contribution to the competitiveness of the European industry. A pro-active competition policy will act as a catalyst unleashing more competition across Europe thereby also helping to better achieve the Lisbon objectives.