

# 6 The EU's approach to Free Trade Agreements Competition

This paper forms part of a series of eight briefings on the European Union's approach to Free Trade Agreements. It aims to explain EU policies, procedures and practices to those interested in supporting developing countries. It is not intended to endorse any particular policy or position, rather to inform decisions and provide the means to better defend them. The views expressed in the briefings do not necessarily reflect the views of the publishers.

## What's at stake?

### *For developing countries*

- Competition policy is a critical tool for governing the market. Used effectively it ensures that consumers and producers get a 'fair' price, and it can be an important tool for nurturing and supporting new industries, particularly small and medium-size enterprises.
- Developing countries increasingly need international co-operation to overcome the anti-competitive effects of international mergers and acquisitions on their own markets, and the anti-competitive practices of foreign firms in their markets. They often lack the leverage, capacity and even information to do this alone.
- Developing countries also appropriate domestic and regional competition frameworks as their markets develop, and as the privatisation and deregulation of recent decades mean that competition and regulation are needed to ensure welfare gains from foreign investments or private takeovers of former state monopolies. These upgrades can be expensive and technically challenging, so EU assistance might be helpful.
- Designing competition policies which are appropriate to developing-country conditions is critical for development gains. The current model of competition policy envisioned by the EU in its draft Free Trade Agreements (FTAs) may not be the appropriate model. Levelling the playing field in developing countries, for example with respect to state aid, might in fact lead to less competition as local firms cannot compete on equal terms with European ones. Competition models need to be appropriate to local conditions and policy objectives, and agreements must allow flexibility to achieve this.
- Developing countries are unlikely to achieve changes in competition rules in EU markets. Few developing countries invest in EU markets, so trade-offs for their own firms' benefit are limited. Moreover, it might be difficult for non-EU firms to bring cases directly against EU firms' anti-competitive practices, not least because of the procedural requirements involved which may be too costly for non-EU developing-country firms to pursue, or because their domestic competition authorities might not be equipped to deal with them fully.

**Competition law** is intended to improve the welfare and economic outcomes arising from structural issues in markets (such as monopolies) or from firms' behaviour (such as price-fixing or collusion).

## For the European Union

- The EU has a strategic interest in developing international rules and co-operation on competition policies to ensure European firms do not suffer in third countries from anti-competitive practices or unreasonable subsidisation of local companies.
- The absence of competition and state aid rules in third countries limits market access as it raises new barriers to substitute for tariffs or traditional non-tariff barriers. The EU wishes to ensure that their trade partners refrain from having recourse to aids to protect their firms from international competition.
- The EU also sees a strategic interest in preparing for the next level of multilateral liberalisation by including competition in FTAs and obtaining convergence around the EU model.
- Competition rules would be backed up by trade defence instruments against unfair trade advantages caused by anti-competitive pricing, subsidies or other state-induced distortions.
- Unlike developed countries, whose fund transfers tend to go to private citizens, in developing countries the share of GDP spend on commercial state-owned enterprises is higher.<sup>1</sup> The EU may also be concerned over the use of state aid to support the competitiveness of developing-country firms in world markets – almost a quarter of the 100 largest developing-country multinational corporations are state-owned.<sup>2</sup>

1 World Bank, *Beyond Economic Growth* (2000), pp. 61–62, at [www.worldbank.org/depweb/beyond/beyondco/beg\\_11.pdf](http://www.worldbank.org/depweb/beyond/beyondco/beg_11.pdf).

2 UNCTAD, *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (2006), pp. 122–124.

### Understanding competition texts: Key terms and definitions

**State aid:** Financial or other help granted by a government (directly or otherwise) to support the establishment and/or operations of a firm or the production of certain goods.

**Market dominance:** Firms are considered to be dominant when they control a significant share of a market. They can abuse this position to fix prices or otherwise distort markets for their own benefits.

**Concerted practices:** This covers different forms of collusion like price-fixing, fixing output, and dividing up markets between a few firms that are able to dominate a market.

**Hard-core cartels:** A cartel is a formal agreement among firms (in markets where a few firms dominate) to fix prices or output, or otherwise collude for their mutual benefit.

**Undertakings:** These are individuals, enterprises, corporations or legal entities that may legally undertake or engage in business operations. This is a broad definition that covers any body engaged in commercial operations – public or private bodies, individuals or companies.

## WTO and the legal backdrop to competition in FTAs

There is no WTO requirement for competition policy to be included in FTAs. In fact, there is no WTO agreement on trade-related aspects of competition, its consideration as a negotiating issue having been rejected by developing countries along with the other “Singapore Issues” at the Cancun WTO Ministerial in 2003, a situation formalised by the General Council in July 2004.

That said, competition policy may also be said to have been already embedded in the main agreements of the WTO. Both the General Agreement on Tariffs and Trade (GATT) 1994 (with respect to goods) and the General Agreement on Trade in Services (GATS) have provisions on monopolies, exclusive service suppliers,

subsidies to state enterprises, and restrictive business practices. And the Trade-Related aspects of Intellectual Property Rights (TRIPS) agreement recognises the right of governments to act against abuses of intellectual property rights having an anti-competitive effect in the relevant market.

## *What the EU might want*

The EU was a strong proponent of competition rules at the WTO. It sought:

- agreement on core principles of transparency, non-discrimination and procedural fairness (protection of confidential information and right of petition to authorities, administrative decisions subject to judicial review)
- ban on hard-core cartels
- modalities for voluntary co-operation and information exchange
- capacity-building to help developing countries develop competition institutions
- flexibility for developing countries to take account of development needs.

In its FTAs, the EU goes further and also seeks substantive convergence around the EU model, as set out in the EU Treaty. The EU Treaty prohibits the following:

- Agreements, decisions or concerted practices between undertakings which affect trade and have as an objective or effect the prevention, restriction or distortion of competition
- Abuse by one or more undertaking of dominant market position
- Aid granted by the state through state resources or any form that distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods, in so far as it affects trade.

There can be exceptions to these general bans, if the practice improves production or distribution of goods or promotes technical or economic progress, provided the consumer gets a fair share of the resulting benefit and provided that there are not restrictions on competition that are not indispensable to the attainment of these aforementioned objectives, and provided that the measures do not allow the undertakings to eliminate competition in the products in question.

Very similar provisions can be found in the Euromed Agreements although the exceptions provisions are absent. The agreements also allow the EU to assess anticompetitive practices in the Euromed partner markets on the basis of its own rules criteria, which would give an advantage in invoking the Agreement's competition provisions against competitors of EU firms in Euromed markets.

In its agreement with South Africa, more flexibilities are included, for example:

- concerted practices must “substantially distort” competition before coming under the ban; and can be exempted if pro-competitive effects outweigh anti-competitive ones;
- the ban on state aid contains an exemption for aid which supports a “specific public policy objective”
- South Africa's domestic laws and regulations apply in implementing the agreement (in contrast to some of the Euromed agreements) so that South Africa can apply a locally appropriate definition of market dominance or measures to deal with it, for example.

The EU–Chile agreement is the “lightest” of all. Because of the established competition legislation and regulatory authority, it makes no reference to prohibited practices, only requiring each party to apply its respective competition laws, and agreement to co-operation and co-ordination among its authorities including “notification, consultation, exchange of non-confidential information and technical assistance”.

- 3 Comity is the principle that countries will respect the laws, judicial decisions, and institutions of each other.

EU agreements also tend to contain provisions on comity<sup>3</sup> and co-operation in investigation and remedies, information exchange (with respect for commercial secrecy) and, in some cases, for technical assistance in building institutional capacity.

According to draft negotiating mandates of the European Commission (EC) for these deals, they are likely to seek substantive agreements on rules and enforcement, binding agreements on co-operation and information exchange and a commitment to establish a competent regulatory authority.

## Key questions in analysing development implications and trade-offs

### *Is the EU model the appropriate one?*

Competition policy is intended to level the playing field to ensure efficiency and welfare gains. However, it assumes certain market conditions that might not exist in developing countries. Where access to domestically sourced capital is difficult, state support to private firms can increase competition, whereas overly strict rules could constrain this by allowing one or a few foreign firms to wipe out local competition.

Other public policy objectives might be more important in developing countries than favouring competitive outcomes. Japan and East Asian economies as well as some Latin American countries used state support to foster the development of big businesses that were internationally competitive and that led in the diffusion of new technologies and adaptation of imported technologies to domestic circumstances.<sup>4</sup> The UK formerly tolerated cartels in order to protect jobs.

These issues would imply that accepting strict substantive or even extra-territorial application of the EU model might not be the most appropriate option for developing countries. Leaving open the precise rules that might be applied (as in the EU–Chile deal) or making less stringent commitments that leave space for these considerations (as in the EU–South Africa deal) might be more appropriate. Most African, Caribbean and Pacific (ACP) regions have instead opted not to negotiate beyond co-operation on competition matters – however, this might be less palatable to the EC in markets where conditions for EU firms is more commercially significant.

### *How best can co-operation on cross-border cases and on the conduct of European firms be achieved?*

Developing countries can benefit from co-operation with European authorities. For example, when European firms merge, the impacts on developing-country markets can be significant but are not necessarily taken into account in EC investigations or remedies. This was demonstrated in some African markets as a result of banking mergers in the 1990s which created anti-competitive situations in their financial services markets. Developing countries on their own can lack the leverage, capacity or information to address this.

The activities of European firms can have anti-competitive effects on developing-country markets. A well-known example is the impact of dominant supermarket buyers with highly integrated supply chains on suppliers in developing-country markets. Developing countries could benefit from co-operation with the EC on investigating and disciplining these kinds of firms. That is, support to restrain the anti-competitive conduct of European firms (especially multinationals) and limit the negative impacts of the mergers of multinationals on the domestic markets and competitiveness of developing-country firms should form part of the co-operation framework.

- 4 Singh and Duhmale, South Centre Working Paper 7, November 1999.

In addition, the EC can support, through skills transfers and other assistance, the development of competition policy in developing countries that would allow them to harness and link industrial policy to competition policy. This would imply accepting, as an integral part of the technical co-operation framework, that encouraging inappropriate competition may be ruinous and that the government may need to intervene in the entry and exit decisions of firms (whether private or state-owned) and promote an industrial policy that on the one hand encourages the development of stronger domestic firms (which may be oligopolies) and on the other hand promotes domestic competition among these firms.

### **Will partner country firms make gains from a leveling of the playing field in EU markets?**

Developing-country firms operating in EU markets are less numerous than their counterparts. In general, developing-country firms willing and able to invest outside their home markets have tended to display a strong preference for investing in other developing-country markets as opposed to developed-country markets, although investments in the latter have also started rising. This has generated mixed reactions from developed-country governments involved in the process (for example, Dubai Port World and CNOOC in the US, Mittal Steel in the EU).<sup>5</sup>

If there are insufficient trade-offs with regard to gains in EU markets or in gains from co-operation and capacity-building assistance – developing countries should consider in the light of their negotiating capacity whether inclusion of competition in FTA talks would actually add significant value.

### **What institutional and regulatory capacity upgrades are needed?**

Accepting binding commitments on setting up regulatory authorities or even on transparency and information exchange can be a risky strategy for developing countries if they cannot be sure of having the capacity to fulfill these obligations. Best endeavour provisions might be a better option, or linking transition periods to capacity to implement or effective assistance being supplied by the EU.

Support for the development of domestic and regional competition legislation and structures is another interest of developing countries in deals with the EU, although maintaining independence as to what kind of regimes are set up is important.

## **Important information and where to find it**

UNCTAD (2005): *Competition provisions in regional trade agreements: How to assure development gains*

Treaty Establishing the European Community, Official Journal of the European Union (C321 E/37, 29/12/2006, Consolidated version)

South Centre *TRADE Working Paper* 7, November 1999

Ajit Singh, *Competition and Competition Policy in Emerging Markets: International and Developmental Dimensions*, University of Cambridge, May 2002.

UNCTAD (2006), *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development*

5 UNCTAD, World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development (2006), pp. 120-121.

The EU FTA Manual is a series of eight briefings on the European Union's approach to Free Trade Agreements.

1. Introduction: Tackling EU Free Trade Agreements
2. Inside European Union Trade Policy
3. The EU's approach to Free Trade Agreements: Market Access for Goods
4. The EU's approach to Free Trade Agreements: Services
5. The EU's approach to Free Trade Agreements: Investment
6. The EU's approach to Free Trade Agreements: Competition
7. The EU's approach to Free Trade Agreements: Government Procurement
8. The EU's approach to Free Trade Agreements: Intellectual Property

We will be updating these briefings as negotiations and understanding progress, and would welcome your feedback.

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