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Regulatory Reform and Competition: How to Push the Agenda Forward

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Regulatory reform and competition: how to push the agenda forward

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1. Introduction

In most European countries, the 1980's have been a turning point for economic policy. Previously there was industrial policy, State owned firms and extensive public intervention; subsequently, less government and greater market discipline. The responsibility of the EC is clear: many EC inspired domestic competition laws have been introduced at that time and pro-competitive regulatory reforms started to be widely discussed and promoted.

On the other hand, although with some exceptions, Europe did not play a major part in the decision taken at the beginning of the 1990s to launch massive privatization programs in countries like the United Kingdom, Italy and France. In fact the decision to privatize was largely the result of reasons connected with public finances and, at least in Italy, the widespread inefficiency associated with public ownership.

The European rules on state aid undoubtedly played an important role. In Italy Nino Andreatta, Minister of the Treasury, and Karel Van Miert, the Competition Commissioner, signed an agreement in 1993 where the Italian government was no longer allowed after 1996 to finance the growing deficits of State owned IRI, at the time Italy's largest industrial group. The agreement was not essential, since the decision to privatize IRI had been already taken. However without the agreement the Government might have changed its mind! As is well known, IRI no longer exists today and the businesses it controlled are all private, with the sole exception of the military industry and airlines. In France, the privatization of Credit Lionnays followed a failed attempt to sustain public ownership with State aid. In the United Kingdom the decision to privatize was taken earlier. I originated with Margaret Thatcher. In all these countries the decision to privatize was fully domestic and not based on European considerations.

In contrast with privatization, liberalization is clearly of European origin, at least in continental Europe. The liberalization of public utility services was marked by the Community directives, not always in line with member States wishes. The first directive, which in 1988 liberalized the market for telephone terminal equipment, was challenged by five countries (France, Italy, Belgium, Germany and Greece). The Court upheld the Commission's initiative, but even so the choice to liberalize was not fully accepted at national level. However, instead of opposing the underlying political decision in Brussels and in the appropriate fora, the strategy adopted by many jurisdictions was to delay the transposition of the subsequent liberalization directives for as long as possible. For example in Italy, the well known Directive 90/388, which liberalized value added telecommunications services was transposed into domestic law only in 1995 (after quite a number of advocacy reports by the Antitrust Authority suggesting that it be transposed). At that time the battle against competition had been definitively lost since in 1994 the European Council had adopted a progressive liberalization plan that was to lead to the complete opening of the market in 1998.

In this process of gradually increasing awareness of the beneficial role of competition, antitrust Authorities played an important part. In Italy the Authority was particularly influential because it was a new institution (the Italian antitrust law was enacted in 1990), it was fully independent from

[•] Italian Antitrust Authority, Rome, Italy. The opinions expressed in this paper are personal and cannot be attributed to the Autorità garante della concorrenza e del mercato.

government, and was also very high profile, with a former very effective Constitutional Court Chairman as its first President and a former Prime Minister as its second Chair. Furthermore the law gave the Authority not only the power to enforce the antitrust provisions, but also to play a relevant advisory role in rule making, a feature of the law quite novel at the time, but standard today. Indeed the three reports that the antitrust law had required the Authority to prepare so as to suggest the actions needed to promote competition in public procurement, retail trade and public utilities were of particular importance. Until then markets had been the subject of political debate only to be regulated or restrained. The reports of the Authority introduced competition in the Italian Parliament. The Merloni reform of public procurement (Law 109/1994), the Bersani law liberalizing retail trade (Legislative Decree 114/1998) and the law establishing the sectoral regulatory authorities (Law 481/1995) are all pro-competition reforms and are largely inspired by the Authority's reports. Lastly, the practice of presenting the Authority's annual report to the public, an initiative adopted voluntarily for the first time in 1992, has made a significant contribution to increasing the country's awareness of the benefits of competition.

Besides these examples, Italy is not different from other countries and the competition advocacy reports of the antitrust Authority are generally not followed, unless there is a strong political drive to do so. From 1990 up to today the Italian Authority has sent to Parliament, the Government and local authorities more than 400 advocacy reports aimed at promoting competition. In large part they have been ignored. There have been two general exceptions in this respect. The first when the advocacy report called on the Government to fulfil Community obligations; in these cases the Authority's reports served only a subsidiary function and were followed only to avoid infringement proceedings in front of the European Court of Justice. The second category of successful interventions consisted of advocacy reports intended to prevent a weakening of the Authority's powers or a narrowing of the scope of the law on the protection of competition. In such cases the opinion of the Authority was considered valuable and worth to be followed. In other cases the Authority's advocacy reports were covered in the press, sometimes with large headlines, but failed to influence reform.

The situation changed on two isolated but related occasions with the entry into the Government of Pier Luigi Bersani. In 1998 as already mentioned, influenced by the report of the Authority published five years earlier, Mr. Bersani modernized the legislation on retail trade. More recently, in June 2006 and January 2007, Mr. Bersani intervened again with far-reaching measures to liberalize numerous sectors of the Italian economy, from the professions, to banks, insurance companies, bars and restaurants, and pharmacies, drawing directly on about thirty of the Authority's advocacy reports, which were cited in the press releases issued by the Ministry for Economic Development as having provided a baseline for the Government's action.

In 1998 the steps taken by the Government to liberalize retail trade had been criticized as not being of sufficiently general scope. "Why only us?" asked retailers. This time more categories were involved and their protests annulled each other to a great extent. The only exception in this respect was provided by taxi services. This is hardly surprising since, unlike the other activities, the liberalization of taxi services not only causes a reduction in taxi drivers' current incomes but also to a capital loss owing to the reduction in the value of their licences. Hence the category's sometimes vehement protests.

Despite the recent very positive (although in my opinion exceptional) results, overall the Authority's advocacy activity has not proved to be very effective, especially as a consequence of the institutional context within which it is set. In the case of existing legislation, advocacy reports were only rarely sufficient to convince legislators to intervene since on its own the Authority was unable to influence the Parliament's agenda. In the case of legislation in the making – which, as is well known, often originates with the Government – the Authority's intervention frequently arrived

too late because it was informed of the content of bills once they are approved by the Council of Ministers, i.e. when a political consensus has already been reached.

Regulatory impact analysis and competition impact assessment are some procedural tools that would make it easier to launch competition oriented reforms or to avoid the introduction of unjustified restrictions to competition.

2. Selective industrial policy and the European Union

Although the EU Treaty is neutral with respect to the public-private ownership of enterprises, the possibility of providing unjustified privileges to firms is strongly limited. According to the Treaty competition-distorting State aid is prohibited. Furthermore national governments are barred from introducing rules and regulations that unduly restrict competition.

State Aid provisions

According to article 87 of the Treaty, State aid "which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market". Distortionary State aid is generally prohibited, but it may be considered compatible with the common market in four hypothesis:

> "a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
>
> b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
>
> c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;
>
> d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest."

For many years article 87 has been applied in a mechanical way, and distortions have been identified only when they appeared country-wide, not on the relevant market (which may have an international dimension) where the affected firms compete. In 2005, the Commission launched its State Aid Action plan,[1] with economic analysis being explicitly identified as the tool to be used for the interpretation of the legal provisions on State aid. In particular this meant the introduction of an effect based approach where the necessity and the proportionality of the aid were going to be ascertained on a case by case basis with respect to the effect on competition the specific measure was going to determine in the relevant market.

As Lowe (2006) underlines, the economic approach to State aid implies the introduction of a three steps checklist:

> "1) Is the aid measure aimed at a well-defined objective of common interest? (e.g., growth, employment, cohesion, environment);
>
> 2) Is the aid well-designed to deliver on this objective? (i.e., does the proposed aid address the market failure or other objective?)

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[1] State Aid Action Plan, *Less and better targeted state aid: a roadmap for state aid reform 2005–2009*, COM(2005) 107 final, Brussels, 7 June 2005.

a) Is State aid an appropriate policy instrument?

b) Is there an incentive effect? (i.e., does the aid change the behaviour of firms?)

c) Is the aid measure proportional? (i.e., could the same change in behavior be obtained with less aid)

3) Are the distortions of competition and effect on trade limited so that the overall balance is positive?"

According to Lowe (2006), following this checklist will not increase legal uncertainty. To the contrary. This case by case approach will be followed for the most serious State aid measures, while block exemptions will provide legal certainty for most of them. What Lowe (2006) is proposing is to follow a consumer welfare standard, acknowledging that objectives other than market failures may justify State aids. However the balancing test that Lowe (2006) suggests is quite difficult (if not impossible) to carry out in the case of State aid granted for achieving an equity goal.

A further important tool is the "market economy investor test", under which a capital injection by the State in a company (both private and public) is considered State aid when it can be demonstrated that a private investor would have not made that investment. The test has been used to facilitate better-informed application of state aid policy to distressed flag carriers; to loss making state owned German local banks; and to state owned conglomerates such as IRI in Italy and ALSTOM in France.[2] In a number of cases, the prohibition of state financing has led governments to privatise distressed companies, leading to efficiency improvements.

Recently, the market economy investor test has been fine tuned to accommodate for special circumstances, enhancing the flexibility of state aid policy and making it more in tune with the economic analysis of market failures. In the case of public services, the 2003 ALTMARK judgement[3] made it clear that in the case of services of general economic interest, a subsidy has to be justified in terms of universal service considerations, where the cost of such obligations be clearly identified. In the context of liberalised industries, the 2005 COMBUS case[4] has made it clear that the financing of cost inefficiencies that originate from labour legislation valid at the time of privatization does not constitute state aid.

State aid policy has also played an important role in facilitating the integration of the new EC Member States into the Community, by helping to ensure that companies are not unfairly subsidised, especially as a result of incentives provided at the time of privatisation (see Merola and Ballestrer, 2004). The institutional structure that originated from accession is different from that of long-time member States. In the new members the competition Authority (and not a Ministry) is in charge of controlling that State aid is coherent with the EC Treaty, a setting that was imposed by the Commission at the time of accession. The positive experience gained so far may lead to some form of decentralization of State aid control, as suggested by the State Aid Action Plan.

As Jenny (2006) argues, like the modernization of EC competition law led to a very successful process of decentralization in the application of EC rules by national competition authorities, the same could be achieved in the enforcement of State aid provisions. This decentralization could make State aid policy much better understood at the national level and could "increase its effectiveness". As Jenny (2006) argues, this "would be a particular important result at a time when there is a renewed … interest in industrial policy measures and the promotion of *national champions* in many Member States".

[2] See MONTI (2007) for an assessment of the role of competition policy, including state aid policy, in recent years.

[3] Case C-280/00, ALTMARK TRANS GMBH and REGIERUNGSPRÄSIDIUM MAGDEBURG v NAHVERKEHRSGESELLSCHAFT ALTMARK GMBH, Decision of 24 July 2003.

[4] Case C 10/2005, Restructuring aid to COMBUS A/S, Commission decision of 2 March 2005.

Liberalization provisions

The European Union is much more than a free trade area. Not only have trade barriers been eliminated by the Treaties, but unprecedented liberalization reforms have been made possible. Indeed the regulatory structure of most Member States would have been very different without the Community initiatives. The reason is that, while everybody understands the importance of an increased rivalry for enhancing the drive for innovation and for increasing the set of consumer choices, competition oriented reforms induce very strong reactions against them. The problem of competition is that it operates with two major pillars, i.e. Shumpeter's creation and destruction. The reaction to the prospects of opening of markets and the resulting greater competition is almost always the fear of destructions of existing firms and jobs, more than the hope of creation of growth opportunities. The reason is very simple and is the fact that, contrary to the threat to existing jobs, the new activities that competition will induce cannot be identified ex-ante, nor past evidences that competition oriented reforms helped growth and competitiveness are of much value because of the perceived uniqueness of each case.

This is why the role of the Community has been important in favoring competition oriented reforms in Member States: Politicians could always blame someone else for unpopular decisions and the Commission has over and over played the role of the scapegoat in domestic political debates. Here are some examples[5].

a) Telecommunications

In the late 1980s, the telecommunications sector was characterised by legal monopolies in most Member States. A directive issued in 1988 on the basis of Article 86 of the Treaty introduced competition in the market of telecommunications terminal equipment. An interesting phenomenon, which shows the type of pressures that originate from pro-competitive reforms and the ways in which the Commission's powers and related institutional machinery have helped to address these powers, is that Member States participated fully in the discussions that led to the directive. However, when the directive entered into force, five Member States (France, Italy, Belgium, Germany, and Greece) challenged it before the Court of Justice. The Court ruled conclusively in favour of the Commission. After this decision, the liberalisation process gathered steam. In 1990, the Commission issued directive No. 388 which liberalised value-added services and data transmission.[6] Only voice telephony was left as a monopoly because a number of countries opposed its liberalization, even though voice telephony was characterizes by high inefficiency in many Member States. After France and Germany offered support for full liberalisation, all Member States finally agreed on a timetable for the comprehensive liberalisation of telecommunications infrastructure (Council resolution of 22 December 1994).[7] Starting on 1 January 1998, the telecommunications sector was opened up to full competition.

Of course, liberalisation did not create competitive markets overnight. It takes time for new entry to become established. As had already happened in the past, some Member State governments were reluctant to introduce a pro-competitive regulatory structure in a timely way. Further action by the Commission was therefore necessary. In 2002, a package of six directives was approved: the common regulatory framework directive;[8] the universal service directive;[9] the data protection and

[5] Some of these examples are taken from Anderson and Heimler (2007).

[6] Directive 90/388/EEC of 28 June 1990 on competition in the markets for telecommunications services, *Official Journal L 192*, 24 July 1990, pp. 10-16.

[7] Council Resolution 94/C 379/03 of 22 December 1994 on the principles and timetable for the liberalization of telecommunications infrastructures, *Official Journal C 379*, 31 December 94, pp. 4-5.

[8] Directive 2002/21/EC of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), *Official Journal L 108*, 24 April 2002, pp. 33-50.

privacy directive;[10] the directive on access and interconnection;[11] and the authorisation directive for electronic communications.[12] The main thrust of these instruments was to promote the use of competition-based regulatory concepts, going a long way to create a level playing field in the European telecom sector.

The 2002 process is still underway. In most Member States, incumbent operators are still the dominant players in fixed-line telecommunications. Nonetheless, in all countries, consumers have the possibility of choosing among alternative service providers, especially in mobile services. As a result, prices have declined significantly everywhere and service quality, including the treatment of consumers by telecom operators, has greatly improved. Possibly the greatest impact of competition-based liberalisation has been in the introduction of new products and services, including internet-based services and mobile services.

In addition to the removal of policy restraints on supply-side competition, important measures have been taken to enhance demand-side flexibility. Mandating number portability has reduced the cost of switching between service providers which in turn, has reduced the market power of incumbent firms. Carrier selection, whereby consumers maintain their contract with the incumbent operator but may select an alternative carrier, has made entry easier by reducing the need for an upfront commitment by consumers. Where consumers are satisfied with the alternative provider, carrier pre-selection makes it possible to fully substitute for the services of the incumbent operator. In both cases, regulation has been essential for ensuring access to the unbundled elements of the network (see ENNIS and HEIMLER 2004).

Implementing competition oriented reforms reduces, but does not eliminate, the necessity of regulation. In sectors such as telecommunications, antitrust enforcement, and regulatory interventions can serve complementary roles. In this regard, the EC Roaming directive[13] has resulted in a substantial reduction of roaming charges, benefiting consumers but potentially introducing some rigidities with respect to long run market developments.[14]

b) Electricity

The degree of opposition to reform of the electricity sector exceeded that which occurred in relation to telecommunications reforms. From December 1990 to June 1996, the initial Commission position to allow direct transactions between as many producers and consumers as possible was blocked by the opposition of Member States believing that a vertically integrated structure for the industry with no possibility for direct transactions by consumers with generators was preferable. In June 1996, after a long debate, the Council of Ministers agreed on a directive concerning common rules for the industry.[15]

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9 Directive 2002/22/EC of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), *Official Journal L 108*, 24 April 2002, pp. 51-77.

10 Directive 2002/58/EC of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications), *Official Journal L 201*, 31 July 2002, pp. 37-47.

11 Directive 2002/19/EC of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive), *Official Journal L 108*, 24 April 2002, pp. 7-20.

12 Directive 2002/20/EC of 7 March 2002 on the authorisation of electronic communications networks and services (Authorisation Directive), *Official Journal L 108*, 24 April 2002, pp. 21-32.

13 Regulation (EC) No 717/2007 of the European Parliament and of the Council of 27 June 2007 on roaming on public mobile telephone networks within the Community and amending Directive 2002/21/EC.

14 As of summer 2007, European consumers benefit from a ‘Eurotariff’ that sets a maximum limit for calls made (EUR 0.49 excl. VAT) and received (EUR 0.24 excl. VAT) when abroad. The price caps will be further reduced in 2008 and 2009.

15 Directive 96/92/EC of 19 December 1996 concerning common rules for the internal market in electricity, *Official Journal L 027* , 30 January 1997 pp. 20-29.

The 1996 directive began the process of introducing competition while leaving important choices to the discretion of individual Member States. For instance, the directive allowed Member States either to provide for free entry in electricity generation or to introduce a tendering procedure in order to identify the actual generator that entered the market, maintaining central control on the technology to be used and the timing of entry. Furthermore, a grid operator could be made responsible for power transmission and for guaranteeing the physical equilibrium of the system and Member States could designate a single buyer with responsibility for ensuring supply to non-eligible customers.

Indeed, leaving to much discretion open, the directive was quite ineffective in changing the market and regulatory structures of Member States. As a result, in order to create a level playing field among suppliers, further important measures were introduced by Directive 2003/54/EC[16] and Regulation (EC) No 1228/2003 on "Cross border Electricity Trading"[17]. Directive 2003/54/EC aimed at complete market opening, requiring that all non-household electricity customers become eligible by 1 July 2004 and all household customers by 1 July 2007. However, in sectors such as electricity where entry requires substantial investments and involves a lengthy authorisation process, simple market opening could not automatically lead to the introduction of vigorous competition. Structural measures such as divestiture would have been be necessary. The directive was silent on this issue, reflecting different beliefs among Member States on the benefits of stronger competition. On their own initiative, some Member States imposed capacity divestitures on the former legal monopolist sometimes coupled with temporary measures to increase competition such as market share caps.[18]

Directive 2003/54/EC also obliged Member States to introduce a regulated third party access regime, removing the possibility of negotiated third party access which had been permitted under the 1996 directive. Furthermore, the directive mandated the appointment of an independent national regulator. As for transmission and distribution, the directive required legal unbundling – stopping short of proprietary unbundling that had been proposed in the OECD as the most effective solution for aligning the incentives of the infrastructure owner with the general interests of society (OECD 2001 and 2006).

As the foregoing account implies, pro-competitive reform in the electricity sector has not gone as far as it has in telecommunications. In many cases, markets remain concentrated and national in character. According to the Commission sector enquiry on gas and electricity published in January 2007 (see EC COMMISSION 2007b), the incumbent operator is vertically integrated in almost all Member States and the degree of cross-border competition is weak, due in part to a lack of inter-connection capacities. Nonetheless, other evidence indicates that, where effective competition has been introduced, important benefits have been generated for consumers. As the INTERNATIONAL ENERGY AGENCY (2005) reports, there is a clear falling trend in the price of electricity in the United Kingdom which is attributable to increased competition promoted by vertical and horizontal separations. In Portugal, vertical unbundling of electricity markets resulted in a 45-80% decline in access prices and a tripling of real investments in transmission facilities in the period 1999-2006 (GERALDES 2007).

As a result of the sector enquiry there is now substantial evidence that competitive Europe wide electricity markets provide lower prices for consumers and enhance (because of the stronger

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[16] Directive 2003/54/EC of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC – Statements made with regard to decommissioning and waste management activities**,** *Official Journal L 176,* 15 July 2003, pp. 37–56.

[17] Regulation (EC) No 1228/2003 of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity, *Official Journal L 176,* 15 July 2003, pp. 1–10.

[18] In the UK and in Italy, the existing state owned monopolists were split up into competing undertakings in order to create competitive markets, a move which in Italy has nonetheless maintained an incumbent operator with a significant market power.

interconnections) the security of supply. As a result of this evidence, the Commission is in the process of proposing a new round of directives where structural separation of transmission will be probably imposed, together with some mandatory minimum interconnection capacity requirements. It is not at all clear that there will be the necessary consensus on this, suggesting that technical arguments are never the key element in a political decision on industry structures.

c) Rail Transport

Introducing competition in the rail transport sector is challenging, due to intrinsic problems in ensuring competitive access by alternative rail carriers to the same rail infrastructure. Recent developments in many European countries show that European policy has been particularly effective with respect to freight services. Efforts to introduce competition in passenger services have been less effective. Council Directive No. 440 of 1991 on the development of Community railways[19] and two complementary Directives (95/18 and 95/19) adopted in 1995[20] had the objective of creating a unified market of railways services throughout the Union. The system of regulation was to be based on common accounting rules and in particular on a common approach to separation between infrastructure and services as well as on the creation of access rights to rail infrastructure for international services. In 1998, the Commission presented further legislative proposals for what was eventually to become the first package of railway directives (Directives 2001/12, 2001/13, 2001/14).[21] The package takes the accounting separation provisions of Directive 91/440 further by requiring that certain essential functions for non-discriminatory network access are carried out independently of the provision of rail transport services.

In practice, entry by new providers was delayed by difficulties associated with logistics and with the need to enter with a full network of coordinated routes so as to ensure a high degree of capacity utilisation. Furthermore, passenger train services in Europe have been subject to pervasive financial problems. According to National Economic Research Associates (NERA) (2004), in 2001 operating revenues were around 30% of operating costs in Italy, 50% in Germany and Spain, 58% in France, and 68% in the UK. The cause of such difficulties was not unrelated to the ownership structure of most rail companies and to the objectives pursued by public policy. Being state owned, rail companies were obliged in many countries to maintain the level of service irrespective of demand and keep prices low (OECD 2005).

Since then, the situation changed substantially. In France, the French rail company, as a result of the success of the TGV project, showed a profit in its accounts for the first time after 70 years. Furthermore, competition in freight increased substantially in recent years, with new entrants gaining rapidly market shares at the expense of the incumbent monopolist in a number of countries and in particular in France, Germany and the Netherlands. One major factor contributing to dampen the prospects of competition in rail is the fact that locomotive technical standards are not homogenized across the EU, so that international freight carriers have to change locomotive when crossing most borders, unless they are willing to pay 50% for a multi standard locomotive. Furthermore, contrary to road signalling, rail-track signalling follow country by country codes, so that when crossing borders a new driver is generally necessary, increasing the cost of competitive

[19] Directive 91/440/EEC of 29 July 1991 on the development of the Community's railways, *Official Journal L 237,* 24 August 1991, pp. 25–28.

[20] Directive 95/18/EC of 19 June 1995 on the licensing of railway undertakings, *Official Journal L 143*, 27 June 1995, pp. 70–74 and Directive 95/19/EC of 19 June 1995 on the allocation of railway infrastructure capacity and the charging of infrastructure fees *Official Journal L 143*, 27 June 1995, pp. 75–78.

[21] Directive 2001/12/EC of 26 February 2001 amending Council Directive 91/440/EEC on the development of the Community's railways, *Official Journal L 75*, 15 March 2001, pp.1-25; Directive 2001/13/EC of 26 February 2001 amending Council Directive 95/18/EC on the licensing of railway undertakings, *Official Journal L 75*, 15 March 2001, pp.26-28; Directive 2001/14/EC of 26 February 2001 on the allocation of capacity and the levying of charges for the use of railway infrastructure and safety certification, *Official Journal L 75*, 15 March 2001, pp. 29-46.

entry.

Currently, the Commission is proposing a third package of railway directives to open up the market for international passenger services by 2010.[22] First of all, a European certification for locomotive drivers will be introduced by 2010 which will require a standardisation of national rules (and signals) by that time. On the other hand, there is no project underway for achieving convergence on locomotive technical standards which are a real concern because they substantially impede entry by competitors into neighbouring markets. These technical difficulties need to be solved if entry in transborder domestic passenger service markets is actually to take place.

d) Banking

In banking, progressive rounds of Council directives have led to a widespread opening of national markets based on the principles of home country control, efficiency-oriented regulation, and mutual recognition. Liberalisation efforts have been directed mainly towards making the entry of new competitors into national markets easier. The system of regulation, although increasingly harmonised across Member States, has evolved towards a relaxation of controls as in the rest of the world.

The first EC banking directive (Directive No. 77/780)[23] reformed entry regulation, eliminating discretionary powers associated with it. The second banking directive of 1989[24] set out a number of important principles such as home country control (meaning that the responsibility for authorisation and financial supervision of credit institutions remains with the supervising authority of the "home" country); the principle of single banking license, which implies that a bank that is authorised to carry out business in one Member State can do so throughout the Union; and the principle of mutual recognition, leading to recognition by all Member States of each others banking laws and regulations. Some related but more technical directives have also been adopted, setting common standards on prudential regulation such as the Own Funds Directive, the Solvency Ratio Directive, the Large Exposure Directive, and the Deposit Guarantee Schemes Directive. These measures have substantially strengthened competition while ensuring appropriate prudential regulation (International Competition Network (ICN) 2005).

Efficient, competition-supporting regulation in the banking sector has been reinforced by a modification of the Basel Accord in 2004 which facilitated more sophisticated approaches to capital requirements and risk-management in banks (BANK FOR INTERNATIONAL SETTLEMENTS 2006). The so called Basel II regulation, whose implementation began in 2006, encourages banks to develop their own systems to compute minimum capital requirements while maintaining supervisory oversight. Basel II also assigns a greater role to market oversight in reducing excessive risks in banking activities. A key aspect of the new framework is its flexibility. This provides institutions with the opportunity to adopt the approaches most appropriate to their situation and to the sophistication of their risk management.

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22 Proposal for a Directive of the European Parliament and of the Council on the certification of train crews operating locomotives and trains on the Community's rail network (COM/2004/0142 final – COD 2004/0048); Proposal for a Regulation of the European Parliament and of the Council on International Rail Passengers' Rights and Obligations (COM/2004/0143 final – COD 2004/0049); Proposal for a Directive of the European Parliament and of the Council amending Council Directive 91/440/EEC on the development of the Community's railways {SEC(2004) 236}(COM/2004/0139 final – COD 2004/0047).

23 Directive 77/780/EEC of 12 December 1977 on the coordination of the laws, regulations, and administrative provisions relating to the taking up and pursuit of the business of credit institutions *Official Journal L 322* , 17 December 1977 pp. 30-37.

24 Second Council Directive 89/646/EEC of 15 December 1989 on the coordination of laws, regulations, and administrative provisions relating to the taking up and pursuit of the business of credit institutions and amending Directive 77/780/EEC, *Official Journal L 386*, 30 December 1989 pp. 1-13.

Notwithstanding these initiatives, the retail banking industry continues to be segmented along national boundaries at least in the original fifteen members of the Community. Mere liberalisation has not yet created an integrated, competitive European market. Partly to address this, the Commission launched a sector enquiry on retail banking which was completed in January 2007 (see EC COMMISSION 2007c). The inquiry, which also addressed payment systems, found that retail banking is characterised by limited competition which reduces the elasticity of demand each bank faces, resulting in extensive market power. This finding underscores the continuing need for effective competition policy oversight in this sector and for the adoption of regulations, for example, account number portability, that facilitate greater competition by increasing flexibility on the demand side.

c) Services

On private services the path to regulatory convergence and greater competition has been full of resistances, not very differently from what happened in public utility services. The internal market for private services remains fragmented and divided. The relative success of the strategy of blocking trade liberalization in services is mainly caused by the fact that for individual suppliers the protectionist rents in services are relatively small, but all together they are quite substantial. This means that consumers benefit from liberalization only globally. Furthermore, many service providers are individuals, not multinationals. As a result, public opinion perceives liberalization of these services not so much as beneficial for consumers, but rather as a cost for stake holders.

As is well known, articles 43 and 49 of the European Treaty establish the freedom of establishment and to supply services, prohibiting, according to European case law, not only the introduction of discrimination based on nationality, but also all national measures that may impede or create obstacle to the exercise of European fundamental freedoms (free movement of goods, services, capital and people). Restriction are allowed only if they are necessary for achieving a public interest objective, strictly defined.

The problem with this requirement of strict necessity, as Barnard (2004) and Amato-Laudati (2002) suggest, is that it is very difficult to intervene for the Courts unless such restrictions are clearly not proportionate or unjustified, which is very rarely the case. As a consequence leaving the removal of regulatory restrictions to the direct application of articles 43 and 49 becomes very ineffective. This led the Commission in 2004 to propose the adoption of a directive on services, the so called Bolkenstein directive, based on a horizontal approach aimed at achieving the freedom of establishment and the free movements of services.

As regards the free movement of services, the draft directive contained a widely criticized "origin" principle, a list of sectoral derogations and a list of regulatory practices that were either prohibited or needed to be justified. on a case by case basis.

The origin principle would have slightly reinforced mutual recognition, an established principle of the Treaty. The adoption of a home country rule standard meant that a number of restrictive regulations would have been made irrelevant. However the result would not have been social dumping, as many were denouncing. Indeed, according to the Posted workers directive, workers on temporary service from another Member State have to be paid at the conditions established in the host country, so that the origin principle could not lead to wage competition.

The insistence in the communication strategy of the Commission that the directive was strengthening mutual recognition instead than concentrating on the impact the directive would have on regulatory reform, led the debate astray. First of all, the insistence on the origin principle led to a long list of sectoral exclusions, not just partial exclusions from the origin principle, but total exclusions from the duties the directive was imposing. Furthermore everybody believed that the directive would make possible for "Polish plumbers" to move to richer countries, competing with

domestic plumbers at Polish pay, a right that is enshrined in the Treaty and that the new directive could not touch.

As I argued elsewhere[25], with a better communication to the public the origin principle could have been saved. Unfortunately the directive, which was finally adopted in 2006, is now much weaker and less effective than it could have been. The origin principle is gone and we are back to mutual recognition. The list of sectoral exclusions is long: finance, communications, transport, temporary work agencies, healthcare, broadcasting, gambling, social services, private security services and notaries. Also on regulatory reform many of the domestic restrictive provisions that were originally to be prohibited have been eliminated.

Article 14 of the Service directive contains a list of prohibitions and they concern the introduction of access requirements based on nationality and restrictions to access based on an administrative assessment of demand and supply. Much more important are the restrictions specified in Article 15 concerning cases in which the law may be unjustifiably restrictive, with a case-by-case assessment. The restrictions to be assessed mainly concern administrative regimes regulating access: subjecting access to compliance with quantitative or territorial restrictions (in particular in the form of limits fixed according to population or of a minimum geographical distance between providers) and limiting access to firms with a given legal form or to particular suppliers. There is also a provision that requires justification for restrictions regarding the scope of the activity and, in particular, when a provider is obliged to supply other services jointly with his service. Finally all price regulations (fixed minimum and/or maximum tariffs with which the provider must comply) have to be justified as well.

Competition Impact Assessment

The introduction of domestic procedures for regulatory impact analysis, transforming a political debate into a technical one, favors the adoption of regulations that are beneficial to society. However, RIA in its original format does not verify whether the proposed regulation is actually the least restrictive of competition possible. Most of the checklists developed for RIA simply ask whether the regulatory intervention is justified, and then go on estimating whether overall it is beneficial. In essence RIA is a cost benefit analysis. If benefits are higher than costs, than the regulation is approved, the null hypothesis being doing nothing.

Traditional RIA does not compare the proposed regulation with a less restrictive alternative. Consequently, in order to determine the best way to achieve the objectives of public intervention, a number of jurisdictions, including the United States, Canada, Australia, Mexico, the United Kingdom and the European Commission, have introduced another procedure alongside RIA, Competition Impact Assessment. Its purpose is to verify whether the proposed regulation introduces restrictions that are proportional to the objectives pursued and checks whether there are less restrictive options. The OECD also has a project under way within the Competition Committee, aimed at promoting the adoption of a Competition Impact Assessment procedure in OECD Member Countries.

In particular, the OECD has identified a checklist serving to identify measures having the potential to constrain competition. For such measures a more detailed assessment is envisaged to determine the degree of restriction that is optimal in the general interest, with an approach similar to that adopted by antitrust authorities in their advocacy activity.

The regulatory restrictions identified in the OECD checklist are as follows. 1) Access restrictions: does the rule/regulation limit the number or range of suppliers of a particular good or service? 2) Restrictions on firms' activities: does the rule/regulation limit the ability of suppliers to compete?

[25] See Heimler (2006)

3) Restrictions that facilitate violations of competition law: does the rule/regulation reduce the incentive of suppliers to compete?

It would be possible to add other elements to this checklist to make it more complete. In particular it would be possible to add controls aimed at fostering a regulatory reform that, while safeguarding the general interests pursued, would promote the working of the markets to the benefit of consumers. For example, in cases of open-end contracts characterized by high explicit and implicit switching costs, it might be necessary to encourage competition on the demand side by eliminating or limiting such costs. Moreover, the process of liberalization of regulated industries may benefit as well from the expertise of the competition authorities for a number of issues, like the most appropriate institutional structure (make sure that in case of State owned companies the ministry/administration exercising controlling rights is separated from the regulator), how to organize a bidding process (competition for the market), how to separate a vertical integrated network.

Regardless of the content of the checklist, for measures identified as a cause for concern in terms of competition, it is necessary to verify whether the restrictions found are really proportional to the general interest pursued. The difficulty of this analysis often lies in the need to hypothesize the probable conduct of operators in response to the restrictions. In this respect antitrust authorities have developed considerable expertise and professionalism. For example, in the United Kingdom the OFT has produced a checklist analogous to that of the OECD and is consulted by government bodies as necessary. In Australia the Government has entrusted the Productivity Commission, a body that for some time has been working on the revision of economic regulations, with the task of systematically analyzing the competitive impact of and suggesting amendments to legislative measures in the making from the standpoint of competition and the market. In Mexico the Competition Authority heads a technical committee that is in charge of competition impact assessment.

The Bersani reforms in Italy

One of the duties of the Italian competition Authority is to promote competition oriented reforms. Indeed the Italian law gives the Authority the power to intervene in the legislative process by identifying *cases of particular relevance in which the provisions of law or regulations or general administrative provisions are creating distortions to competition or to the sound operation of the market which are not justified by the requirements of general interest* (article 21 of law n. 287/90). What this means is that the Authority should suggest regulatory restrictions of competition strictly proportionate to the general interest they pursue. The law allows the Authority to intervene, but does not introduce any obligation on the part of the legislative body to listen. And indeed, being competition not very popular, only a few of the almost 450 reports the Authority issued since its establishment have been followed. In Heimler (2002) I identified three reasons why it is so difficult to introduce competition oriented reforms.

> "First of all there are quite a number of interested parties to any restriction especially to those restrictions, and there are so many in all our countries, that impede or restrict entry. As a consequence of legal barriers, protected existing producers get higher profits, employees get higher pay, suppliers get better deals, ministries of industry get their national champions. Second, special interests are concentrated and gain substantially from any restriction of competition. On the other hand, losers from such restrictions are scattered across society each losing a minimal amount. This is why it is very difficult for them to organize their own pressure group. Third, special-interests are quite effective in lobbying for protectionist regulations that benefit them, because such regulations get always justified in terms of what are widely perceived as general interest objectives: employment, social cohesion, quality, universal service, market stability etc. With respect to such objectives, competition is often

> pictured as disruptive. The difficulty for competition advocates is that they have to prove that market failures are not relevant or that they can be addressed with less intrusive solutions. A very difficult task indeed. In any event the case for competition is relatively easier when the objective is to bloc a new proposal, while it is much more difficult to eliminate existing protections. These are considered like facts of nature."

Had it not been for Minister Bersani, Italy would not have been an exception to this general pattern. Unless Bersani was part of Government, only reports advocating for Italy to comply with European obligations were considered seriously or instances when a draft law was going to weaken some of the enforcement powers of the competition Authority (see on this Parcu, 1997).

In 1998 the Authority report on retail trade issued in 1993 was extensively used by Minister Bersani to eliminate quite a number of restrictions in national legislation: elimination of entry restrictions based on an administrative definition of supply and demand; full liberalization of the opening of small shops up to 250 m^2, introduction of a regional authorization for the opening of large surfaces; partial liberalization of opening hours. The draft law liberalizing retail trade was criticized by incumbent retail traders of all dimensions, each category fearing that the increase in competition that the liberalization would induce would decrease their profitability. In the process of approval, the Parliament introduces the prohibition of sales below costs.

The major criticism that Bersani had to face in 1998 was the fact that the liberalization affected only retail trade. Why only us? asked repeatedly the representative of the retail trade association, implicitly suggesting that there were political considerations in the choice and, for example that most shop owners would not vote for the leftist party of Mr Bersani.

When Bersani joined the government again in 2006, he had learned the lesson and just after a few months after having entered office he issued a decree with the objective of liberalizing a number of activities, affecting quite a number of categories, not just one as he had done in 1998. In January 2007 the Minister issues a second liberalization decree.

Besides strengthening the enforcement powers of the competition Authority, the decrees: 1) abolished mandatory minimum tariffs in the professions, allowed informative advertisement and result pricing; 2) abolished the legal monopoly of pharmacies in the sale of non prescription drugs; 3) liberalized access to bread making; 4) abolished all cases where commissions of peers were responsible for authorizing entry; 5) eliminated all sorts of limitations to entry/expansion based on minimum distances, on market shares, on the portfolio of products to be carried; 6) abolished exclusive dealing requirements in insurance; 7) abolished closing charges in checking accounts and imposed on banks the obligation to transfer mortgages at zero cost; impeded region/municipality owned corporations from operating freely on the market but only for the benefit of the controlling body; 8) liberalized access to the activity of barbers, hair dressers, tourist guides, driving schools; 9) imposed on highways the obligation to inform drivers about gasoline prices; 10) abolished the requirement that taxi licenses be granted only to individuals, doubling the number of taxi licenses in the country.

All these liberalizing measures were based on advocacy reports by the antitrust authority, issued sometimes years before, that were cited one by one by the Ministry's press releases presenting the decrees.

As soon as the decrees were issued (but before they were approved by Parliament) all categories reacted very strongly against them, all using general consideration arguments. Except taxi drivers they all said that that greater competition would impede the attainment of general interests, such as trust in the professional-client relationship, universal service in pharmacies, stability consideration in banking and insurance, etc. Nobody said that greater competition would reduce profits, increase productivity and reduce prices. This is probably why their arguments were not accepted by Parliament that approved the decrees without change.

Contrary to all the others, taxi drivers argued very strongly that liberalization would have imposed on them severe income losses (reduction of prices for taxi service) and capital losses (strong reduction in the value of the medallion). As a result of strikes by angry taxi drivers in many cities, the Minister backed off and degree of protection of taxi services was only marginally reduced: greater flexibility in shifts management and increase in the number of licenses to be decided by each municipality. The case of taxis shows the importance of providing temporary relief to those most affected by greater competition. Failing to do so, may risk blocking the reform. For example, in Ireland the liberalization of taxi services, as reported by Heimler (2008), led to a reduction in the value of a Dublin taxi licence from 150000 EUR in 2000, to 6 300 in 2007. In order to provide relief the Irish government first gave a licence for free to each existing taxi driver and then instituted a reimbursement fund. In Italy the proposal to liberalize taxi services, not having carefully considered the reimbursement issue, rapidly collapsed because of the protests of stakeholders.

Conclusions

A few years ago at a lecture during an antitrust course at the World Bank Joseph Stiglitz, then Vice President of the Bank, rightly emphasized the importance of structural policies for development, suggesting that privatization is not enough and that markets, in order to produce benefits to society, need to be made ready for competition, freeing them from unnecessary restrictions, licensing and alike, that are among the most damaging legacies of both colonial times and socialist experiences.

Indeed, we all know that a competitive environment creates the right incentives for promoting innovation and growth. New entrants fight for market share and by so doing they disrupt existing equilibria. Furthermore, if producers know that their market position can be weakened by competition, they will do their best to anticipate it, innovating, reducing prices and operating for the benefit of consumers. But why is it that the case for competition is so difficult to make?

First of all there are quite a number of well organized interested parties to any restriction of competition, especially to those that impede or restrict entry. Second, special interests are concentrated and gain substantially from any restriction of competition. On the other hand, losers from such restrictions are scattered across society each losing a minimal amount. Third special interests always picture competition as disruptive, while justifying restrictive regulations in terms of what are widely perceived as general interests objectives: employment, social cohesion, quality, universal service, market stability etc. Finally people are attracted by the opportunities that competition brings, but may be quite scared by the uncertainties that it also provides.

The difficulty for competition advocates is that they have to prove that there is no market failure warranting regulator intervention or that, if indeed there is one, it can be addressed with less intrusive solutions. Competition enhancing reforms have an effect on existing competitors, making it more difficult for the weakest to remain in the market or not to adjust, but they mainly create greater possibilities for new entrants. The net effect is strongly positive. However what people are mostly concerned about is the challenges that greater competition brings to the weakest firms, more than the opportunities for new entrants.

Alfred Hilmer in its 1993 report on how to introduce a competition oriented reform in Australia suggested that only a constitutional change, imposing that regulatory restriction are proportionate, would be effective. This is what has happened in Europe where the EU Treaty is indeed our constitution, constraining Member States to adopt competition friendly legislation. Indeed the great liberalization effort in western Europe, first in manufacturing and more recently in public utilities and private services, is clearly the result of EU membership and the action of the European Commission. Europe and the Treaty are the scapegoats of unpopular reforms. Competition is very often presented at the domestic level as the “bitter pill” to be swallowed in order to remain or to enter in Europe, very seldom as a beneficial policy on its own sake.

What the European experience has taught us is that competition can win when the political discretion associate with its introduction is strongly reduced. The EU Treaty goes quite far in that direction, but a number of areas, especially in private services, continue to be subject to domestic jurisdiction only. In this respect RIA and competition impact assessment instruments serve the very important function of channeling competition into a technical debate, reducing political discretion and making sure that choices are made with a full information on alternatives.

It is necessary in any case to identify the organizational/institutional arrangements that are likely to foster cooperation among all the parties concerned, so as to ensure the success of competition impact assessment. In most countries competition authorities have developed a unique expertise in assessing the proportionality of regulatory restrictions. They can therefore play a leading role in the process of regulatory reform. The problem does not arise so much when the restrictions are justified as when they are not justified or only justified in part. In these circumstances the opinion of the authority, aimed at eliminating unjustifiably restrictive regulations, should be examined by some governmental body and lead to concrete operational proposals and specific reform measures.

Recent Italian experience shows that there are considerable advantages, including some of a political nature, to be gained from liberalization. Opinion polls conducted last year indicate that 70% of Italians are in favour of the Government's liberalization policies. For the Government's other measures the consensus rarely exceeded 40%. In this context an assessment of the competition impact of regulation disciplines the reform process and gives lawmakers an instrument with which to overcome the corporatist resistance that always tries to obstruct modernization projects and the dismantling of protectionist barriers. As the experience with the two Bersani decrees shows, protests and demonstrations by the categories involved lose all their force and ability to impose a block when faced with the general interest, if this is identified on the basis of solid technical arguments (and political objectives), made known to the public, and above all if the categories involved are numerous.

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