



## **Seminar on Competition FAS, Moscow, October 18, 2005**

### **Converging markets require converging competition rules**

#### **Address by Director General Claes Norgren, Swedish Competition Authority**

#### **Check by delivery**

I would start by expressing how delighted I am to participate in this seminar in Moscow. The Swedish and the Russian Competition Authorities have entered into a programme of cooperation and one of the items in this programme is this seminar.

The Swedish and Russian Governments have a programme for economic and social cooperation. The main areas for cooperation are economic transformation, social security, environment and security policy. In the years 2005 -2008 this cooperation will be focused on the north-western part of Russia. It is within this context the cooperation between the Swedish and the Russian Competition authorities should be seen.

#### **Opening of markets**

From a Swedish perspective Russia is a neighbouring country that over time has been in close trade relations with Sweden. In history there are many examples of those relations and one can just think about the Nobel Prize. This prize that has the name of the founder originates back to the family Nobel who had major business operations in Russia and in Saint Petersburg where much of the wealth was created. This made it possible to create the world's leading price in sciences.

The Russian economy has had a high and steady growth during the last five years. This has been mainly driven by the oil and gas sectors that today account for approximately 25 per cent of GDP in Russia. Sweden on the other hand is a part of the EU internal market and has gone through a period of structural change. Growth in the Swedish economy is on a good European level but the overall economic growth in the EU has been rather sluggish.



The opening up of trade between the two markets has created new business opportunities. Swedish companies can exploit comparative advantages by relocating production or distribution to markets with favourable conditions or can expand into new and important markets. At the same time Russian companies can establish themselves in Sweden. Our economies are thus increasingly coming closer to each other. Companies try to enhance profitability and productivity by exploiting the economic gains that can be reached from international diversification and specialisation. Responding to costs and competences, companies may divide their research, production, marketing, and customer relations functions to different countries.

The result of such a process will lead to benefits for consumers. Strong forces can be identified that demonstrate this in terms of increased supply and lower prices through the creation of larger markets and increased competition.

### **The importance of competition policy to economic growth and consumer welfare**

Well-functioning markets are crucial to us all: for consumers to satisfy our basic needs, for companies to secure vital inputs and to safeguard a free and fair access to the marketplace. But well-functioning markets are not created by themselves. They also need fending and caretaking. They would not exist nor develop without rules or without institutions that enforce these rules. The rationale for competition rules is simple, almost trivial: competition is rivalry, which weeds out companies that fails to meet the demands of consumers and promote those companies that are good at that. Any action that eliminates such rivalry is to the detriment to consumers and companies.

When markets do not function well consumers lose in terms of higher prices, poorer service and eventually lower quality. But weak competition has also similar negative effects for companies. Over time, growth is negatively affected and the basis for our welfare erodes.

Therefore, welfare and economic growth requires markets that function well, and a balance in influence between consumers, companies and the government. Our vision for the competition policy reflects this – welfare through well-functioning markets. Sound competition is not a goal in itself but a means to achieve growth, variety and welfare. The principal tool at our disposal is the competition rules, complemented with a strong advocacy role.



By monitoring markets and identifying competition problems and taking appropriate action competition authorities we can contribute to well functioning markets which is of tremendous importance for consumers in both countries.

### **How to make markets work well**

Companies should compete, not conspire against consumers by organising cartels or by abusing market power. The big issue for competition authorities is: how do we achieve this? When promoting competition we meet three main challenges.

The first challenge is to *make enforcement effective*. Competition authorities must allocate sufficient resources to detect and enforce cartels or abuse of dominance in markets. When taking legal action against such infringements we must make sure that sanctions do have a sufficient bite. Fines should be set on a level that constitutes a true and real deterrence. However, high fines are not enough. We must also spread the message that those who give information about their participation in a cartel can be freed from sanctions. Informers should thus have real incentives to provide information. International experiences show that such rules are one of the most efficient means to destabilise and fight cartels.

An example from the Swedish market is the so called asphalt cartel. The Swedish Competition Authority has brought a number of companies before court, for taking part in a bid-rigging cartel. Municipalities and consumers have lost lots of money as a result of their price-fixing and market-sharing agreements. We have requested that the eleven companies involved should be imposed fines totalling 1.600 million Swedish crowns – just under 6 billion Rouble. As a result of this enforcement activity market prices on asphalt fell by around 25 per cent.

For the Swedish Competition Authority fighting cartels is the number one priority. These serious infringements of the competition laws must be stopped and heavily punished.

Even if cartels might exist in several sectors of the economy, they are more frequent in some sectors than others. According to our experiences we find that sectors that are characterised by a relatively high degree of concentration, significant barriers to entry, homogeneous products, similar cost structures and mature technologies are particularly exposed to collusive behaviour by firms. Steel, cement and chemical industries are often mentioned as examples of such sectors. To this, I would like to add the construction industry.



The second challenge is to *contribute to a business culture where the rules are respected*. It is necessary to encourage a more widespread acceptance and respect for competition rules among companies and their employees. This is a big challenge, but a number of good signs can be registered. Violations of competition rules are increasingly considered as just another kind of economic crime.

Companies must learn the rules. The level of knowledge differs a lot among companies. Better knowledge, however, in the corporate sector about competition rules is therefore paramount for better compliance.

The third challenge is to *make the voice of the victims heard*. Unfortunately, the victims of breaches of competition rules seldom or never get compensation for their losses. I am now talking about consumers, companies and tax-payers. This is true in the Nordic countries as well as in the European Union overall. Therefore the number of civil litigation processes in our courts must increase. In the US the majority of cases of breaches of competition rules relate to private litigation.

The EU Commission is currently working to increase civil litigation also in Europe. Of course, it is equally important also for national authorities. In Sweden we have a promising example. Recently ten municipalities sued asphalt companies for the excessive prices they paid as a result of their cartel. Money badly needed for schools, health care and welfare. It is time to make the voice of the victims heard.

No market can operate efficiently without active consumers. Greater freedom of choice, however, requires increased awareness among consumers if they are to reap the full benefits of competition. Informed consumers are better placed to influence production and improve the way the market operates. An often neglected problem that may arise in markets exposed to competition is that consumers do not possess enough information about the competitors.

Also the public sector can do a lot to promote competition. Regulations for public procurement are here important. If efficient tenders are in place the public sector can save money and the competitive environment will benefit. In Sweden the AC procurement regulation plays important role in this respect. The current proposals in Russia to stimulate and improve procurement systems are important steps in taken to make markets work better.

No doubt, competition authorities have a central role to play to make markets function well for consumers. Liberalisation of markets and globalisation are two factors that have made this role even more important.

## **Converging economies require converging competition rules**

As is the case for firms the landscape has also changed for competition authorities and regulators. In order to be efficient in our tasks we have to have a more uniform outreach in order to address problems that are multinational in character. The need for convergence in regulatory frameworks thus has become stronger over time as a response to increased cross-border trade.

It is in this light the reforms of competition rules within Europe should be seen. In order to achieve a common market, competition rules need to be fair and similar for players in different countries within the common market. When the modernisation regulation 1/2003 entered into force on the 1<sup>st</sup> of May 2004, competition policy took a further step in this direction.

The need for a more uniform approach goes even beyond cartel enforcement. Also when dealing with *mergers* it is clear that companies invest on a European market and not only in a particular country.

The aim of the EU internal market was to establish a free market as well as authorities that monitor business activity with the same objectives and use similar enforcement instruments.

Today globalisation has made it necessary to look further and not only concentrate on the EU internal market. The same case for convergence and cooperation can be made when talking here today in Moscow. It will thus be important for the EU to work together with Russia, USA and other major economies in order to make sure that competition rules work in tandem and if possible converge over the longer run. Russia has taken important steps in the last years to make its competition legislation more effective and in line with the prevailing rules internationally. The Russian Competition Authority also takes active part in the Competition Committee of the OECD, the aim of which is to promote convergence. The fact that Sweden and Russia discuss competition policy as we do here today is just another example of this process of convergence.

## **Swedish experiences of market liberalisation in infrastructure sectors**

In the process of opening of markets the introduction of competition in infrastructure sectors have been an important element. The effects of this has not only created increased competition and new markets for foreign investors, it has also been an important element in the modernisation of the economy at large.

In Sweden significant reforms of market liberalisation were carried out during the 1990s. Domestic aviation, electricity, postal services and the telecommunications markets were all opened up to competition during the last decade.

The liberalisation of these markets raised the question of how to regulate the new industries in order to promote competition and safeguard consumer interests. Although many problems linger, it seems clear that these reforms created new markets and consumer welfare by reducing prices and increasing quality and supply. The liberalisation, in particular of infrastructure markets such as telecommunications and transports, has implied that former state monopolies have been subject to significant changes.

As regards the Swedish experiences, one overall conclusion is that prices have risen in markets where the dominant company, often the former state monopoly, has been able to maintain its position of strength, while the reverse applies where newcomers have increased their market shares. Experience shows that in some cases it takes a considerable time for new companies to gain a foothold in the market.

Regulatory reform is an important driver of change. All over the world we see former monopoly markets being opened to competition. Technological development has been one factor here, but also the insight that public utility industries are made up of many separate parts that to varying degree can be exposed to competition.

This process is often referred to as deregulation, although the opening up of former monopoly markets typically requires the introduction of new rules. The whole process of liberalisation is a great challenge that can give substantial and real benefits to consumers. In order to succeed however, a number of criteria must be met. Strong and independent regulators with clear objectives seem to be a necessary condition for achieving well-functioning markets in these fields. Another necessary condition is active and informed consumers.

In network industries, it is usually not in the interest of those who own the infrastructure to grant competitors access to it. Infrastructure owners may, for instance, choose to charge such a high price for the use of the infrastructure bottleneck that existing competitors are eliminated and potential newcomers are prevented from entering. To avert such situations, the regulator must decide which principles should be applied to the provision of infrastructure access.

In a regulated market, it is harder for infrastructure owners to charge fees that exceed the actual cost of the service, as the size of the fee normally has to be objectively justified. Owners are, however, in a position to raise the cost to competitors by only offering a package of services (bundling) instead of offering the services individually. Competitors may then have to purchase more services than they need in order to compete, which would mean paying an unnecessarily high price.

The main difficulty for governments lies in drawing up regulations that strike a balance between measures designed to boost infrastructure-based competition, i.e. competition between networks, and ones designed to boost service-based competition within the same network. Where infrastructure-based competition is viable it is to be preferred to service based competition within the same network. The former is less in need of regulation, i.e. there is less risk of regulatory failure. Also, when there are competing networks, competitive pressure develops throughout the value chain.

### **The importance of an open infrastructure**

The Swedish experience of opening infrastructure markets to competition points to the benefit of opening these markets even further. Let me give one example.

Swedish energy prices have been increasing during the last years. Behind this are several explanations. First of all taxes on energy have increased. Secondly, environmental measures have had an impact on prices. Thirdly, prices have levelled out between the north European countries.

In the electricity sector a Nordic market has been created. In the EU the energy infrastructure is opening up. The same argument behind these liberalisations could be put forward for integrating further the electricity and gas markets in north-western Europe with Russia.

To promote competition in infrastructure sectors is associated with specific regulatory problems Sweden and the EU have developed special measures to solve them. As trade intensifies between Sweden and Russia it will be more important to open up infrastructure. And how we solve competition problems in these areas will become more and more important.

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It seems to me that Russia have taken very important steps in putting a modern competition regulation and system of enforcement in place. This has been underpinned by important structural reforms.

The scope for effective competition is expanding in Russia as well as in Sweden. Restrictions that have sheltered our domestic markets are now being dismantled and trade increases. This creates a more competitive climate and both Russia and Sweden can benefit from exploiting comparative advantages. This has required an active competition policy. For markets it is important that competition authorities work in a transparent way under objective processes. Today's seminar demonstrates the commitment to the strengthening of competition in both Russia and Sweden.

Thank you for yore attention