Anticompetitive Behaviour of Public Enterprises – Lessons to Be Learned from European State Aid Control[1]

FOREWORD: PUBLIC ENTERPRISES – ABUSE OF A DOMINANT POSITION – EUROPEAN STATE AID CONTROL – FINANCIAL CRISIS – ECONOMIC PRINCIPLES

The financial crisis has put pre-crisis political consensus with respect to market organization in Europe under pressure: Several formerly private banks have come under state control; the willingness of governments to bailout failing firms has risen again; only the future will show whether liberalization efforts will come to a halt.[2]

In such an environment the question arises whether competition policy requires specific rules vis-à-vis public firms. Indeed, this has been the topic of a recent OECD roundtable[3] and of this year's competition policy conference of the Swedish Competition authority. The latter was initiated by a current competition policy reform in Sweden allowing the application of Article 102 TFEU to public firms without proving dominance (but proving common interest violation).

Key differences between public and private firms

Economics teaches that public firms act often differently than their private counterparts. The following four key differences are identified in the economic literature:

The main difference between private and public firms is often seen in their different objective function. Regarding the objective function of private firms it is normally assumed that private firms maximize their profits. In contrast to that, public firms are considered to follow different goals, often pursued in parallel. Potential objectives of the public firm are welfare maximization, output maximization or unemployment minimization. The objectives of the public firm may or may not overlap with the policy objectives pursued by the state as shareholder.

A second, important difference is the closer tie to the government. Key positions in public firms are often assigned to political allies, increasing their ability to lobby

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[1] This foreword is based on a chapter of the conference proceedings "The Pros and Cons of Competition in/by the Public Sector", edited by the Swedish competition authority (together with Jakub Kaluzny; forthcoming).

[2] To some extent the primacy was already contested before the financial crisis heated-up. In an effort to react to the failed quorum of the French citizens on the Lisbon treaty the French President Sarkozy succeeded in toning down the relevance of 'undistorted competition' among the EC policy objectives.

[3] OECD,Discussion on Corporate Governance and the Principle of Competitive Neutrality for State-Owned Enterprises', 20 October 2009, DAF/COMP/WP3/WD(2009)57 and OECD,Roundtable on the Application of Antitrust Law to State-Owned Enterprises', 20 October 2009, DAF/COMP/WP3/WD(2009)42

politicians, influence over legislation and regulation. The closer ties to government may also result in captive government customers.

A third difference – closely linked the difference mentioned before – are incumbency effects working for or against an incumbent operator. Public firms may exhibit a strategic advantage vis-à-vis private firms for instance because of cheaper access to finance or implicit government guarantees (see for instance the German Landesbanken cases). They may also control important facilities in network industries. On the other hand, public firms are also often affected by strategic (sometimes also labelled "structural") disadvantages. Lock-in in long term labour contracts that increase costs is one example; public service obligation is another one.

Finally, state-owned firms are often considered less efficient. This may partially be a consequence of the points raised earlier, partially be due to other reasons: in particular public firms are protected from credible takeover threats, which lowers the incentives to improve efficiency. Internal incentives structures are often less powerful, resulting in low growth (but eventually also low risk) path.

An analytical experiment - public firms as a form of state intervention

One fresh look on the application of competition policy to public firms arises when one considers public firms as a form of state intervention. In this case the principles recently laid down in the field of European State aid control apply. By implementing the State Aid Action plan the EC Commission initiated a refined assessment of the economic effects. As a conceptual framework for evaluating state aid measures, the EC Commission puts forward the use of a general balancing test.[4]

Applying this balancing test to public enterprises reveals several implications for the proper assessment of the potentially anti-competitive behaviour of public firms:

First, a consumer welfare standard – applied in most jurisdictions in the field of competition policy – may require adaptation to remain useful when applied to public firms. In a static environment public firms tent to extent output and depress prices – factors which are considered positive under a consumer welfare standard. A thorough assessment of public firms under a **total welfare standard** – as applied in the field of state aid control – may be required to properly understand the negative, long term effects of public interventions.

Second, the question of whether the 'public firm' as a regulatory instrument is the **best regulatory instrument** available for reaching the policy goal shall be assessed carefully. In case of an existing regulatory body, i.e. existence of sector specific regulation,

[4] See in particular State Aid Action Plan (footnote 5), paragraph 11 and 20; Community Framework for State Aid for Research and Development and Innovation (2006/C 323/01), para 1.3.1. and "Common principles for an economic assessment of the compatibility of State aid under Article 87.3 EC-Treaty". DG Competition staff working paper (2009).

intervention by state subsidized competition seems to me inferior and requires strong justifications.

Finally, **specific theories of harm** exist in the field of state interventions which are not typical under a traditional competition policy perspective, e.g. its strong focus on crowding-out effects, concerns of keeping inefficient market structures alive or distorting dynamic incentives. Reviewing a case from that perspective might provide additional insights.

Summing up it is not the author's position to undermine the neutrality principle enshrined in Article 395 of the TFEU, establishing that the Commission has to apply competition law independently from the ownership status of the firm. However, some of the competition problems may be unique to public firms and may require a different focus of the Competition authority's assessment: there are lessons to be learned from the field of European State aid control for the assessment of the anticompetitive behaviour by public firms.