TRADE AND COMPETITION POLICY IN THE EUROPE AGREEMENTS: LESSONS OF THE EEA EXPERIENCE

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There is a long held belief among economists that the international application of competition policy (or the application of international competition policy) would provide a way to do away with the most widely used and probably most criticised instrument of contingent protection.

In 1991 the European Union (EU) and a group of states belonging to the European Free Trade Area (Austria Finland Norway Sweden and Iceland) signed European Economic Area agreement covering the single market four freedoms, mainly affecting industrial goods. Within this zone all tariffs, non-tariff barriers and contingent protection were abolished and competition rules regulated trade as within the EU. Many have seen this as model for relations between the EU and the Countries of Central and Eastern Europe (CEECs), but as we shall show this is an inappropriate analogy. Adoption of common competition rules was only a minor element in the creation of a system of wholly free industrial trade between the EU and the other countries of the EEA.

We argue that while the EEA was a useful response to the situation it addressed, it cannot be extrapolated to the case of the CEECs for a number of reasons. The core of the argument is the argument that an agreement by partner countries to adopt EU-style internal competition laws cannot be used as a vehicle to circumvent pressure for contingent protection emanating within the EU.

Within the EU itself competition law has superseded commercial policy as the main instrument for regulating cross border trade and this was also the case in the European Economic Area. We argue however that in both these cases this was only possible because other factors were also present. In the final analysis the EEA required a unilateral cession of sovereignty that was in the long run unacceptable to the EEA member states.

The Europe Agreements first signed in 1991 lay down the removal of all traditional instruments of protection by both sides. They now cover – Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Nevertheless they still allow both sides the use of contingent protection instruments, notably anti-dumping duties. While the Commission has increasingly indicated a willingness to relax the use of this instrument, the possibility is still there. The measures are fewer in number, but it remains a major issue in relations with Poland.

The problem is encapsulated in a statement that surfaced first in a Commission communication in July 1994 (Commission, 1994). It reproduced almost verbatim in Annex IV of the Essen conclusions (Council, 1994), and is now quoted in paragraph 6.5 of the White Paper: 'once satisfactory implementation of competition and state aids policies (by the associated countries) *has been achieved, together with the wider application of other parts of Community law linked to the wider market*, the Union *could* decide to *reduce* progressively the application of commercial defence instruments for industrial products from the countries concerned' [emphases added].

This statement makes it very clear that common competition rules are far from being a sufficient condition for the removal of trade barriers. Much more was required by the EU from the EEA and will be required from the CEECs.

We do not seek here to diminish the importance of competition rules in intra-European trade, but simply to set this importance in context. Nor are we arguing that the state of affairs we claim exists is desirable. If both trade policy and competition policy were in fact directed at goal of promoting economic efficiency this would be welcome. But they are not and this has important consequences for the extent to which internationalisation of competition policy can be a lever for freer trade.

We need to acknowledge for example that while competition policy has always had the promotion of economic efficiency as one of its central aims (though not the only one), anti-dumping has quite different objectives which cannot be achieved by competition rules alone. The core of the problem arises when firms in one country have or are alleged to have an advantage in export markets due to an "artificial" barrier in their home country that permits strategic behaviour in the foreign country. Belderbos and Holmes (1995) argue that there indeed a small number of cases where even from the point of view of economic efficiency competition law cannot adequately address. But even more than the efficiency case, business firms will lobby hard against what they see as cut price imports from markets allegedly closed to them as a result of an "arbitrary" legal device.

This is the basis of the claim for a "level playing field", and though economists have always disputed the desirability of basing trade policy on these principles we have to acknowledge that it actually plays a much stronger part in competition law than is sometimes admitted and is the clear basis for international and intra-EU rules on subsidies.

Lessons from the EEA: regime performance and policy alignment

The Europe Agreements have been much criticised for the remaining trade controls they allow the EU to use against the CEEC s. The wish to overcome narrow sectoral interests in the EU and the consequent pressures for contingent protection has prompted some authors to advocate the development of a more formal and binding trade arrangement as part of a pre-accession strategy. A model along the lines of the European Economic Area (EEA) has often been seen to offer such advantages by allocating legal rights at the level of economic operators, eliminating EU anti-dumping measures and

countervailing duties, and limiting the use of safeguards (Baldwin 1994). From the point of view of economists what was attractive about this was that competition policy instruments replaced trade policy. The Commission's DG IV was authorised to apply EU law to cases of private anti competitive behaviour and state aids, while the EFTA states who joined the EEA agreed to set up an EFTA Surveillance Authority with supra national authority to ensure internal compliance with all the EU rules, not just competition rules.

However, there are key features of the EEA that make it a questionable model for the CEECs (Rollo and Wallace, 1991). It linked to the EU a group of advanced, industrialised, export-oriented economies with already a high level of economic interdependence and industrial and corporate interconnection. The EFTA countries already had sophisticated market regulation with experienced administrative and legal infrastructures without which they could not have handled the often bizarre constraints imposed on them by the EU side. More to the point, the EEA states had to agree not merely to applying EU competition rules, but the whole of the internal market rules and to put in place legal mechanisms for enforcement. Protocol 13 of the EEA Agreement makes clear.

> *The application of Article 26 of the Agreement* (the suspension of anti-dumping policy and countervailing duties) *is limited to the areas covered by the provisions of the Agreement and in which the Community acquis is fully integrated into the Agreement.*

The difficult negotiation of the EEA clearly demonstrated the price the EU demanded of EFTA for unrestricted access to the single market. From an early stage, elimination of EU contingent protection, and the supposed unlimited market access that the EEA would offer, was made conditional on the full acceptance of internal market legislation by the EFTA side. Derogations were ruled out, and transitional arrangements were in large part limited to two years. The two thousand pieces of Community legislation annexed to the final EEA Agreement serve as a sobering reminder of the limits of EU trade policy flexibility.

Moreover, the operation of the agreement in practice, with asymmetric access to day-to-day decision-making, to information flows, and to policy-making arenas, gave a second class status even to the EU's closest trading partners. The sophistication of the Eftans' approach to the EEA exposed the lines of exclusion inherent in the regime's design and the extent of the Eftans' frustration generated by its inherent asymmetry. The fact that the Eftans could tolerate this, and indeed implement the agreement very successfully, reflects the operation of the EEA as a short-term transitional regime for EU membership, but it does not suggest a quick fix for the CEECs. (See Smith, 1995)

Operation of the EEA regime

While one of the purposes of the EEA Agreement was to allow EFTA states tomaintain legal sovereignty over EEA/EU rules, this in practice was limitedby the persistent threat that protection could and would be possible in theevent of a perceived deviation from EU regulation. It is also clear thatwhile EU member states were full players in EU regulatory regimes, theEFTA/EEA states had only limited formal and informal access to regulatoryinstitutions and actors. The legislative process was a particular source ofgrievance for the Eftans. Adoption of additional legislation in the EEAJoint Committee (acquis not included in the original agreement) wascharacterised by one EEA official as a mechanistic hammering down of EUlegislation on the EFTA side , highlighting the formality with which theprocess has been viewed by the EU. In this case the Janus-like role playedby the Commission, acting as the initial arbiter of EEA-relevantlegislation, as EFTA s only voice in Council working groups, and finally asthe Council s negotiator in the EEA Joint Committee, constituted anextraordinarily opaque procedure from an EFTA perspective and one whichgenerated considerable frustration. For example, Iceland s genuine concernsregarding the application of the Working Time Directive to its fishingindustry were finally dismissed by one Commission official remarking: ifthe UK could agree to it, then so could Iceland . Similar problems besetthe rather vague EEA decision-shaping process applying to new EUlegislation. Eftan participation in Commission committees was alsostrictly limited to the minimum prescribed in the Agreement.

In this sense, set against initial aspirations, the EEA formulation failedto provide a durable regime for extending the EU internal market. For theEFTA states, the process did not match the specific combination of marketaccess, preservation of sovereignty, and political voice which had tovarying degrees been demanded from the start (Gstohl, 1994). This wasparticularly important following the rejection by the ECJ of an overarchingEEA Court to monitor the application of the EEA on both sides (ECJ 10/91). The EU was not legally in a position to pool its sovereignty.

The EEA as a transitional regime

In the face of pronounced political and administrative handicaps, theachievements of the EFTA pillar have been notable. EFTA had an impressiverecord in harmonisation, measured by the amount of new legislation adoptedand by legal conformity checking. Problem areas like the alcohol monopolies(Sweden, Norway, Finland, Iceland), environment (Austria), and sociallegislation (Sweden, Iceland) were encountered, but they were largelyresolved via informal consultations between national administrations andthe EFTA Surveillance Authority.

A very significant factor in the success of the EFTA pillar, however, wasthe operation of the EEA as a short-term transitional regime in tworespects. Firstly, for most EFTA states, the EEA constituted a visiblestepping stone to EU membership. The influence of

membership had a numberdimensions. The parallel accession process significantly altered thestructure and operation of the EEA regime. While the Commission formallytried to keep the administration of the EEA separate from accessionnegotiations, the distinction was often a semantic one for prospectivemembers. Problems with new legislation (such as the directive on weightsand dimensions of lorries, as well as the problems over veterinary borderchecks) were either to be resolved in the context of accession negotiationsor postponed until accession had taken place. Prospective membership alsocarried admission to all Commission committees as well as access to Councilworking groups, thereby eliminating the absence of EFTA voices in the EEA.The prospect of membership impacted on the administration of the agreementamong EFTA governments. According to one Austrian official, the EEA wasviewed as the penultimate fine tuning stage in a process of policyalignment dating from the mid-eighties, enabling independent judgement onthe extent of policy conformity.

The second sense in which the EEA served as a transitional regime lay inits interactions with shifting patterns regulation in the domestic EFTAcontext. In most EFTA states, established processes of policy adjustmenthad been generated as a responses to the economic crisis in the early 1990sand the perceived crisis in systems of economic governance. As aconsequence, comprehensive reviews of regulatory policy were undertaken inSweden, Finland and (to a lesser extent) Austria in the early 1990sreflecting ideological realignments among political and economic elites.Key union and business interests had become configured around a need toundertake sectoral and horizontal policy deregulation, a shift which wasalso reflected in the 1991 elections in Sweden and Finland. For manybusiness and political actors, the importance of membership had becomeviewed as an intrinsic part of an economic reform strategy aimed atmaintaining European export markets, and stemming the flow of foreigndirect investment out of the EFTA states. Important sectors in all EFTAstates declared support for EU membership, along with a view that the EEAshould act as a stepping stone to that goal. From certain perspectives asimilar situation prevails in the CEECs, but the degree of reform requiredis far greater and the potential for political opposition is much greater.

In many ways, the asymmetric functioning of the EEA reinforced theattraction of membership, particularly among exporting sectors. A survey ofbusiness responses to the EEA undertaken by the Swedish Board of Trade(Kommerskollegium) catalogues a series of disadvantages encountered bySwedish export industries. It concludes that these will be eliminated byobtaining full membership ... As for the new member states of the EU,membership will allow new possibilities to influence the development of theinternal market. Thus, in a perverse sense, asymmetries in theperformance of the EEA served a purpose insofar as they enlarged theconstituency of gainers from full EU membership.

In this sense the EEA has been a tolerable regime for the EFTA states giventhat implementation fitted neatly around domestic programmes of reform, andthat the asymmetries and weaknesses of the EEA institutions made theavailable option of membership much more attractive. But this EEAexperience has been seen by the CEECs who have concluded that the EEA byitself was not attractive. The non-EU states of the

EEA were already veryadvanced industrial economies close to the EU in structure and rules andthe adjustments were still non-trivial.

Competition policy in the Europe Agreements: levelling the playing field?

We have thus seen that the although competition policy did become a central element in EU-EEA relations, its centrality was conditioned on the existence of a much broader and deeper legal harmonisation process. The Europe Agreements are of a subtly different character and although they appear to place extreme importance on harmonisation of competition rules we shall see that this is only one small part of the picture. The mere fact that the obligation to make competition law compatible is one of the most explicitly highlighted features of the Europe Agreements should only serve to remind us that this is necessary but not to mislead us into thinking that it is sufficient.

The EAs with the Czech Republic, Hungary, Poland and Slovakia and now the other EA associates all called for the adoption within three years of their entry into force of legislation in each partner country to mirror the competition provisions (anti-trust and state aids) of the Treaty of Rome. But let us be clear what is being asked for. The Polish Europe agreement is typical in stating (our italics) that:

> 63.1. The following are incompatible with the proper functioning of the Agreement, *in so far as they may affect trade between the Community and [CEEC country]*:
>
> i. all agreements between undertakings, decisions by associations of undertakings and concerted practices between undertakings which have as their object or effect the prevention, restriction or distortion of competition;
>
> ii. abuse by one or more undertakings of a dominant position in the territories of the Community or of [CEEC country] as a whole or in part thereof;
>
> iii. any public aid which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods....
>
> 63.2 Any practice contrary to this Article shall be assessed on the basis of criteria arising from the rules and Articles 85, 86 and 92 of the Treaty establishing the European Community.

The legal obligation is thus not to harmonise competition laws but to adopt competition rules that will not have the effect of "distorting" trade between the EU and the CEEC partners. The obligation is to prevent absence of competition rules or their lack of enforcement from allowing private or public barriers to market entry arising. Competition law is highlighted because of its potential cross border impact, not because it can replace trade policy.

They can adopt whatever rules they like to regulate local taxi monopolies. But in practice the only feasible way to achieve the stated aim is to take over EU competition law more or less as it stands. There is indeed a good economic case for doing this

While it is indeed desirable to seek early harmonisation of competition policy as a force for the promotion of economic efficiency,. it is important to remember that it has other roles within the EU. One of the features of EU competition law is that from the outset the criteria for decision used by the Commission and the Court were not strictly efficiency-based but tended to favour economic integration for its own sake (for example, the greater stress on intra-brand competition than in the USA).

It is arguable that in some areas of competition policy, the needs of the CEECs are for a more relaxed regime than in the EU. There is debate, for example, about what are the right rules for vertical restraints. Here the Commission is insisting that the CEECs adopt rules that match EU practices, including block exemptions. This is bureaucratically very demanding, and it is economically questionable, as economies with poorly developed distribution systems might want to encourage investment in distribution networks. But as the recent 1996 Green Paper on Vertical Restraints notes, EU law in this are reflects the fact that every article must be interpreted in terms of the initial goals which include the promotion of economic integration for its own sake. Nevertheless as an off the shelf model, the EU system is likely to be a good basis - so long as deeper integration is indeed goal all parties really are committed to.

A supranational competition policy was a central element in the political economy of the original EEC, reassuring member states that they would be protected against 'unfairness' by their partners. It could replace commercial policy instruments applied by national governments in trade relations between the member states of the EEC, doing away with many of the political economy problems associated with the process of trade policy formation.

Many hoped that in the transition towards CEEC accession, competition policy instruments could wholly replace commercial policy. but as the statement we quote in the introduction makes clear, there are many conditions to be satisfied before the EU is willing to "consider" abolishing all contingent protection 'once satisfactory implementation of competition and state aids policies (by the associated countries) *has been achieved, together with the wider application of other parts of Community law linked to the wider market*, the Union *could* decide to *reduce* progressively the application of commercial defence instruments for industrial products from the countries concerned' [emphases added].

The commission and several of the member states are keen to work towards this end as fast as possible but no guarantee can be given.

In the area of competition policy on state aids, the 1995 White Paper requires that the CEECs adopt a form of control that parallels that of the member states, with pre-notification of aids to a national body and an *implicit* expectation that there may be ex

ante consultations between the Commission and the national surveillance authorities to ensure that the surveillance authority does not authorise an aid that will later be contested by the Commission. It arguable that, even within the union, the main goal of state aids policy has become that of providing symmetrical conditions (a level playing-field for the different firms within any given industry) rather than regulating inter-industry distortions. Thus in practice state aid rules allow different levels of support to be given in different sectors, with cars and electronics being favourably treated. From the viewpoint of economic efficiency and the avoidance of distortions in the CEECs, the objective of policy should be to avoid favouring some sectors or some investors over others except where there is a case that one type of investment brings more positive spillover effects than others. But the use of the EU's existing procedures could lead the national authorities to be more concerned with the level playing-field aspects rather than the efficiency aspects, and one suspects that the avoidance of unfavourable effects on EU firms would dominate the agenda. Commission decisions on subsidies typically take account of considerations such as the amount of capacity in the sector and the likely growth of demand, and it would be natural for such considerations to be taken account of in state aid cases in such a way that a CEEC could be deterred from promoting and investing where it had a genuine comparative advantage but where this might imply that its output would displace output from existing capacity elsewhere in Europe.

Despite the anomalies in EU subsidy rules, the CEECs have something to gain from the application of a set of procedures to at least ensure transparency and predictability of subsidies. The subsidy area is also one where a direct pay-off might be expected: if the CEECs do adopt EU-type codes, it is possible to see the EU definitively relinquishing the use of countervailing duties. Though these are little used in practice, they now exist as a threat. However, there is limited value to the CEECs of the EU's eliminating one contingent protection instrument without also eliminating the possibility of anti-dumping actions.

Asymmetry of rules and of needs

The obligation of the partner countries to adopt competition rules broadly comparable to those of the EU imposes a stricter formal requirement on the CEECs – to make their national regimes conform to the Treaty of Rome – than is imposed on existing EU member states. This is because for member states the Rome Treaty has direct effect and overrides any inconsistent national law - at least as it affects trade between member states. The White Paper states for example that: 'A legal obligation for Member states to, align their legislation to the Community state aid control system does not exist and would indeed be superfluous because of the Commission's role of the controlling authority under the EC Treaty.' In the section on articles 85 and 86 the White Paper states that '[s]uch an approximation is therefore necessary *inter alia* to ensure that economic operators can be sure to act on a level playing field, and in order to prepare the CEECs' economies for future membership.' The White Paper does not actually impose new conditions that were not in the EAs but it makes clear that these are to be strictly interpreted. The precedents of the Court of Justice are always to be used wherever relevant. However as Thinam Jacob has argued, the nature of the Europe Agreements does not actually make them in any way

directly effective. There is no equivalent of the ESA and while the EA's require the CEECs to adopt EU competition laws there is no agency to ensure their enforcement in the respects implied by the EA's. Within the EU and in relations between the EEA and the EU, competition laws were in effect applied so as to directly correct any distortion that might occur. But the Europe Agreements impose obligations such that the response triggered by non-compliance is not supra-national intervention to force compliance via the direct effect of law; rather the consequence of non compliance with a Europe Agreement obligation is the right of one party to impose contingent protection. It is only if there is absolute certainty that the supra national enforcement mechanisms will work that the right to retaliate with commercial policy will be given up.

Conclusions: the institutional context and the EEA comparison

The EEA does not therefore provide a model for the EU -CEEC relationship in terms for competition policy. The initial playing field was almost level to begin with, and yet a massive superstructure of legislative harmonisation going well beyond competition law, in fact covering the whole range of internal market rules had to be put in place as well as an enforcement framework.

We have argued that competition law can only replace trade law in a context where there is an overarching supra-national legal framework that allows a party claiming to be the victim of a trade barrier to seek redress by invoking a mechanism such as the direct effect of EU law to remove the alleged problem at source. The EU has such a system, and the EEA was forced to invent one. But the Europe Agreements do not provide for any sort of supra-national régime - other than implicitly by the EA states agreeing to do whatever the EU tells them. Such an undertaking would be highly unpalatable as well as potentially politically reversible.

To move further in this direction would require either unilateral transfer of sovereignty by the CEECs or full membership of the EU. Our argument is that the EEA experience indicates that kind of transitional arrangement for the CEECs advocated for example by Richard Baldwin (1994) would not work. The use of competition rules to replace trade rules is only feasible in practice in the context of a higher degree of legal harmonisation and integration than exists between the EU and the Europe Agreement associates.

If the EU is ready to give the countries of Eastern and Central Europe wholly free market access, this will have to be on the basis of mutual trust and credibility rather than hoping some kind of EEA type arrangement will make this work.

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