



European Commission

Competition

# The relationship between competition enforcement and sector regulation

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## Outline

- Competition enforcement & regulation:
- Financial sector
- Telecoms



## Interplay between regulation and competition

- Regulation has comparative advantage when decisions about correct levels of prices and conditions of interconnection are frequent -  
“Antitrust can say no but struggles with saying yes”  
(Carlton and Picker, 2007)
- But competition policy can still have a role to play, filling out the gaps and generally being a “last resort”? “Antitrust say no very well, while regulators often have a hard time saying no”



## European idiosyncracries

- Two levels of regulation. Typically NRA, NCA at MS level. DG Comp and directives at EU level – directives affects the nature of regulation, scope of NRA.
- Two sets of competition rules and delegation of EU competition rules
- State aids rules (SGEI) : governments can compensate companies (universal service obligations and more)
- Art 86 : governments can grant exclusive rights in full compliance with competition rules



## Shortcomings ?

- Effects across jurisdictions (internal markets) – process of coordination across NRAs
- Enforcement of regulatory design. Violation procedures are long and cumbersome
- Enforcement of regulatory frameworks across member states is uneven. In the area of Telecom, EU can affect the behaviour of NRA to some extent.
- Regulation at EU level is limited to some sectors



## Consequences

- Bottlenecks in energy transmission across countries : refusal to invest case ?
- Regulatory capture. Temptation to impose regulatory changes in the context of other procedures ?
- MS which provides excessive compensation for the reserved SGEI service – as a way to subsidize services open to competition. But this is undertaken by an “independent” regulator. Broaden the notion of state involvement ?
- Effectiveness of competition remedies ?



## Payment cards

- The multilateral interchange fee (MIF) is a fee paid by the merchant's bank (acquirer) to the cardholder's bank (issuer) for each card transaction
- MasterCard Decision:
  - Efficiency justification of MasterCard rejected
  - No prohibition of MIFs as a matter of principle
  - However, vague allegations to efficiencies are not sufficient
  - Instead, concrete demonstration of benefits to consumers
  - Discussion on appropriate MIF levels for compliance
- No regulation at the EU level – great diversity of the level of the MS
- Discusses how to evaluate distortions of competition and efficiencies in the 81 framework

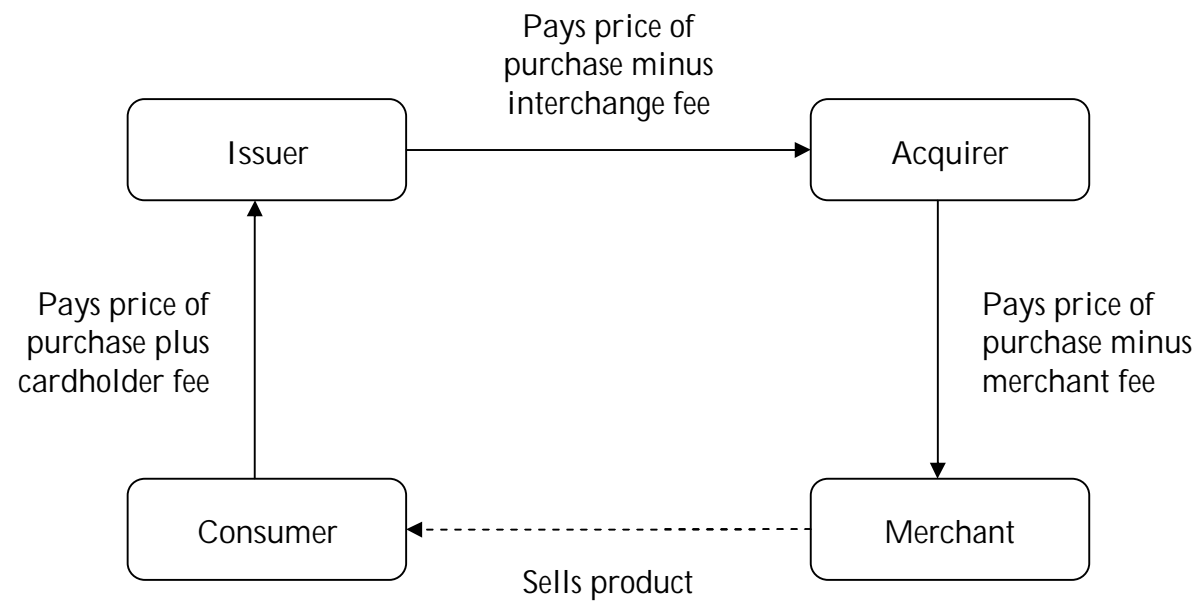


Figure 1: Main payment flows in a four-party system



## Interchange fees

- MIF increases marginal cost of acquiring and decreases marginal cost of issuing
- Hence, it tends to incentivize issuing to the detriment of acquiring
- MIF allows to internalize network externalities in an efficient way
- Decision to pay by card affects not only consumer's utility, but also merchant's
- If merchants benefit more from card payments than they cost (e.g., because of lower costs of holding cash or administrative savings), card usage exerts a positive externality on merchants



## Interchange fees

- With retail competition, merchants are willing to accept cards even at prices that exceed their transactional benefits
- Willingness to pay consists of transactional benefits and a business stealing effect (prisoner's dilemma for merchants)
- As a result, card usage increases merchants' marginal cost, which leads to retail price increases
- However, consumers do not take this negative externality of card usage into account, as higher retail prices are born by all consumers (including cash users), not the individual card user



## Interchange fees

- With imperfectly competitive banks, the cost pass-through of issuing and acquiring will generally not be identical
- In this situation, increasing the MIF beyond the output maximizing level pays off for banks:
- It shifts revenues to issuing (where 60% can be retained as profit), and shifts costs to acquiring (where 100% is passed on to merchants)
- Result: banks push merchants into negative externality scenario



## Balancing fee

- With perfectly competitive banks, optimal fee makes merchants indifferent between payment instruments  
Balancing fee = merchants' transactional benefits – costs of acquiring
- Optimal MIF internalizes usage and membership externalities (perfect instrument under perfect competition)
- Balancing fee makes market one-sided (equivalent to perfect surcharging)
- Balancing fee is relatively easy to measure
- What are the benefits?
  - Only transactional benefits
  - Specifically excludes benefits of business stealing, as they cancel out across merchants



## Telecoms

- EU: Deutsche Telecom & Telefonica
- US: Trinko & Linkline



## Telecoms – EU (I)

### Deutsche Telekom (CFI, 2008)

1. Article 82 applies if regulation leaves some discretion for companies to determine their pricing policy
2. “The Commission cannot be bound by a decision taken by a national body pursuant to Article 82 EC”



## Telecoms – EU (II)

### Telefonica (Commission, 2007)

1. Telefonica could have avoided the margin squeeze by increasing retail charges or decreasing wholesale charges
2. “[T]he Commission is entitled to adopt ... decisions under Articles 81 and 82 of the Treaty, even where an agreement or practice has already been the subject of a decision by a national Court or the decision contemplated by the Commission contemplated by the Commission conflicts with that national court’s decision”



## Telecoms – US (I)

### Trinko (Supr. Court, 2004)

1. 1996 Telecommunications Act: “nothing in this Act ... shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws”
2. But, “[t]he regulatory framework that exists in this case demonstrates how, in certain circumstances, ‘regulation significantly diminishes the likelihood of major antitrust harm’”.
3. “[I]n short, the regime was an effective steward of the antitrust function”.



## Telecoms – US (II)

### Linkline (Supr. Court, 2008)

1. Majority: Price squeeze not possible because neither an antitrust duty to deal at wholesale nor predatory pricing at retail level was demonstrated
2. Minority: “When a regulatory structure exists to deter and remedy anticompetitive harm, the costs of antitrust enforcement are likely to be greater than the benefits.” Alternative operators “could have gone to the regulators and asked for ... wholesale prices to be lowered in light of the alleged price squeeze”.



## EU-US telecoms comparison

- Both systems place competition/antitrust laws on a higher level than regulation
- Greater distinction between regulatory access and “antitrust duty to deal” in US than in EU
- Greater reliance on regulation “doing its job” in US than in EU



## Conclusion

- Maybe apparent differences mainly come from different perceptions of how well the regulatory system works in the EU and the US
- Regulatory failures (including absence of regulation)
- Antitrust is not well suited to the calibration of prices
- Ring fencing of competition decision